Small Business Identification
How and Why
Richard Prisinzano
Overview

• How
  • Tax Data
  • Simple & Malleable Rules

• Why
  • Policy Goal
  • Inconsistent
Small Business Definition

• The Tax Code provides no single, explicit definition of small business.

• Definitions used for spending programs appear to be overly broad and problematic to apply to tax data.

• Definition of small business can be improved from labeling all pass through businesses as small businesses.
Overview of Methodology

• Keep tests and thresholds simple and constant across all business returns.

• Count all income and deductions that are reported by business entity, including Schedule K.

• Exclude entities that only report income, but allow entities that only report deductions.
Small Business Methodology

• **Step 1:** Consider all “business” income base.
  • Include sole proprietors, partnerships, S and C corporations, Schedule E rental real estate, farmers
  • Include any investment income and deductions from Schedule K for partnerships and S corporations
• **Step 2:** Separate business from non-business activity.
• **Step 3:** Separate small businesses from all businesses.
What is a Business?

We use three general principles to distinguish business from non-business activity:

1. Does the entity attempt to make a profit?

2. Do the owners operate in a “businesslike” manner?

3. Does the activity have potential to generate non-negligible income for the owners?
Business Test

• **Test 1: De Minimis Activity**
  - Total Deductions or Total Income $\geq 10,000$
  - OR
  - Total Deductions and Total Income $\geq 15,000$

• **Test 2: General Business Activity**
  - Total Deductions $> 5,000$
Identifying Businesses
Thousands of Filers

- **2007 Business**
- **2010 Business**
- **2014 Business**
- **2007 Non**
- **2010 Non**
- **2014 Non**

- **C Corp**
- **S Corp**
- **Part**
- **Farm**
- **Renter**
- **Sole Prop**
Business vs. Non-Business
Net Income, Billions of Dollars

- 2007 Business
- 2010 Business
- 2014 Business
- 2007 Non
- 2010 Non
- 2014 Non

- C Corp
- S Corp
- Part
- Farm
- Renter
- Sole Prop
Identification of Small Businesses

• We define small business as entity that reports < $10 million Total Income and < $10 million in Total Deductions.

• Result:
  • For each year, we retained 99% of business entities, but between only 17% and 18% of total income and between 17% and 19% of net income.
Business vs. Small Business
Thousands of Filers

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>C Corp</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>S Corp</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Part</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Farm</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Renter</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sole Prop</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Business vs. Small Business
Net Income, Billions of Dollars

[Bar chart showing net income comparisons for various types of businesses across different years.]
Identification of Employers

• We define a small business as an employer if entity reports > $10K in labor deductions

• Result:
  • For each year, only 20% of small businesses are employers.
Small Business Employers
Net Income, Billions of Dollars
CARES ACT (PPP)

• Loan program ‘Small Business’

• Eligibility
  • # employees at establishment (phase 1 & 2)
  • Size of lender (phase 2)
### CARES ACT (PPP)

**Table 1. Characteristics by Firm Size, 2016**

<table>
<thead>
<tr>
<th>Number of Employees</th>
<th>Number of Firms</th>
<th>Employment</th>
<th>Annual payroll ($1,000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>500 or more</td>
<td>0.3%</td>
<td>52.7%</td>
<td>59.3%</td>
</tr>
<tr>
<td>Fewer than 500</td>
<td>99.7%</td>
<td>47.3%</td>
<td>40.7%</td>
</tr>
<tr>
<td>100-499</td>
<td>1.5%</td>
<td>14.0%</td>
<td>13.5%</td>
</tr>
<tr>
<td>20-99</td>
<td>9.0%</td>
<td>16.6%</td>
<td>14.0%</td>
</tr>
<tr>
<td>5-19</td>
<td>27.6%</td>
<td>11.9%</td>
<td>9.0%</td>
</tr>
<tr>
<td>0-4</td>
<td>61.6%</td>
<td>4.7%</td>
<td>4.2%</td>
</tr>
<tr>
<td>Total</td>
<td>5,954,684</td>
<td>126,752,238</td>
<td>6,435,142,055</td>
</tr>
</tbody>
</table>

Table 2. Average Annual Growth in Wages and Employment by Size Category, 2012-2016

<table>
<thead>
<tr>
<th>Firm Size (Number of Employees)</th>
<th>Wages</th>
<th>Employment</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Percent Change</td>
<td>Contribution to Percent Change</td>
</tr>
<tr>
<td>Total</td>
<td>4.3</td>
<td>4.3</td>
</tr>
<tr>
<td>500 or more</td>
<td>4.8</td>
<td>2.7</td>
</tr>
<tr>
<td>100-499</td>
<td>4.5</td>
<td>0.6</td>
</tr>
<tr>
<td>50-99</td>
<td>3.4</td>
<td>0.2</td>
</tr>
<tr>
<td>20-49</td>
<td>3.6</td>
<td>0.3</td>
</tr>
<tr>
<td>0-19</td>
<td>3</td>
<td>0.4</td>
</tr>
</tbody>
</table>