Both the Trump administration and House Republicans have proposed to cut the tax rate on income of passthrough businesses—a proposal that they repeatedly refer to as a tax cut for small businesses.¹ But in reality, this tax cut would create a new loophole for some of America’s wealthiest business owners, including President Donald Trump.

A so-called small-business tax cut would only benefit the wealthy

Their proposals would cut the top tax rates on income from passthrough businesses. Passthroughs are businesses that do not pay the corporate income tax.² They include S corporations; partnerships; limited liability companies, or LLCs; and sole proprietors. The income of these businesses is “passed through” to the owners and taxed at regular individual income tax rates, which range from 10 percent for people with a modest amount of taxable income to 39.6 percent for those with very high incomes.³

While Trump and House Republicans describe their proposal as a tax cut for small businesses, the biggest beneficiaries are anything but small businesses. Some of the most profitable and largest companies in the United States are organized as passthroughs, including hedge funds and other financial firms, lobbying firms, and law firms. In fact, many people would be surprised to learn that large companies such as Bechtel and the Trump Organization are also passthrough businesses.⁴ The largest accounting firms, such as PricewaterhouseCoopers, Ernst & Young, and Deloitte, as well as the largest global law firms, are as well.

It is mainly the owners of these really big passthroughs, which make the majority of all passthrough business income,⁵ that would benefit from the proposed cut in the top passthrough business income tax rate.
Many small businesses would get little or nothing from a cut in the passthrough tax rate.

Cutting the top tax rate for passthrough businesses from 39.5 percent to 15 percent (as Trump has proposed) or 25 percent (as the House GOP has proposed) would only benefit the comparatively small number of large passthrough businesses that currently pay higher tax rates. But 86 percent of passthrough businesses fall in the 25 percent bracket or lower, which means they would not benefit at all from cutting the top tax rate to 25 percent. In fact, two-thirds of passthrough businesses are in the 15 percent bracket or lower and thus would not benefit from either proposal.

The Tax Policy Center has estimated the cost of this windfall for wealthy business owners and has shown just how skewed it is to the very top of the income ladder:

- Share of the tax cut that goes to millionaires: 68 percent under the Trump plan and 79 percent under the House GOP plan
- Share of the tax cut that goes to taxpayers with annual incomes less than $200,000: 0.8 percent under the Trump plan and less than 2.9 percent under the House GOP plan
- Average tax cut for millionaires: $114,000 under the Trump plan and $49,000 under the House GOP plan

Passthrough businesses already pay lower average tax rates than traditional corporations.

Some policymakers have argued that cutting the top passthrough rate is necessary to provide “parity” with C corporations. In fact, passthrough businesses today are taxed more favorably than C corporations.
Historically, S corporations and partnerships were created for smaller, simpler forms of business. But cuts to the individual tax rates in the Tax Reform Act of 1986 combined with more lenient legal rules for passthroughs across the 50 states led an increasing number of businesses to shift to LLC and S corporation form. These companies can now enjoy limited liability for their owners, just as traditional, or C, corporations do, and have up to 100 unrelated shareholders or an unlimited number of partners, while not paying corporate income tax. Overall, the average effective tax rate for passthrough businesses—the percentage of their income that they actually pay in taxes, taking into account both business-level and owner-level taxes—is lower than for C corporations.

Lost revenue from the Trump loophole would threaten programs and investments that ensure economic opportunity for all Americans, including small-business owners.

The Trump loophole would reduce federal revenue by $1.4 trillion over the next 10 years, according to the Tax Policy Center; when taking into account that business owners would recharacterize some of their wage and salary income to exploit the new loophole, the loophole would cost $2 trillion. The House GOP passthrough tax cut would cost $572 billion over 10 years—or $664 billion, taking into account the recharacterization of income.

In their budgets, Trump and the House Republicans plan to pay for the Trump loophole and other tax cuts for the wealthy with cuts to programs that help ensure an economy that works for all, including small-business owners. For example, the Trump budget released in May would cut domestic programs (so-called nondefense discretionary programs) even further than they were cut under the automatic, across-the-board “sequestration” cuts. These funds go to investments in education, job training, basic research, and infrastructure—which provide a foundation for economic growth and support domestic businesses.

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7 Ibid.


