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Small Business and Flow-Through Entities

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The vast majority of businesses in the United States are small, while the vast majority of sales accrue to large businesses. The table below uses data from tax returns to classify businesses according to their receipts in 2000. It shows the number of tax returns, and the aggregate amount of receipts, by type of business. About 25 million returns showed income through either a C corporation or other business type, with the vast majority (23.9 million) having receipts of less than $1 million. Perhaps not surprisingly, the receipt distribution is very skewed: The 5 percent of returns with more than $1 million in business receipts accounted for 92 percent of aggregate business receipts reported.

A common belief is that most small business activity occurs through "flow-through" entities, such as S corporations, partnerships, and sole proprietorships. These entities are taxed through the individual income tax system, with the income flowing through to the tax return of their owners, rather than being subject to the separate corporate income tax. C corporations, by contrast, are subject to the corporate income tax; the dividends and capital gains accruing to owners of C corporations are also subject to the individual income tax.

The data show that most, but not all, small business activity does indeed occur outside C corporations, at least when "small businesses" are defined as those with $1 million or less in receipts. In 2000, C corporations accounted for 21 percent of the total receipts for these businesses.

The image of flow-through activity as concentrated in "small" businesses, though, is inaccurate. Almost 90 percent of the total receipts of S corporations and partnerships combined accrued to those with receipts of more than $1 million; roughly two-thirds of total receipts accrued to those entities with more than $10 million in receipts. Only regarding sole proprietorships is the common image accurate: Few sole proprietorships have receipts exceeding $1 million, and they account for only about one-quarter of total sole proprietorship revenue.

Small Business Returns — 2000

Type of Business	Receipts Under $1 Million		Receipts $1 Million or More	
	Number	Receipts ($ m.)	Number	Receipts ($ m.)
C corporation	1,695,304	$367,127	489,491	$14,270,963
S corporation	2,417,447	$474,044	443,031	$3,090,629
Partnership	1,939,432	$120,752	118,068	$1,972,847
Non-farm sole proprietorship	17,812,217	$752,704	90,574	$257,633
Total	23,864,400	$1,714,627	1,141,164	$19,592,072
C corporations as percent of total	7.1%	21.4%	42.9%	72.8%

Source: Author's calculations based on Joint Committee on Taxation, "Background and Proposals Relating to S Corporations," June 18, 2003, JCX-62-03.

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