Comments on:

# "Examining the Pattern of S Corporation Losses"

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# "The Impact of Preferential Rates on Pass-Through Businesses: Evidence from Kansas"

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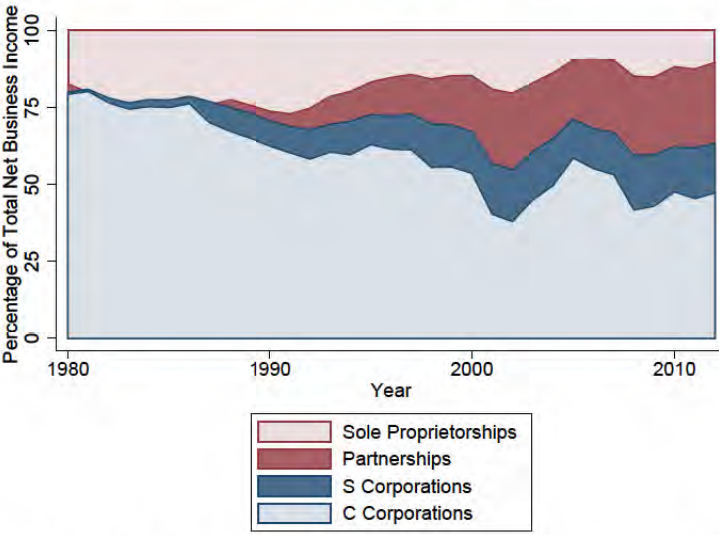
Disclaimer: The views expressed are not necessarily those of the U.S. Dept. of the Treasury.

# 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

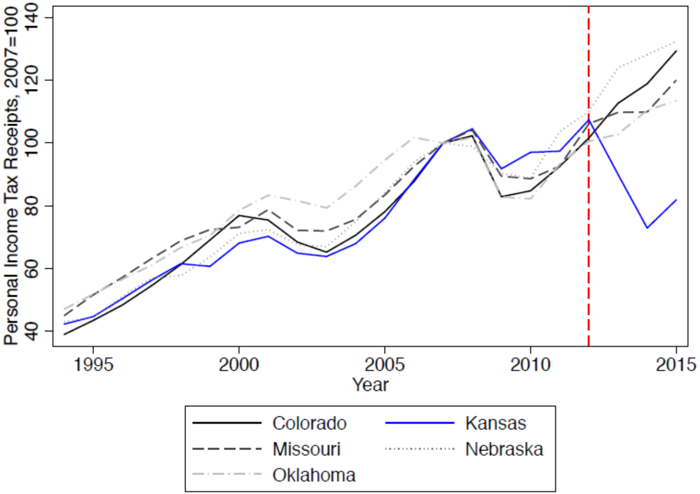
# “The Impact of Preferential Rates on Pass-Through Businesses: Evidence from Kansas”

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 $\Rightarrow$ 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

# Related work

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

4. Bull and Burnham (2008)
   - Estimate "true" reasonable comp wages over 2000-2004
     - Wages of S corp owners artificially $\downarrow$ 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 $\Rightarrow$ 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