

**FISCAL NOTE**  
**Requested by Legislative Council**  
**01/13/2015**

Bill/Resolution No.: HB 1296

- 1 A. **State fiscal effect:** *Identify the state fiscal effect and the fiscal effect on agency appropriations compared to funding levels and appropriations anticipated under current law.*

	2013-2015 Biennium		2015-2017 Biennium		2017-2019 Biennium	
	General Fund	Other Funds	General Fund	Other Funds	General Fund	Other Funds
Revenues			\$(292,000,000)			
Expenditures						
Appropriations						

- 1 B. **County, city, school district and township fiscal effect:** *Identify the fiscal effect on the appropriate political subdivision.*

	2013-2015 Biennium	2015-2017 Biennium	2017-2019 Biennium
Counties			
Cities			
School Districts			
Townships			

- 2 A. **Bill and fiscal impact summary:** *Provide a brief summary of the measure, including description of the provisions having fiscal impact (limited to 300 characters).*

HB 1296 flattens the individual income tax and reduces tax liabilities.

- B. **Fiscal impact sections:** *Identify and provide a brief description of the sections of the measure which have fiscal impact. Include any assumptions and comments relevant to the analysis.*

HB 1296 authorizes a deduction from income based on filing status, removes the income tax brackets and imposes a flat individual income tax rate of 2%. If enacted, HB 1296 is expected to reduce state general fund revenues by an estimated \$292 million in the 2015-17 biennium.

3. **State fiscal effect detail:** *For information shown under state fiscal effect in 1A, please:*

- A. **Revenues:** *Explain the revenue amounts. Provide detail, when appropriate, for each revenue type and fund affected and any amounts included in the executive budget.*
- B. **Expenditures:** *Explain the expenditure amounts. Provide detail, when appropriate, for each agency, line item, and fund affected and the number of FTE positions affected.*
- C. **Appropriations:** *Explain the appropriation amounts. Provide detail, when appropriate, for each agency and fund affected. Explain the relationship between the amounts shown for expenditures and appropriations. Indicate whether the appropriation or a part of the appropriation is included in the executive budget or relates to a continuing appropriation.*

**Name:** Kathryn L. Strombeck

**Agency:** Office of Tax Commissioner

**Telephone:** 328-3402

**Date Prepared:** 01/24/2015

**2015 HOUSE FINANCE AND TAXATION**

**HB 1296**

# 2015 HOUSE STANDING COMMITTEE MINUTES

## Finance and Taxation Committee Fort Totten Room, State Capitol

HB 1296  
1/27/2015  
22623

- ☐ Subcommittee  
☐ Conference Committee

Committee Clerk Signature

*Mary Bruecker*

### Explanation or reason for introduction of bill/resolution:

A Bill relating to individual, estate, and trust income tax rate schedule replacement with a flat rate income tax and reduced North Dakota taxable income amount subject to the tax.

### Minutes:

Attachment #1, 2

**Chairman Headland:** Opened hearing.

**Representative Kim Koppelman:** Introduced bill. This bill is an opportunity for not only income tax reduction but for income tax reform. We have an unnecessarily completed income tax process in our state. We don't have a high income tax but with the 14% of the federal obligation it still hurt business in North Dakota and had several negative effects. I think the current status of our income tax is somewhat the same because it is very difficult for people to determine how much they're going to pay due to the graduated tax and the wrinkles with it. This session we all know that money is going to be tighter but we also have had a lot of talk about reducing income taxes. I want to be both fiscally responsible and offer our taxpayers a tax break or a tax cut. I believe that HB 1296 does both; it represents nearly a \$300 million tax cut to North Dakota taxpayers and it flattens our tax so we no longer have all the brackets and confusion. We simply have a flat tax at two percent with adequate exemptions to protect the lower income families. People who have little means are going to pay less tax across the board up to the people who are very well to do in North Dakota; this lowers everyone's tax. Even the ones who want to eliminate property tax in this state like this idea. I think it would do a lot for the reputation of North Dakota not to mention the pocketbooks of our taxpayers. I really believe now is the time. If we as legislators are going to move forward with a tax reduction and a tax reform bill this is the session to do it. This could be a real opportunity for us to make real change.

**Chairman Headland:** It's a difficult bill to grasp. I think when we're providing reductions for taxpayers we want to make sure every taxpayer receives a reduction. Somebody is going to have to help us and show us how some of the bottom level payers are going to receive a reduction when their portion of the tax actually flattens out at two percent.

**Representative Koppelman:** I agree with you. We approached this bill in a unique way. We wanted a bill that was going to lower income tax, we wanted a bill that was not going to



hurt anyone and we wanted a bill that was going to flatten income tax. I would encourage you to ask Mr. Walstad for more details. On the bottom of page one it talks about an exemption level and it goes on from there. The benefit curve on this is like a smiley face; everybody benefits but the ones at the lower end and the ones at the higher end probably benefit a little bit more than the ones in the middle. Our current tax code is sort of like a frown face based on how people pay.

**Representative Froseth:** On page 9 under the tax credits item L is crossed off. How come just that one type of credit was eliminated?

**Representative Koppelman:** I would defer that to John Walstad.

**Representative Dockter:** Did you look at reducing any corporate and doing a flat tax with the corporate tax?

**Representative Koppelman:** I did not and it's not because I'm against a flat tax but I simply felt that we needed to do this one step at a time. I was focused on personal income tax and that's where I was looking.

**Chairman Headland:** We'll now take support for HB 1296.

**Dustin Gawrylow, Lobbyist for North Dakota Watchdog Network:** The written testimony from HB 1167 would apply to this bill as well. See attachment #1. This could be a compromise for not going as far as eliminating but at least giving a lot of relief for everybody. On the exemptions I would agree that they have to be large enough to benefit more people. Generally the way you can make sure that there's nobody in the middle that gets hurt is to raise the exemptions so the effective rate, not the two percent, of what actually gets taxed. Right now exemptions are pretty low in the state and when you raise those that apply to everybody. A lot of folks will propose to remove other exemptions, right offs, and deductions as a way to increase that exemption level for everybody.

**Chairman Headland:** Further testimony in support of HB 1296? Is there any opposition to HB 1296?

**Representative Froseth:** Mr. Walstad, why was the homestead tax credit removed on page nine? There should be another income tax bill floating around, do you know the fiscal note on that one?

**John Walstad, Legal Counsel for Legislative Council:** I don't know the fiscal effect. There are a number of proposals out there. As to the homestead tax credit, that's an obsolete reference, there isn't any credit there. It's a dead reference to a provision that's gone.

**Vice Chairman Owens:** That's in reference to the 2009 property tax relief of the homestead on the income tax and it had a limited life of that two year period.

**John Walstad:** It was a pretty good idea but not perfect. With regard to the rate, the deduction at the bottom end of every one of those brackets is exactly one half of the

maximum amount in that bracket. Because only half of that income is taxable anybody in that bracket currently the maximum effective rate they would pay is one percent. As your income creeps from the halfway point up you go from no tax to two percent but for the entire bracket the maximum is one. Nobody in that bracket would be paying more than current law would impose. Everybody gets that low end reduction.

**Representative Schneider:** In light of the current revenue projections do you have some favorite features.

**John Walstad:** I don't have favorite anything. I think everything that has been presented has some merits and maybe some warts. It doesn't matter what my favorites are, it matters to what you all think.

**Chairman Headland:** Any other questions for John? Closed hearing on HB 1296.

**Jon Godfreed, Greater North Dakota Chamber:** Distributed written testimony but was not at the hearing. See attachment #2.

# 2015 HOUSE STANDING COMMITTEE MINUTES

## Finance and Taxation Committee

Fort Totten Room, State Capitol

HB 1296

2/11/2015

23655

☐ Subcommittee

☐ Conference Committee

Committee Clerk Signature



### Explanation or reason for introduction of bill/resolution:

A bill relating to individual, estate, and trust income tax rate schedule replacement with a flat rate income tax and reduced North Dakota taxable income amount subject to the tax.

### Minutes:

No attachment.

**Chairman Headland:** This is Representative Koppelman's flat tax bill with a fiscal note of about \$292 million. I liked the concept; however, it's a little more reduction than the budget can handle right now. I prefer the amended version of the other bill.

**Representative Klein:** I like the concept but I don't think we can handle that at this time.  
**MADE A MOTION FOR A DO NOT PASS.**

**Representative Dockter:** **SECONDED.**

**Representative Kading:** I'm on this bill but it's probably more than we can handle right now so I'm not going to vote for it.

**Representative Froseth:** I like the idea of a flat tax too but this is a straight two percent across the board so it doesn't give the lower brackets any type of break.

**Chairman Headland:** It exempts income up front from taxation in order to allow for no one to pay more in taxes at those lower ends. It may sound nice but everybody needs to have a little skin in the game. If you provide the relief in the same fashion as the prior bill everybody does maintain a little skin.

**ROLL CALL VOTE: 10 YES 2 NO 2 ABSENT**  
**MOTION CARRIED FOR DO NOT PASS**

**Representative Hatlestad will carry this bill.**

Date: 2-11-15  
Roll Call Vote #: 1

2015 HOUSE STANDING COMMITTEE  
ROLL CALL VOTES  
BILL/RESOLUTION NO. 1296

House Finance and Taxation Committee

☐ Subcommittee

Amendment LC# or Description: \_\_\_\_\_

Recommendation: ☐ Adopt Amendment  
☐ Do Pass ☒ Do Not Pass ☐ Without Committee Recommendation  
☐ As Amended ☐ Rerefer to Appropriations  
☐ Place on Consent Calendar  
Other Actions: ☐ Reconsider ☐ \_\_\_\_\_

Motion Made By Rep. Klein Seconded By Rep. Dockter

Representatives	Yes	No	Representatives	Yes	No
CHAIRMAN HEADLAND	✓		REP HAAK	✓	
VICE CHAIRMAN OWENS	AB		REP STRINDEN		✓
REP DOCKTER	✓		REP MITSKOG		✓
REP TOMAN	✓		REP SCHNEIDER	✓	
REP FROSETH	✓				
REP STEINER	AB				
REP HATLESTAD	✓				
REP KLEIN	✓				
REP KADING	✓				
REP TROTTIER	✓				

Total (Yes) 10 No 2

Absent 2

Floor Assignment Rep. Hatlestad

If the vote is on an amendment, briefly indicate intent:

**REPORT OF STANDING COMMITTEE**

**HB 1296: Finance and Taxation Committee (Rep. Headland, Chairman)** recommends  
**DO NOT PASS** (10 YEAS, 2 NAYS, 2 ABSENT AND NOT VOTING). HB 1296 was  
placed on the Eleventh order on the calendar.

2015 TESTIMONY

HB 1296



**Income Tax Reform and Reductions** – Addressing HB 1167, 1223, 1296, 1298 Collectively

**Testimony by Dustin Gawrylow (Lobbyist #244) N.D. Watchdog Network**

1. We can zero-out the income tax, either immediately or in phases – to say that we can't because we don't know what will happen with oil tax revenues ignores the fact that question was not applied to the rate the legislature increased spending in recent years.
2. If zeroing out immediately is too difficult to do, a phase out plan that gives the next session the ability to re-evaluate the 1<sup>st</sup> phase of tax cuts, without reversing the reductions would be acceptable. Or, basing the phases on triggers of overall revenue would be acceptable.
3. The middle ground, as far as from both a reform and relief standpoint is HB 1296 which takes us to a Flat Tax with medium-sized exemptions for everyone at the bottom.
  - How much those large exemptions should be debated, but this approach is really the moderate of what has been proposed and introduced this session.

**Disclaimer: If spending increases the way it has for the last three biennium's, all bets are off as to whether "we can afford" the kind of tax reform and relief the taxpayers deserve.**

**2015 Proposed Approaches – Ranked**

1. HB 1167 – Zero-Out Now
2. HB 1223 – Phase to Zero
3. HB 1296 – Flat Rate –  
w/medium exemptions
4. HB 1298 – reduced rates,  
bottom faster than top
5. SB 2349 – small across the board
6. SB 2313/2212 – zero bottom bracket,  
no change for others

**State Business Tax Climate Index 2014  
as of July 1, 2013**

State	Overall Index Rank	Ranking on Five Component Taxes				
		Corp. Tax	Ind. Income Tax	Sales Tax	Unemp. Ins. Tax	Prop. Tax
AL	21	19	22	37	15	10
AK	4	28	1	5	29	25
AZ	22	26	18	49	1	6
AR	35	39	26	42	11	19
CA	48	31	50	41	16	14
CO	19	21	15	44	28	22
CT	42	35	33	32	23	49
DE	13	50	28	2	2	13
FL	5	13	1	18	6	16
GA	32	8	41	12	24	31
HI	30	4	35	16	38	12
ID	18	18	23	23	47	3
IL	31	47	11	33	43	44
IN	10	24	10	11	13	5
IA	40	49	32	24	36	38
KS	20	37	17	31	12	29
KY	27	27	29	10	48	17
LA	33	17	25	50	4	24
ME	29	45	21	9	33	40
MD	41	15	46	8	40	41
MA	25	34	13	17	49	47
MI	14	9	14	7	44	28
MN	47	44	47	35	41	33
MS	17	11	20	28	5	32
MO	16	7	27	26	9	7
MT	7	16	19	3	21	8
NE	34	36	30	29	8	39
NV	3	1	1	40	42	9
NH	8	48	9	1	46	42
NJ	49	41	48	46	32	50
NM	38	40	34	45	17	1
NY	50	25	49	38	45	45
NC	44	29	42	47	7	30
ND	28	22	38	21	19	2
OH	39	23	44	30	10	20
OK	36	12	39	39	3	11
OR	12	32	31	4	34	15
PA	24	46	16	19	39	43
RI	46	43	36	27	50	46
SC	37	10	40	22	30	21
SD	2	1	1	34	37	18
TN	15	14	8	43	27	37
TX	11	38	7	36	14	35
UT	9	5	12	20	18	4
VT	45	42	45	13	22	48
VA	26	6	37	6	35	26
WA	6	30	1	48	20	23
WV	23	20	24	25	26	27
WI	43	33	43	15	25	36
WY	1	1	1	14	31	34
DC	44	35	34	41	26	44



# More than Half of all Private Sector Workers are Employed by Pass-through Businesses

January 22, 2015

By Kyle Pomerleau, Richard Borean

This week's tax map comes from a report we released this morning and takes a look at the amount of private sector employment that comes from pass-through businesses.

Sole proprietorships, S corporations, limited liability companies (LLCs), and partnerships are also known as pass-through businesses. These entities are called pass-throughs, because the profits of these firms are passed directly through the business to the owners and are taxed on the owners' individual income tax returns.

This is in contrast with traditional C corporations, which pay tax at the entity level through the corporate income tax. Their owners (shareholders) then pay tax on this income again when they receive a dividend or sell their stock and realize a capital gain.

Today, Pass-through businesses play a significant role in the United States Economy. They account for 95 percent of all businesses and more than 60 percent of all business income.

Even more, pass-through businesses account for 55.2 percent of all private sector employment. This represents 65.7 million workers who are employed at or self-employed as pass-through businesses.

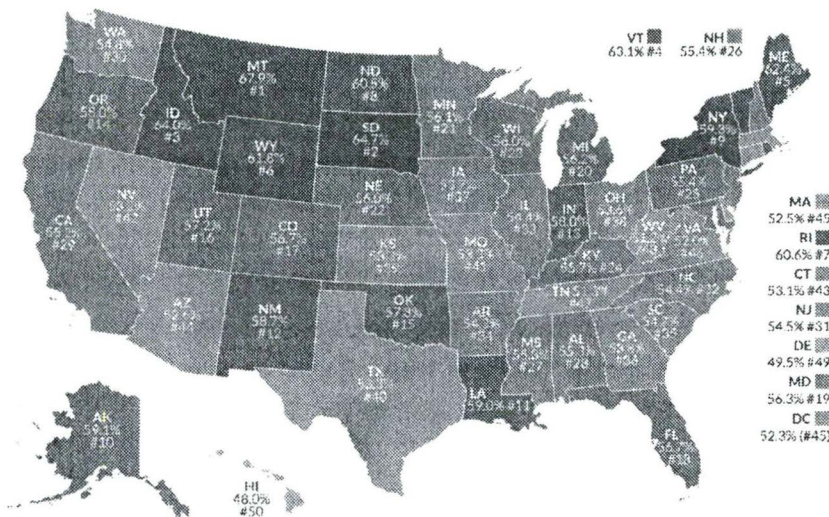
The prevalence of pass-through employment varies among U.S. states. According to 2011 Census Bureau data, pass-through businesses accounted more than 60 percent of business employment in eight states: Idaho (64 percent), Maine (62.4 percent), Montana (67.9 percent), North Dakota (60.5 percent), Rhode Island (60.6 percent), South Dakota (64.7 percent), Vermont (63.1 percent), and Wyoming (61.8 percent).

In contrast, Delaware (49.5 percent) and Hawaii (48 percent) had pass-through employment as a share of total private sector employment of less than 50 percent.

Click on map to enlarge. (See our reposting policy here.)

## Pass-Through Businesses Account for Most Private Sector Employment in Nearly all States

Pass-Through Business Employment as a Share of Total Private Sector Employment, 2011.



Notes: Published Jan 21, 2015.

Source: U.S. Census Bureau, County Business Patterns, and Nonemployer Statistics, 2011.

Pass-Through Business Employment as a Share of Total Private Sector Employment



taxfoundation.org/maps

Read more about pass-through businesses here.

# An Overview of Pass-through Businesses in the United States

By Kyle Pomerleau

Economist

HB 1296  
1-27-15  
#1 p. 3

## Key Findings

- Pass-through business income is taxed on the business owners' tax returns through the individual income tax code.
- Pass-through business income faces marginal tax rates that exceed 50 percent in some U.S. states.
- Pass-through businesses face only one layer of tax on their profits compared to the double taxation faced by C corporations.
- The number of pass-through businesses has nearly tripled since 1980, while the number of traditional C corporations has declined.
- Pass-through businesses earn more net business income than C corporations.
- Pass-through businesses employed more than 50 percent of the private sector work force and accounted for 37 percent of total private sector payroll in 2011.
- Although pass-through businesses are smaller than C corporations on average, they are not all small businesses. Many people work for large pass-through companies.
- The majority of pass-through business income is taxed at top individual tax rates.
- Tax reform aimed at improving the competitiveness of U.S. businesses needs to address the individual income tax code due to the economic importance of pass-through businesses.



## Introduction

One of the goals of tax reform is to improve the competitiveness of U.S. businesses and grow the economy. A promising way to do that is by lowering taxes on saving and investment through business tax reform. Much time is devoted to improving the corporate side of the tax code, but corporate-only business tax reform misses a significant portion of business activity.

The United States currently has a large number of pass-through businesses, or businesses that pay their taxes through the individual income tax code rather than through the corporate code. These sole proprietorships, S corporations, and partnerships make up the vast majority of businesses and more than 60 percent of net business income in America. In addition, pass-through businesses account for more than half of the private sector workforce and 37 percent of total private sector payroll. Pass-through businesses are represented in all industries in the United States.

Given that pass-through businesses are a significant part of the U.S. economy, tax reform should address the individual income tax code along with the corporate tax code.

## What Are Pass-through Businesses?

Table 1. Major Types of Pass-through Businesses

Legal Form	Description
Sole Proprietorship	An unincorporated business owned by a single individual that reports its income on schedule C of the 1040 tax form.
Partnership	An unincorporated business with multiple owners, either individuals or other businesses.
Limited Liability Company (LLC)	A type of business that has limited liability like a traditional C corporation.
S Corporation	A domestic corporation that can only be owned by U.S. citizens (not other corporations or partnerships) and can only have up to 100 shareholders.

Sole proprietorships, S corporations, limited liability companies (LLCs), and partnerships are also known as pass-through businesses (Table 1). These entities are called pass-throughs, because the profits of these firms are passed directly through the business to the owners and are taxed on the owners' individual income tax returns.

This is in contrast with traditional C corporations, which pay tax at the entity level through the corporate income tax. Their owners (shareholders) then pay tax on this income again when they receive a dividend or sell their stock and realize a capital gain.

Another difference between pass-through businesses and traditional C corporations is that owners of pass-through businesses pay the full tax on their business's income every year as the business earns it. Contrast this with owners or shareholders of C corporations, who can defer the taxation on their share of corporate income as long as the corporation retains its earnings or if the shareholder does not realize a capital gain on his stock.

## What Taxes Do Pass-through Businesses Pay?

Since pass-through businesses pass their income and losses directly to their owners, these businesses face the same marginal tax rates as individuals. These rates start at 10 percent on the first \$9,075 of taxable income (\$18,150 married filed jointly) and rise to 39.6 percent on taxable income over \$406,750 (\$457,601 married filed jointly) (Table 2).

Table 2. 2014 Federal Income Tax Brackets and Rates, Pass-through Businesses

Rate	Single Filers	Married Joint Filers
10%	\$0 to \$9,075	\$0 to \$18,150
15%	\$9,076 to \$36,900	\$18,151 to \$73,800
25%	\$36,901 to \$89,350	\$73,801 to \$148,850
28%	\$89,351 to \$186,350	\$148,851 to \$226,850
33%	\$186,351 to \$405,100	\$226,851 to \$405,100
35%	\$405,101 to \$406,750	\$405,101 to \$457,600
39.6%	\$406,751+	\$457,601+

Source: Internal Revenue Service.

In addition, sole proprietorships and partnerships pay the self-employment (SE) tax. SE taxes are levied on self-employment income in order to fund both Social Security and Medicare and are ultimately equivalent to what wage earners pay in payroll taxes.<sup>1</sup> The SE payroll tax is a combined 15.3 percent on the first \$117,000, 2.9 percent on the next \$83,000, and 3.8 percent on any income above \$200,000 (\$250,000 for joint filers) (Table 3).

Table 3. Payroll and Self-Employment Taxes for a Single Filer, 2014

Taxable Earnings	Social Security	Medicare	Total
\$0-\$117,000	12.40%	2.9%	15.3%
\$117,000-\$200,000	0%	2.9%	2.9%
\$200,000 and over	0%	3.8%	3.8%

Source: Social Security Administration.

Owners of sole proprietorships and partnerships are subject to the SE payroll tax on most of their net business income.<sup>2</sup> S corporation owners are subject to SE payroll taxes on the portion of their net income paid out in wages. Specifically, an owner of an S corporation can designate his income as either a profit distribution or wages. The income designated as wages is subject to the SE tax while the non-wage income is not.<sup>3</sup>

S corporation income earned by a passive shareholder—an S corporation owner that does not actively participate in the day-to-day activities of the business but still receives income<sup>4</sup>—is not subject to the SE payroll tax. However, a passive shareholder is liable for the 3.8

<sup>1</sup> Half of a worker's payroll taxes are paid by their employer.

<sup>2</sup> Rental real estate income is exempt from the self-employment tax.

<sup>3</sup> The IRS sets a limit on how much income an owner can designate as a non-wage distribution to prevent abuse.

<sup>4</sup> The IRS sets guidelines on what they consider active or passive participation. If shareholders do not satisfy the "material participation" guidelines, the income received from the business is deemed passive and subject to the Net Investment Income Tax. See Michael Kosnitzky & Michael Grisolia, *Net Investment Income Tax Regulations Affecting S Corporations*, [http://www.bsfilp.com/news/in\\_the\\_news/001548/\\_res/id=sa\\_File1/](http://www.bsfilp.com/news/in_the_news/001548/_res/id=sa_File1/).



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percent Net Investment Income Tax that was passed as part of the Affordable Care Act.<sup>5</sup> This tax applies to investment income when a taxpayer's modified AGI exceeds \$200,000 (\$250,000 for joint filers).

Pass-through business income can also be subject to the Alternative Minimum Tax (AMT), which increases the effective tax rate paid by business owners.<sup>6</sup>

In addition, pass-through businesses pay state and local income taxes, which vary from zero percent in states without personal income taxes to 13.3 percent, the top marginal income tax rate in California.<sup>7</sup>

Combined, the top marginal income tax rates faced by pass-through businesses can exceed 50 percent in some cases. For example, the top marginal tax rate faced by sole proprietors in California tops 51.9 percent (see Table 4). The top marginal income tax rate for active shareholders of S corporations is slightly lower, since they do not pay the payroll tax on non-wage, business income (California's top rate is 48.8 percent).<sup>8</sup> Passive S corporation shareholders in California face an effective marginal rate of 52.6 percent.

**Table 4. Top Marginal Tax Rate for a Sole Proprietorship in California**

Top Marginal Federal Income Tax	39.60%
Top Marginal State Income Tax	13.30%
Self-employment Tax	3.80%
Deduction for State/Local Income Taxes and Self Employment Taxes (Less Pease)	-4.80%
<b>Total</b>	<b>51.90%</b>

Source: Author's calculations.

The average top marginal income tax rate on sole proprietorships and partnerships in the United States is 47.2 percent, and 44.5 and 48.3 percent, respectively, for active and passive shareholders of S corporations.<sup>9</sup>

<sup>5</sup> Regulations require equal distribution among all S corporation shareholders, active or passive. S corporations must distribute enough money to all shareholders, including active shareholders, to cover the 3.8 percent Net Investment Tax, even though active shareholders are not actually required to pay the tax. Although not strictly a tax on S corporations, this limits the amount of money available for reinvestment.

<sup>6</sup> More than 2 million income tax returns with pass-through business income were subject to the AMT in 2007. U.S. Department of the Treasury, Office of Tax Analysis, Mathew Knittel et al., OTA Technical Paper 4: *Methodology to Identify Small Businesses and Their Owners* (Aug. 2011), <http://www.treasury.gov/resource-center/tax-policy/tax-analysis/Documents/OTA-T2011-04-Small-Business-Methodology-Aug-8-2011.pdf>.

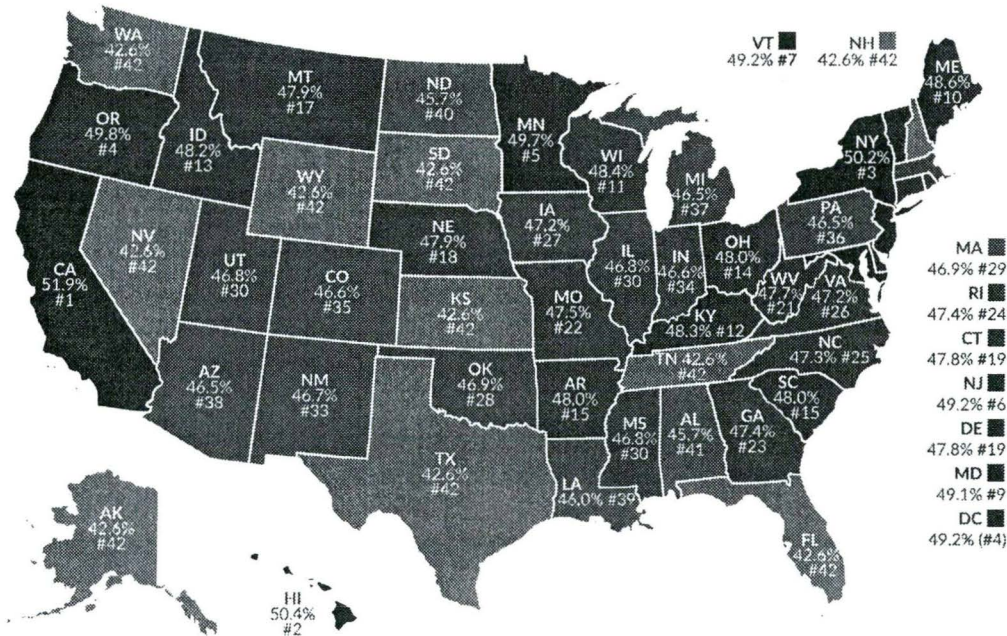
<sup>7</sup> Tax Foundation, *State Personal Income Tax Rates and Brackets 2014 Update*, <http://taxfoundation.org/article/state-personal-income-tax-rates-and-brackets-2014-update>.

<sup>8</sup> Assuming the last dollar earned by an active shareholder is his non-salary income from his business.

<sup>9</sup> Averages are both weighted by the amount of pass-through income in each state. Assumes no effect of Pease in states with no individual income tax. Pease may apply in states with no income tax, in some cases adding 1.118 percent to the marginal rate. Many states also apply gross receipts, margin, and franchise taxes to pass-through business income. These numbers do not account for those.

### Figure 1. Pass-through Businesses Face Marginal Tax Rates Over 50 percent in Some States

Combined Federal and State Top Marginal Income Tax Rate on Sole Proprietorships and Partnerships, 2014



**Notes:** Marginal tax rates include federal, state, and local income taxes, payroll taxes, the deduction for state and local income taxes, and the effect of the Pease limitation on itemized deductions. Published January 20, 2015.

**Source:** State statutes, state tax forms and instructions; Tax Foundation calculations.

Combined Federal, State, and Local Top Marginal Income Tax Rate on Sole Proprietorships and Partnerships



### Tax Differential with Traditional C Corporations

Due to the different tax treatment of pass-through businesses and C corporations, the two business forms face a tax burden differential (see Table 5). C corporations are first taxed at the entity level at the 39.1 percent combined federal and average state tax rate.<sup>10</sup> Then, when those profits are realized by the owners (shareholders) as either dividends or capital gains, the owners pay taxes on that income again. The double-taxation of corporate income creates a disparity between the total tax burden on the income of pass-through businesses and C corporations.

Pass-through businesses facing the top marginal tax rate (combined with the average state rate) face an average rate of 47.2 percent compared to an average total tax rate of 56.5 percent on C corporate income realized at the shareholder level.

<sup>10</sup> Assuming equity-financed investment.



Table 5. Total Tax Burden on Business Income, C Corporation vs. Pass-through Business

	Traditional C corporation	Pass-through business
Entity-Level Tax	39.1%	0.0%
Individual-Level Tax	28.6%	47.2%
Total Tax Rate	56.5%	47.2%

Note: Assumes C corporation distributes dividends. Pass-through business is a partnership.  
Source: Author's calculations.

Although traditional C corporations pay a higher overall tax rate on their income, there are specific advantages to the C corporate form that make it worthwhile for some businesses, specifically the ease of raising money, less restrictive shareholder rules (compared to an S corporation), deferral of domestic taxation on foreign income, and the ability to retain earnings without triggering shareholder taxation.<sup>11</sup>

## The Number of Pass-through Businesses Filing Tax Returns Has Greatly Increased Over the Past Thirty Years

The number of pass-through businesses in the United States has increased considerably since the Tax Reform Act of 1986, which substantially lowered individual income tax rates.<sup>12</sup>

Between 1980 and 2011, the number of pass-through business tax returns has increased by 175 percent from roughly 10.9 million returns to about 30 million returns (Figure 2).<sup>13</sup> The number of sole proprietorships increased from 8.9 million in 1980 to 23.4 million in 2011. The number of partnership businesses grew from 1.3 million returns to 3.2 million returns.

S corporations experienced the fastest growth during this period. From 1980 to 2011, the number of S corporations filing tax returns grew from approximately 545,000 returns to over 4.15 million; an increase of 660 percent, more than three times the rate of growth experienced by pass-through businesses overall.

The number of C corporations filing tax returns during this period steadily declined from 2.2 million returns in 1980 to 1.6 million returns in 2011.

11 Nearly 40 percent of corporate equities are held by tax-exempt organizations and individuals (college endowments, pension funds, and tax preferred retirement accounts). The corporate income passed to these taxpayers is exempt from the second layer of tax. See Congressional Budget Office, *Taxing Capital Income: Effective Marginal Tax Rates Under 2014 Law and Selected Policy Options* (Dec. 2014), [http://www.cbo.gov/sites/default/files/cbofiles/attachments/49817-Taxing\\_Capital\\_Income\\_0.pdf](http://www.cbo.gov/sites/default/files/cbofiles/attachments/49817-Taxing_Capital_Income_0.pdf).

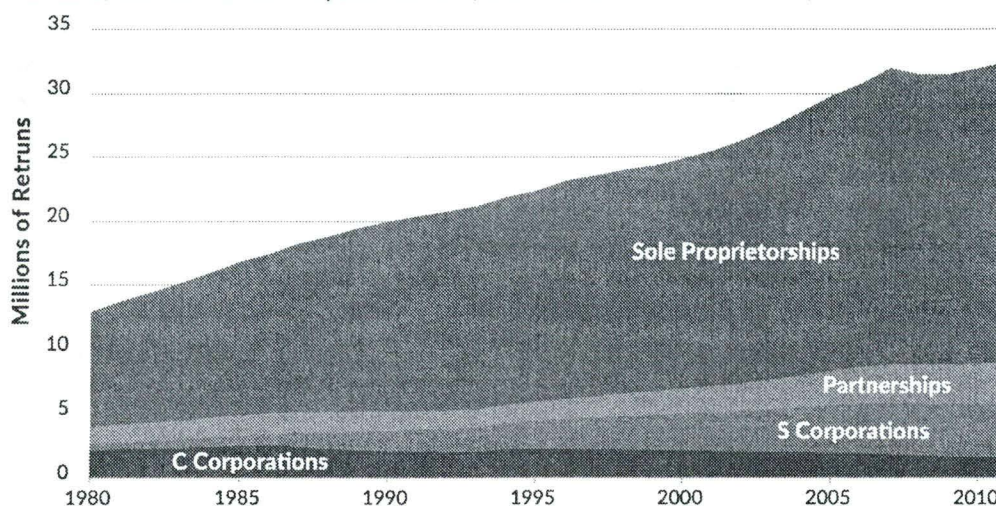
12 The top marginal individual income tax rates were reduced from 50 percent in 1986 to 28 percent in 1988. This is compared to the corporate income tax rate that was lowered from 46 percent in 1986 to 34 percent in 1988. See Tax Foundation, *U.S. Federal Individual Income Tax Rates History, 1862-2013 (Nominal and Inflation-Adjusted Brackets)*, <http://taxfoundation.org/article/us-federal-individual-income-tax-rates-history-1913-2013-nominal-and-inflation-adjusted-brackets>; Tax Foundation, *U.S. Federal Individual Income Tax Rates History, 1862-2013 (Nominal and Inflation-Adjusted Brackets)*, <http://taxfoundation.org/article/us-federal-individual-income-tax-rates-history-1913-2013-nominal-and-inflation-adjusted-brackets>.

13 Internal Revenue Service, *SOI Tax Stats - Integrated Business Data, 1980-2008*, <http://www.irs.gov/uac/SOI-Tax-Stats-Integrated-Business-Data>; Internal Revenue Service, *Business Tax Statistics, 2009-2011*, <http://www.irs.gov/uac/Tax-Stats-2>. IRS data double counts some businesses due to the fact that some private partnerships can be owned by one or more other business entities.



**Figure 2. The Number of Pass-through Businesses has Nearly Tripled Since 1980**

Number of Business Tax Returns by Business Form, 1980-2011

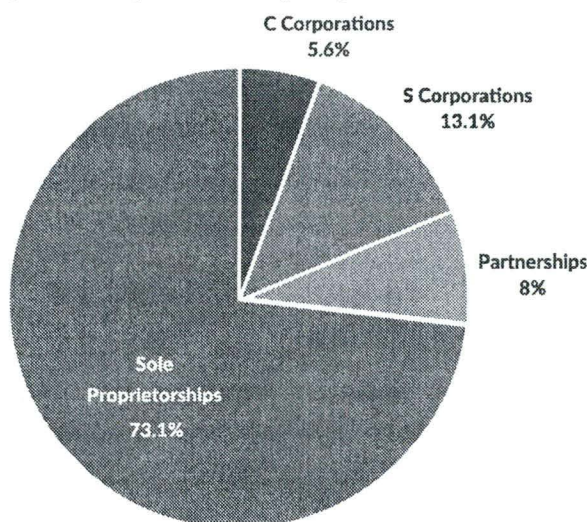


Source: IRS.

## Pass-through Businesses Are the Most Common Business Form in the United States

Pass-through businesses are the most common business form in the United States. Of the 27.7 million firms in 2011,<sup>14</sup> about 94 percent of them were pass-through businesses according to the Census Bureau (Figure 3).<sup>15</sup>

**Figure 3. Sole Proprietorships Are a Majority of All Businesses**



Source: Census Bureau.

<sup>14</sup> The number of firms differs from the number of returns. Specifically, an individual firm may own several different businesses that separately file tax returns.

<sup>15</sup> Census Bureau, *County Business Patterns*, <http://www.census.gov/econ/cbp/>; Census Bureau, *Nonemployer Statistics*, <http://www.census.gov/econ/nonemployer/>. 2011 is the most up-to-date year for all data sources.

Sole proprietorships comprise the majority of all business forms. According to Census data, 73.1 percent of all businesses were sole proprietorships (20.3 million firms). 13.1 percent of all businesses were S corporations (3.65 million firms), and about 8 percent were partnerships (2.2 million firms).

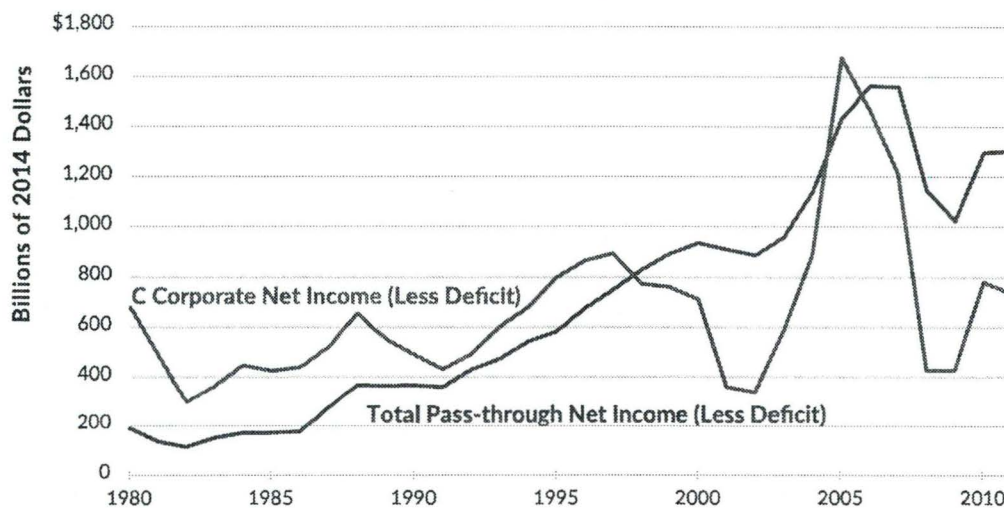
C corporations make up the remaining 5.6 percent of businesses in the United States (1.5 million firms).

## Pass-through Businesses Now Earn More Net Income Than Traditional C Corporations

As the number of pass-through businesses increased, they began to generate more net business income as a group than traditional C corporations. The combined net income of sole proprietorships, partnerships, and S corporations in 1980 was \$188 billion compared to total C corporate net income of \$697 billion (Figure 4).<sup>16</sup> By 1998, net pass-through income had grown by 340 percent to \$829 billion, overtaking C corporate income—\$773 billion in 1998—for the first time.

**Figure 4. Pass-through Businesses Now Earn More Net Income Than Traditional C Corporations**

*Net Business Income, C Corporations vs. Pass-through Businesses, 1980–2011*



Source: IRS.

Pass-through business income has been persistently higher than corporate income since 1998, with the exception of 2005, when corporate net income peaked at \$1.6 trillion. The most recent data shows that pass-through businesses earned \$1.3 trillion in net income, or 63.9 percent of total business net income in 2011.

<sup>16</sup> Internal Revenue Service, *SOI Tax Stats – Integrated Business Data, 1980–2008*, <http://www.irs.gov/uac/SOI-Tax-Stats-Integrated-Business-Data>; Internal Revenue Service, *Business Tax Statistics, 2009–2011*, <http://www.irs.gov/uac/Tax-Stats-2>.



9

## Most of the Private Sector Workforce Works at, or Is Self-Employed as, a Pass-through Business

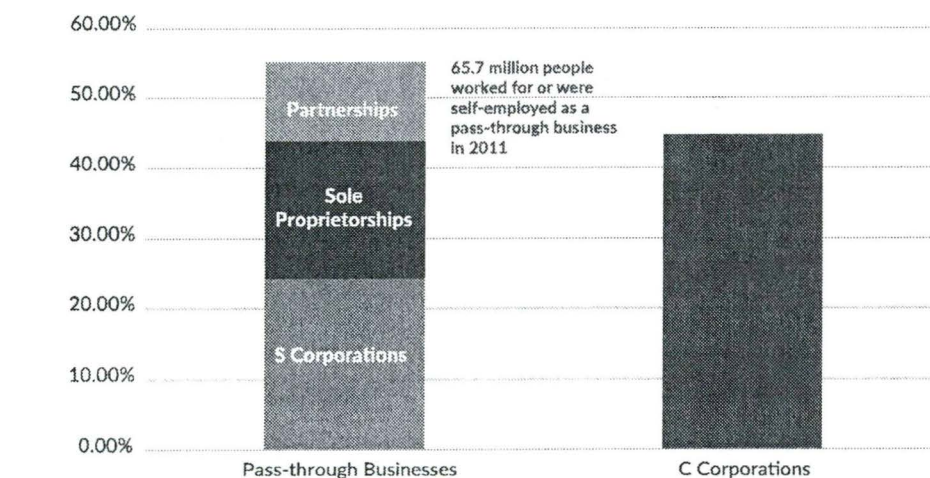
Not only do pass-through businesses earn more net income than traditional C corporations, they also account for more employment.

According to 2011 Census data, pass-through businesses account for 55.2 percent of all private sector employment.<sup>17</sup> This represents 65.7 million workers. In contrast, traditional C corporations comprise 44.7 percent of the private sector workforce, or 53.2 million workers.

S corporations account for the most employment of all pass-through business types. In 2011, S corporations employed 24.4 percent of the private sector workforce, or 29 million workers. Sole Proprietorships comprised 19.5 percent of the private sector workforce. Partnerships accounted for the lowest amount of employment with only 11.3 percent of the private sector workforce.

### Figure 5. Pass-through Businesses Employ More Than Half of the Private Sector Workforce

Share of Private Sector Workforce by Business Type, 2011



Source: Census Bureau.

### Pass-Through Businesses Are Generally Smaller Than C Corporations, but Pass-Through Businesses Are Not Always Small Businesses

A major reason why C corporations account for a significant amount of employment but so few firms is that they are significantly larger than pass-through businesses on average. Figure 6, below, compares the distribution of pass-through and corporate employment by the size of firm.

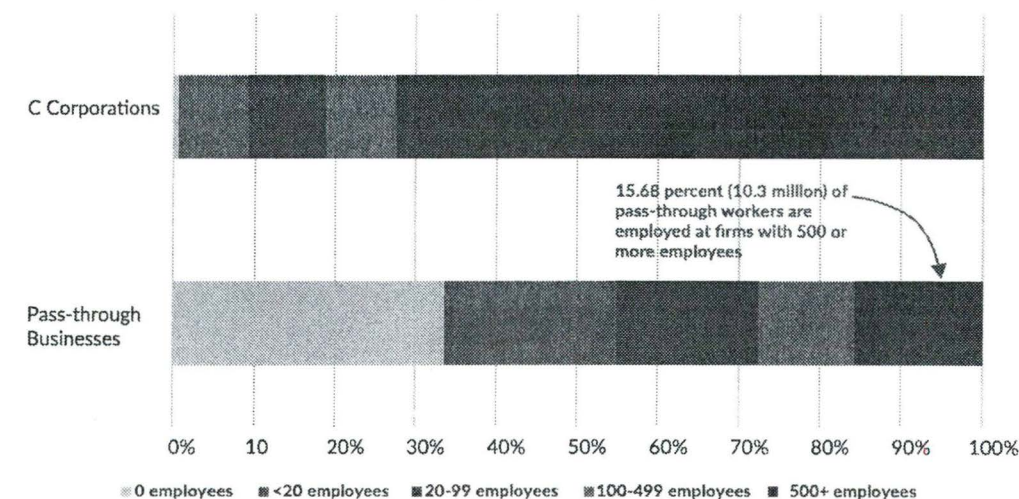
<sup>17</sup> Numbers include self-employed individuals in order to get a complete picture of employment by business form. Census Bureau, *County Business Patterns*, <http://www.census.gov/econ/cbp/>; Census Bureau, *Statistics of U.S. Businesses*, <http://www.census.gov/econ/susb/>; Census Bureau, *Nonemployer Statistics 2011*, <http://www.census.gov/econ/nonemployer/>.

Employment at C corporations is heavily concentrated in large firms. In 2011, 72.3 percent (38 million) of C corporate workers were employed at large firms with 500 or more employees with an additional 8.9 percent (4.7 million) working at firms with between 100 and 500 employees.<sup>18</sup> The remaining 18.7 percent (9.9 million) of corporate employment was at firms with fewer than 100 employees.

Pass-through business employment is more heavily distributed among smaller firms. However, it would be a mistake to completely conflate pass-through businesses with small businesses. While most pass-through employment is either self-employment (33.6 percent) or at small firms with between 1 and 100 employees (38.7 percent), a significant number of employees work at large pass-through businesses. According to 2011 Census data, a combined 27.5 percent (18.1 million) of pass-through employment was at firms with more than 100 employees, and 15.9 percent (10.3 million) of pass-through employees work at large firms with 500 or more employees.

**Figure 6. Not All Pass-through Businesses Are Small Businesses**

*Distribution of Pass-through and Corporate Employment by Firm Size, 2011*



### Pass-through Businesses Account for Most of the Private Sector Workforce in 48 States

The prevalence of pass-through employment varies among U.S. states. According to Census Bureau data, pass-through businesses accounted more than 60 percent of business employment in eight states: Idaho (64 percent), Maine (62.4 percent), Montana (67.9 percent), North Dakota (60.5 percent), Rhode Island (60.6 percent), South Dakota (64.7

<sup>18</sup> Census Bureau, *County Business Patterns*, <http://www.census.gov/econ/cbp/>; Census Bureau, *Statistics of U.S. Businesses*, <http://www.census.gov/econ/susb/>; Census Bureau, *Nonemployer Statistics 2011*, <http://www.census.gov/econ/nonemployer/>.

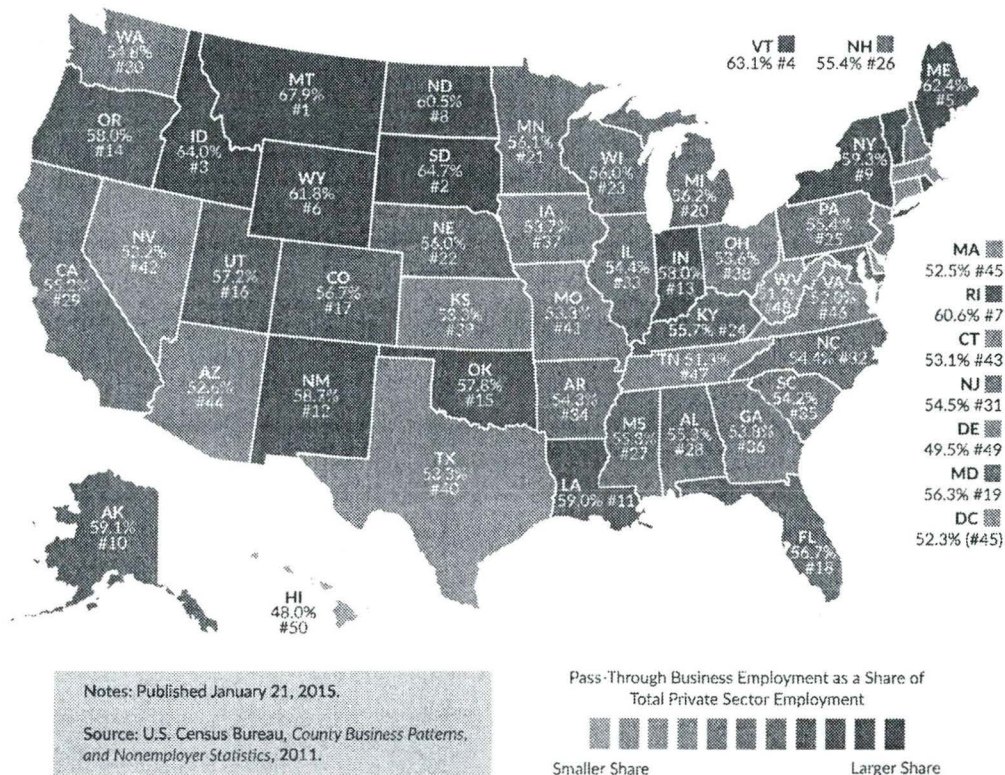


11

percent), Vermont (63.1 percent), and Wyoming (61.8 percent).<sup>19</sup> In contrast, Delaware (49.5 percent) and Hawaii (48 percent) had pass-through employment as a share of total private sector employment of less than 50 percent.<sup>20</sup>

### Figure 7. Pass-through Businesses Account for Most Private Sector Employment in Nearly all States

*Pass-through Business Employment as a Share of Total Private Sector Employment, 2011*



### Pass-Through Businesses Accounted for Nearly 40 Percent of Private Sector Payroll

Pass-through businesses also account for a significant amount of private sector payroll. Of the \$4.48 trillion of salaries and wages paid in 2011, pass-through businesses accounted for approximately \$1.65 trillion, or 37 percent (Figure 8).<sup>21</sup> S corporations accounted for most pass-through business payroll with a total of \$1 trillion. Partnerships paid \$505 billion and sole proprietorships paid \$98 billion.<sup>22</sup>

19 Census Bureau, *County Business Patterns*, <http://www.census.gov/econ/cbp/>; Census Bureau, *Statistics of U.S. Businesses*, <http://www.census.gov/econ/susb/>; Census Bureau, *Nonemployer Statistics 2011*, <http://www.census.gov/econ/nonemployer/>.

20 See Appendix for full employment data table.

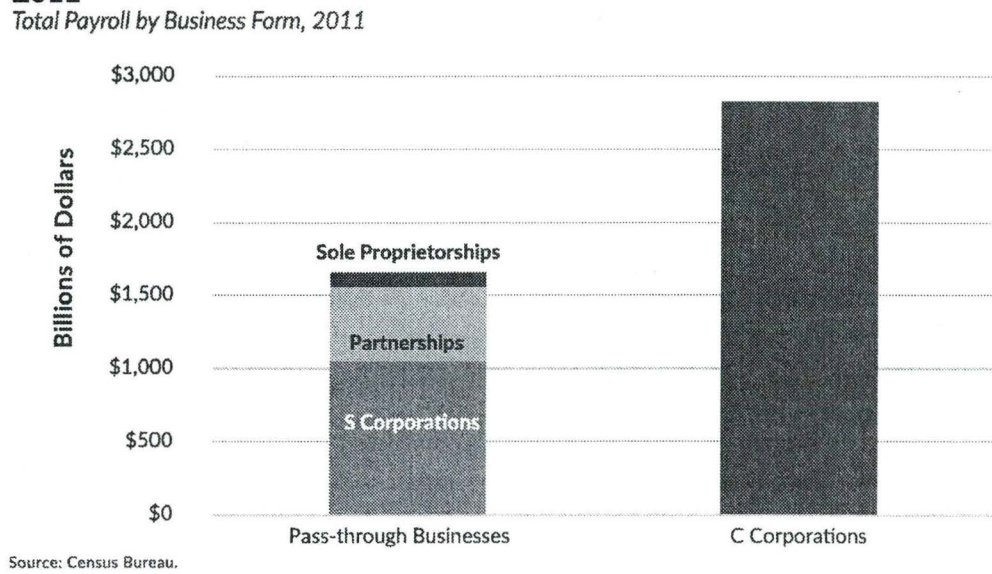
21 Census Bureau, *County Business Patterns*, <http://www.census.gov/econ/cbp/>; Census Bureau, *Statistics of U.S. Businesses*, <http://www.census.gov/econ/susb/>; Census Bureau, *Nonemployer Statistics 2011*, <http://www.census.gov/econ/nonemployer/>.

22 These numbers do not account for self-employment income, which is disproportionately earned by pass-through businesses, especially sole proprietorships. Unincorporated self-employed individuals reported approximately \$600 billion in gross receipts in 2011. However, gross receipts cannot be directly compared to payroll due to the omission of business expenses. Wages would more accurately be compared to gross receipts minus costs.

12

However, given their larger size, C corporations accounted for most of the private sector payroll in the United States. In 2011, 63 percent of private sector payroll was paid by C corporations, or \$2.8 trillion.<sup>23</sup>

**Figure 8. Pass-through Businesses Paid \$1.6 Trillion in Wages and Salaries in 2011**  
*Total Payroll by Business Form, 2011*

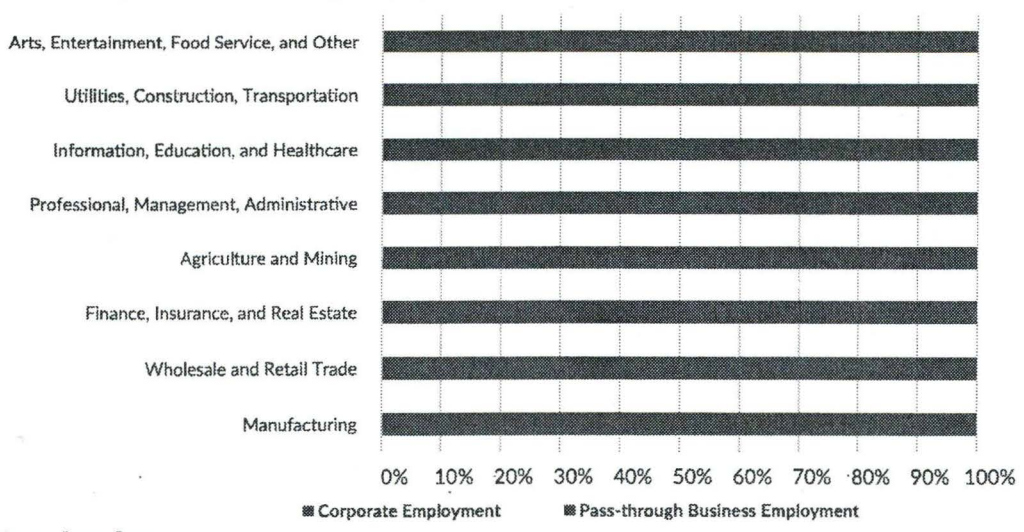


**Pass-through Businesses Employ the Majority of Workers in Service Sector Industries**

Pass-through businesses employ workers in every industry. However, service sector industries have larger shares of pass-through employment than corporate employment. In contrast, manufacturing and trade industries are dominated by C corporate employment.

**Figure 9. Pass-through Business Employment Dominates Service Industries**

*Share of Corporate and Pass-through Employment by Industry, 2011*



23 See Appendix for full data table with payroll by state and business form for 2011.



13

Figure 9 shows the share of corporate versus pass-through employment by industry. According to Census data, pass-through business employment accounts for most employment in most industries. Pass-through employment accounts for 60 percent or more employment in the Arts, Entertainment, and Food Service (72.1 percent); Utilities, Construction, and Transportation (60.8 percent); and Information, Education, and Healthcare (60.3 percent) industries.<sup>24</sup>

C corporations accounted for a majority of employment in only three major industries: manufacturing (63.7 percent); wholesale and retail trade (58 percent); and Finance, Insurance, and Real Estate (50.6 percent).

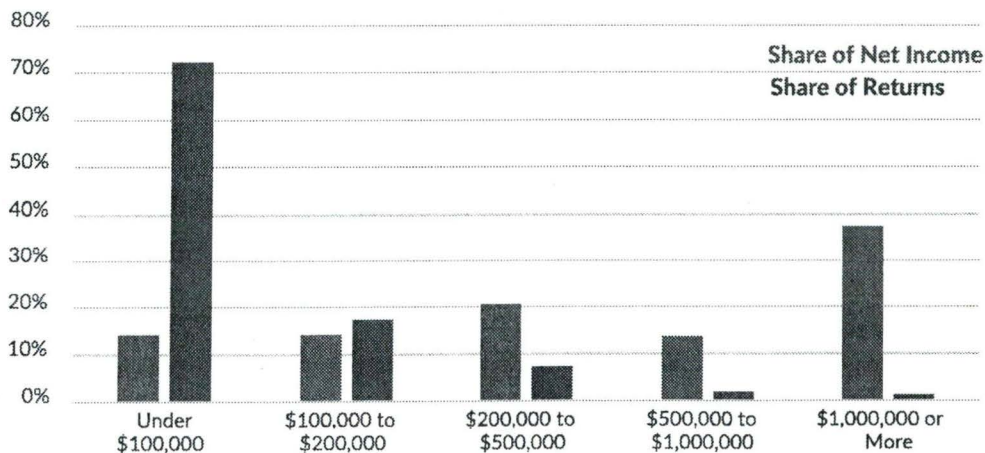
Although C corporations accounted for more employment in these industries, there are consistently more pass-through businesses (firms) in all industries. For example, most employment in manufacturing is at C corporations, but the vast majority of manufacturing firms are pass-through businesses.<sup>25</sup> (See Appendix for complete industry numbers.)

## High Income Individuals Report Most Pass-through Business Income

Since pass-through business income is taxed at the individual level, the distribution of pass-through income across individuals is important in understanding the effect of individual marginal tax rates.

**Figure 10. High Income Taxpayers Report Most Pass-through Business Income**

*Distribution of Total Pass-through Income*



Source: IRS.

<sup>24</sup> Census Bureau, *County Business Patterns*, <http://www.census.gov/econ/cbp/>; Census Bureau, *Statistics of U.S. Businesses*, <http://www.census.gov/econ/susb/>; Census Bureau, *Nonemployer Statistics 2011*, <http://www.census.gov/econ/nonemployer/>.

<sup>25</sup> Robert Carroll & Gerald Prante, *The Flow-Through Business Sector and Tax Reform: The economic footprint of the flow-through sector and the potential impact of tax reform* (Apr. 2011), <http://www.s-corp.org/wp-content/uploads/2011/04/Flow-Through-Report-Final-2011-04-08.pdf>.



If most pass-through business income were earned by low to moderate income individuals, pass-through business income would face relatively low marginal rates. Conversely, if most business income is earned by high-income individuals, pass-through business income would be taxed at potentially high marginal rates.

According to IRS data, 72 percent of returns with business income reported between \$1 and \$100,000 in business income.<sup>26</sup> However, these returns only accounted for 14 percent of total business income.<sup>27</sup>

The largest concentration of pass-through business income was reported on the 1.3 percent of returns that earned \$1 million in net business income or more. This group of taxpayers earned 37 percent of total pass-through business income.

Combined with the 1.8 percent of tax returns with business income between \$500,000 and \$1 million, 51 percent of business income was earned by the few taxpayers (3.1 percent of returns) with net business income of \$500,000 or more.

This means that 51 percent of pass-through business income in 2012 was potentially subject to the federal top marginal tax rate on individual income of 39.6 percent.

## Conclusion

In the last thirty years, the number of pass-through businesses has greatly increased while the number of C corporations has declined. As a result, pass-through businesses now account for 94 percent of all businesses, earn more than 64 percent of total business net income, and employ more than half of the private sector workforce in the United States. In addition, they pay more than \$1.6 trillion in wages and salaries and operate in every U.S. industry.

One of the main goals of fundamental tax reform is to make U.S. businesses more competitive and to increase economic growth. This requires a reduction in taxes on businesses and investment. Most attention is given to traditional C corporations because they face high tax burdens by international standards and account for a large amount of economic activity. As a result, less attention has been given to pass-through businesses. Since pass-through businesses now account for more than half of the business income and employment in the United States, any business tax reform needs to address the individual income tax code as well as the corporate income tax code.

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26 Internal Revenue Service, *SOI Tax Stats – Individual Statistical Tables by Size of Adjusted Gross Income, Table 1.4*, <http://www.irs.gov/uac/SOI-Tax-Stats---Individual-Statistical-Tables-by-Size-of-Adjusted-Gross-Income>. Business income includes: business and professional income (Schedule C, 1040 Line 12), Rents, Royalties, S Corporation and Partnerships income (Schedule E), and Farm Income (Schedule F).

27 It is important to note that individuals can report business income from incidental business activity. For example, an individual can earn rental income from a vacation home.

## Appendix

Appendix Table 1. Combined Top Marginal Tax Rate on Pass-through Businesses by State, 2014

State	Top Marginal Income Tax Rate (Sole Proprietorships/Partnerships)	Top Marginal Income Tax Rate (S Corporations)	
		Active Shareholders	Passive Shareholders
Alabama	45.65%	42.67%	46.47%
Alaska	42.58%	39.60%	43.40%
Arizona	46.51%	43.53%	47.33%
Arkansas	48.00%	45.02%	48.82%
California	51.86%	48.88%	52.68%
Colorado	46.56%	43.58%	47.38%
Connecticut	47.81%	44.83%	48.63%
Delaware	47.81%	44.83%	48.63%
Florida	42.58%	39.60%	43.40%
Georgia	47.39%	44.41%	48.21%
Hawaii	50.41%	47.43%	51.23%
Idaho	48.24%	45.26%	49.06%
Illinois	46.79%	43.81%	47.61%
Indiana	46.61%	43.63%	47.43%
Iowa	47.22%	44.25%	48.05%
Kansas	42.58%	39.60%	43.40%
Kentucky	48.30%	45.32%	49.12%
Louisiana	45.96%	42.98%	46.78%
Maine	48.57%	45.59%	49.39%
Maryland	49.05%	46.07%	49.87%
Massachusetts	46.91%	43.93%	47.73%
Michigan	46.52%	43.54%	47.34%
Minnesota	49.72%	46.74%	50.54%
Mississippi	46.79%	43.81%	47.61%
Missouri	47.51%	44.53%	48.33%
Montana	47.93%	44.96%	48.76%
Nebraska	47.90%	44.92%	48.72%
Nevada	42.58%	39.60%	43.40%
New Hampshire	42.58%	39.60%	43.40%
New Jersey	49.18%	46.21%	50.01%
New Mexico	46.73%	43.75%	47.55%
New York	50.24%	47.26%	51.06%
North Carolina	47.27%	44.29%	48.09%
North Dakota	45.71%	42.73%	46.53%
Ohio	48.01%	45.03%	48.83%
Oklahoma	46.94%	43.96%	47.76%
Oregon	49.81%	46.83%	50.63%
Pennsylvania	46.53%	43.55%	47.35%
Rhode Island	47.38%	44.41%	48.21%
South Carolina	48.00%	45.02%	48.82%
South Dakota	42.58%	39.60%	43.40%
Tennessee	42.58%	44.41%	48.21%
Texas	42.58%	39.60%	43.40%
Utah	46.79%	43.81%	47.61%
Vermont	49.17%	46.19%	49.99%
Virginia	47.24%	44.26%	48.06%
Washington	42.58%	39.60%	43.40%
West Virginia	47.69%	44.71%	48.51%
Wisconsin	48.39%	45.41%	49.21%
Wyoming	42.58%	39.60%	43.40%
District of Columbia	49.17%	46.19%	49.99%
U.S. Average	47.25%	44.51%	48.31%

Note: Many states also apply gross receipts, margin, and franchise taxes to pass-through business income. These numbers do not account for those.

Source: Author's calculations.



Appendix Table 2. Employment by Business Form and State, 2011

State	C Corporations		Pass-through Total		Sole Proprietorship		Partnership		S Corporations	
	Share	Employment	Share	Employment	Share	Employment	Share	Employment	Share	Employment
Alabama	44.66%	759,390	55.34%	941,143	19.86%	337,810	10.38%	176,477	25.10%	426,856
Alaska	40.87%	109,453	59.13%	158,359	22.64%	60,631	11.60%	31,054	24.90%	66,674
Arizona	47.42%	1,082,867	52.58%	1,200,610	17.43%	397,950	12.50%	285,528	22.65%	517,132
Arkansas	45.68%	470,789	54.32%	559,763	19.41%	200,025	10.43%	107,464	24.48%	252,274
California	44.79%	6,281,899	55.21%	7,743,121	22.55%	3,162,609	9.67%	1,356,736	22.99%	3,223,776
Colorado	43.28%	940,781	56.72%	1,233,139	18.54%	402,999	13.04%	283,389	25.15%	546,751
Connecticut	46.90%	670,857	53.10%	759,461	20.03%	286,557	14.79%	211,596	18.27%	261,308
Delaware	50.50%	183,955	49.50%	180,326	13.57%	49,425	13.63%	49,656	22.30%	81,245
District of Columbia	47.72%	167,067	52.28%	183,012	15.44%	54,037	21.26%	74,435	15.58%	54,540
Florida	43.30%	3,347,252	56.70%	4,382,664	19.28%	1,490,678	9.57%	739,885	27.84%	2,152,101
Georgia	46.21%	1,728,269	53.79%	2,011,755	20.61%	770,791	9.64%	360,372	23.55%	880,592
Hawaii	51.96%	262,206	48.04%	242,420	20.58%	103,853	10.32%	52,053	17.14%	86,514
Idaho	35.98%	192,506	64.02%	342,513	21.29%	113,916	15.06%	80,578	27.67%	148,019
Illinois	45.65%	2,381,740	54.35%	2,836,017	17.50%	912,902	9.85%	513,968	27.01%	1,409,147
Indiana	41.98%	1,036,757	58.02%	1,433,031	16.49%	407,276	11.75%	290,192	29.78%	735,563
Iowa	46.27%	570,868	53.73%	662,857	17.63%	217,458	8.79%	108,486	27.31%	336,913
Kansas	46.70%	526,274	53.30%	600,592	18.27%	205,836	10.72%	120,835	24.31%	273,921
Kentucky	44.34%	677,683	55.66%	850,549	19.90%	304,105	11.74%	179,351	24.02%	367,093
Louisiana	41.03%	712,283	58.97%	1,023,924	20.02%	347,506	15.05%	261,321	23.91%	415,097
Maine	37.64%	182,221	62.36%	301,958	24.41%	118,201	8.29%	40,159	29.66%	143,598
Maryland	43.75%	952,896	56.25%	1,225,339	20.13%	438,505	10.55%	229,728	25.58%	557,106
Massachusetts	47.52%	1,322,241	52.48%	1,460,544	18.21%	506,686	9.62%	267,801	24.65%	686,057
Michigan	43.80%	1,553,073	56.20%	1,992,942	19.41%	688,336	11.44%	405,675	25.35%	898,931
Minnesota	43.94%	1,012,541	56.06%	1,291,745	17.43%	401,737	8.43%	194,226	30.20%	695,782
Mississippi	44.65%	425,946	55.35%	528,010	22.49%	214,554	11.23%	107,121	21.63%	206,335
Missouri	46.72%	1,076,499	53.28%	1,227,605	18.39%	423,710	10.66%	245,567	24.23%	558,328
Montana	32.10%	113,952	67.90%	241,049	23.97%	85,091	11.13%	39,516	32.80%	116,442
Nebraska	44.02%	350,531	55.98%	445,817	16.58%	132,034	8.72%	69,434	30.68%	244,349
Nevada	46.82%	530,211	53.18%	602,201	17.00%	192,474	15.32%	173,438	20.87%	236,289
New Hampshire	44.65%	250,754	55.35%	310,874	20.67%	116,064	9.60%	53,901	25.05%	140,909
New Jersey	45.46%	1,617,960	54.54%	1,941,400	17.12%	609,281	13.66%	486,253	23.76%	845,866
New Mexico	41.31%	262,688	58.69%	373,147	20.85%	132,589	12.97%	82,499	24.86%	158,059
New York	40.69%	2,985,817	59.31%	4,351,881	21.13%	1,550,289	12.49%	916,635	25.69%	1,884,957
North Carolina	45.56%	1,576,409	54.44%	1,883,894	19.20%	664,216	9.47%	327,524	25.78%	892,154
North Dakota	39.54%	111,283	60.46%	170,176	18.77%	52,831	10.37%	29,201	31.32%	88,144
Ohio	46.43%	2,071,166	53.57%	2,389,484	17.68%	788,483	11.40%	508,487	24.49%	1,092,514
Oklahoma	42.23%	573,296	57.77%	784,340	20.33%	276,021	13.08%	177,594	24.36%	330,725
Oregon	42.03%	577,733	57.97%	796,751	19.97%	274,531	11.04%	151,715	26.96%	370,505
Pennsylvania	44.64%	2,150,826	55.36%	2,667,428	18.03%	868,870	10.54%	507,738	26.79%	1,290,820
Rhode Island	39.39%	152,988	60.61%	235,359	19.30%	74,945	8.40%	32,629	32.90%	127,785
South Carolina	45.77%	751,398	54.23%	890,332	19.01%	312,102	10.95%	179,753	24.27%	398,477
South Dakota	35.27%	111,142	64.73%	203,998	20.85%	65,698	11.28%	35,561	32.60%	102,739
Tennessee	48.72%	1,193,808	51.28%	1,256,432	22.21%	544,306	14.90%	364,991	14.17%	347,135
Texas	46.72%	4,715,695	53.28%	5,378,460	21.02%	2,121,668	14.54%	1,468,145	17.72%	1,788,647
Utah	42.84%	472,883	57.16%	630,968	15.39%	169,915	14.84%	163,839	26.93%	297,214
Vermont	36.88%	96,160	63.12%	164,610	26.69%	69,589	9.45%	24,653	26.98%	70,368
Virginia	48.01%	1,521,565	51.99%	1,647,972	16.81%	532,800	10.01%	317,146	25.18%	798,026
Washington	45.23%	1,087,939	54.77%	1,317,293	18.45%	443,831	10.73%	258,114	25.58%	615,348
West Virginia	48.80%	270,479	51.20%	283,815	19.43%	107,701	11.77%	65,268	20.00%	110,846
Wisconsin	44.03%	1,002,392	55.97%	1,274,178	16.53%	376,296	9.90%	225,355	29.54%	672,527
Wyoming	38.17%	86,542	61.83%	140,161	20.13%	45,631	13.22%	29,965	28.48%	64,565

Source: Author's calculations based on U.S. Census data.



Appendix Table 3. Payroll by Business Form and State, 2011

State	C Corporate Payroll		Pass-Through Payroll		Sole Proprietorship Payroll		Partnership Payroll		S Corporation Payroll	
	Share	Amount	Share	Amount	Share	Amount	Share	Amount	Share	Amount
Alabama	60.5%	\$32,007,619	39.5%	\$20,921,116	2.3%	\$1,242,116	9.35%	\$4,948,624	27.8%	\$14,730,376
Alaska	58.9%	\$6,837,634	41.1%	\$4,777,962	3.9%	\$450,529	10.87%	\$1,263,055	26.4%	\$3,064,378
Arizona	66.4%	\$50,723,125	33.6%	\$25,705,549	1.5%	\$1,138,622	10.18%	\$7,778,764	22.0%	\$16,788,163
Arkansas	65.0%	\$19,880,118	35.0%	\$10,727,277	1.8%	\$548,160	9.68%	\$2,962,057	23.6%	\$7,217,060
California	66.3%	\$391,528,884	33.7%	\$199,022,094	2.5%	\$14,631,666	9.64%	\$56,916,574	21.6%	\$127,473,854
Colorado	62.2%	\$51,740,233	37.8%	\$31,422,572	1.5%	\$1,285,006	11.89%	\$9,889,960	24.3%	\$20,247,606
Connecticut	65.0%	\$45,463,512	35.0%	\$24,480,045	2.6%	\$1,806,889	15.18%	\$10,618,564	17.2%	\$12,054,592
Delaware	63.1%	\$9,733,653	36.9%	\$5,699,143	1.4%	\$221,388	17.36%	\$2,679,297	18.1%	\$2,798,458
District of Columbia	56.5%	\$12,464,549	43.5%	\$9,595,380	2.9%	\$630,936	27.74%	\$6,119,752	12.9%	\$2,844,692
Florida	59.9%	\$142,247,165	40.1%	\$95,084,198	1.3%	\$3,105,904	10.41%	\$24,716,547	28.3%	\$67,261,747
Georgia	66.1%	\$83,965,206	33.9%	\$43,133,496	1.6%	\$1,976,450	9.93%	\$12,619,545	22.5%	\$28,537,501
Hawaii	68.3%	\$10,349,394	31.7%	\$4,807,095	3.6%	\$549,641	10.35%	\$1,568,729	17.7%	\$2,688,725
Idaho	52.5%	\$7,778,024	47.5%	\$7,026,080	2.2%	\$320,483	15.97%	\$2,364,049	29.3%	\$4,341,548
Illinois	62.0%	\$132,851,641	38.0%	\$81,256,813	2.1%	\$4,574,599	11.38%	\$24,375,339	24.4%	\$52,306,875
Indiana	57.4%	\$47,204,435	42.6%	\$35,090,766	2.1%	\$1,724,555	11.25%	\$9,255,257	29.3%	\$24,110,954
Iowa	63.3%	\$24,808,579	36.7%	\$14,408,835	2.2%	\$844,610	6.90%	\$2,704,843	27.7%	\$10,859,382
Kansas	65.0%	\$24,718,807	35.0%	\$13,321,261	2.2%	\$828,865	8.77%	\$3,336,798	24.1%	\$9,155,598
Kentucky	61.7%	\$28,913,905	38.3%	\$17,918,397	3.8%	\$1,788,935	10.67%	\$4,994,966	23.8%	\$11,134,496
Louisiana	55.6%	\$32,183,055	44.4%	\$25,695,038	2.3%	\$1,350,352	16.15%	\$9,344,547	25.9%	\$15,000,139
Maine	56.3%	\$7,762,347	43.7%	\$6,035,022	3.2%	\$438,128	7.41%	\$1,021,861	33.2%	\$4,575,033
Maryland	59.9%	\$51,226,319	40.1%	\$34,226,875	2.2%	\$1,913,324	9.98%	\$8,531,057	27.8%	\$23,782,494
Massachusetts	66.7%	\$89,890,293	33.3%	\$44,910,224	1.7%	\$2,327,184	9.78%	\$13,178,838	21.8%	\$29,404,202
Michigan	62.3%	\$78,744,124	37.7%	\$47,663,679	1.9%	\$2,449,317	10.78%	\$13,623,258	25.0%	\$31,591,104
Minnesota	63.8%	\$59,108,837	36.2%	\$33,589,449	1.9%	\$1,764,278	7.62%	\$7,059,076	26.7%	\$24,766,095
Mississippi	62.9%	\$15,818,019	37.1%	\$9,310,039	2.8%	\$698,193	10.93%	\$2,747,398	23.3%	\$5,864,448
Missouri	64.7%	\$50,397,113	35.3%	\$27,542,251	1.9%	\$1,486,279	9.51%	\$7,411,191	23.9%	\$18,644,781
Montana	51.2%	\$4,632,791	48.8%	\$4,423,065	2.9%	\$259,706	9.29%	\$841,740	36.7%	\$3,321,619
Nebraska	58.8%	\$15,008,653	41.2%	\$10,536,723	1.7%	\$443,661	6.90%	\$1,763,625	32.6%	\$8,329,437
Nevada	59.2%	\$21,750,823	40.8%	\$14,967,337	4.1%	\$1,497,066	14.65%	\$5,377,575	22.0%	\$8,092,696
New Hampshire	61.6%	\$12,618,559	38.4%	\$7,856,197	3.0%	\$620,889	7.10%	\$1,453,691	28.2%	\$5,781,617
New Jersey	64.5%	\$106,136,669	35.5%	\$58,534,325	2.0%	\$3,235,618	10.88%	\$17,912,850	22.7%	\$37,385,857
New Mexico	56.4%	\$10,599,304	43.6%	\$8,204,404	2.7%	\$512,359	15.03%	\$2,825,448	25.9%	\$4,866,597
New York	59.9%	\$218,057,598	40.1%	\$146,082,409	2.1%	\$7,636,085	16.49%	\$60,063,617	21.5%	\$78,382,707
North Carolina	65.0%	\$73,648,168	35.0%	\$39,575,743	1.9%	\$2,183,591	8.59%	\$9,723,911	24.4%	\$27,668,241
North Dakota	57.0%	\$5,435,830	43.0%	\$4,099,686	2.3%	\$217,953	7.94%	\$757,496	32.8%	\$3,124,237
Ohio	63.7%	\$99,012,006	36.3%	\$56,340,183	2.1%	\$3,266,377	10.12%	\$15,722,600	24.0%	\$37,351,206
Oklahoma	60.8%	\$26,676,707	39.2%	\$17,185,828	2.4%	\$1,032,740	12.38%	\$5,428,372	24.5%	\$10,724,716
Oregon	63.0%	\$29,763,256	37.0%	\$17,498,294	2.3%	\$1,072,023	8.37%	\$3,955,555	26.4%	\$12,470,716
Pennsylvania	61.1%	\$111,739,161	38.9%	\$71,289,612	2.6%	\$4,823,178	9.53%	\$17,438,586	26.8%	\$49,027,848
Rhode Island	54.1%	\$7,406,493	45.9%	\$6,294,069	4.6%	\$625,134	7.34%	\$1,005,234	34.0%	\$4,663,701
South Carolina	62.2%	\$29,860,505	37.8%	\$18,155,968	2.3%	\$1,107,622	10.60%	\$5,091,516	24.9%	\$11,956,830
South Dakota	49.6%	\$4,249,432	50.4%	\$4,325,195	2.8%	\$243,397	10.20%	\$874,870	37.4%	\$3,206,928
Tennessee	66.6%	\$53,449,846	33.4%	\$26,780,728	3.1%	\$2,481,896	13.86%	\$11,118,643	16.4%	\$13,180,189
Texas	65.5%	\$249,208,105	34.5%	\$131,034,636	2.3%	\$8,837,959	15.18%	\$57,711,580	17.0%	\$64,485,097
Utah	60.7%	\$21,540,940	39.3%	\$13,958,186	1.2%	\$419,387	11.21%	\$3,979,060	26.9%	\$9,559,739
Vermont	56.6%	\$4,248,011	43.4%	\$3,255,347	3.5%	\$265,584	7.24%	\$543,079	32.6%	\$2,446,684
Virginia	63.5%	\$82,006,387	36.5%	\$47,083,789	1.9%	\$2,401,574	9.68%	\$12,501,885	24.9%	\$32,180,330
Washington	65.7%	\$67,815,134	34.3%	\$35,472,191	2.5%	\$2,573,819	8.62%	\$8,906,822	23.2%	\$23,991,550
West Virginia	66.9%	\$11,431,956	33.1%	\$5,666,790	3.4%	\$581,332	10.32%	\$1,763,804	19.4%	\$3,321,654
Wisconsin	60.4%	\$48,179,529	39.6%	\$31,615,544	2.3%	\$1,854,671	7.78%	\$6,204,305	29.5%	\$23,556,568
Wyoming	56.1%	\$4,545,034	43.9%	\$3,559,474	2.3%	\$188,161	10.63%	\$861,799	31.0%	\$2,509,514

Note: Does not include non-employer firms; dollar amounts in thousands.

Source: Author's calculations based on U.S. Census data.



Appendix Table 4. Pass-through Businesses, Employment, and Payroll by Industry

NAICS Classification	NAICS Code	Total Private Sector			C Corporations			Pass-through Businesses		
		Firms	Employment	Payroll	Firms	Employment	Payroll	Firms	Employment	Payroll
Agriculture, forestry, fishing and hunting	11	258188	386229	\$5,186,733	6767	50678	\$1,957,557	251421	335551	\$3,229,176
Mining, quarrying, and oil and gas extraction	21	131247	758959	\$55,142,854	8863	433115	\$39,779,751	122384	325844	\$15,363,103
Utilities	22	20703	580534	\$52,791,916	2159	537163	\$50,520,384	18544	43371	\$2,271,532
Construction	23	3032846	7570862	\$264,873,890	180636	1862122	\$101,836,009	2852210	5708740	\$163,037,881
Manufacturing	31-33	585945	11237036	\$571,217,485	95521	7160805	\$406,976,997	490424	4076231	\$164,240,488
Wholesale trade	42	712192	5955180	\$353,649,072	129530	3223821	\$230,411,033	582662	2731359	\$123,238,039
Retail trade	44-45	2498799	16365278	\$366,560,872	191122	9735727	\$233,317,378	2307677	6629551	\$133,243,494
Transportation and warehousing	48-49	1202842	5115544	\$174,926,243	62017	2794022	\$125,680,588	1140825	2321522	\$49,245,655
Information	51	383354	3340315	\$229,570,366	29305	2323834	\$188,692,027	354049	1016481	\$40,878,339
Finance and insurance	52	940019	6214086	\$472,183,897	63534	4461143	\$376,795,088	876485	1752943	\$95,388,809
Real estate and rental and leasing	53	2604917	4209817	\$82,333,393	132816	823592	\$36,584,148	2472101	3386225	\$45,749,245
Professional, scientific, and technical services	54	3924278	10847469	\$551,274,359	200958	3681456	\$302,677,017	3723320	7166013	\$248,597,342
Management of companies and enterprises	55	25009	2605175	\$278,703,195	12321	2131746	\$240,527,725	12688	473429	\$38,175,470
Administrative and support and waste management and remediation services	56	2301092	11257122	\$321,620,087	79696	4547393	\$176,609,396	2221396	6709729	\$145,010,691
Educational services	61	630490	1405289	\$25,206,522	13364	400570	\$14,262,759	617126	1004719	\$10,943,763
Health care and social assistance	62	2534133	10742519	\$367,325,270	125854	3421261	\$175,269,506	2408279	7321258	\$192,055,764
Arts, entertainment, and recreation	71	1277971	2545644	\$47,681,968	31199	541619	\$16,208,131	1246772	2004025	\$31,473,837
Accommodation and food services	72	824512	11744451	\$190,190,752	100135	4130380	\$77,708,593	724377	7614071	\$112,482,159
Other services (except public administration)	81	3905021	6121087	\$73,832,944	124134	1000942	\$31,498,530	3780887	5120145	\$42,334,414
Industries not classified	99	15970	3716	\$262,048	2123	2544	\$54,870	13847	1172	\$207,178

Note: Dollars in thousands of dollars.

Source: Author's calculations based on U.S. Census data.

Testimony of Jon Godfread  
Greater North Dakota Chamber of Commerce  
HB 1296  
January 27, 2015

Mr. Chairman and members of the committee, my name is Jon Godfread; I am the Vice President of Government Affairs for the Greater North Dakota Chamber. GNDC is working on behalf of our more than 1,100 members, to build the strongest business environment in North Dakota. GNDC also represents the National Association of Manufacturers and works closely with the U.S. Chamber of Commerce. As a group we stand in Support income tax relief.

The Greater North Dakota Chamber has been among the principle advocates for tax reductions in past sessions and that role will continue in this session. In seeking those reductions our goal is that any reductions given will be measured, fairly distributed among all classes of taxpayers and above all else sustainable for the long term. Our overarching goal is drive North Dakota to a position where it is considered the best state to do business. As you know, taxes play an important role in those rankings, we have made some good strides over the last three biennia and we feel we can take another step this biennium.

GNDC often advocates for a fair tax. A flat tax is the epitome of that. It also creates an easier system to follow and administer. As is the usual practice, we are anticipating that the tax relief package will be passed through both houses as one bill. This bill, in its current form, does not include any relief for corporate income tax. That is something we would like addressed as corporate income tax is also a priority to us and greatly benefits the state.

We understand that there are many unknowns this session and tax relief will be one of the biggest issues debated. That being said, we will be advocating for the largest amount of tax relief possible, should that be dropping the income tax rates to 0% or the higher rates outlined in other of legislation. We believe it's likely somewhere in the middle.

Thank you and I would be happy to answer any questions.