

**Impact of the Bush Tax Cut Extension on Small Family-Owned Businesses**

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**Abstract**

This study examines the impact of the potential lapse in the Bush tax cuts established under the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) and Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA) utilizing data from the Federal Reserve Board's Survey of Consumer Finance for 2007. This analysis utilizes regression analyses to identify households owning small business which are most likely to be impacted by the tax cut lapse. Preliminary results suggest that households most likely to create jobs and expand their businesses realize a disproportionate share of the impact.

**Introduction**

The Bush tax cuts were established under the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) and Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA). EGTRRA and JGTRRA are set to expire after 2010. The current political debate is focused on whether the tax cuts should be extended or not. The Obama Administration has proposed keeping the tax cuts for most Americans; however, the Administration has proposed raising income taxes rates back to 1990s rates for households making \$250,000 or more (or individuals making \$200,000 or more). If the tax cuts lapse the top two tax rates would revert to where they were in the late 1990s: The 35% rate would go to 39.6% and the 33% rate would go to 36%. In addition, high income households would realize higher taxes on capital gains, dividends and estate taxes. The Administration is facing opposition from those suggesting it's the wrong time to raise taxes given the fragile economic recovery. At the center of this debate are concerns about the impact of the tax increase on households owning small businesses.

Allowing EGTRRA and JGTRRA to lapse would impact several of their provisions, including the following: Child tax credit, 15-percent individual income tax rate bracket expansion for married taxpayers filing joint returns; increased standard deduction for married taxpayers filing joint returns; 10-percent individual income tax rate bracket expansion; reduction in individual income tax rates for households and an increase and extension of bonus depreciation and increased expensing for small business. In addition, a lapse in the two acts would increase taxes on dividends and capital gains. This study will examine only the impact of the "reduction in individual income tax rates for households" owning small businesses. This study will utilize the Survey of Consumer Finances for 2007 to address the following research questions:

- (1) What percentage (and number) of all households would be impacted by allowing EGTRRA and JGTRRA to lapse? Households owning and not owning small businesses will be compared;
- (2) What types of small businesses are impacted by allowing EGTRRA and JGTRRA to lapse? Small business characteristics, including age, size, minority ownership, women ownership, legal organization, founding status, industrial classification and share of total income from the small business will be examined; and,
- (3) Recent work by Haynes (2010) suggests that households owning multiple small businesses have accumulated wealth at a somewhat faster rate than households owning just one small business. If households owning multiple small businesses leverage their success in one business by expanding an existing business or starting other small businesses, then these households appear to have the most potential to grow the economy. Are households owning multiple small businesses more likely to be impacted by allowing EGTRRA and JGTRRA to lapse than other small businesses?

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### Literature Review

The current debate on the impact of the Bush tax cuts has been aired in the popular press with a substantial portion of the debate focused on the disproportionate effect on small businesses. The theoretical and empirical literature has examined the impact of tax policy on job creation and gross domestic product growth; however, the most substantive research has examined the impact of tax policy on entrepreneurship.

Research by Gale (2004) and Carroll, Holtz-Eakin, Rider, and Rosen (2001) has examined the influence of personal income tax on the growth rates of firms. Gale has described the distribution effects of the tax cuts and concluded that over 70% of households with business income would realize a decrease in their after-tax income, when financing to pay for the tax cut was included in the analysis. This rather counter-intuitive result was supported by other research by Cronin (1999) and Gravelle (2001) in earlier work without the “financing to pay for the tax cut” included in their research studies. Other research by Carroll, et al has suggested just the opposite by arguing that lowering income tax rates increases business growth rates. Earlier work by Carroll, Holtz-Eakin, Rider and Rosen (1998) investigated the effect of entrepreneurs’ personal income tax situations on their capital investment decisions. They found that individual income taxes exert a significant influence on investment decisions, where a five percentage point increase in marginal tax rates would reduce the proportion of entrepreneurs who make new capital investments by 10.4 percent, and decrease mean investment expenditures by 9.9 percent.

The decision of the small business owner to invest directly impacts job creation and gross domestic product (GDP) growth. Clearly, small businesses make substantial contributions to employment and sales in the economy (Brock and Evans, 1989); however, it’s less clear exactly what types of small businesses make the largest contributions. Early work by Birch (1981) argued that a vast majority of new jobs were created by firms four years of age or younger; however, more recent work by Armington and Acs (2004) have suggested that larger and older firms (hereafter, called gazelles) are the most dynamic sector of the economy contributing to net job creation. More recently, Acs, Parsons and Tracy (2008) have revisited the revenue growth and employment expansion potential of gazelles and have concluded that the firms contributing the most to overall economic growth are relatively old and rare, representing only 2 to 3 percent of all firms.

While job creation and GDP growth are critically important considerations, a substantial and conflicting literature has evolved examining the impact of tax policy on startup businesses, or entrepreneurs. Schuetze (2008) has suggested that while this literature has provided a substantial increase in the knowledge regarding the effects of tax policy on entrepreneurship this literature is far from complete. Recent work by Cullen and Gordon (2002) has shown that higher tax rates, which lower the return and increased the risk of entrepreneurial activity, may increase the level of self-employment and entrepreneurial activity in the economy. Other work by Papke (1991), Gurley-Calvez and Bruce (2008), and Bruce and Mohsin (2006) has contradicted Cullen and Gordon. Papke found that high state marginal effective tax rate reduces the number of firm births for half of the industries examined. Gurley-Calvez and Bruce find that cuts in tax rates in terms of either higher income tax rates for wage earners or lower rates for entrepreneurs, increase business entry. Other work by Bruce and Mohsin uses more sophisticated econometric techniques to examine the importance of federal income, payroll, capital gains, corporate income and estate taxes on self-employment rates. They found that most of these taxes have statistically significant, but have very small effects on self-employment activity. And finally, the most empirically rigorous work on this topic was completed by Moore (2003), where he found that tax policy changes seems to have no significant effect on the self-employment decision. Moore suggested that other variables, such as education, industry, wealth, attitudes toward risk and previous self-employment experience were more important determinants of self-employment than tax policy.

This study makes an important contribution to the policy debate (and the literature on small business finance) by examining the distributional impact of the changes in the Bush tax cuts on small businesses. Most importantly this study expands the current research to examine the impact of tax policy on high income small business owning households, especially the gazelles.

### Conceptual Model

Income taxation considerations are important for households owning small businesses because additional income taxes will not only lower their household income and reduce the demand for goods and services in the household, but reduce the supply of internal capital available to invest in the existing business or to start a new business. Classical economic theory would argue that decreases in household income will reduce the demand for normal goods and services sold. However, when considering the income elasticity of goods and services purchased by high income households, a more thorough analysis would examine the types of goods and services impacted. In

addition, classical economic theory would suggest that lower business income would likely reduce the level of savings and subsequently reduce the level of investing in the existing business or new business ventures.

The proponents of allowing the tax cut to lapse would argue that the impact on small business is minimal because it impacts so few businesses. The opponents of allowing the tax cut to lapse argue that the impact on small business is substantial because these high income small businesses are the ones most likely to increase job creation and GDP growth. While the political debate would suggest that the additional income lost by the lapse of the “permanent” tax cuts would be taken away from business investment, this argument fails to recognize the reduced household consumption.

This study is largely descriptive by examining the burden of the tax cut lapse on high income small business owning households. This study is focused on households owning more than one small business and share of the tax burden borne by these households. They are especially important because they are the households most likely to be making substantial contributions to job creation and GDP growth in the U.S. economy.

### **Empirical Model**

#### **Sample**

This study utilizes the 2007 Survey of Consumer Finances. The 2007 SCF was designed by the Federal Reserve Board and the survey data were collected by the National Opinion Research Center (NORC) at the University of Chicago. The surveys are designed to supply detailed and reliable information on balance sheets, use of financial services, pensions, labor force participation, cash income and demographic characteristics of U.S. households. The SCF utilizes a dual frame sample to provide adequate coverage of the population. One frame is a multistage area probability sample, which provides adequate coverage of widely held assets and liabilities. The second frame is a list design employed to over-sample relatively wealthy households. Response rates for the area probability and list samples in 2007 were approximately 70 and 30 percent, respectively (Bucks, Kennickell, Mach & Moore (2009).

Research conducted by the Federal Reserve Bank suggests that non-response is positively correlated with wealth. This study is primarily interested in examining small business owning households. However, the entire sample is employed to assess the differences between business owning and non-business owning households. The SCF survey asks respondents about the previous year, hence the SCF for 2007 actually gathers information about finances of the household and business in 2006.

The variables of interest in this study include household income, dummy variable for households owning and managing more than one small business, business age, business size (number of employees and gross sales), minority ownership, gender of business leader, legal organization (partnership, sole proprietorship, subchapter s corporation, regular corporation and limited partnership/limited liability company, founding status (bought/invested, started, or inherited), industry (agricultural related; mining and construction; manufacturing; wholesale and retail trade; finance, insurance and real estate; and service) and share of total income from the business.

The sampling frame for this analysis is U.S. households. Personal and demographic characteristics are those characteristics of the respondent interviewed, typically the household head. If the respondent or someone in the household owns and manages a business, this study is referring to the largest business. No business information is reported in the SCF for businesses owned, but not managed, by the respondent or respondents indicating that they or their spouse is self-employed.

This study focuses on households owning and managing at least one small business, where the small business includes 500 or fewer employees. Although, business owners in this study include those owning and managing businesses with more than 500 employees, business owners, who have no management responsibilities (hereafter, called owners only) and household with a self-employed person are discussed. The empirical analysis examines the impact of the Bush tax cuts on households owning more than one business. High income households are those with taxable incomes exceeding \$250,000 for a married couple filing jointly or separately or \$200,000 for individuals filing as head of the household or single. Income estimates were inflated to 2009 dollars using the consumer price index as reported by the Bureau of Labor Statistics. The distribution of household income across the 2009 tax brackets differs substantially from the distribution of individuals reporting small business income on schedules C, E or F as reported by others, especially the Tax Policy Center (Gale, 2004)

The analysis utilizes the first implicate of the Survey of Consumer Finances for 2007 and employs the population weights. The sample includes 4,418 observations representing over 116.1 million households.

## Model

This study is largely descriptive, where households owning and managing small businesses are compared with other households not owning and managing a small business; and where households owning one small business are compared with households owning more than one small business. The empirical model examines the likelihood of a household owning more than one small business being classified as high income and subsequently being impacted by the lapse of the Bush tax cuts. The model is specified as follows:

High\_income\_household=f(multiple\_owner; controls), where

High\_income\_household = household income greater than \$250,000 for married and \$200,000 for non-married (AGI = gross income in this study – establishes cut-off);

Multiple\_owner= household owns more than one small business;

Controls = business characteristics, including business age, number of employees, minority owner, male led, legal organization (partnership, sole proprietorship, subchapter s corporation, regular corporation and limited partnership/limited liability company), founding status (bought/invested, started, inherited), industrial classification (agricultural-related; mining and construction; manufacturing; wholesale and retail; finance, insurance and real estate (FIRE); and service) and share of income from business.

Based on previous work by Haynes (2010) and others, it's expected that households owning multiple small businesses will be more likely to be impacted by the lapse of the Bush tax cuts than households owning one small business, ceteris paribus. Most importantly, this empirical analysis will profile the types of small businesses most likely to be impacted.

## Results

High income households are those with taxable incomes exceeding \$250,000 for a married couple filing jointly or separately or \$200,000 for individuals filing as head of the household or single. Just over 4% of all households in the SCF population are classified as high income; however, business owning households are over 3 times more likely to be high income than households not owning at least one business (Table 1). Nearly all of the households owning larger businesses (employees greater than 500) were classified as high income, while just over 16% of households owning small businesses were classified as being high income. In addition, less than 4% of all households with a self-employed head or spouse while over 26% of households owning, but not managing small businesses, were classified as high income.

**Table 1**  
*Proportion of Households Earning More than \$250,000 by Selected Characteristics*

Type of Household	n	N	Percentage of All Households	Percentage of Households That Are High Income <sup>1</sup>	Number of High Income Households	Share of All High Income Households
All households	4,418	116,122,124	100.0	4.4	5,129,068	100.0
No business ownership	2,865	96,688,171	83.3	2.3	2,243,977	43.8
<b>Business Owning Households</b>						
Large business owners	82	95,617	0.1	100.0	95,609	1.9
Self-employed, either head or spouse	136	3,670,129	3.2	3.6	132,951	2.6
Owner/manager, 1 business only	733	11,774,200	10.1	12.3	1,446,361	28.2
Owner/manager, more than 1 business	467	2,635,864	2.3	33.3	876,738	17.1
Total business owner manager households	1,200	14,410,064	12.4	16.1	2,323,099	45.3
Owner only, no management function	135	1,258,143	1.1	26.5	333,435	6.5
Total business owning households	1,553	19,433,953	16.7	14.8	2,885,092	56.2

<sup>1</sup>Gross income cut-off for married households is \$250,000 and non-married households is \$200,000.

Households owning and managing one or more small businesses represent about 12% of all households; however, they represent over 45% of the share of households classified as high income. These households owning and managing only one small business comprise about 10% of all households and comprise over 28% of the share of

all high income households; while households owning and managing more than one small business comprise less than 3% of all households and comprise over 17% of the share of all high income households. If small business investment is important, then this group of households owning and managing more than one small business is particularly important because they have experience growing different small businesses.

Multiple small business owners reside in 2.6 million households and own and manage 5.9 million small businesses and own an interest in, but don't participate in the management of another 0.95 million businesses. These small business owners comprise just over 18% of the households (2.6 million) owning small businesses, but participate in the ownership (0.95 million businesses) or management (2.6 million primary businesses and 3.2 million other businesses) of nearly 37% of all small businesses. Most importantly, these households owning more than one small business are significantly more likely to be high income than households owning only one small business. In fact, only households owning large businesses are more likely to be high income than these households owning more than one small business in this sample.

Table 2 examines the characteristics of small businesses impacted by the lapse in the Bush tax cuts. The small businesses significantly more likely to be negatively impacted the tax increase have the following characteristics: Somewhat older, larger (more employees and sales), non-minority, men-led, any legal organization except sole proprietor and engaged in manufacturing, FIRE or services. Firms 10 years of age or older and larger firms with five or more employees (or \$500,000 or more in gross sales) comprise about 60% of the high income firms. Over 93% of these businesses are owned and managed by a non-minority person and over 98% are small businesses led by men. Nearly 30% of the high income small businesses are subchapter s corporations with the remainder distributed among sole proprietorships (20.5%), limited partnerships/limited liability companies (26.3%), partnerships (12.6%) and regular corporations (10.7%). A majority of these high income small businesses were started by the owner (65.8%) and were engaged in the service industry (51%).

Table 3 separates small business-owning households into two groups, those owning just one small business and those owning more than one small business. The story is very similar for the two groups, where the most important determinants of high income are age and size. In both samples, older and larger small businesses were more likely to reside in high income households. Minority ownership and industrial classification are important. Minority ownership and industrial classification are important determinants for the households owning one small business, but not for those owning more than one small business. Non-minority owned small businesses were significantly more likely to be high income than minority owned small businesses, and small businesses engaged in mining, construction, wholesale and retail industries were less likely to be high income than small businesses engaged in the service industry for those households owning only one small business.

Perhaps the most interesting comparison in the Table 3 is between the percentage of high income households owning and managing small businesses across the two size groups. Smaller businesses, especially those with only 1 employee (or sales less than \$100,000) comprised a substantially larger share of high income households for households owning one business than households owning more than one business (44.2% versus 24.2%). This results recognizes the impact of high income earners with home offices, primarily doctors, lawyers and construction contractors. Minority-owned small businesses comprised a substantially larger share of high income households for those owning more than one business (12.5%) than households owning only one business (2.6%). Limited partnerships/limited liability companies comprised nearly 33% of high income households owning more than one business and just over 22% of high income households owning only one business. Sole proprietorships comprised nearly 13% of high income households owning more than one business and just over 25% of high income households owning only one business. And finally, service businesses comprised over 42% of high income households owning more than one business and over 56% of high income households owning one small business.

Table 4 examines likelihood that households owning multiple small businesses are impacted by the lapse in the tax cut. These results suggest that multiple small business owner households are significantly more likely to be high income and subsequently be adversely impacted by the lapse in the Bush tax cuts. In fact, this result is robust across several specifications as reported on Table 4. The first specification regresses the likelihood of being high income on the multiple small business owner variable. The second specification includes business age; third specification includes business age and size; and fourth specification is the complete model, which includes business age and size and other controls. Other control variables, such as business age, size, male-led and industrial classification are statistically significant. Older small businesses are more likely to be higher income than the youngest small businesses, those 4 years old or less. Small businesses with 10 or more employees are more likely to be high income than small businesses with fewer than 5 employees. Small businesses led by men are more likely to be high income than those led by women. Sole proprietorships and regular corporations are less likely to be high

income than limited partnerships/limited liability companies. And finally, mining, construction, wholesale and retail industry small businesses are less likely to be high income than service industry small businesses.

**Table 2**  
*Percentage of high income households owning and managing small businesses*

Characteristics	n	Number of Households	Percentage of Households That Are High Income <sup>1,2</sup>	Number of High Income Households	Share of High Income Households Owning and Managing Small Businesses
All owned and managed small businesses	1,200	14,410,064	16.1	2,323,099	100.0
Business age, 0 to 4	258	4,938,763	8.0 *	397,503	17.1
Business age, 5 to 9	218	2,800,012	14.1	394,025	17.0
Business age, 10 to 19	312	3,576,686	22.1	791,259	34.1
Business age, 20 and older	412	3,094,603	23.9	740,312	31.9
Business size, 1 employee or manager	280	5,825,696	7.6 *	440,156	18.9
Business size, 2 to 4	295	4,700,602	10.9 *	511,087	22.0
Business size, 5 to 9	160	1,566,437	24.3 *	380,657	16.4
Business size, 10 to 500 employees	465	2,317,329	42.8	991,199	42.7
Gross sales, less than \$100,000	343	8,170,512	5.1 *	416,931	17.9
Gross sales, \$100,000 to \$249,999	140	2,069,630	11.2 *	232,493	10.0
Gross sales, \$250,000 to \$499,999	100	1,209,756	22.1 *	266,811	11.5
Gross sales, \$500,000 to \$999,999	84	952,950	34.9 *	332,236	14.3
Gross sales, \$1 million or more	533	2,007,216	53.5	1,074,629	46.3
Owner, non-minority	1,087	12,053,403	18.1 *	2,175,987	93.7
Owner, minority	113	2,356,661	6.2	147,112	6.3
Owner, woman	57	1,345,358	2.8 *	37,577	1.6
Owner, man	1,143	13,064,706	17.5	2,285,522	98.4
Owner, not married	207	3,675,879	10.8 *	396,995	17.1
Owner, married	993	10,734,185	18.0	1,932,153	83.2
Partnership	147	1,691,914	17.3	292,839	12.6
Sole proprietorship	343	6,975,305	6.8 *	475,832	20.5
Sub-chapter S corporation	289	2,184,105	31.8	694,776	29.9
Regular corporation	90	1,152,891	21.6	249,165	10.7
Limited partnership/limited liability company	331	2,405,849	25.4	610,488	26.3
Bought/invested	244	2,521,292	17.3	436,062	18.8
Started	815	10,315,680	14.8	1,528,738	65.8
Inherited	141	1,573,092	22.8	358,298	15.4
Agricultural related	83	1,498,067	9.2 *	138,334	6.0
Mining and construction	182	2,516,349	7.7 *	192,591	8.3
Manufacturing	81	930,997	20.4	190,168	8.2
Wholesale/retail	148	1,976,116	9.8 *	192,701	8.3
FIRE	293	2,121,435	20.1	425,470	18.3
Service	413	5,367,100	22.1	1,183,834	51.0
Business share of total income, less than 25%	511	8,036,151	12.3	987,576	42.5
Business share of total income, 25% to 49.9%	184	1,882,360	20.4	384,562	16.6
Business share of total income, 50% to 74.9%	198	1,398,864	24.9	348,969	15.0
Business share of total income, 75% or more	307	3,092,689	19.5	602,864	26.0

<sup>1</sup>Gross income cut-off for married households is \$250,000 and non-married households is \$200,000.

<sup>2</sup>Significance level at 0.05 or lower is denoted by an asterisk.

**Table 3**  
High income households owning and managing small businesses by number of businesses owned

Characteristics	Household Owns and Manages One Small Business					Household Owns and Manages More Than One Small Business				
	n	N	Percentage of Households That Are High Income <sup>1</sup>	Number of High Income Households	Share of High Income Households Owning and Managing Small Businesses	n	N	Percentage of Households That Are High Income <sup>1</sup>	Number of High Income Households	Share of High Income Households Owning and Managing Small Businesses
All owned and managed small businesses	733	11,774,200	12.3	1,446,361	100.0	467	2,635,864	33.3	876,738	100.0
Business age, 0 to 4	168	4,035,776	6.4 *	495,761	34.3	90	902,987	15.6 *	300,351	34.3
Business age, 5 to 9	134	2,235,121	11.3	274,566	19.0	84	564,891	25.0	187,893	21.4
Business age, 10 to 19	190	3,006,364	17.1	369,306	25.5	122	570,323	48.7	189,700	21.6
Business age, 20 and older	241	2,496,939	17.0	306,728	21.2	171	597,663	53.0	198,794	22.7
Business size, 1 employee or manager	211	5,187,027	6.5 *	637,182	44.1	69	638,669	16.4 *	212,433	24.2
Business size, 2 to 4	195	3,758,516	7.9 *	461,702	31.9	100	942,086	22.9 *	313,356	35.7
Business size, 5 to 9	102	1,258,056	21.8 *	154,542	10.7	58	308,381	34.5	102,573	11.7
Business size, 10 and larger	225	1,570,601	34.5	192,935	13.3	240	746,728	60.3	248,376	28.3
Gross sales, less than \$100,000	264	7,308,922	4.5 *	897,839	62.1	79	861,590	10.3 *	286,581	32.7
Gross sales, \$100,000 to \$249,999	103	1,683,625	9.6 *	206,819	14.3	37	386,005	18.2 *	128,393	14.6
Gross sales, \$250,000 to \$499,999	64	883,758	24.1 *	108,562	7.5	36	325,998	16.4 *	108,433	12.4
Gross sales, \$500,000 to \$999,999	48	667,723	24.9 *	82,024	5.7	36	285,227	58.1	94,872	10.8
Gross sales, \$1 million or more	254	1,230,172	46.8	151,116	10.4	279	777,044	64.1	258,459	29.5
Owner, non-minority	654	9,803,878	14.4 *	1,408,425	97.4	433	2,249,525	34.1	767,562	87.5
Owner, minority	79	1,970,322	1.9	37,935	2.6	34	386,339	28.3	109,176	12.5
Owner, woman	40	1,043,620	2.0	20,995	1.5	17	301,738	5.5	16,582	1.9
Owner, man	693	10,730,580	13.3	1,425,365	98.5	450	2,334,126	36.9	860,156	98.1
Owner, not married	138	3,153,385	9.0	283,805	19.6	69	522,494	21.7	113,381	
Owner, married	595	8,620,815	13.5	1,163,810	80.5	398	2,113,371	36.1	762,927	
Partnership	90	1,355,790	15.6	210,839	14.6	57	336,124	24.4	81,999	9.4
Sole proprietorship	271	6,123,238	6.0	366,485	25.3	72	852,067	12.8	109,346	12.5
Sub-chapter S corporation	155	1,742,378	24.7	429,875	29.7	134	441,727	60.0	264,901	30.2
Regular corporation	47	755,433	15.5	117,334	8.1	43	397,458	33.2	131,830	15.0
Limited partnership/limited liability company	170	1,797,361	17.9	321,826	22.3	161	608,488	47.4	288,661	32.9
Bought/invested	132	1,977,350	11.9	235,966	16.3	112	543,942	36.8	200,097	22.8
Started	507	8,503,843	11.9	1,011,425	69.9	308	1,811,837	28.6	517,313	59.0
Inherited	94	1,293,007	15.4	198,969	13.8	47	280,085	56.9	159,328	18.2
Agricultural related	60	1,392,766	8.8	122,605	8.5	23	105,301	14.9	15,728	1.8
Mining and construction	119	2,211,123	5.0 *	110,984	7.7	63	305,226	26.7	81,607	9.3
Manufacturing	44	715,373	16.2	116,000	8.0	37	215,624	34.4	74,168	8.5
Wholesale/retail	86	1,482,831	5.1 *	75,273	5.2	62	493,285	23.8	117,428	13.4
FIRE	158	1,673,150	12.2	204,136	14.1	135	448,285	49.4	221,334	25.2
Service	266	4,298,957	19.0	817,362	56.5	147	1,068,143	34.3	366,472	41.8
Business share of total income, less than 25%	329	6,757,899	10.1	681,616	47.1	182	1,278,251	24.4	311,366	35.5
Business share of total income, 25% to 49.9%	113	1,492,205	16.8	250,519	17.3	71	390,156	33.8	131,884	15.0
Business share of total income, 50% to 74.9%	97	1,048,862	13.7	144,094	10.0	101	350,002	57.1	199,826	22.8
Business share of total income, 75% or more	194	2,475,234	15.0	371,716	25.7	113	617,455	36.9	227,928	26.0

**Table 4**

*Small businesses most likely to be impacted by the lapse of the Bush tax cuts by number of businesses owned*

Characteristic	Parameter Standard			Parameter Standard			Parameter Standard			Parameter Standard		
	Estimate	Error	p-value	Estimate	Error	p-value	Estimate	Error	p-value	Estimate	Error	p-value
Intercept	-1.9658	0.1439	0.0001	-1.4839	0.2361	0.0001	-0.2740	0.3109	0.3782	-1.2176	1.0809	0.2600
Multiple small business owner	1.2695	0.2562	0.0001	1.3496	0.2657	0.0001	1.1309	0.2849	0.0001	1.1837	0.3217	0.0002
Business age, 0 to 4				-1.3312	0.3541	0.0002	-1.1398	0.3720	0.0022	-1.1663	0.4290	0.0066
Business age, 5 to 9				-0.7099	0.3642	0.0513	-0.6721	0.3867	0.0822	-0.5744	0.4292	0.1807
Business age, 10 to 19				-0.0519	0.3091	0.8667	0.0420	0.3304	0.8987	0.0627	0.3712	0.8658
Business size, 1 employee or manager							-1.9592	0.3468	0.0001	-1.7550	0.4478	0.0001
Business size, 2 to 4							-1.7030	0.3369	0.0001	-1.4327	0.4108	0.0005
Business size, 5 to 9							-0.7964	0.3910	0.0417	-0.6359	0.4641	0.1706
Owner, minority										-0.9701	0.5257	0.0650
Owner, man										2.4780	0.9657	0.0103
Owner, married										0.0768	0.3913	0.8444
Partnership										-0.9210	0.4981	0.0645
Sole proprietorship										-1.1972	0.4174	0.0041
Sub-chapter S corporation										-0.0760	0.4221	0.8571
Regular corporation										-1.1386	0.5631	0.0432
Bought/invested										-0.1783	0.5193	0.7314
Started										0.0942	0.4669	0.8401
Agricultural related										-1.1429	0.5814	0.0493
Mining and construction										-1.7643	0.4891	0.0003
Manufacturing										-0.3506	0.5352	0.5124
Wholesale/retail										-1.4474	0.5272	0.0060
FIRE										-0.3154	0.3967	0.4265
Business share of total income, less than 25%										-0.5708	0.3779	0.1310
Business share of total income, 25% to 49.9%										-0.3916	0.4588	0.3934
Business share of total income, 50% to 74.9%										-0.0502	0.5001	0.9200
Number of observations												1,200
McFadden R-squared												0.2880

Reference categories are 20 or more years of age, 10 or more employees, non-minority, woman owned, not married, limited partnership/limited liability company, inherited, service industry and share 75% or more.

## Discussion

The recent political debate has focused on the incidence and amount of impact of the tax cut lapse on small business owners. Previous research suggests that the tax cut lapse could have positive and negative impacts on small business growth and new business ventures by entrepreneurs. This study examines which small businesses are most likely to be impacted with special attention on small business owning households with more than one small business. This analysis confirms that a disproportionate share of the impact is borne by households owning small businesses, especially older and larger small businesses engaged in the service industry.

This study examines those households owning and managing small businesses, rather than households filing IRS Schedules E, F and C. The number of small businesses varies wildly across the analyses employed to examine the impact of the Bush tax cuts from the 37 million individuals filing an IRS Schedule E, F or C to the 19 million households with some small business ownership to the 14 million households owning and managing a small business. The population could be further reduced to less than 9 million households owning and managing a small business which hires employees. The population identified in this study examines those small business households, where the ownership and management of the small business is important to the financial stability of the household. This population of households owning small businesses will be impacted by the lapse in the Bush tax cuts assuming that taxes paid by these households are based on the household income estimates provided in the SCF. In addition, further research is needed to address the impact of the tax lapse on the consumption or savings behavior of the household.

Utilizing other secondary results would suggest the impact of the tax cut lapse would largely be borne by the household (or family) in changes in consumption and to a lesser degree by the business in changes in savings and investment. Unfortunately, this research is unable to determine what consumption or what savings and investing would be impacted in these high income households. If the tax cut lapse resulted in the family deciding to reduce their consumption spending by the entire amount of the tax increase, then savings and investment would not be impacted. If the tax cut lapse resulted in the family deciding to keep consumption spending constant and reduce savings by the entire amount then savings and investment would certainly be impacted.

This research does raise one important concern: Households owning multiple small business, those most likely to create jobs, are more likely than other small business owners to be impacted by the tax cut lapse. Among these households owning multiple small businesses, this study would suggest that older and larger firms are most at risk, simply because they are the high income households in the sample. However, it's interesting to note that only the oldest (20 years or older) and largest (10 employees or more) small businesses have a higher probability of being impacted than other small businesses. All other business characteristics were not statistically significant in identifying high income business owning households.

What types of policy prescriptions are needed to help this select (older and larger) group of small business owning households? They comprise only 1.5% of small business owning households (about 200,000 households of the 14.4 million households owning small businesses households), but they are important contributors to job creation and GDP growth in the US economy. When considering the ambiguous results of previous research on the impact of tax policy on entrepreneurship and small business growth and differential impacts on consumption, savings and investing, it's not possible to generate any firm estimates of the aggregate impact on small business households, however this research is an important step forward in identifying those small businesses most likely to be impacted.

So what – This study utilizes the Survey of Consumer Finances to examine households owning small businesses and assesses the impact of the proposed tax cut lapse on these households. While these data enable us to examine the incidence of the tax cut lapse by identifying high income households, they don't enable us to examine the behavior of these households in reallocating their financial resources between consumption and savings/investing. The results have important policy implications because they help policy makers identify those types of businesses most likely to be impacted. In this instance, the focus is on older and larger small businesses where the household owns more than one small business. While these aren't the only small businesses impacted, they are perhaps the most important because of their potential to create jobs and contribute to growth in GDP.

This political debate has progressed with many bold statements about the impact on small business owners without solid empirical evidence to support those positions. The most widely utilized evidence was provided by the Tax Policy Center (TPC), which estimated the percentage of "tax units with small business income" in each tax bracket. An examination of households yields substantially different descriptive results when allocating small business to each of the tax brackets. TPC suggests that about 3% of units with small business income are impacted, while this study suggest that about 12% of households owning a small business are impacted (please note – the units of analysis are substantially different). Perhaps, the most important conclusions from the TPC and this study are

that some small businesses will be impacted with a disproportionate share of the impact borne by the gazelles, the older and larger small businesses. While arguably the impacts may be relatively small, the impact is centered on a very important set of small businesses.

Further analysis of the impact of the tax cut lapse is constrained by the access to data households owning small businesses. Small business owners are unique among households because they realize the tax impacts of a supplier, facing higher costs and lower consumer demand for their products, and a consumer with less income. While the SCF provides high quality cross sectional data on a limited sample, panel data on a representative sample of households owning small business is needed to carefully assess the impact of tax policy and other shocks to the financial stability of households owning small businesses.

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