PASS-THROUGH BUSINESSES AND THE RECONCILIATION BILL

The Real Estate Roundtable

- Through the combination of several, independent tax changes, the reconciliation bill would raise the top marginal income tax rate on many small and pass-through business owners from 29.6% today to 46.4%.

- Small and closely held businesses are the principal drivers of job growth and entrepreneurial activity in the U.S. economy. This level of increase in the pass-through tax rate likely is unintended by Members of Congress.

- The dramatic hike in the pass-through tax rate results in large part from capping the 20% deduction on pass-through business income (section 199A).

- President Biden did not include restrictions on section 199A in his budget, the American Families Plan, or the American Jobs Plan.

- The increase in the tax burden on pass-through businesses is disproportionately large relative to the tax changes for large, multinational corporations. As a result, the bill would create a historically high differential in the tax rates between pass-throughs and C corps and put pass-through businesses at a major competitive disadvantage.

- We believe the legislation should avoid tax changes that discriminate against specific industries or types of entities, such as partnerships and S corps.

Top Tax Rate on Pass-Through Businesses

Pre-2017	**39.6%**

Post-2017	37% ordinary tax rate
	Minus 20% deduction for pass-through business income
	= 29.6%

Reconciliation Bill	Current law: 29.6%
	Cap on the 20% deduction (+7.4%)
	Increase in the top ordinary rate from 37% to 39.6% (+2.6%)
	Expansion of the 3.8% net investment income tax to active business owners and limited partners (+3.8%)
	Surtax on incomes over $5 million (+3%)
	= 46.4%

Top Tax Rate on Corporations

Pre-2017	**35%**
Post-2017	**21%**
Reconciliation Bill	**26.5%**

- The disproportionate tax burden on pass-through businesses is evident whether the reconciliation bill is compared to the tax rates after enactment of the *Tax Cuts and Jobs Act* or those in effect during the Obama Administration.

Percentage increase in the top tax rate under the reconciliation bill compared to pre-2017 tax rates and current law

	Corporations	**Pass-through Businesses**
Reconciliation bill compared to pre-2017 tax law	**24% tax cut**	**17% tax increase**
Reconciliation bill compared to current law	**26% tax increase**	**57% tax increase**

- Compared to large corporations, the reconciliation bill would create a tax penalty on pass-through businesses unlike any we have seen in recent history. The rate differential between pass-throughs and C corps would be 20 percentage points, more than twice the level of any period over the last four decades.

Tax rate differentials over the last 40 years

Years	**Pass-Through Rate**	**Corporate Rate**	**Pass-Through Differential**
1982 – 1986	50	46	+ 4
1987	38.5	40	- 1.5
1988 – 1990	28	34	- 6
1991 – 1992	31	34	- 3
1993 – 2000	39.6	35	+ 4.6
2001	39.1	35	+ 4.1
2002	38.6	35	+ 3.6
2003 – 2012	35	35	--
2013 – 2017	39.6	35	+ 4.6
2018 – 2021	29.6	21	+ 8.6
Reconciliation Bill	46.4	26.5	+ 19.9

- As the reconciliation bill moves forward, Congress should adjust the legislation to reduce the tax burden on pass-through businesses. Modest adjustments in the legislation would ensure these businesses can continue contributing to economic growth, innovation, and job creation.

- Specifically, Congress should consider preserving the 20% deduction for pass-through business income (section 199A), which is directly tied to hiring workers and investing in capital equipment and property.

- The proposed limitation on section 199A represents only 3.7% of the total tax revenue in the reconciliation. It is not a critical component of the overall revenue title in the bill.

- Preserving the full 199A deduction would still result in a top tax rate on pass-through businesses of 38.5%, a 30% increase over current law.

- In short, the final bill should seek to avoid unintended consequences and potential economic harm caused by the stacking of tax increases on pass-through entities which, when combined, would severely increase the tax burden on these job-creating businesses.

# # #