



TCJA and Organizational Form Changes

Erin Henry

University of Memphis



Agenda

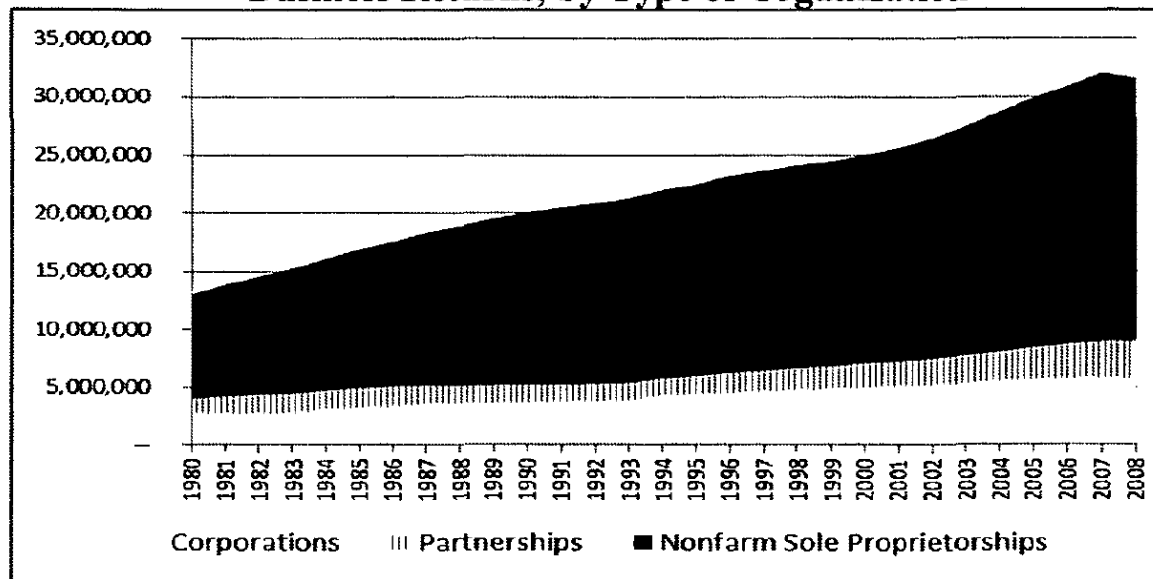
- **Tax Incentives and Organizational Form Choice**
 - Henry, Plesko and Utke (2018) framework
 - TRA 86 versus TCJA
- **Anecdotal Evidence**
- **Implications for SOI**

Tax Incentives and Organizational Form Choice



- TRA 86 inverted the top individual and corporate statutory tax rates

Figure 1
Business Returns, by Type of Organization



Data source: SOI Tax Stats - Integrated Business Data (<http://www.irs.gov/taxstats/bustaxstats/article/0,,id=152029,00.html>)

Tax Incentives and Organizational Form Choice



- TCJA substantially lowered the corporate tax rate and now it's below the top individual statutory tax rate.
- *Will there be a widespread shift back to the corporate form??*



Tax Incentives and Organizational Form Choice

- Simple model of organizational form choice:

$$(1-\tau_P) > (1-\tau_C)(1-\tau_E)$$

After-tax
return of
pass-through
entity

After-tax
return of
corporate
entity

Post TRA 86	72%	48%
Post TCJA	63%	63.2%

Henry, Plesko and Utke (2018)

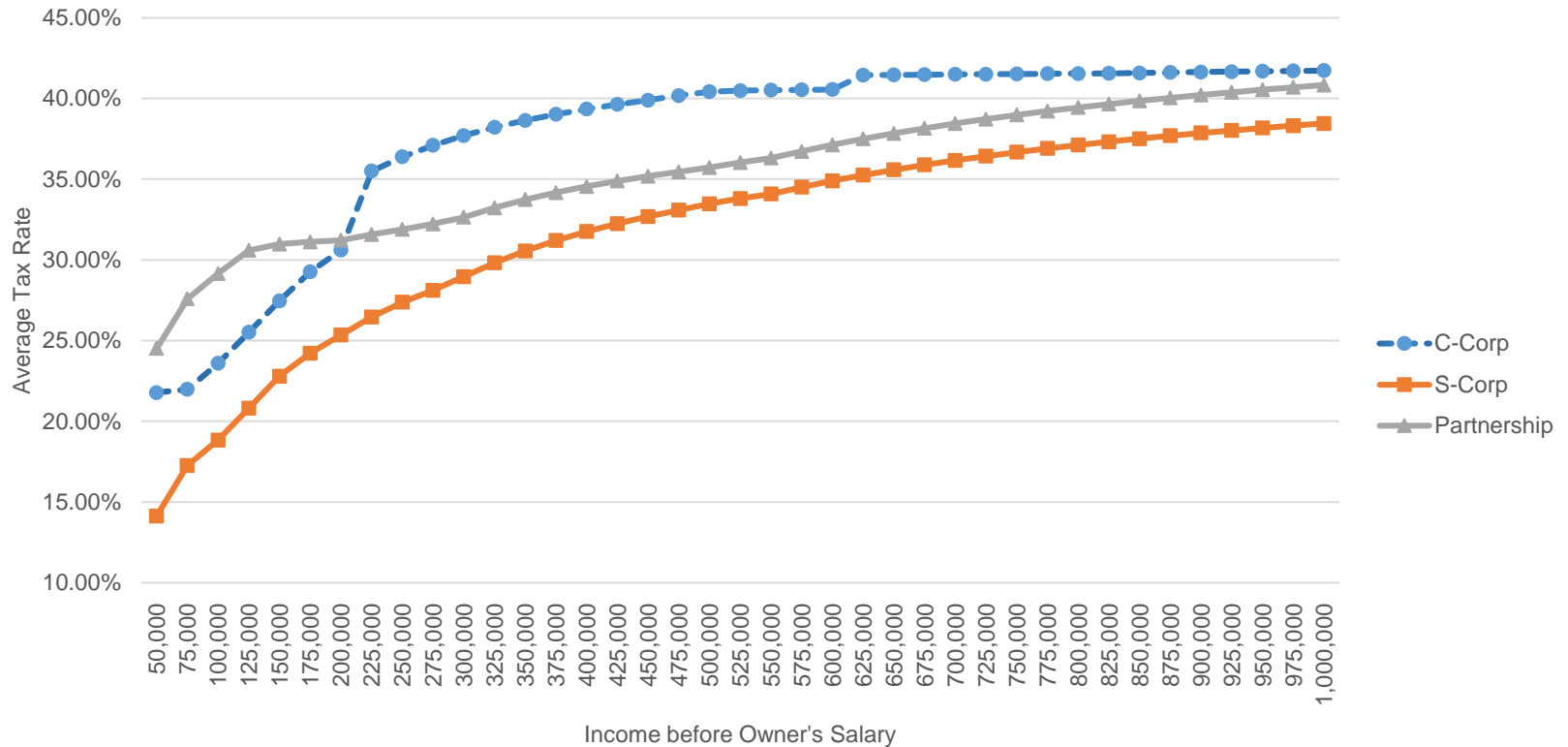


- Includes the effects of varying tax rates on methods of distributions to shareholder-employees:
 - Salary – self-employment tax rate
 - Dividends/Retained Earnings – preferential rates

Tax Rates across Organizational Forms: Pre-TCJA



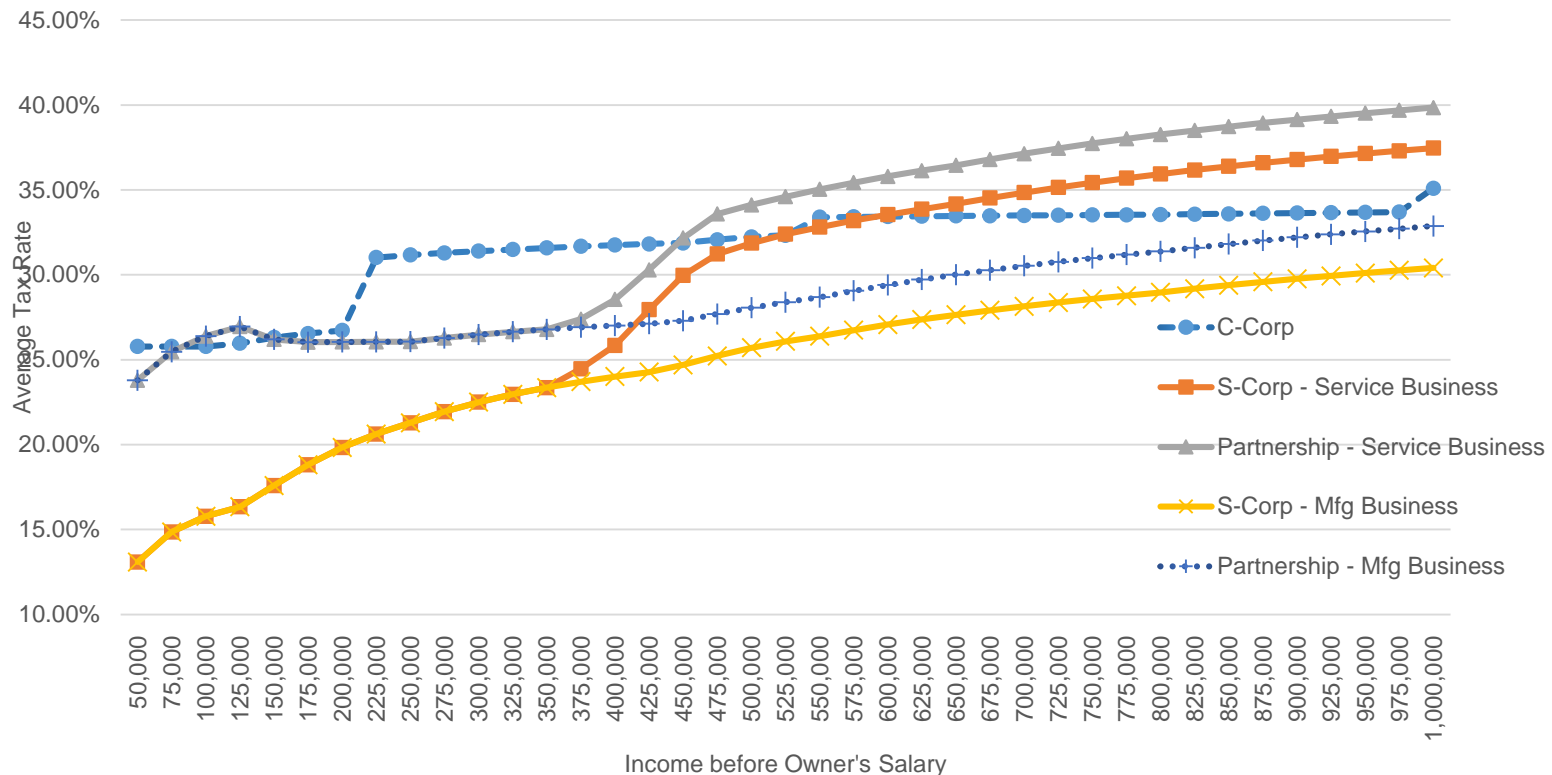
Figure 4 Panel A
Average Tax Rates: Pre-TCJA by Organizational Form



Tax Rates across Organizational Forms: Post-TCJA



Figure 4 Panel B
Average Tax Rates: Post-TCJA by Organizational Form and Type of Business



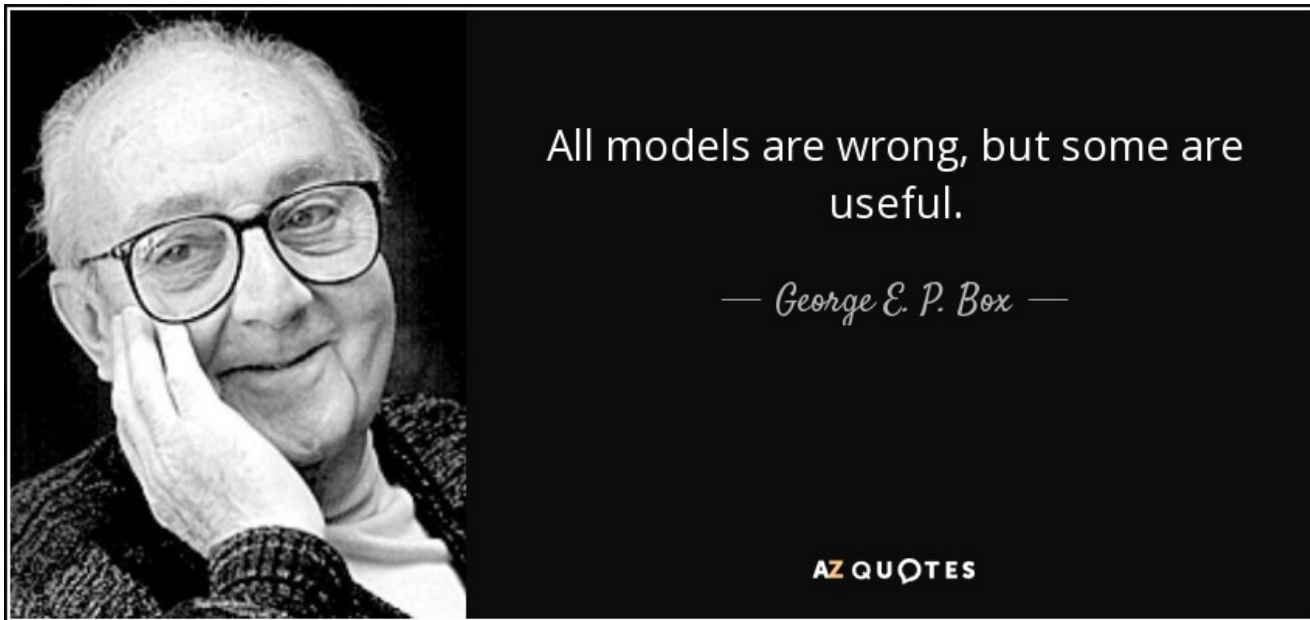


Anecdotal Evidence

- Be patient (in contrast to response to TRA86)
 - Uncertainty with respect to bill's longevity and interpretation of its provisions
- Many individual-specific circumstances are important in the decision (KPMG, BDO)
- Non-tax costs may become important (in contrast to response to TRA86)
 - Ares Management LP and KKR & Co LP conversions

What we think.

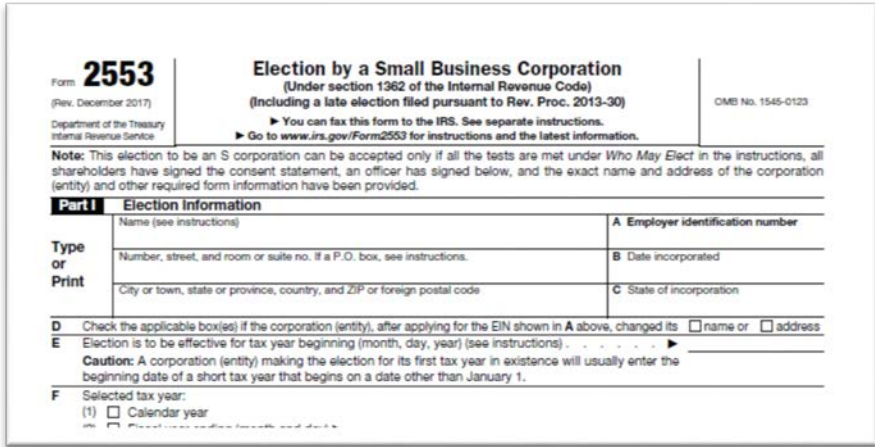
- The organizational form response to TCJA will likely be less drastic than TRA 86.



Implications of Organizational Form Changes for SOI



- When entities change organizational form, where in the SOI do they go?
 - Advantage of TRA86 = switches largely remained within the corporation file (C to S corp switches)
- Our analyses suggest that S corps are preferred in many scenarios.



Form **2553**
(Rev. December 2017)
Department of the Treasury
Internal Revenue Service

Election by a Small Business Corporation
(Under section 1362 of the Internal Revenue Code)
(Including a late election filed pursuant to Rev. Proc. 2013-30)

CMB No. 1545-0123

▶ You can fax this form to the IRS. See separate instructions.
▶ Go to www.irs.gov/Form2553 for instructions and the latest information.

Note: This election to be an S corporation can be accepted only if all the tests are met under *Who May Elect* in the instructions, all shareholders have signed the consent statement, an officer has signed below, and the exact name and address of the corporation (entity) and other required form information have been provided.

Part I Election Information

Name (see instructions)	A Employer identification number
Type or Print	B Date incorporated
Number, street, and room or suite no., if a P.O. box, see instructions.	C State of incorporation
City or town, state or province, country, and ZIP or foreign postal code	

D Check the applicable box(es) if the corporation (entity), after applying for the EIN shown in A above, changed its name or address.

E Election is to be effective for tax year beginning (month, day, year) (see instructions) ▶

Caution: A corporation (entity) making the election for its first tax year in existence will usually enter the beginning date of a short tax year that begins on a date other than January 1.

F Selected tax year:
(1) Calendar year
 Fiscal year beginning on month and day

Implications of Organizational Form Changes for SOI



- When entities change organizational form, where in the SOI do they go?
 - What if major shift from C Corp to LLCs?
 - Liquidation under §336.
 - Likely change in EIN.
 - What if major shift from LLCs to C Corps?
 - “Check the box” elections on Form 8832
- **CHALLENGE:** Maintaining a “business” panel that tracks the same entities over time (e.g., to understand effects of changing org. form)



THANK YOU