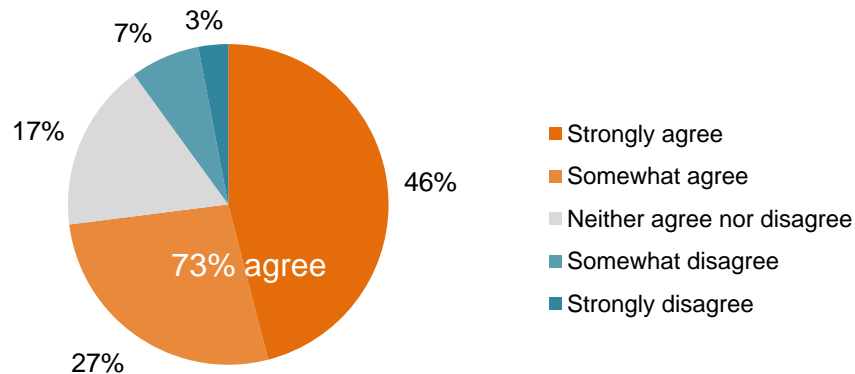


Fostering a Level Playing Field - The Small Business Case for Equitable Tax Reform

Small businesses have long represented the underpinning of a diverse and thriving economy, but for too long, our nation’s tax system has benefited the largest businesses – leaving small business owners with an inequitable tax burden. Small Business Majority [research](#) has revealed that over two-thirds (73%) of small businesses agreed that the current tax system favors big businesses over their small business.¹ Rather than continuing to give tax breaks to big business, an equitable tax system that will help all entrepreneurs—from the Main Street restaurants and independent retailers to the solo-entrepreneur just getting their business off the ground – is an essential component of fostering a competitive marketplace.

Small business owners agree current tax system favors big business over small businesses



One way to support a thriving small business ecosystem is to review and address inequities in the existing tax code – a critical component to that debate centers around the expiring 20% pass-through deduction (otherwise known as the Section 199A business deduction) implemented in 2017.

What is the Section 199A Qualified Business Income Deduction?

The Section 199A Qualified Business Income (QBI) Deduction was enacted through the 2017 Tax Cuts and Jobs Act, (PL 117-97) which allows pass-through entities to deduct up to 20% of their eligible, pass-through business income from their federal taxes. Unlike corporate profits, which are taxed at the entity and shareholder level, pass-through entities are only taxed once at the owner level. Pass-through entities, which include sole proprietorships, partnerships, LLCs, and S-Corporations, make up the vast majority (95%) of all small businesses in the U.S.

The smallest Main Street businesses aren’t seeing the benefits of 199A

While the creation of the Section 199A deduction was touted as a much-needed tax relief program for America’s small businesses, the data show that the distribution of this tax benefit is heavily skewed towards large well-resourced firms as opposed to your typical Main Street small businesses.

- Approximately 95% of small businesses (primarily S-Corporations and partnerships) pass their profits and losses through to their owners, according to 2022 Tax Policy Center data. However, while only 4.5% of businesses have pass-through income taxed in the top two brackets, a disproportionate 69.2% of all pass-through income is earned by those few business owners in these two rarified brackets.²

- Concentration of pass-through income at the top has resulted in the concentration of deductions among higher earning individuals and businesses. The financial benefit to a pass-through entity making \$500,000 is 20 times the benefit to a business making \$75,000. This leaves America’s smallest businesses and self-employed entrepreneurs, who make an average annual profit of just over \$33,000, left behind. While the wealthiest passthrough entities claimed an average deduction of over \$1 million in 2021, claimants with adjusted gross incomes (AGI) below \$100,000 took home an average deduction of just \$1,997.³
- Finally, the current tax structure also incentivizes wealthy individuals to classify their income from wages and salaries as pass-through income since pass-through income is taxed at a lower rate than labor income.⁴ This loophole further exacerbates the disparity that honest, small businesses face when trying to leverage tax deductions for their business.

Congress should consider and enact a standard bottom-up tax deduction for small businesses

Looking ahead, we face a timely opportunity to revisit the tax code to ensure it’s working for the small businesses that desperately need relief. The year 2025 presents a golden opportunity as Section 199A deduction is set to expire. The expiration of this provision, alongside others, presents a critical opportunity for impactful, bottom-up reform that can have a significant, direct benefit to small businesses and self-employed individuals, as opposed to larger businesses.



- To ensure tax relief is reaching America’s small businesses, Small Business Majority proposes **replacing the 199A deduction with a bottom-up, small business standard deduction** of their first \$25,000 of Qualifying Business Income (QBI).
- This **bottom-up approach** will allow the vast majority of small businesses, primarily the smallest businesses with the thinnest margins, to benefit rather than a select number of wealthy businesses.
- This deduction should be accompanied by a **phase-out for business owners with \$400,000+** in income to ensure it benefits the entities most in need.

We encourage Congress to consider this proposal, which would provide simplified, and streamlined tax relief to millions of small businesses, giving them the ability to save and invest back into their business, create jobs, and grow their enterprises.

¹ “Small Businesses Share Views on Proposed Tax Reforms, Workforce Shortages,” Small Business Majority, 2021, <https://smallbusinessmajority.org/our-research/small-businesses-views-on-tax-reforms-workforce-shortages>

² “Sources of Flow-Through Business Income by Statutory Marginal Tax Rate; Current Law, 2022,” Tax Policy Center, 2023, <https://www.taxpolicycenter.org/model-estimates/distribution-business-income-february-2023/t23-0028-sources-flow-through-business>

³ “The 2017 Tax Bill’s Pass-Through Deduction Largely Favors the Wealthy and Encourages Gaming of the Tax Code,” Center for American Progress, 2024, [The 2017 Tax Bill’s Pass-Through Deduction Largely Favors the Wealthy and Encourages Gaming of the Tax Code - Center for American Progress](https://www.americanprogressaction.org/issue/economic-justice/2024/02/2017-tax-bill-pass-through-deduction-largely-favors-the-wealthy-and-encourages-gaming-of-the-tax-code/)

⁴ “The Pass-Through Deduction Is Tilted Heavily to the Wealthy, Is Costly, and Should Expire as Scheduled,” Center on Budget and Policy Priorities, 2023 <https://www.cbpp.org/research/federal-tax/the-pass-through-deduction-is-tilted-heavily-to-the-wealthy-is-costly-and>