

New Treasury Press Release Inflates Impact of Lowering Top Tax Rate On Small Business Owners

by Robert Greenstein and Isaac Shapiro

On May 7, the Treasury Department issued a press release entitled “Small Businesses Gain Big Benefit From the President’s Tax Relief Proposal: 77% of the tax relief associated with cutting the top rate would go to small business owners and entrepreneurs.”¹ The press release also claims that “business owners make up 63% (about .8 million) of the 1.3 million tax returns that will benefit from the new 33% rate.”

Several days before issuance of this press release, the Center on Budget and Policy Priorities issued an analysis finding that only one percent of small business owners pay the top rate and that, in fact, there are 15 owners who would receive no benefit from the Administration’s tax plan for every one who would benefit from lowering the 39.6 percent rate.² This analysis also found that many more small business owners would benefit from extending the child credit to more low-income working families that do not earn enough to pay federal income tax or from improving the Earned Income Tax Credit than from reducing the 39.6 percent rate.

The figures in the Treasury press release and the Center analysis seem to contradict each other. Closer examination of the claims in the Treasury press release shows, however, that the release is carefully crafted to create an impression that lowering the top rate would do far more to help small business owners than is actually the case.

- First, the figures in the Treasury release do *not* simply reflect the effects of lowering the 39.6 percent tax rate. These figures also include the effects of lowering the 36 percent rate.
- Second, the 800,000 figure that the press release says is the number of small business owners who would gain from lowering the top rate includes large numbers of individuals who are *not* small business owners. The figures in the Treasury release includes many individuals who, as a *Wall Street Journal* article recently reported, are not active small business owners but rather are affluent investors who “receive income from partnerships or Subchapter S corporations

¹ U.S. Treasury Department, Office of Public Affairs, May 7, 2001 PO-357

² Isaac Shapiro and Robert Greenstein, “Reducing the Top Tax Rates: How Much Benefits to Small Businesses?,” Center on Budget and Policy Priorities, May 3, 2001.

— entities that are often used for passive investment vehicles.”³ The numbers of small business owners cited in the press release also include lawyers, doctors, and others who operate partnerships. (The Treasury press release counts as a small business owner or entrepreneur “any taxpayer that reports income from a sole proprietorship, farm proprietorship, partnership, S-corporation, or rental activities.”)

- Third, even if one uses the press release’s creative (and misleading) definition of a small business owner, it remains true that only a tiny fraction of such individuals— three percent of them — pay either the 36 percent or 39.6 percent rate. Treasury data indicate that 26.2 million taxpayers fall into the so-called small business owner and entrepreneur category, as the press release defines it. The 800,000 taxpayers said to have small business income and to be in either the 36 percent or 39.6 percent bracket constitute just three percent of these 26.2 million filers. The numbers of taxpayers with these forms of business income who are subject to the 15 percent rate — or who do not earn enough to owe any federal income tax and thus would receive no tax reduction from the Administration’s plan — are many times larger than the number who are in either of the top tax brackets.
- Finally, the 800,000 figure includes taxpayers whose small business income is negative. These are taxpayers who have some business losses but secure so much income from *other*, non-small business sources that they are in the 36 percent or 39.6 percent bracket. Such individuals generally are not small business owners; they are much more likely to be high-income individuals who have some business investments but whose high incomes come from other sources. These are not the types of individuals the public has in mind when it hears the Administration argue that small business owners would gain greatly from dropping the top rate. (Other Treasury data show that one-fourth of the 800,000 “small business returns” that the Treasury press release cites as paying the 36 percent or 39.6 percent rate are returns filed by individuals who incur losses from small business income sources and who are in the top brackets because of high incomes from other sources.)

To gain a sense of the degree to which the Treasury public affairs office has taken liberties with the data to inflate these figures, consider the following. Internal Revenue Service data and analysis of that data by Citizens for Tax Justice indicate that, as noted above , only one percent of small business owners pay the 39.6 percent rate (“Small business owner” is defined here in a more reasonable fashion that does not count lawyers and doctors who operate partnerships or investors with business losses but high incomes from other sources.) As the Center’s May 3 analysis reported, for every small business owner who pays the top rate, there

³ John D. McKinnon, “Bush Argues Cutting Top Tax Rate Helps Entrepreneurs: Data Raise Skepticism,” *The Wall Street Journal*, May 7, 2001.

are 15 who would receive no tax reduction from the Administration's tax plan because their earnings are too low to owe federal income tax. (These owners pay other taxes.) In addition, when the more reasonable definition of small business owner is used, only one-fifth of the taxpayers who are in the 36 percent or 39.6 percent brackets and thus would benefit from lowering the top rate to 33 percent are found to be small business owners. This figure is far below the 63 percent figure the Treasury press release trumpets.