Comments on:

“Examining the Pattern of S Corporation Losses”

&

“The Impact of Preferential Rates on Pass-Through Businesses: Evidence from Kansas”

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Disclaimer: The views expressed are not necessarily those of the U.S. Dept. of the Treasury.
What are “pass-throughs”? 

- No corporate income tax
- Income is taxed when earned
  - No deferral via retained earnings
- Income is taxed at the individual level
- Losses may offset other income (e.g. wage income)
  - Only if the investor is active in the business
- Typical industries: finance, real estate, professional services
- PTs earned 54% of all business income in 2011
- 69% of pass-through income goes to the top 1% of tax units (compared to 45% for C corps) (Cooper et al. 2016)
SHARES OF BUSINESS INCOME, 1980-2012

Source: Cooper et al. 2016
“The Impact of Preferential Rates on Pass-Through Businesses: Evidence from Kansas”

Authors: Jason DeBacker, Lucas Goodman, Brad Heim, Shanthi Ramnath, Justin Ross

- Identifying variation: Kansas HB 2117
  - Exempted pass-through business income 2013-2016
  - Tax rate was 0% rather than 4.9% for wage income
  - Partnership guaranteed payments carved out 2015-2016

- Sample: Partnership and S corp tax returns, 2003-2016
  - They compare KS vs. adjacent states
TAX REVENUE FROM PERSONAL INCOME TAX

Figure 1: Kansas and Control State Tax Revenue
Findings:

1. No clear effects on...
   - Gross receipts
   - Wages paid
   - Investment
   - Business formation
   - However there is a lot of noise here, so these are generally not convincing zeros

2. Partnership “guaranteed payments” decline by 24% after carveout
   - No change in aggregate partnership income ⇒ shifting response
   - Results here are more convincing
These findings raise some questions...

1. Why do partnerships change guaranteed payments but S corps don’t reduce owners’ wages?

2. Why no “real” effects?
   - Is a 5 ppt incentive insufficient?
   - Policy uncertainty?
   - Note: salience is not a likely answer

3. What about sole proprietors (schedule C)?
RELATED WORK

1. DeBacker et al. (2017)
   - Kansas reform 2013-2016
     - Individual-level data, not entity-level
     - Evidence of shifting wage income to pass-through income
     - No real effects

2. Goodman (2017)
   - Kansas reform 2013-2015
     - Wages of S corp owners $\downarrow$ 6%
     - $\sim$2% fall using propensity score matching / synthetic control
3. Auten, Splinter and Nelson (2016)
   - 1994 “uncapping” of Medicare 2.9% tax
     ▶ Wages of S corp owners in 1990-91: 53% of S corp income
     ▶ Wages of S corp owners in 1994: 33% of S corp income

   - Estimate “true” reasonable comp wages over 2000-2004
     ▶ Wages of S corp owners artificially ↓ 35%
SUGGESTIONS

○ The parallel trends assumption appears to be violated
  ▶ Not surprising for S corps given average gross receipts are $9.8m in KS and $3.7m in control states
  ▶ Try IPW or a synthetic panel approach (Goodman 2017)

○ Can you isolate firms with 100% KS-residing owners? Perhaps they are more responsive. (Controls would also have 100% in-state owners)

○ A picture like Figure 1 for each outcome variable would be useful

○ Have you tried dropping small firms? Regression puts equal weight on small and large firms
“Examining the Pattern of S Corporation Losses”

Authors: Katie Lim, Elena Patel, Molly Saunders-Scott

- Descriptive statistics
- Sample: S and C corps 2005-2014
- How are losses used at entity vs. individual level?
Findings:

- Relative to C corps, a smaller percentage of S corps have losses and losses are less cyclical.
- Relative to C corps, S corp losses are concentrated in agriculture, IT, and petro-chem.
- 70-80% of losses used by owners in concurrent year.
- If used at *entity level*: after 8 years, only 40% of S corp losses would be used.
  - Pass-throughs effectively receive more symmetric tax treatment of losses and gains.
  - This is important because (in theory) asymmetry discourages investment, risk-taking.
Suggestions:

○ How concentrated are S corp losses?
  – We know 67% of S corp income accrues to the top 1% (Cooper et al. 2016)
  – Are losses more or less concentrated?

○ Losses ⇒ risk taking and/or heavy investment
  – Do businesses with losses contribute to job growth?
  – Do people tend to own multiple risk-taking businesses?

○ Can you quantify the asymmetry of tax treatment of positive vs. negative income?
  – What is the present value of negative income in C vs. S corps?

○ In quantifying the benefit of pass-through treatment of losses...
  – Compare hypothetical C and S corp that are identical except for tax treatment
Thank you