

The Fair Share Amendment Helps Small Businesses Public Investment, S-Corporations, and Million-Dollar Incomes in MA

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All businesses in the Commonwealth depend on investment in public programs and infrastructure that ensure a well-educated workforce and reliable, far-reaching transportation networks. These public systems may be especially important for smaller businesses, which can't create their own distribution networks, shuttle services, training programs and childcare centers.

In November 2022, Massachusetts will vote on the Fair Share Amendment, a ballot question that would generate over \$2 billion each year to support education and transportation in the Commonwealth.¹ It provides these resources through an additional 4 percent tax on the portion of personal income exceeding \$1 million per year.

The Fair Share Amendment tax is not a tax on businesses; it is a tax on personal income. Some may find this confusing because people with extremely high incomes often use legal entities such as *S-corporations* and

partnerships to pass business profits directly to personal income for tax purposes. This income is then known as “pass-through income.” *S-corporations* and *partnerships* were types of business organization originally created for small businesses to simplify administration and reduce taxes.

Just 2.6 percent of those receiving pass-through income from these legal entities earn over \$1 million and would be subject to the Fair Share Amendment tax, and less than 0.6 percent of all income tax filers in Massachusetts even receive an annual income over \$1 million.²

Key Takeaways

- The definition of a small business can be slippery, and often includes entities that either are not small or are not even businesses.
- Small business owners are not the same as those who pay tax on “pass-through” income from partnerships and *S-corporations*. A U.S. Treasury analysis found that less than half of people who claim pass-through income on their taxes conduct traditional business activity.
- Only **2.6 percent of tax filers with pass-through income have income over \$1 million**, and many in this small group are not primarily engaged in operating small businesses.
- Public investment in transportation and education is crucial to small business success.
- Ownership of small businesses has been concentrated in white households in part because Black and Latinx prospective business owners face obstacles due to lack of access to capital and connections, not due to taxes.

Recipients of “Pass-Through” Income are Not Necessarily Small Business Owners

A “pass-through” entity includes businesses organized as [S-corporations](#) or partnerships, such as most limited liability corporations (LLCs) with more than one member. It generally does not pay corporate income taxes, and the profits that are passed through to partners or individual shareholders are taxed only as personal income.³

If an individual receives income from a pass-through entity, it doesn’t necessarily mean they run a small business. Many tax filers who receive pass-through income get most of their income from other sources, such as other businesses and investments. Some pass-through income recipients are just one of dozens of passive shareholders with little regular involvement in a company.

A U.S. Treasury analysis found that less than half of people who claim pass-through income on their taxes conduct traditional business activity.⁴ As a *New York Times* discussion of the study explained, “Some ‘non-business’ pass-throughs claim a small amount of income or losses, indicating that they may be claiming earnings from hobbies or vacation home rentals, for example.”⁵ They note that the federal tax law passed in 2017 provides a 20 percent deduction on pass-through income, providing “an incentive for people to find ways to classify their earnings as business income to take advantage of the lower rates.” People with higher incomes have a greater incentive and more access to lawyers and accountants to reclassify their income this way.

Moreover, some pass-through businesses are giant multi-billion dollar companies, [such as Fidelity Investments](#), which is an S-corporation. The Massachusetts Department of Revenue provided a recent Senate Study Group with 2016 information on the 107,194 S-corporations with taxes due in Massachusetts. It showed there were 112 S-corporations that each distributed over *\$1 billion* in profits to their shareholders for the year, and 1,356 such businesses that distributed profits over \$100 million. Similarly, there were 8,481 Massachusetts S-corporations with distributed income exceeding \$10 million. These pass-through entities are not what most people would consider small businesses.

What is a Small Business?

The meaning of small business can be slippery. The official definition of a “small business” varies [considerably by context](#) and often includes companies that most people would regard as large. For example, the U.S. Small Business Administration uses a different definition for every type of industry, with “small” sometimes encompassing companies with as many as 1,500 employees and as much as \$40 million in annual revenue. Meanwhile, in their [Small Business Pulse Survey](#), the Census Bureau defines small businesses as “single business locations with one to 499 employees and at least \$1,000 in annual revenue.” On the other hand, businesses eligible for the Massachusetts “small business” energy exemption must have less than \$1 million in income and fewer than 5 employees.

Partly as a response to these ambiguities, people sometimes distinguish between small businesses and “micro businesses” or “micro enterprises.”⁶ Exact definitions vary, though typically an employee limit is set in the single digits and sometimes include informal businesses. The U.S Small Business Administration defines micro enterprise as having between 1 to 9 employees.⁷ By their analysis, micro businesses make up the large majority of American businesses, but a small and declining share of total employment.

Owning a small business is often thought of as a middle-class activity,⁸ but pass-through income is highly concentrated in the hands of a few people with very high incomes. Among all tax filers claiming any pass-through income in Massachusetts, about one in 40 have taxable income of \$1 million or more, but they claim roughly half of all pass-through income in Massachusetts.⁹ Similarly, U.S. Treasury analysis of 2010 income found 69 percent of pass-through income nationwide went to the top 1 percent of highest-income households.¹⁰

Very few people who spend their day running a truly small business collect seven-figure incomes, but people with extremely high incomes often take advantage of special tax breaks meant for small business.

Although recipients of pass-through income are distinct from small business owners, they are similarly disproportionately white. Tax filers do not list their race on tax forms, but a 2017 study by U.S. Census researchers overcame this obstacle by linking administrative tax records on individuals with their Census records. The study found that in 2015, the working population in the U.S. was 12.4 percent Black, but the U.S. population of pass-through income filers was 2.4 percent Black. Similarly, the working age population was 15.5 percent “Hispanic”, but the pass-through filers were only 5.5 percent Hispanic.¹¹ Immigrants are also under-represented among pass-through income recipients compared to their share of the workforce. The authors of the Census study found this surprising because other research shows immigrants are more likely than native-born residents to be entrepreneurs. They surmise that, “the under-representation of immigrants that we find here could simply reflect that, while immigrants may be more likely to own businesses, the businesses they own may be less likely to be organized as partnerships and S-corps.”¹²

Race and Small Business

A small business can be an important way for families and communities to build wealth, but ongoing legacies of systemic racism have created obstacles for people of color starting and growing small businesses.¹³ Analysis by the St. Louis Federal Reserve of the 2016 Survey of Consumer Finances found Black families were less than half as likely to be business owners as white families were. Brookings Institution analysis of the now-discontinued 2012 Survey of Business Organizations found Black-owned businesses are one-fifth as likely as white-owned businesses to be big enough to hire even a single employee. Even among the universe of solo firms (businesses without employees), [Census analysis](#) of administrative records shows people of

color tend to be marginalized. Black-owned solo firms in Massachusetts comprise just 3.4 percent of total sales revenue. Latinx-owned businesses, including Black Latinx, represent 4.1 percent of all sales among solo firms.

The obstacles to Black and Latinx businesses are rooted in the inequalities faced by people of color. Access to capital is crucial for a small business to build capacity and to get through periods with little income. Two-thirds of entrepreneurs that hire employees use family or personal savings to start a company, yet a typical U.S. white family holds eight times the wealth of the typical Black family and five times the wealth of a typical Latinx family.¹⁴ Black-owned businesses are also far less likely than white-owned businesses to obtain bank loans.¹⁵ Moreover, Brookings Institution analysis shows that businesses in Black-majority neighborhoods tend to see slower revenue growth than similar businesses in white neighborhoods, even when Yelp reviews suggest they are particularly high-quality businesses.¹⁶ Brookings speculates that this may be due in part to the media ignoring these businesses, and customers from other areas being less likely to travel to less white neighborhoods.

Tax Policy and Public Investment to Support Small Businesses

There are many ways tax policy and public investments can better support small businesses. For instance, policy makers can enact [policies](#) that increase the share of business taxes paid by larger corporations and to reduce the share of business taxes paid by small companies. Small businesses rely on investments made with *public revenue*, such as support for schools to educate workers, public transit so that people can get to work, and roads that get goods to market. While very few genuinely small business owners would pay additional taxes as a result of the Fair Share amendment, all would benefit from its investments.

Acknowledgements: MassBudget thanks the following reviewers for their valuable input and suggestions on earlier drafts of this paper: Jen Benson, President, Alliance of Business Leadership; Mason J. Klinck, Director and Legislative Relations Chair for the Massachusetts Society of Enrolled Agents; Alan Krinsky, Senior Fiscal Policy Analyst, Economic Progress Institute; Diana Painter, Main Street Majority a project of the Coalition for Social Justice; and Rosario Ubiera-Minaya, Executive Director, Amplify Latinx. All potential mistakes are the sole responsibility of the author.

Endnotes

¹ The Department of Revenue conducted a 2015 estimate projecting 2019 additional revenues at a mid-point estimate of \$1.9 billion. Income has become more concentrated among the highest incomes since 2015. See U.S. Census, “[Income and Poverty in the United States: 2020](#),” (Sept. 2021), [Table A-5. Selected Measures of Equivalence-Adjusted Income Dispersion: 1967 to 2020](#). Moreover, billions in additional annual education and transportation investment would be a stimulus to the economy and would enhance productivity to boost future growth, further increasing future revenues. Opponents of the amendment argue some affluent taxpayers would change residence from Massachusetts, though these impacts are likely quite small. See MassBudget, “[Building a Strong Economy: The Roles of Education, Transportation, and Tax Policy](#)” (2016) and MassBudget, “[The Evidence on Millionaire Migration and Taxes](#),” (2018).

² According to the most recent 2018 IRS statistics at <https://www.irs.gov/pub/irs-soi/18in22ma.xlsx>.

³ Shareholders of C-corporations who have dividends distributed to them also pay income taxes on those dividends. Large S-corporations, those with annual revenues in excess of \$6 million annually, pay a smaller 1.97 percent tax on their net income. Even larger S-corporations, with annual revenues over \$9 million, pay a 2.95 percent tax on net income, still less than half the 8 percent corporate income tax paid by C-corporations. All corporations must pay at least the \$456 minimum tax.

⁴ U.S. Treasury Department, “[Methodology for Identifying Small Businesses and their Owners](#)” (Nov. 2016).

⁵ *New York Times*, “[How the ‘Small-Business Tax Cut’ Would Also Be a Tax Cut for the Wealthy](#),” Dec. 20, 2017.

⁶ For an alternate categorization of small businesses between sole proprietorships, Main Street entrepreneurs, business-to-business suppliers, and high-growth start ups, see Karen Mills, *Harvard Business Review*, “[The 4 Types of Small Businesses, and Why Each One Matters](#)” (October 30, 2015).

⁷ Small Business Administration, Small Business Facts, “[The Role of Micro Businesses in the Economy](#)” (Feb. 2015).

⁸ See, for example, “Small Business and the Middle Class” in [Public Affairs Pulse Survey 2012](#). In a Boston speech in 2014, Federal Reserve Chair Janet Yellen observed that, “the opportunity to build a business has long been an important part of the American dream” and noted “research shows that business ownership is associated with higher levels of economic mobility.” See Federal Reserve, “[Perspectives on Inequality and Opportunity from the Survey of Consumer Finances](#)” (October 17, 2014).

⁹ Analysis provided by request from the Institute on Taxation and Economic Policy in September 2021. Based on 2019 taxes, 47.5 percent of all pass-through income is claimed by tax returns with total taxable income over \$1 million and positive pass-through income.

¹⁰ Department of the Treasury, Office of Tax Analysis, “[Methodology to Identify Small Businesses and their Owners](#),” Technical paper 4 (updated), November 2016.

¹¹ Asian individuals are slightly overrepresented in the population of pass-through income recipients compared to the workforce population. Two-thirds of tax filers reporting pass-through income are male. U.S. Census, “Just Passing Through,” U.S. Census Bureau, Center for Economic Studies Working Papers, CES 17-69 (2017).

¹² Likewise, it may be the case that this study overestimates the actual percent of Black and Latinx pass-through filers because the analysis excludes pass-through entities that are owned by other pass-through entities. If these indirect and generally higher income owners tend to be whiter than the overall sample, this exclusion would indirectly decrease the reported percent of pass-through filers who are white.

¹³ This is especially true of larger businesses. The [Boston Business Journal](#) in 2020 listed only 27 Massachusetts companies with annual income over \$1 million where Black and Latinx owners together held majority ownership of the business.

¹⁴ See Ewing Marion Kauffman Foundation, “[Access to Capital for Entrepreneurs: Removing Barriers](#),” Figure 1, citing the Census Bureau’s Annual Survey of Entrepreneurs (now called the Annual Business Survey). Also see Boston Indicators, “The Color of the Capital Gap” (May 2021) at <https://www.bostonindicators.org/reports/report-detail-pages/the-color-of-the-capital-gap-2021>. On racial wealth gaps, see Federal Reserve [analysis](#) of the 2019 national Survey of Consumer Finances, available at <https://www.federalreserve.gov/econres/notes/feds-notes/disparities-in-wealth-by-race-and-ethnicity-in-the-2019-survey-of-consumer-finances-20200928.htm>.

¹⁵ Robert W. Fairlie, Alicia Robb, & David T. Robinson, “Black and White: Access to Capital Among Minority-Owned Startups,” National Bureau of Economic Research, November 2020, https://www.nber.org/system/files/working_papers/w28154/w28154.pdf.

¹⁶ Brookings Institution, Metropolitan Policy Program (2018), “[The Devaluation of Businesses in Black Communities](#),” p.11.