Flow-Through Business Income as a Share of AGI

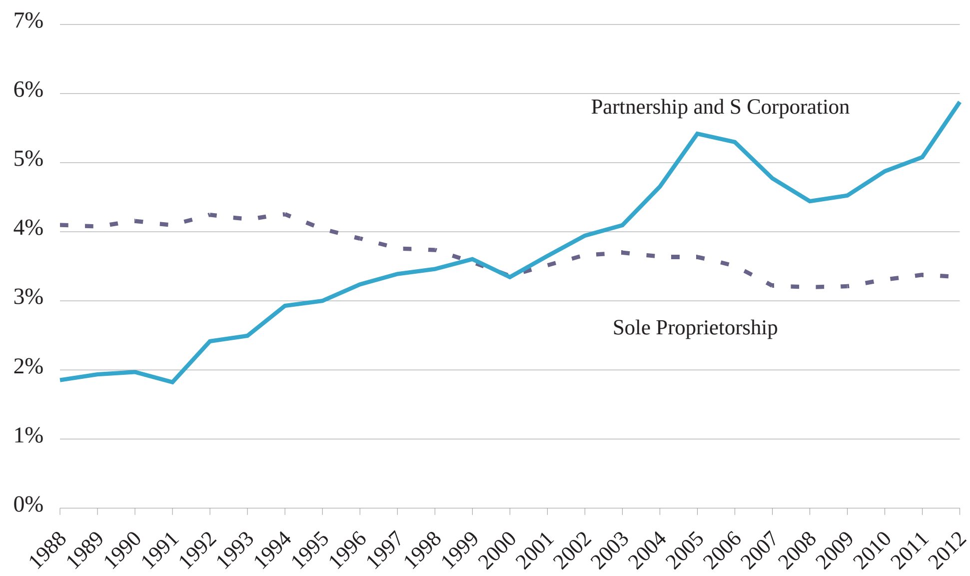
By Joseph Rosenberg

More than 90 percent of businesses, representing more than one-third of all business activity, in the United States are structured as flow-through entities — businesses that do not pay the corporate income tax, but rather pass profits through to owners who pay tax under the individual income tax. Over the past two decades, the importance of flow-through businesses — partnerships and S corporations in particular — has grown dramatically. In 2012 net income from sole proprietorships, partnerships, and S corporations totaled nearly $840 billion and accounted for more than 9 percent of total adjusted gross income reported on individual income tax returns.

Sole proprietor income (reported on Schedule C) declined gradually as a percentage of AGI beginning in the mid-1990s, from 4 percent down to just over 3 percent. In 2012, 23 million returns reported net income of roughly $300 billion or 3.3 percent of AGI.

In contrast, income from partnerships and S corporations has more than tripled as a share of AGI since the late 1980s. Following the Tax Reform Act of 1986, partnership and S corporation income accounted for 2 percent of AGI. Beginning in 1992, that share increased sharply, reaching 5.4 percent by 2005. Following a drop associated with the Great Recession, partnership and S corporation income again rose as a percentage of AGI, reaching 5.9 percent in 2012 (the most recent year IRS data are available). In 2012, 8.3 million returns reported $535 billion in net income from those sources.

Flow-Through Business Income as a Percentage of Adjusted Gross Income, 1988-2012



Source: IRS, Statistics of Income Division, "Individual Complete Report," Table 1.4, 1988-2012.