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Fewer Businesses Are Organized As Taxable Corporations

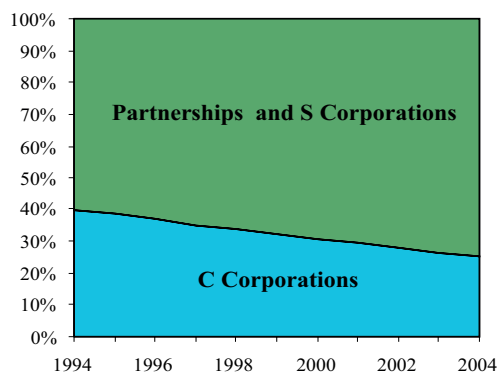
By Eric Toder and Julianna Koch

Corporations that are taxed under subchapter C of the Internal Revenue Code pay a separate entity-level tax on their income (the corporate income tax) and their owners pay additional tax on corporate dividends and capital gains on sales of corporate shares. Other businesses are taxed as flow-through entities; they file tax returns and report their income but do not pay an entity-level tax. Instead, they allocate their net income or loss to their shareholders or partners, who include that income in computing their individual income tax liability. Flow-through entities include partnerships, limited liability companies, and corporations that qualify for and elect to be taxed under subchapter S of the tax code. (S corporation status may be selected by domestic companies that have between 1 and 100 shareholders and meet some other tests.)

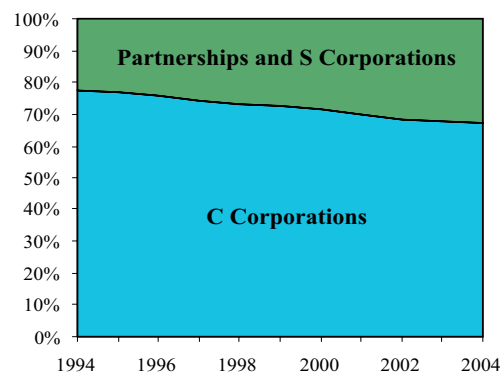
While only one-quarter of all businesses were organized as C corporations in 2004, those companies accounted for two-thirds of business receipts. Over time, however, both the share of businesses organized as C corporations and their share of business receipts have declined. Between 1994 and 2004, the share of C corporations decreased every year, falling from 40 percent to 25 percent of all businesses (excluding sole proprietors), and their share of business receipts declined from 77 percent to 67 percent. In absolute terms, the number of C corporations fell by about 12 percent.

The flow-through form of organization is dominant for smaller businesses, but most large businesses are still corporate taxpayers. For example, in 2004, S corporations were 64 percent of all corporations with assets less than \$10 million and received 56 percent of gross business revenues of those companies. In contrast, S corporations were 37 percent of corporations with assets greater than \$10 million and received only 12 percent of the revenues of those companies.

Business Returns Filed by Type of Return As a Share of All Returns



Business Receipts by Type of Business As a Share of All Business Receipts



Notes: Shares are calculated as the ratios of numbers of returns filed and business receipts for flow-through businesses (computed as the sum of partnerships and corporations other than sub-S corporations, real estate investment trusts, and regulated investment companies) to all businesses (computed as the sum of partnerships and all corporations). Sole proprietorships are not included in the calculations.

Source: Internal Revenue Service, Statistics of Income Division, and authors' calculations.



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