

**CHOICE OF BUSINESS ENTITY:  
PRESENT LAW AND DATA RELATING TO  
C CORPORATIONS, PARTNERSHIPS, AND S CORPORATIONS**

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of the  
JOINT COMMITTEE ON TAXATION



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## INTRODUCTION

This document,<sup>1</sup> prepared by the staff of the Joint Committee on Taxation, provides information about present law and data relating to C corporations, partnerships (including LLCs), and S corporations. Part A of this document provides background information on the choice of business entity in the United States, describes sole proprietorships and their Federal tax treatment, summarizes present law governing the Federal tax treatment of C corporations, partnerships, and S corporations, and presents a table of the principal differences in tax treatment of these three types of business entities. Part B of this document presents data concerning the distribution of business entities by number, size, industry, and net income.<sup>2</sup>

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<sup>1</sup> This document may be cited as follows: Joint Committee on Taxation, *Choice Of Business Entity: Present Law And Data Relating To Corporations, Partnerships, And S Corporations* (JCX-71-15), April 10, 2015. This document can be found on the Joint Committee on Taxation website at [www.jct.gov](http://www.jct.gov).

<sup>2</sup> For further detail, see Joint Committee on Taxation, *Selected Issues Relating to Choice Of Business Entity* (JCX-66-12), July 27, 2012. This document can be found on the Joint Committee on Taxation website at [www.jct.gov](http://www.jct.gov).

## **A. Present Law: Tax Treatment of C Corporations, Partnerships (including LLCs), and S Corporations**

### **1. Overview**

#### **Business entities**

In 2012, there were approximately 1.6 million C corporations, 3.4 million partnerships, and 4.2 million S corporations. The number of passthrough entities (partnerships and S corporations) surpassed the number of C corporations in 1987 and has nearly tripled since then, led by growth in small S corporations (those with less than \$100,000 in assets) and limited liability companies (“LLCs”) taxed as partnerships.

Owners of business enterprises historically have chosen to incorporate a business for various nontax reasons. One reason has been that corporate form generally shields the shareholders from liabilities of the business. Another has been that corporate stock may be issued in public markets for access to capital.

A passthrough entity such as a partnership or S corporation, however, may be preferred for Federal tax reasons. A primary reason is that no Federal income tax normally applies at the entity level in the case of a passthrough entity. Rather, items of income, gain, or loss are taken into account for tax purposes by the partners or S corporation shareholders on their own tax returns. By contrast, a C corporation (which is not a passthrough entity) is taxed separately on its income, and shareholders are taxed separately on distributions by the corporation. Other Federal tax rules may give rise to incentives (or disincentives) to select a particular type of entity through which to conduct a business.<sup>3</sup>

These incentives have resulted in disputes between the Internal Revenue Service (“IRS” or the “Service”) and taxpayers about the proper classification of business entities for Federal tax purposes. Case law and Treasury regulations have addressed whether an entity is properly treated as a C corporation subject to entity-level tax, or as another type of entity such as a partnership.

From the 1950s to 1996, the determination of whether a business entity was a C corporation or a partnership was governed by case law and by 1960 regulations<sup>4</sup> that set forth factors considered indicative of corporate status. These corporate characteristics are (1) continuity of life, (2) centralization of management, (3) limited liability for owners of the entity,

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<sup>3</sup> A number of present law provisions affect small businesses such as expensing under section 179, deduction of start-up and organizational expenditures under sections 195, 248 and 709, tax accounting rules under sections 448 and 471, and others are also relevant to manufacturers.

<sup>4</sup> Former Treas. Reg. sec. 301.7701-2. These were known as the Kintner regulations because they were based on the analysis in *U.S. v. Kintner*, 216 F.2d 418 (9th Cir. 1954). See also *Larson v. Commissioner*, 66 T.C. 159 (1976), acq. 1979-2 C.B. 1.

and (4) free transferability of interests. An unincorporated entity was classified as a partnership if it lacked any two or more of the four corporate characteristics.

Entity classification issues are not especially relevant to S corporations, passthrough entities which came into being in 1958 Federal tax legislation. S corporation status is open to a domestic corporation, requires an affirmative election, and is subject to specific requirements as to the number and nature of shareholders, class of stock, and other characteristics. These features make identification of an entity as an S corporation relatively unambiguous.

In late 1996, the IRS adopted new entity classification regulations known as the check-the-box regulations.<sup>5</sup> These regulations allow tax classification as either a partnership or a corporation to be explicitly elective subject to minimal restrictions for any domestic nonpublicly traded unincorporated entity with two or more members. The check-the-box regulations also provide that a single-member unincorporated entity may be disregarded for Federal tax purposes, that is, treated as not separate from its owner.

The 1996 regulations did not, however, alter the statutory rules enacted in 1987 treating publicly traded partnerships as C corporations to address concern about long-term erosion of the corporate tax base. A publicly traded partnership generally is treated as a C corporation for Federal tax purposes, unless 90 percent or more of its gross income is qualifying income (described below).

### **Sole proprietorships**

The vast majority of businesses in the United States are organized for tax purposes as sole proprietorships. In 2012, there were more than 23.5 million nonfarm sole proprietorships out of 34.6 million total business returns, and 1.8 million farms. Unlike a C corporation, partnership,<sup>6</sup> or S corporation, a sole proprietorship typically is not an entity distinct from its individual owner. Rather, the business owner is taxed directly on business income, and files Schedule C (sole proprietorships generally), Schedule E (rental real estate and royalties), or Schedule F (farms) with his or her individual tax return.

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<sup>5</sup> Treas. reg. secs. 301.7701-1 through 301.7701-3.

<sup>6</sup> However, as mentioned above, a single-member unincorporated entity is treated as a disregarded entity for Federal tax purposes.

## 2. Choice of business entity

### C Corporations

#### In general

A C corporation is subject to Federal income tax as an entity separate from its shareholders. A C corporation's income generally is taxed when earned at the corporate level and is taxed again at the individual level when distributed as dividends<sup>7</sup> to its shareholders. Corporate deductions and credits reduce only corporate income (and corporate income taxes) and are not passed directly through to shareholders.

Corporate income that is not distributed to shareholders generally is subject to current tax at the corporate level only. To the extent that income retained at the corporate level is reflected in an increased share value, the shareholder may be taxed at capital gains rates upon sale or exchange (including certain redemptions) of the stock or upon liquidation of the corporation.<sup>8</sup> Foreign investors generally are exempt from U.S. income tax on capital gains, but are subject to withholding tax on dividends. Tax-exempt investors generally are not subject to tax on corporate distributions or on sales or exchanges of corporate stock.

The gain on appreciated corporate assets generally is subject to corporate level tax if the assets are distributed to the shareholders, yielding the same tax result as if the assets had been sold by the corporation and the proceeds distributed to the shareholders.

#### Deductible and nondeductible payments

In general, amounts paid as reasonable compensation to shareholders who are also employees are deductible by the corporation,<sup>9</sup> and are taxed as ordinary income at the individual level (unless a specific exclusion applies). On the other hand, amounts paid as dividends to shareholders generally are not deductible by the corporation and are taxed as income to the

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<sup>7</sup> Distributions with respect to stock that exceed corporate earnings and profits are not taxed as dividend income to shareholders but are treated as a tax-free return of capital that reduces the shareholder's basis in the stock. Distributions in excess of corporate earnings and profits that exceed a shareholder's basis in the stock are treated as amounts received in exchange for the stock which, in general, are taxed to the shareholder at capital gains rates. Sec. 301(c).

<sup>8</sup> If stock is held until the death of the shareholder, the heirs are given a fair market value basis in the stock at death, resulting in no shareholder level income tax on appreciation prior to death if the heirs sell the stock to a third party, or receive corporate distributions in the form of a redemption (*i.e.*, a sale of their stock to the corporation).

<sup>9</sup> Annual compensation in excess of \$1 million that is payable to the chief executive officer or the three other most highly compensated employees of a public corporation is not deductible unless the compensation qualifies as performance-based compensation or another exception applies. Sec. 162(m); IRS Notice 2007-49, 2007-25 I.R.B. 1429.

shareholders (generally at the same preferential rates as apply to capital gains).<sup>10</sup> However, amounts paid to corporate shareholders as dividends generally are eligible for a dividends-received deduction for the recipient corporation that results in the recipient corporation being taxed on at most 30 percent and possibly on none of the dividend received by the shareholder.<sup>11</sup>

### **Treatment of equity and debt holders**

Investors in a C corporation receive different treatment depending upon whether an instrument is characterized as equity or debt for tax purposes.<sup>12</sup> A distinction is also made at the entity level, where in general, interest paid by a C corporation is deductible but dividends paid are not.<sup>13</sup> The latter rule (especially when coupled with the ability of many tax-exempt or foreign investors to exclude interest income) creates a tax incentive that generally favors debt over equity in a corporation's capital structure. However, in some special situations, equity may be preferred to debt. For example, an issuing corporation with losses may prefer to issue preferred stock with characteristics similar to debt, effectively passing through some of the benefit of its losses to shareholders.<sup>14</sup> Foreign shareholders may prefer either dividend or interest income, depending on the tax treatment in their country of residence and the applicable U.S. corporate income tax and withholding tax rates.

Shareholders receive different treatment depending on whether a corporate equity distribution is characterized as a dividend or as a payment in exchange for stock that is entitled to both capital gain treatment and basis recovery. While the individual tax rates for dividends and capital gains on stock generally are the same under present law, capital gain treatment permits

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<sup>10</sup> Sec. 1(h)(11).

<sup>11</sup> Sec. 243. The recipient corporation generally can claim a 100 percent dividends-received deduction if the recipient corporation owns 80 percent or more of the distributing corporation. If the recipient corporation owns less than 80 percent but at least 20 percent of the distributing corporation, the dividends-received deduction is 80 percent. If the recipient corporation owns less than 20 percent of the distributing corporation, the dividends-received deduction is 70 percent.

<sup>12</sup> Debt and equity investments also provide different consequences to certain types of investors in the passthrough regimes of partnerships and S corporations. For example, tax-exempt and foreign investors generally are not taxed on interest income from a partnership if they are debt investors, but generally are taxed on their share of partnership income from business activity of the partnership if they are equity investors. The S corporation rules do not permit certain tax-exempt investors or foreign investors to own stock of an S corporation. Those tax-exempt investors that may own S corporation stock, with the exception of employee stock ownership plans, are subject to an unrelated business income tax on their share of S corporation income. These factors can lead to a preference for structuring partnership or S corporation investment by such investors as debt.

<sup>13</sup> If certain requirements are satisfied, dividends paid on stock held by an employee stock ownership plan are deductible by the corporation. Sec. 404(k).

<sup>14</sup> Distributions to shareholders by a loss corporation are taxed as dividends, with accompanying dividend treatment to shareholders if the loss corporation had prior year earnings and profits that have not yet been distributed. If all earnings and profits have been distributed, distributions to shareholders would be nontaxable return of capital distributions, reducing the shareholders' basis in the stock.

basis recovery.<sup>15</sup> A number of Code provisions have attempted to provide guidance in this area. For example, section 302 provides rules to determine whether a shareholder whose stock has been partially redeemed has experienced a sufficient contraction in his or her interest to be treated as having sold the stock rather than as having received a dividend. Section 304 provides additional rules intended to deal with sales of stock to commonly controlled corporations.

### **Consolidated returns of affiliated groups of corporations**

An affiliated group of corporations may elect to file a consolidated return in lieu of separate returns.<sup>16</sup> A condition of electing to file a consolidated return is that all corporations that are members of the affiliated group must consent to all the consolidated return regulations prior to the last day prescribed by law for filing the consolidated return. The Treasury department has issued extensive consolidated return regulations under its authority to provide such rules. The regulations generally are directed toward preventing double taxation of income earned within the group, while preserving tax attributes if assets or corporations that were members leave the group and preventing avoidance of tax due to shifting of attributes in the course of intragroup transactions.<sup>17</sup>

A C corporation often is the entity of choice if a corporation anticipates a public offering, because publicly traded partnerships generally are taxed as corporations,<sup>18</sup> and S corporations (discussed below) are not permitted to have more than 100 shareholders.<sup>19</sup>

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<sup>15</sup> Foreign shareholders, in addition, may not be subject to tax on capital gains, though they are taxed (often at a reduced rate under tax treaties) on dividends. On the other hand, some corporate shareholders may prefer dividend treatment if they are eligible for the dividends-received deduction.

<sup>16</sup> Sec. 1504. An affiliated group for this purpose includes a parent corporation that directly owns 80 percent of the vote and value of the stock (excluding certain nonvoting preferred stock) of at least one subsidiary (causing that subsidiary to be a qualified member of the group) and other corporations of which qualified upper tier members in turn hold such stock ownership. Foreign corporations and certain other entities are not eligible to be members of such a group.

<sup>17</sup> Sec. 1502.

<sup>18</sup> Sec. 7704. As discussed below, an exception from the general rule whereby publicly traded partnerships are taxed as corporations is provided under section 7704(c). This exception permits publicly traded partnerships, at least 90 percent of whose gross income is qualifying income (*i.e.*, interest, dividends, real property rents, certain gains and other income specified in section 7704(d)), to be taxed as a passthrough entity.

<sup>19</sup> In some circumstances, it is possible that nonpublicly traded entities also might choose to operate as C corporations, for example to obtain the benefit of a separate corporate rate bracket or the benefit of special corporate treatment (*e.g.*, the dividends-received deduction) for earnings that are to be retained in the corporation. Appreciation in corporate assets generally is subject to corporate level tax when the assets are distributed to shareholders, and there is no lower rate for corporate capital gains. These factors generally would be a deterrent to placing assets into a C corporation. Nevertheless, there may be situations where lower effective corporate rates could provide benefits. For a more detailed discussion of debt and equity, see Joint Committee on Taxation, *Present Law and Issues Related to the Taxation of Financial Instruments and Products* (JCX-56-11), December 2, 2011, and



## **Personal holding companies**

In addition to the regular corporate income tax, the Code provides for taxes designed to prevent retention of corporate earnings so as to avoid individual income tax. The personal holding company tax is imposed on certain undistributed personal holding company income, generally where the corporation meets certain closely held stock requirements and more than 60 percent of the adjusted ordinary gross income (as defined) consists of certain passive-type income such as dividends, interest, and similar items.<sup>20</sup>

## **Partnerships**

### **Federal income tax treatment of partnerships**

Partnerships generally are treated for Federal income tax purposes as passthrough entities, not subject to tax at the entity level.<sup>21</sup> Items of income (including tax-exempt income), gain, loss, deduction, and credit of the partnership are taken into account in computing the tax of the partners (based on the partnership's method of accounting and regardless of whether the income is distributed to the partners).<sup>22</sup> A partner's deduction for partnership losses is limited to the amount of the partner's adjusted basis in his or her partnership interest.<sup>23</sup> To the extent a loss is not allowed due to a limitation, it generally is carried forward to the next year. A partner's adjusted basis in the partnership interest generally equals the sum of (1) such partner's capital contribution to the partnership, (2) the partner's distributive share of partnership income, and (3) the partner's share of partnership liabilities, less (1) such partner's distributive share of losses allowed as a deduction and nondeductible expenditures not properly chargeable to capital account, and (2) any partnership distributions.<sup>24</sup>

Partnerships provide partners with a significant amount of flexibility to vary their respective shares of partnership income. Unlike corporations, partnerships may allocate items of

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see Joint Committee on Taxation, *Present Law and Background Relating to Tax Treatment of Business Debt* (JCX-41-11), July 11, 2011.

<sup>20</sup> Secs. 541-547. In addition, the accumulated earnings tax can be imposed on certain earnings in excess of \$250,000 (\$150,000 for certain service corporations in certain fields) accumulated beyond the reasonable needs of the business. However, the rate is 20 percent. Secs. 531-537.

<sup>21</sup> Sec. 701.

<sup>22</sup> Sec. 702(a). The recognition of income under this rule does not necessarily correspond with distributions from the partnership to cover the tax liabilities of individual partners.

<sup>23</sup> Sec. 704(d). In addition, passive loss and at-risk limitations limit the extent to which certain types of income can be offset by partnership deductions (sections 469 and 465). These limitations do not apply to corporate partners (except certain closely held corporations) and may not be important to individual partners who have partner-level passive income from other investments.

<sup>24</sup> Sec. 705.

income, gain, loss, deduction, and credit among the partners, provided the allocations have substantial economic effect.<sup>25</sup> In general, an allocation is permitted to the extent the partner to which the allocation is made receives the economic benefit or bears the economic burden of such allocation, and the allocation substantially affects the dollar amounts to be received by the partners from the partnership independent of tax consequences.

State law has historically provided for general partnerships and limited partnerships, which differ as to the liability of partners for liabilities of the partnership.<sup>26</sup> State laws also provide for other types of partnerships, such as limited liability partnerships (commonly used by professional service businesses such as law or accounting firms).

### **Limited liability companies**

In the last four decades,<sup>27</sup> States have enacted laws providing for another form of entity, the limited liability company (“LLC”). LLCs are neither partnerships nor corporations under applicable State law, but they generally provide limited liability to their owners for obligations of the business. LLCs are generally treated as partnerships for Federal tax purposes, unless an election is made to be treated as a corporation. Specifically, under regulations promulgated in 1996, any domestic unincorporated entity with two or more members that is not publicly traded is treated as a partnership under the default rules but may elect to be treated as a corporation for Federal income tax purposes, and any single-member unincorporated entity is disregarded (*i.e.*, treated as not separate from its owner)<sup>28</sup> for Federal income tax purposes under the default rules (though it may elect to be treated as a corporation).<sup>29</sup> These regulations, known as the check-the-box regulations, were a response, in part, to the growth of LLCs.<sup>30</sup>

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<sup>25</sup> Sec. 704.

<sup>26</sup> Data relating to the number of partnership returns by type is presented in Part B of this document.

<sup>27</sup> The first LLC statute was enacted in Wyoming in 1977. All States (and the District of Columbia) now have an LLC statute, though the tax treatment of LLCs for State tax purposes may differ.

<sup>28</sup> Thus, if the single member is an individual, such a disregarded LLC is treated as a sole proprietorship. If the single member is a corporation, the LLC is treated as a division or branch.

<sup>29</sup> Treas. Reg. sec. 301.7701-3.

<sup>30</sup> More recently, some State laws have provided for so-called series LLCs (the first was Delaware in 1996, Del. Code Ann. Title 6, section 18-216). Treasury regulations have been proposed that address the tax treatment of series LLCs and domestic cell companies created under applicable State law (as well as certain foreign series or cells). The proposed regulations set forth criteria for determining whether the series or cell is treated as an entity for Federal tax purposes. See REG-119921-09, September 14, 2010. The proposed regulations define a series as “a segregated group of assets and liabilities that is established pursuant to a series statute...by agreement of a series organization....” Prop. Treas. Reg. sec. 301.7701-1(a)(5)(viii)(C).

## **Publicly traded partnerships**

Under present law, a publicly traded partnership generally is treated as a corporation for Federal tax purposes.<sup>31</sup> For this purpose, a publicly traded partnership means any partnership if interests in the partnership are traded on an established securities market or interests in the partnership are readily tradable on a secondary market (or the substantial equivalent thereof).<sup>32</sup>

An exception from corporate treatment is provided for certain publicly traded partnerships, 90 percent or more of whose gross income is qualifying income.<sup>33</sup> However, this exception does not apply to any partnership resembling a mutual fund, *i.e.*, that would be described in section 851(a) if it were a domestic corporation, which includes a corporation registered under the Investment Company Act of 1940<sup>34</sup> as a management company or unit investment trust.<sup>35</sup>

Qualifying income is defined<sup>36</sup> to include interest, dividends, and gains from the disposition of a capital asset (or of property described in section 1231(b)) that is held for the production of income that is qualifying income. Qualifying income also includes rents from real property, gains from the sale or other disposition of real property, and income and gains from the exploration, development, mining or production, processing, refining, transportation (including pipelines transporting gas, oil, or products thereof), or the marketing of any mineral or natural resource (including fertilizer, geothermal energy, and timber), industrial source carbon dioxide, or the transportation or storage of certain fuel mixtures, alternative fuel, alcohol fuel, or biodiesel fuel. It also includes income and gains from commodities (not described in section 1221(a)(1)) or futures, options, or forward contracts with respect to such commodities (including foreign currency transactions of a commodity pool) where a principal activity of the partnership is the buying and selling of such commodities, futures, options, or forward contracts.

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<sup>31</sup> Sec. 7704(a). The reasons for change stated by the Ways and Means Committee when the provision was enacted provide in part: “[t]he recent proliferation of publicly traded partnerships has come to the committee’s attention. The growth in such partnerships has caused concern about long-term erosion of the corporate tax base.” H.R. Rep. 100-391, Omnibus Reconciliation Act of 1987, October 26, 1987, p. 1065.

<sup>32</sup> Sec. 7704(b).

<sup>33</sup> Sec. 7704(c)(2).

<sup>34</sup> Pub. L. No. 76-768 (1940).

<sup>35</sup> Sec. 7704(c)(3).

<sup>36</sup> Sec. 7704(d).

## **S Corporations**

### **In general**

An S corporation provides the Federal income tax advantage of passthrough treatment while retaining the nontax advantages of corporate status under Federal securities laws and State law. To make an election to be treated as an S corporation, a corporation must meet certain requirements primarily regarding its capital structure and the identity and number of its shareholders.

### **Limitations on number and type of shareholders and class of stock**

To be eligible to elect S corporation status, a corporation may not have more than 100 shareholders and may not have more than one class of stock.<sup>37</sup> Only individuals (other than nonresident aliens), certain tax-exempt organizations, and certain trusts and estates are permitted shareholders. A corporation may elect S corporation status only with the consent of all of its shareholders, and may terminate its election with the consent of shareholders holding more than 50 percent of the stock.<sup>38</sup> Although there are limitations on the types of shareholders and stock structure an S corporation may have, there is no limit on the asset size of such a corporation (as there is no limit on the size of a C corporation or partnership). Certain corporations may not elect S corporation status including financial institutions using the reserve method of accounting for bad debts and insurance companies subject to tax under subchapter L.<sup>39</sup>

### **Passthrough of income and losses to S corporation shareholders**

For Federal income tax purposes, an S corporation generally is not subject to tax at the corporate level.<sup>40</sup> Items of income (including tax-exempt income), gain, loss, deduction, and credit of the S corporation are taken into account in computing the tax of the shareholders (under the S corporation's method of accounting and regardless of whether the income is distributed to the shareholders). A shareholder's deduction for corporate losses is limited to the sum of the shareholder's adjusted basis in the S corporation stock and the indebtedness of the S corporation to such shareholder. To the extent a loss is not allowed due to this limitation, the loss generally is carried forward to the next year. The shareholder's basis in the S corporation stock (and debt) is reduced by the shareholder's share of losses and (in the case of stock) by distributions and is

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<sup>37</sup> Sec. 1361. For this purpose, a husband and wife and all members of a family (and their estates) are treated as one shareholder. Under this rule, the term "members of a family" means a common ancestor and any lineal descendant up to six generations removed, and the spouse or former spouse of the common ancestor or lineal descendant. Sec. 1361(c)(1).

<sup>38</sup> Sec. 1362.

<sup>39</sup> Sec. 1361(b)(2).

<sup>40</sup> Secs. 1363 and 1366.

increased (in the case of stock) by the shareholder's share of the S corporation's income and contributions to capital.<sup>41</sup>

Unlike a partnership but like a C corporation, gain realized on the distribution of built-in gain property by the S corporation to shareholders is recognized. The shareholders take their shares of such gain into account on their individual tax returns.

### **S corporations that were previously C corporations**

There are two principal exceptions to the general passthrough treatment of S corporations. Both are applicable only if the S corporation was previously a C corporation and generally are intended to prevent avoidance of otherwise applicable C corporation tax consequences.

First, an S corporation is subject to tax on excess net passive investment income (but not in excess of its taxable income, subject to certain adjustments), if the corporation has subchapter C earnings and profits and has gross receipts more than 25 percent of which are passive investment income for the year.<sup>42</sup>

Second, if a C corporation elects to be an S corporation (or transfers assets to an S corporation in a carryover basis transaction), certain net built-in gains that are attributable to the period in which it was a C corporation, and that are recognized during the first 10 years (five years for taxable years before 2015) in which the former C corporation is an S corporation, are subject to corporate-level tax.<sup>43</sup>

In general, an S corporation shareholder is not subject to tax on corporate distributions unless the distributions exceed the shareholder's basis in the stock of the corporation, or unless the S corporation was formerly a C corporation and has undistributed earnings and profits.<sup>44</sup> To the extent of such earnings and profits, corporate distributions are treated as dividends of C corporations and generally are subject to tax as such in the hands of the shareholders.

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<sup>41</sup> Sec. 1367.

<sup>42</sup> Sec. 1375. Subchapter C earnings and profits generally refers to the earnings of the corporation prior to its subchapter S election which would have been taxable as dividends if distributed to shareholders by the corporation prior to its subchapter S election. If the S corporation continues to have C corporation earnings and profits and has gross receipts more than 25 percent of which are passive investment income in each year for three consecutive years, the S corporation election is automatically terminated. Sec. 1362(d)(3).

<sup>43</sup> Sec. 1374. The period was seven years for taxable years beginning in 2009 and 2010, and five years for taxable years beginning in 2011, 2012, 2013, and 2014.

<sup>44</sup> Sec. 1368.

## **Comparison of Features of Partnerships, S Corporations, and C Corporations**

Notwithstanding that they both provide for passthrough tax treatment, there are several significant Federal tax differences between S corporations and partnerships. First, corporate liabilities (other than those owed to its shareholders) are not included in a shareholder's basis of an interest in an S corporation, whereas a partner's share of partnership-level debt generally is taken into account. However, unlike a partner in a partnership, an S corporation shareholder's limitation on corporate deductions looks to the shareholder's adjusted basis in both S corporation stock and indebtedness of the S corporation to such shareholder. Thus, S corporation shareholders might be able to substitute shareholder-level debt for entity-level borrowing and contribute or re-lend such amounts to the S corporation to provide basis (in the shareholder's stock or debt) against which to take entity losses.

Further, S corporations may have only one class of stock and, thus, do not offer the same flexibility as partnerships to allocate income and losses among investors. In addition, if a tax-exempt entity (including any individual retirement account or qualified retirement plan) is an equity investor in a partnership, its share of business income of the partnership is subject to unrelated business income tax. An S corporation likewise generally is not permitted to have a tax-exempt shareholder that is not subject to unrelated business income tax on S corporation income, except that an employee stock ownership plan ("ESOP") is permitted to be a shareholder in an S corporation without unrelated business income tax.<sup>45</sup>

An S corporation, unlike a partnership, permits a C corporation to convert to a passthrough form without immediate recognition of gain at either the corporate or the shareholder level. Since 1986, the liquidation of a C corporation has required the corporation to recognize gain on its assets. A conversion of a C corporation to a partnership is treated as a liquidation of the C corporation. However, conversion of a C corporation to an S corporation is achieved through electing S corporation status without immediate tax consequences, rather than by liquidating the corporation in a taxable transaction. Certain built-in gain and built-in income items of a C corporation that elects S corporation status remain subject to C corporation tax if recognized within 10 years (for 2015; five years for taxable years before 2015) after the conversion. Thus, if a C corporation can satisfy the limit on the number and type of shareholders, the single class of stock requirement, and other requirements for S corporation status, a conversion of a C corporation to the S corporation passthrough form is not taxable, and all post-conversion income and appreciation of assets in the entity are subject only to shareholder level tax.

Table 1 lists the principal differences in the taxation of partnerships, S corporations, and C corporations, and their owners.

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<sup>45</sup> Sec. 512(e)(3).

**Table 1.–Principal Differences in Taxation of Partnerships, S Corporations, and C Corporations and Their Owners**

Item	Partnerships	S Corporations	C Corporations
Maximum number of equity interests	No maximum number. Partnerships with over 100 partners may elect a special passthrough regime. <sup>46</sup>	Maximum number of shareholders is 100. Family members treated as one shareholder for this purpose.	No maximum number.
Classes of equity interests	No limitation.	One class of stock. Voting rights are disregarded in making this determination.	No limitation.
Ineligible entities	Generally, partnerships with equity interests that are publicly traded.	Foreign corporations; financial institutions using reserve method of accounting; insurance companies; DISCs and former DISCs.	None.
Eligible shareholders	All persons eligible to be partners.	Eligible shareholders include individuals, estates and certain trusts, charities, and qualified retirement plans.	All persons eligible.

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<sup>46</sup> See secs. 771-777 and 6240-6255 for treatment of electing large partnerships.

Item	Partnerships	S Corporations	C Corporations
Foreign taxpayers	Eligible to be a partner; certain income subject to withholding tax.	Ineligible to be a shareholder.	Eligible to be a shareholder; dividends subject to withholding tax with possible reduced treaty rate; generally no tax on sale of stock unless effectively connected income.
Tax-exempt taxpayers	Eligible to be a partner; income subject to generally applicable unrelated business income tax	Tax-exempt taxpayers (other than charities and qualified retirement plans) ineligible to be a shareholder. All items of income and loss of charities and qualified retirement plans (other than ESOPs) included in unrelated business taxable income; items of income and loss of ESOPs not included in unrelated business taxable income.	Eligible to be a shareholder; dividend generally not subject to unrelated business income tax.
Trusts	Eligible to be a partner; usual trust taxation rules apply.	Only qualified subchapter S trusts and electing small business trusts eligible as shareholders; special taxation rules apply.	Eligible to be a shareholder; usual trust taxation rules apply.
Allocation of income and losses	Allocation in accordance with partnership agreement so long as allocation has substantial economic effect.	Pro rata among shares on a daily basis.	Not applicable (income and losses do not pass through).



Item	Partnerships	S Corporations	C Corporations
Limitation on losses	Losses limited to basis in partnership interest, which includes partner's share of partnership debt.	Losses limited to basis in stock and indebtedness of corporation to shareholder; no inclusion of corporate debt in shareholder basis.	Losses deductible against corporate income; NOLs generally can be carried back two years and forward 20 years; capital losses generally can be carried back three years and forward five years.
Contributions of property to entity	Tax-free; built-in gain or loss allocated to contributing partner.	Tax-free (if control requirement met); no special rules allocating built-in gain or loss to contributor.	Tax-free if transferors are in control of the company after the exchange; possible exception where contributed property is subject to debt.
Distributions of property (liquidating or otherwise)	Generally tax-free; carryover or substituted basis to partner; partnership may elect to make basis adjustment in partnership property to reflect adjustments to distributee partner.	Any gain in distributed property is taxable (shareholders include it); fair market value basis to shareholder; no basis adjustments to corporate property.	Any gain in distributed property taxable to the corporation; shareholder taxed if amount of distribution exceeds stock basis.
Transfer of equity interests	Gain treated as ordinary income to extent of ordinary income on assets held by partnership; partnership may elect to adjust basis of its assets with respect to transferee partner to reflect purchase price.	No ordinary income look-through provision; no adjustments to basis of corporate property.	Gain treated as capital.

Item	Partnerships	S Corporations	C Corporations
Termination of entity	Termination if sale or exchange of 50 percent or more of partnership interests within 12 months.	No provision.	Generally taxable to both corporation and shareholders.
Treatment of C corporation converting to partnership or S corporation.	Corporation must liquidate and gain or loss is recognized to corporation and shareholders.	Generally no taxation upon election; corporate tax is imposed on built-in gain if assets sold during 10 year period after election effective (special rules before 2015 shortened the period); distribution of subchapter C earnings and profits taxable as a dividend; special rules applicable to a corporation with accumulated earnings and excess net passive investment income.	Not applicable.
Mergers and other reorganizations with corporations	Not eligible to engage in tax-free reorganization with corporation.	Eligible party to a tax-free corporate reorganization.	Generally tax-free.
Corporate tax rules of subchapter C	Rules inapplicable.	Rules generally applicable.	Rules applicable.
Wholly owned corporation	Corporation treated as separate entity.	Wholly owned subsidiary corporation may elect to be treated as part of parent S corporation.	Not subject to tax on dividends or liquidating distributions paid between wholly-owned subsidiaries.

Item	Partnerships	S Corporations	C Corporations
Application of employment and self-employment (OASDI and HI) taxes	Except in certain cases involving a limited partner not performing services, each partner's share of net business income is net earnings from self-employment.	Amounts paid as compensation to a shareholder-employee are wages subject to FICA; no amount of shareholder's share of S corporation income is net earnings from self-employment; case law provides "reasonable compensation" is wages subject to FICA.	Amounts paid as compensation are wages subject to FICA; no amounts are net earnings from self-employment.
Treatment of earnings as investment income for purposes of the net investment income (NII) tax	Business income of limited partners who are not active in the business which is not net earnings from self-employment is treated as investment income for the NII tax.	Business income of S corporation shareholders not active in the business is treated as investment income for the NII tax.	Dividends paid to individuals by C corporations are treated as investment income for the NII tax.

## **B. Data Relating to Business Entities and Sole Proprietorships**

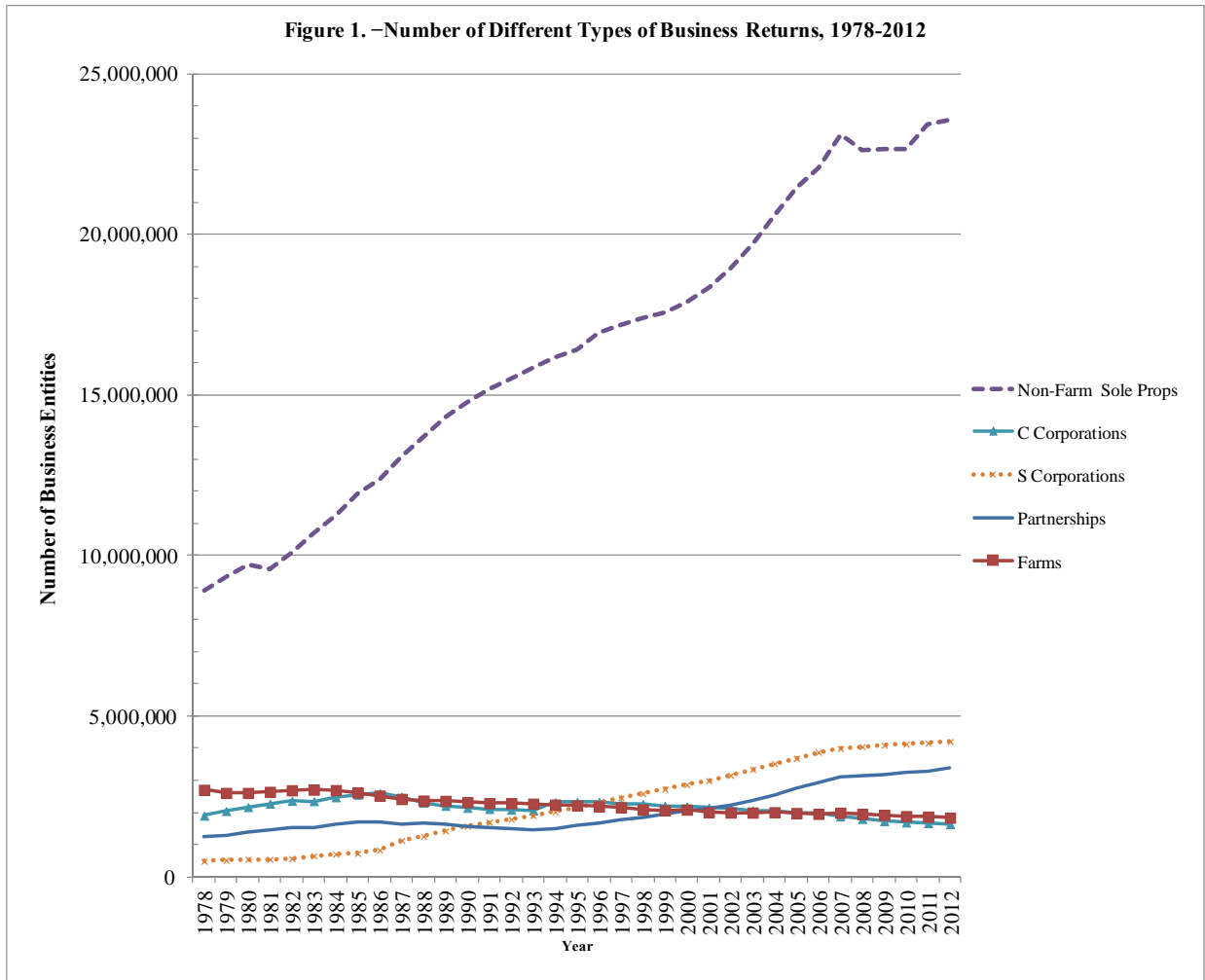
### **1. Data on number of business entities**

As shown in the table below, throughout the recent past, nonfarm sole proprietorships made up the vast majority of businesses. The S corporation is the second most prevalent business form. The growth in the number of S corporations was most dramatic immediately following 1986, while the number of C corporations declined each year from 1987 through 1993. After an increase in the number of C corporation returns in the mid-1990s, the number of C corporation returns has again declined since 1998. The number of farm returns (that is, individuals reporting income on Schedule F of Form 1040) generally declined throughout the period from 1978-2012.

**Table 2.—Number of Different Types of Business Returns, 1978-2012**

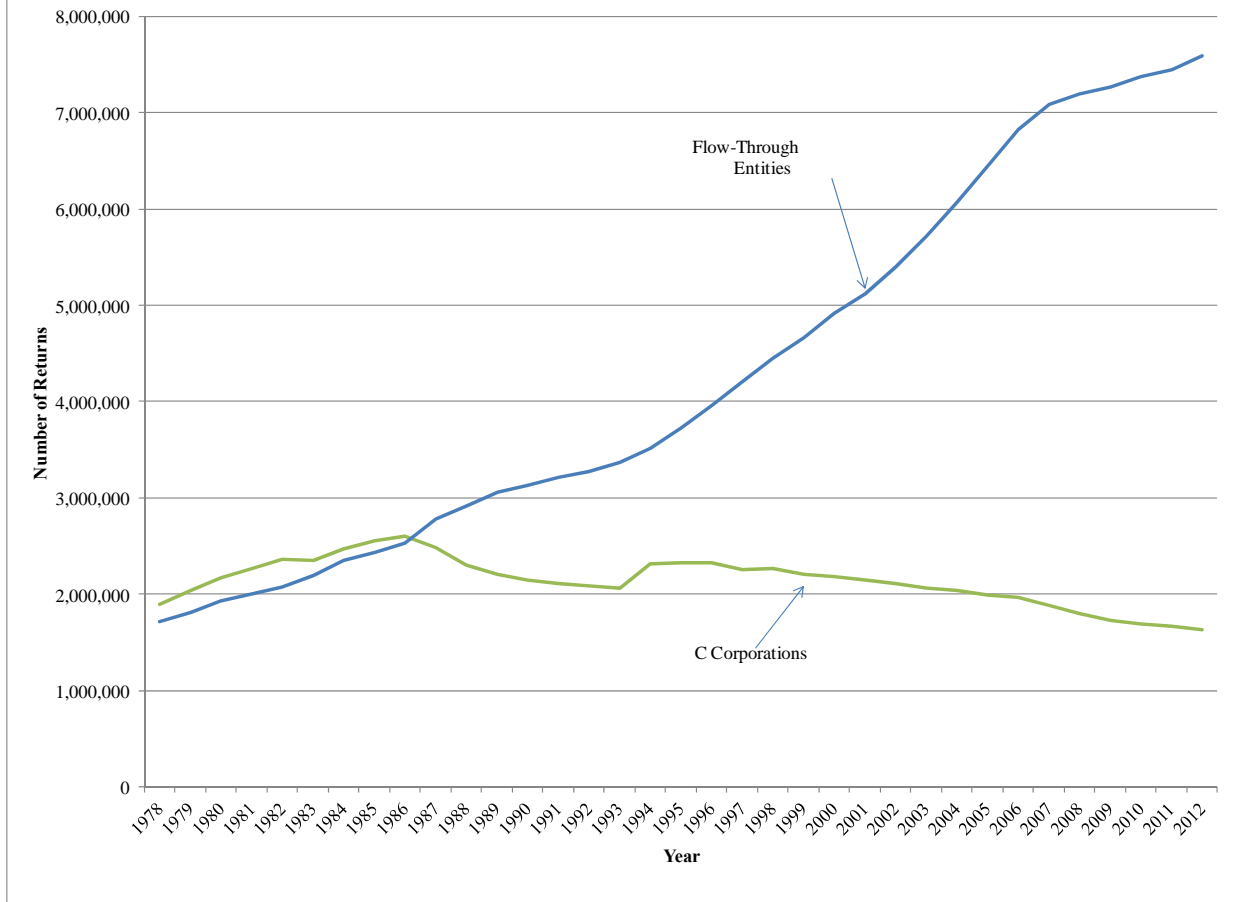
<b>Year</b>	<b>Non-Farm Sole Props</b>	<b>C Corporations</b>	<b>S Corporations</b>	<b>Partnerships</b>	<b>Farms</b>	<b>Total</b>
1978	8,908,289	1,898,100	478,679	1,234,157	2,704,794	15,224,019
1979	9,343,603	2,041,887	514,907	1,299,593	2,605,684	15,805,674
1980	9,730,019	2,165,149	545,389	1,379,654	2,608,430	16,428,641
1981	9,584,790	2,270,931	541,489	1,460,502	2,641,254	16,498,966
1982	10,105,515	2,361,714	564,219	1,514,212	2,689,237	17,234,897
1983	10,703,921	2,350,804	648,267	1,541,539	2,710,044	17,954,575
1984	11,262,390	2,469,404	701,339	1,643,581	2,694,420	18,771,134
1985	11,928,573	2,552,470	724,749	1,713,603	2,620,861	19,540,256
1986	12,393,700	2,602,301	826,214	1,702,952	2,524,331	20,049,498
1987	13,091,132	2,484,228	1,127,905	1,648,035	2,420,186	20,771,486
1988	13,679,302	2,305,598	1,257,191	1,654,245	2,367,527	21,263,863
1989	14,297,558	2,204,896	1,422,967	1,635,164	2,359,718	21,920,303
1990	14,782,738	2,141,558	1,575,092	1,553,529	2,321,153	22,374,070
1991	15,180,722	2,105,200	1,696,927	1,515,345	2,290,908	22,789,102
1992	15,495,419	2,083,652	1,785,371	1,484,752	2,288,218	23,137,412
1993	15,848,119	2,063,124	1,901,505	1,467,567	2,272,407	23,552,722
1994	16,153,871	2,318,614	2,023,754	1,493,963	2,242,324	24,232,526
1995	16,423,872	2,321,048	2,153,119	1,580,900	2,219,244	24,698,183
1996	16,955,023	2,326,954	2,304,416	1,654,256	2,188,025	25,428,674
1997	17,176,486	2,257,829	2,452,254	1,758,627	2,160,954	25,806,150
1998	17,398,440	2,260,757	2,588,081	1,855,348	2,091,845	26,194,471
1999	17,575,643	2,210,129	2,725,775	1,936,919	2,067,883	26,516,349
2000	17,902,791	2,184,795	2,860,478	2,057,500	2,086,789	27,092,353
2001	18,338,190	2,149,105	2,986,486	2,132,117	2,006,871	27,612,769
2002	18,925,517	2,112,230	3,154,377	2,242,169	1,995,072	28,429,365
2003	19,710,079	2,059,631	3,341,606	2,375,375	1,997,116	29,483,807
2004	20,590,691	2,039,631	3,518,334	2,546,877	2,004,898	30,700,431
2005	21,467,566	1,987,171	3,684,086	2,763,625	1,981,249	31,883,697
2006	22,074,953	1,968,032	3,872,766	2,947,116	1,958,273	32,821,140
2007	23,122,698	1,878,956	3,989,893	3,096,334	1,989,690	34,077,571
2008	22,614,483	1,797,278	4,049,943	3,146,006	1,948,054	33,555,764
2009	22,659,976	1,729,984	4,094,562	3,168,728	1,924,214	33,577,464
2010	23,003,656	1,686,171	4,127,554	3,248,481	1,886,058	33,951,920
2011	23,426,940	1,664,553	4,158,572	3,285,177	1,867,208	34,402,450
2012	23,553,850	1,635,369	4,205,452	3,388,561	1,835,687	34,618,919

Source: Internal Revenue Service, Statistics of Income, published and unpublished data.



Source: Internal Revenue Service, Statistics of Income, published and unpublished data.

**Figure 2.—Number of C Corporation Returns Compared to the Sum of S Corporation and Partnership Returns, 1978-2012**



Source: Internal Revenue Service, Statistics of Income, published and unpublished data.

## 2. Data on size of business entities

Tables 3 through 8 display 2012 SOI data on C corporations, S corporations, entities taxed as partnerships, nonfarm sole proprietorships, and farms. For the first three forms of organization, the tables classify all taxpayers using that form of organization both by the size of assets and total receipts.<sup>47</sup> For sole proprietorships (Table 7) and farms (Table 8), there is no tax data on assets, so the table uses only total receipts as a classifier. Present law does not impose a limit on the size of a business that is conducted in the form of a sole proprietorship, a partnership, an S corporation, a C corporation, or a farm. While many small businesses are organized as a sole proprietorship, a partnership, or an S corporation, not all businesses organized in those forms are small, and not all businesses organized as C corporations are large.

When businesses are classified by asset size, one can see that there are a significant number of C corporations of small size. Almost 750,000 C corporations report assets under \$50,000. This represents approximately 45 percent of the total number of C corporations. Similarly, for S corporations, approximately one-half have assets under \$50,000. About 40 percent of partnerships have assets under \$50,000.

The concentration of assets differs among the three entity forms. C corporations have the largest disparity in asset holding. Firms with over \$100 million in assets, which represent slightly more than one percent of all C corporations, hold more than 97 percent of all assets owned by C corporations. Partnerships are fairly similar: those with over \$100 million in assets, which represent about two-thirds of one percent of all partnerships, hold nearly three-quarters of all assets owned by partnerships.<sup>48</sup> By comparison, S corporations with \$100 million or more in assets constitute only about 0.1 percent of all S corporations and account for only about 39 percent of all assets owned by S corporations.

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<sup>47</sup> Total receipts are used in lieu of business receipts to classify statistics for finance and insurance and management of companies (holding companies) sectors. Total receipts may be negative due to the addition of negative items (*e.g.*, net capital losses) to business receipts. Total assets may also be negative if, for example, balance sheet assets reflect depreciation of assets held in a lower tier partnership. This could occur if the balance sheet were prepared using tax accounting rather than generally accepted accounting principles. For example, a partnership may hold an interest in a lower tier partnership that in turn holds leveraged assets that have been depreciated for Federal tax purposes. The depreciated basis of the assets may be less than debt encumbering the assets. In some cases this could be reflected as a negative asset value for the underlying partnership interest.

<sup>48</sup> The partnership data reported here, as compiled by the Statistics of Income Division of the Internal Revenue Service, include partnerships whose partners are C corporations. In 2012, approximately two-thirds of the income reported on partnership returns was ultimately reported on individual returns.



When businesses are classified by total receipts, a picture emerges that is similar to that seen in the asset data. There are a substantial number of relatively small C corporations: more than 400,000 C corporations report total receipts of \$25,000 or less, approximately 25 percent of the total number of C corporations. However, across the other forms of organization there are generally higher percentages of businesses with small amounts of total receipts. For nonfarm sole proprietorships, 70 percent have total receipts of \$25,000 or less. For farms, about 68 percent have total receipts of \$25,000 or less. For partnerships, nearly 72 percent have total receipts of \$25,000 or less. However, only a little less than one-quarter of S corporations report \$25,000 or less in total receipts.

As with assets, the dispersion of total receipts across the classifications is more skewed for C corporations and entities taxed as partnerships than for S corporations. C corporations with over \$50 million in total receipts, which represent approximately one percent of all C corporations, collect about 90 percent of total receipts of all C corporations. For partnerships, the approximately one-quarter of one percent of partnerships with total receipts in excess of \$50 million report 71 percent of all partnership total receipts. For S corporations, 0.4 percent of S corporations with total receipts in excess of \$50 million report 39 percent of S corporation total receipts. For nonfarm sole proprietorships, less than 0.002 percent of such businesses report total receipts in excess of \$50 million, and these businesses report about three percent of all nonfarm sole proprietorship total receipts. Similarly, less than 0.002 percent of farms report total receipts in excess of \$50 million, and these farms report about one percent of all farm total receipts.

**Table 3.—Distribution of C Corporations, 2012**

Firms classified by assets	Number of Returns	Total Assets (millions)	Cumulative Percent	
			Returns	Total Assets
\$0 or less.....	344,612	0	21.07%	0.00%
\$1 to \$25,000.....	279,930	2,039	38.19%	0.00%
\$25,001 to \$50,000.....	119,774	4,064	45.51%	0.01%
\$50,001 to \$100,000.....	151,991	10,515	54.81%	0.02%
\$100,001 to \$250,000.....	215,199	34,566	67.97%	0.06%
\$250,001 to \$500,000.....	158,589	56,533	77.66%	0.13%
\$500,001 to \$1,000,000.....	126,128	89,440	85.38%	0.24%
\$1,000,001 to \$10,000,000.....	178,396	514,908	96.29%	0.88%
\$10,000,001 to \$50,000,000....	31,301	691,202	98.20%	1.72%
\$50,000,001 to \$100,000,000...	7,434	529,526	98.65%	2.38%
More than \$100,000,000.....	22,016	79,425,962	100.00%	100.00%
<b>All Assets.....</b>	<b>1,635,369</b>	<b>81,358,757</b>		

Firms classified by receipts	Number of Returns	Total Receipts (millions)	Cumulative Percent	
			Returns	Total Receipts
\$0 or less.....	209,901	-1,169	12.84%	-0.01%
\$1 to \$2,500.....	42,551	45	15.44%	-0.01%
\$2,501 to \$5,000.....	23,201	86	16.86%	0.00%
\$5,001 to \$10,000.....	41,376	299	19.39%	0.00%
\$10,001 to \$25,000.....	94,136	1,594	25.14%	0.00%
\$25,001 to \$50,000.....	111,694	4,061	31.97%	0.02%
\$50,001 to \$100,000.....	140,882	10,310	40.59%	0.07%
\$100,001 to \$250,000.....	236,684	39,495	55.06%	0.25%
\$250,001 to \$500,000.....	185,414	66,890	66.40%	0.56%
\$500,001 to \$1,000,000.....	185,719	132,170	77.75%	1.17%
\$1,000,001 to \$10,000,000.....	294,274	886,398	95.75%	5.27%
\$10,000,001 to \$50,000,000....	50,033	1,033,403	98.81%	10.04%
More than \$50,000,000.....	19,504	19,469,284	100.00%	100.00%
<b>All Receipts.....</b>	<b>1,635,369</b>	<b>21,642,866</b>		

\* Details do not add to totals due to rounding.

Source: JCT calculations on SOI data.

**Table 4.—Distribution of S Corporations, 2012**

Firms classified by assets	Number of Returns	Total Assets (millions)	Cumulative Percent	
			Returns	Total Assets
\$0 or less.....	747,657	0	17.78%	0.00%
\$1 to \$25,000.....	1,060,992	7,921	43.01%	0.22%
\$25,001 to \$50,000.....	420,370	13,896	53.00%	0.61%
\$50,001 to \$100,000.....	441,335	30,460	63.50%	1.45%
\$100,001 to \$250,000.....	585,588	92,233	77.42%	4.02%
\$250,001 to \$500,000.....	364,237	127,743	86.08%	7.58%
\$500,001 to \$1,000,000.....	244,965	171,784	91.91%	12.36%
\$1,000,001 to \$10,000,000.....	299,196	835,207	99.02%	35.60%
\$10,000,001 to \$50,000,000....	33,504	658,977	99.82%	53.94%
\$50,000,001 to \$100,000,000...	3,872	269,332	99.91%	61.44%
More than \$100,000,000.....	3,737	1,385,725	100.00%	100.00%
<b>All Assets.....</b>	<b>4,205,452</b>	<b>3,593,278</b>		

Firms classified by receipts	Number of Returns	Total Receipts (millions)	Cumulative Percent	
			Returns	Total Receipts
\$0 or less.....	563,894	-3,420	13.41%	-0.05%
\$1 to \$2,500.....	96,155	102	15.70%	-0.05%
\$2,501 to \$5,000.....	54,793	199	17.00%	-0.05%
\$5,001 to \$10,000.....	80,031	576	18.90%	-0.04%
\$10,001 to \$25,000.....	202,996	3,431	23.73%	0.01%
\$25,001 to \$50,000.....	284,347	10,469	30.49%	0.18%
\$50,001 to \$100,000.....	415,507	30,363	40.37%	0.65%
\$100,001 to \$250,000.....	769,034	126,769	58.66%	2.61%
\$250,001 to \$500,000.....	569,970	205,296	72.21%	5.78%
\$500,001 to \$1,000,000.....	459,997	323,755	83.15%	10.79%
\$1,000,001 to \$10,000,000.....	616,617	1,710,611	97.81%	37.24%
\$10,000,001 to \$50,000,000....	76,420	1,531,082	99.63%	60.92%
More than \$50,000,000.....	15,690	2,527,471	100.00%	100.00%
<b>All Receipts.....</b>	<b>4,205,452</b>	<b>6,466,705</b>		

\* Details do not add to totals due to rounding.

Source: JCT calculations on SOI data.

**Table 5.—Distribution of Partnerships, 2012**

Firms classified by assets	Number of Returns	Total Assets (millions)	Cumulative Percent	
			Returns	Total Assets
\$0 or less.....	908,432	-81,865	26.81%	-0.37%
\$1 to \$25,000.....	343,424	2,779	36.94%	-0.36%
\$25,001 to \$50,000.....	127,417	4,717	40.70%	-0.34%
\$50,001 to \$100,000.....	207,533	15,282	46.83%	-0.27%
\$100,001 to \$250,000.....	317,448	52,986	56.20%	-0.03%
\$250,001 to \$500,000.....	350,630	127,855	66.54%	0.55%
\$500,001 to \$1,000,000.....	306,011	217,800	75.57%	1.54%
\$1,000,001 to \$10,000,000.....	684,026	2,068,158	95.76%	10.94%
\$10,000,001 to \$50,000,000....	105,756	2,178,199	98.88%	20.83%
\$50,000,001 to \$100,000,000...	15,709	1,106,634	99.35%	25.86%
More than \$100,000,000.....	22,174	16,322,386	100.00%	100.00%
<b>All Assets.....</b>	<b>3,388,561</b>	<b>22,014,929</b>		

Firms classified by receipts	Number of Returns	Total Receipts (millions)	Cumulative Percent	
			Returns	Total Receipts
\$0 or less.....	2,143,161	0	63.25%	0.00%
\$1 to \$2,500.....	63,031	65	65.11%	0.00%
\$2,501 to \$5,000.....	39,260	142	66.27%	0.00%
\$5,001 to \$10,000.....	56,283	415	67.93%	0.01%
\$10,001 to \$25,000.....	130,944	2,205	71.79%	0.06%
\$25,001 to \$50,000.....	100,183	3,665	74.75%	0.14%
\$50,001 to \$100,000.....	141,807	10,212	78.93%	0.35%
\$100,001 to \$250,000.....	210,177	34,305	85.13%	1.07%
\$250,001 to \$500,000.....	140,004	50,915	89.27%	2.14%
\$500,001 to \$1,000,000.....	126,895	90,707	93.01%	4.04%
\$1,000,001 to \$10,000,000.....	198,992	584,107	98.88%	16.31%
\$10,000,001 to \$50,000,000....	28,789	597,322	99.73%	28.84%
More than \$50,000,000.....	9,036	3,389,677	100.00%	100.00%
<b>All Receipts.....</b>	<b>3,388,561</b>	<b>4,763,737</b>		

\* Details do not add to totals due to rounding.

Source: JCT calculations on SOI data.

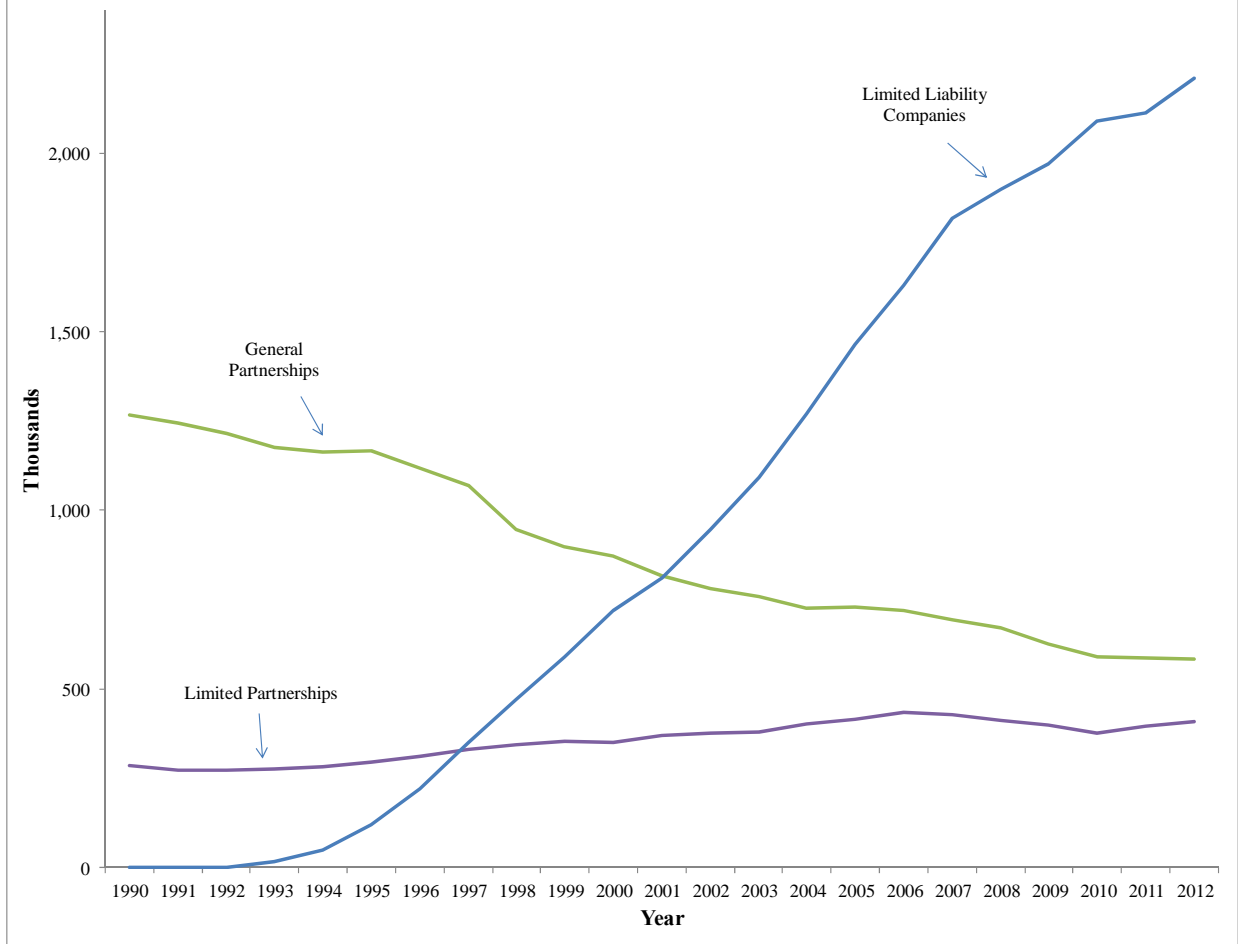
**Table 6.—Number of Partnership Returns by Type, 1990-2012**

Year	Type of Partnership					
	Domestic General Partnerships (thousands)	Domestic Limited Partnerships (thousands)	Domestic Limited Liability Companies (thousands)	Domestic Limited Liability Partnerships (thousands)	Foreign Partnerships (thousands)	Other Partnerships (thousands)
1990	1,267	285	n.a.	n.a.	n.a.	n.a.
1991	1,245	271	n.a.	n.a.	n.a.	n.a.
1992	1,214	271	n.a.	n.a.	n.a.	n.a.
1993	1,176	275	17	n.a.	n.a.	n.a.
1994	1,163	283	48	n.a.	n.a.	n.a.
1995	1,167	295	119	n.a.	n.a.	n.a.
1996	1,116	311	221	n.a.	n.a.	5
1997	1,069	329	349	n.a.	n.a.	13
1998	945	343	470	26	n.a.	71
1999	898	354	589	42	n.a.	52
2000	872	349	719	53	3	61
2001	815	369	809	69	5	65
2002	780	377	946	78	3	58
2003	757	379	1,092	88	3	55
2004	725	403	1,270	89	4	56
2005	729	414	1,465	100	5	50
2006	718	433	1,630	109	7	50
2007	694	426	1,819	110	8	40
2008	670	412	1,898	122	11	33
2009	624	397	1,969	118	12	48
2010	590	375	2,090	142	13	38
2011	586	394	2,111	148	14	32
2012	583	407	2,211	129	16	43

n.a. - not available

Sources: Bill Pratt, "Partnership Returns, 2000," *SOI Bulletin*, 22, Fall 2002; Nina Shumofsky and Lauren Lee, "Partnership Returns, 2009," *SOI Bulletin*, 31, Fall 2011; and Ron DeCarlo and Nina Shumofsky, "Partnership Returns, 2012," *SOI Bulletin*, 34, Winter 2015.

Figure 3.—Domestic Partnership Returns by Type of Partnership, 1990-2012



Sources: Bill Pratt, “Partnership Returns, 2000,” *SOI Bulletin*, 22, Fall 2002; Nina Shumofsky and Lauren Lee, “Partnership Returns, 2009,” *SOI Bulletin*, 31, Fall 2011; and Ron DeCarlo and Nina Shumofsky, “Partnership Returns, 2012,” *SOI Bulletin*, 34, Winter 2015.

**Table 7.—Distribution of Nonfarm Sole Proprietorships, 2012**

Firms classified by receipts	Number of Returns	Total Receipts (millions)	Cumulative Percent	
			Returns	Total Receipts
\$0 or less.....	1,200,399	0	5.10%	0.00%
\$1 to \$2,500.....	4,508,328	5,262	24.24%	0.41%
\$2,501 to \$5,000.....	2,429,305	8,792	34.55%	1.09%
\$5,001 to \$10,000.....	3,187,588	23,308	48.08%	2.90%
\$10,001 to \$25,000.....	5,213,449	83,411	70.22%	9.38%
\$25,001 to \$50,000.....	2,800,354	99,110	82.11%	17.07%
\$50,001 to \$100,000.....	1,872,758	132,510	90.06%	27.36%
\$100,001 to \$250,000.....	1,477,496	229,532	96.33%	45.18%
\$250,001 to \$500,000.....	499,008	173,326	98.45%	58.63%
\$500,001 to \$1,000,000.....	232,476	156,960	99.44%	70.82%
\$1,000,001 to \$10,000,000.....	129,114	273,420	99.98%	92.04%
\$10,000,001 to \$50,000,000....	3,259	58,119	100.00% <sup>1</sup>	96.56%
More than \$50,000,000.....	316	44,355	100.00%	100.00%
<b>All Receipts.....</b>	<b>23,553,850</b>	<b>1,288,105</b>		

\* Details do not add to totals due to rounding.

<sup>1</sup> The actual figure is 99.9987 percent which rounds to 100.00 percent.

Source: JCT calculations on SOI data.

**Table 8.—Distribution of Farms, 2012**

Farms classified by gross income	Number of Returns	Gross Income (millions)	Cumulative Percent	
			Returns	Gross Income
\$0 or less.....	247,804	-150	13.50%	-0.08%
\$1 to \$2,500.....	399,317	406	35.25%	0.14%
\$2,501 to \$5,000.....	175,092	625	44.79%	0.50%
\$5,001 to \$10,000.....	188,645	1,328	55.07%	1.25%
\$10,001 to \$25,000.....	233,201	3,710	67.77%	3.34%
\$25,001 to \$50,000.....	149,672	5,231	75.92%	6.29%
\$50,001 to \$100,000.....	124,249	8,725	82.69%	11.21%
\$100,001 to \$250,000.....	145,606	23,933	90.62%	24.71%
\$250,001 to \$500,000.....	87,104	31,202	95.37%	42.30%
\$500,001 to \$1,000,000.....	53,281	37,245	98.27%	63.31%
\$1,000,001 to \$5,000,000.....	30,546	51,472	99.94%	92.34%
\$5,000,001 to \$10,000,000.....	771	5,157	99.98%	95.24%
\$10,000,001 to \$15,000,000.....	204	2,472	99.99%	96.64%
\$15,000,001 to \$25,000,000.....	111	2,082	100.00% <sup>1</sup>	97.81%
\$25,000,001 to \$50,000,000.....	59	1,871	100.00% <sup>2</sup>	98.87%
More than \$50,000,000.....	24	2,008	100.00%	100.00%
<b>All Receipts.....</b>	<b>1,835,687</b>	<b>177,315</b>		

\* Details do not add to totals due to rounding.

<sup>1</sup> The actual figure is 99.9954 percent which rounds to 100.00 percent.

<sup>2</sup> The actual figure is 99.9986 percent which rounds to 100.00 percent.

Source: JCT calculations on SOI data.



### **3. Data on business entities by industry**

Taxpayers filing returns as C corporations, S corporations, and partnerships are asked to self-report the primary industry in which the business operates. Table 9, below, reports the distribution of entities by number of returns and by assets across various industry classifications. Distributing by number of returns, for C corporations, the three most prevalent industries are professional, scientific, and technical services; real estate; and retail. These three industries account for approximately 33 percent of all C corporations. For S corporations, the three most prevalent industries are professional, scientific, and technical services; construction; and real estate. These three industries account for approximately 40 percent of all S corporations. For entities taxed as partnerships, the three most prevalent industries are real estate; finance and insurance; and professional, scientific, and technical services. These three industries account for approximately 65 percent of all partnerships.

Distributing by assets, for C corporations, the three largest industries are finance and insurance, holding companies, and manufacturing. These three industries account for more than 83 percent of all assets reported by all C corporations. For S corporations, the three largest industries are holding companies, manufacturing, and wholesale. These three industries account for nearly 37 percent of all assets reported by all S corporations. For partnerships, the two largest industries by far are finance and insurance and real estate, followed by manufacturing at a distant third. These three industries account for more than 81 percent of all assets reported on all partnership returns.

**Table 9.—Distribution of Certain Business Entities and Assets by Industry, 2012**

Industry	C Corporations		S Corporations		Partnerships	
	Percent of Returns	Percent of Total Assets	Percent of Returns	Percent of Total Assets	Percent of Returns	Percent of Total Assets
Agriculture.....	3.00	0.08	2.10	2.31	4.46	0.94
Mining .....	0.82	1.35	0.61	1.80	0.95	2.27
Utilities .....	0.19	2.10	0.08	0.15	0.09	1.37
Construction .....	9.20	0.35	12.76	9.54	4.74	0.84
Manufacturing .....	5.48	14.22	3.75	11.62	1.98	3.48
Wholesale Trade.....	8.62	2.64	5.86	10.98	1.89	1.04
Retail Trade .....	9.91	1.68	9.71	10.32	4.68	0.76
Transportation and Warehousing.....	4.20	0.78	3.39	2.60	1.23	1.98
Information .....	2.74	3.09	1.77	1.72	1.13	3.01
Finance and Insurance .....	5.26	51.42	3.78	10.97	9.04	55.20
Real Estate and Rental and Leasing.....	10.82	1.71	11.06	9.89	49.11	22.50
Professional, Scientific, and Technical Services.....	12.20	1.02	16.48	4.29	6.89	1.03
Holding Companies	1.60	18.15	0.63	14.29	0.83	2.89
Administrative and Support and Waste Management and Remediation Services .....	4.39	0.33	4.94	1.91	2.07	0.35
Educational Services.....	0.91	0.05	0.99	0.33	0.42	0.02
Health Care and Social Services.....	6.73	0.36	8.13	2.16	2.47	0.65
Arts, Entertainment, and Recreation.....	2.02	0.09	2.15	1.00	1.95	0.49
Accommodation and Food Services .....	4.54	0.46	5.43	2.93	3.65	1.09
Other Services .....	7.32	0.10	6.38	1.18	2.41	0.09
Not Allocable.....	0.03	0.00	0.00	0.00	0.00	0.00
<b>Total<sup>1</sup>.....</b>	<b>1,635,369</b>	<b>81,358,757</b>	<b>4,205,452</b>	<b>3,593,278</b>	<b>3,388,561</b>	<b>22,014,929</b>

<sup>1</sup> The totals show the actual numbers of returns in the ‘Percent of Returns’ columns and the total assets in millions of dollars for the ‘Percent of Total Assets’ columns.

\* Details do not add to 100 percent due to rounding.

Source: JCT calculations on SOI data.

#### 4. Data on business entities by net income

On average, in any given year, relatively smaller businesses are more likely to operate at a loss. Tables 10 and 11 below classify businesses by size of their reported total receipts. The tables report the aggregate income, or loss, reported within a class by entity type. Tables 10a and 10b report results for S corporations, partnerships, and sole proprietorships while Tables 11a and 11b report results for C corporations. Tables 10 and 11 are not directly comparable because the net income of C corporations may include investment income (*e.g.*, interest income) while S corporations and partnership returns generally provide that investment income be reported

separately on the owner's or partner's individual income tax return. Similarly, investment income of the owner of a sole proprietorship is not reported as part of schedule C of Form 1040.

Table 10a reports that in 2012, on average, S corporations reporting \$25,000 or less in total receipts and partnerships reporting positive receipts of \$100,000 or less operated at a loss. Consistent with these data, Table 10b reports that among S corporations reporting less than \$10,000 in total receipts and partnerships reporting positive receipts of less than \$10,000, more than half of such entities operated at a loss in 2012. Nonfarm sole proprietorships more consistently reported profits at all size classes but the very smallest and the very largest.

Tables 11a and 11b report similar results for C corporations. Overall, 45 percent of C corporations reported net operating losses in 2012. For C corporations reporting \$25,000 or less in total receipts, 50 percent or more reported net operating losses in 2012. Less than a third of the largest C corporations reported losses.

**Table 10a.—Distribution of Net Income by Gross Receipts and Entity Type, 2012**

Firms classified by receipts	Net Income (millions of dollars)		
	S Corporations	Partnerships	Nonfarm Sole Proprietorships
\$0 or less .....	-2,066	36,588	-4,038
\$1 to \$2,500.....	-812	-825	-6,644
\$2,501 to \$5,000.....	-296	-436	-202
\$5,001 to \$10,000.....	-390	-726	7,766
\$10,001 to \$25,000.....	-710	-2,053	39,969
\$25,001 to \$50,000.....	15	-1,787	39,926
\$50,001 to \$100,000.....	4,280	-543	49,228
\$100,001 to \$250,000.....	16,610	630	68,945
\$250,001 to \$500,000.....	20,300	3,125	42,819
\$500,001 to \$1,000,000.....	27,617	3,249	30,843
\$1,000,001 to \$10,000,000.....	117,477	45,222	31,338
\$10,000,001 to \$50,000,000.....	85,217	42,337	3,264
More than \$50,000,000 .....	111,114	267,448	1,682
<b>All Receipts.....</b>	<b>378,357</b>	<b>392,228</b>	<b>304,896</b>

**Table 10b.—Percent of Firms with a Net Operating Loss by Gross Receipts and Entity Type, 2012**

Firms classified by receipts	Percent of Firms with a Net Operating Loss		
	S Corporations	Partnerships	Nonfarm Sole Proprietorships
\$0 or less .....	54	25	81
\$1 to \$2,500.....	79	66	40
\$2,501 to \$5,000.....	69	64	30
\$5,001 to \$10,000.....	51	62	21
\$10,001 to \$25,000.....	47	46	12
\$25,001 to \$50,000.....	35	37	10
\$50,001 to \$100,000.....	26	39	9
\$100,001 to \$250,000.....	23	35	10
\$250,001 to \$500,000.....	23	31	10
\$500,001 to \$1,000,000.....	19	35	9
\$1,000,001 to \$10,000,000.....	19	25	14
\$10,000,001 to \$50,000,000.....	15	23	23
More than \$50,000,000 .....	12	21	37
<b>All Receipts.....</b>	<b>31</b>	<b>30</b>	<b>23</b>

\* Details do not add to totals due to rounding.

Source: JCT calculations on SOI data.

**Table 11a.—Distribution of Net Income by Gross Receipts of C Corporations, 2012**

<b>Firms classified by receipts</b>	<b>Net Income (millions of dollars)</b>
\$0 or less .....	13,525
\$1 to \$2,500.....	-2,147
\$2,501 to \$5,000.....	-649
\$5,001 to \$10,000.....	-1,129
\$10,001 to \$25,000.....	-1,619
\$25,001 to \$50,000.....	-1,452
\$50,001 to \$100,000.....	-1,849
\$100,001 to \$250,000.....	-2,472
\$250,001 to \$500,000.....	-2,991
\$500,001 to \$1,000,000.....	-1,952
\$1,000,001 to \$10,000,000.....	4,318
\$10,000,001 to \$50,000,000.....	40,540
More than \$50,000,000 .....	1,353,793
<b>All Receipts .....</b>	<b>1,395,916</b>

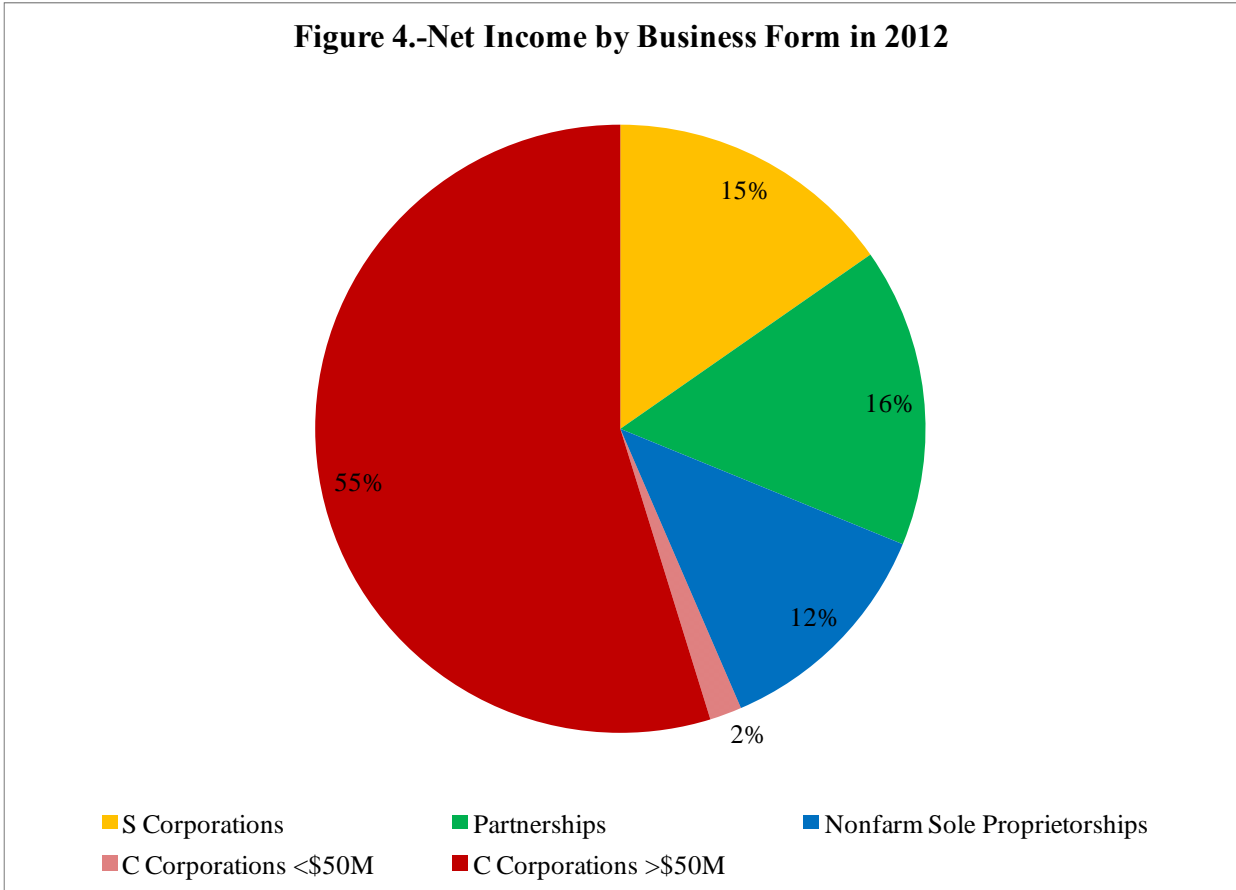
**Table 11b.—Percent of C Corporations with a Net Operating Loss  
by Gross Receipts, 2012**

<b>Firms classified by receipts</b>	<b>C Corporations</b>
\$0 or less .....	74
\$1 to \$2,500.....	66
\$2,501 to \$5,000.....	55
\$5,001 to \$10,000.....	63
\$10,001 to \$25,000.....	52
\$25,001 to \$50,000.....	47
\$50,001 to \$100,000.....	48
\$100,001 to \$250,000.....	41
\$250,001 to \$500,000.....	40
\$500,001 to \$1,000,000.....	34
\$1,000,001 to \$10,000,000.....	29
\$10,000,001 to \$50,000,000.....	24
More than \$50,000,000 .....	24
<b>All Receipts .....</b>	<b>45</b>

\* Details do not add to totals due to rounding.

Source: JCT calculations on SOI data.

Figure 4 reports net income by business form for 2012.<sup>49</sup> The largest portion of total net income is attributable to C corporations (57 percent), with nearly all of that attributable to those C corporations with more than \$50 million in gross receipts. The next largest share of business income is from entities classified as partnerships for Federal income tax purposes, though as noted above, there may be some double counting of partnership income that flows to partners that are C corporations. S corporations report a similar share of all business income followed by sole proprietorships.



<sup>49</sup> Farm proprietorships, shown in table 1, are excluded here as they reported negative aggregate farm net income less loss in 2012 (and every year since at least 1985).

**Table 12.—Individual vs. Corporate Business Income in 2012**

	Number of Returns	Thousands of Dollars
Business Income (Schedule C)	23,034,726	304,191,539
Rental Real Estate, Royalties, Partnerships, S Corporations, Trusts, etc. (Schedule E)	17,208,947	613,258,347
Farm Income (Schedule F)	1,835,688	(5,531,687)
Total Passthrough Business Income	42,079,361	911,918,199
Total Net Income (Less Deficit) of C Corporations	1,617,739	1,051,906,039

Table 12 reports the split of business income that is reported on individual tax returns versus that which is reported on C corporation tax returns. For this purpose, passthrough business income includes income reported on schedule C (profit or loss from business of nonfarm sole proprietorships), schedule E (supplemental income from rental real estate, royalties, partnerships, S corporations, estates, trusts, real estate mortgage investment conduits, etc.), and schedule F (profit or loss from farming for individuals, trusts, and partnerships) of the individual income tax Form 1040. Total net income (less deficit) of C corporations includes income of corporations other than S corporations, real estate investment trusts, and regulated investment companies.

Total passthrough business income reported on Form 1040 for 2012 totaled \$911.9 billion. Total net income of C Corporations for 2012 totaled \$1.052 trillion. For 2012, approximately 46 percent of total business income was reported on individual income tax returns, while 54 percent was reported on corporate income tax returns.