The Tax Law Center NYU LAW

THE HAMILTON PROJECT

Toward a uniform business tax system: Examining proposals to tax large pass-through entities as corporations

Miles Johnson, Thalia T. Spinrad, Kathleen Bryant, and Chye-Ching Huang

JUNE 2026

ACKNOWLEDGMENTS

The authors are grateful to participants in a March 2026 authors' conference organized by The Hamilton Project for their generative feedback on an earlier draft, as well as to numerous additional academics, practitioners, and experts for their thoughtful feedback. Tia Cole, of The Hamilton Project, provided excellent research assistance. Thanks also to the rest of the Hamilton Project team for their thoughtful guidance on the paper.

MISSION STATEMENT

The Hamilton Project seeks to advance America's promise of opportunity, prosperity, and growth.

We believe that today's increasingly competitive global economy demands public policy ideas commensurate with the challenges of the 21st century. The Project's economic strategy reflects a judgment that long-term prosperity is best achieved by fostering economic growth and broad participation in that growth, by enhancing individual economic security, and by embracing a role for effective government in making needed public investments.

Our strategy calls for combining public investment, a secure social safety net, and fiscal discipline. In that framework, the Project puts forward innovative proposals from leading economic thinkers—based on credible evidence and experience, not ideology or doctrine—to introduce new and effective policy options into the national debate.

The Project is named after Alexander Hamilton, the nation's first Treasury secretary, who laid the foundation for the modern American economy. Hamilton stood for sound fiscal policy, believed that broad-based opportunity for advancement would drive American economic growth, and recognized that "prudent aids and encouragements on the part of government" are necessary to enhance and guide market forces. The guiding principles of the Project remain consistent with these views.

THE HAMILTON PROJECT

THE HAMILTON PROJECT

Toward a uniform business tax system: Examining proposals to tax large pass-through entities as corporations

Miles Johnson
Senior Attorney Advisor, Tax Law Center at NYU Law

Thalia T. Spinrad
Attorney Advisor, Tax Law Center at NYU Law

Kathleen Bryant
Policy Advisor at the Tax Law Center at NYU Law

Chye-Ching Huang
Executive Director, Tax Law Center at NYU Law

June 2026

BROOKINGS

Abstract

The U.S. tax system raises insufficient revenue to meet national needs. The erosion of taxes on business income, including as a result of both the increasing use of pass-through entities and the growth in size and complexity of such entities, has been a significant driver of these revenue losses. Furthermore, applying pass-through taxation to an increasing number of complex arrangements has created substantial challenges for tax administration, compliance, and enforcement. This paper examines an approach that many policymakers have offered to address these issues: requiring large or complex pass-through entities to pay federal income tax at the entity level, as corporations do. This paper outlines the challenges that the current system presents and the reasons such an approach has been attractive. It then develops and evaluates a concrete proposal to treat certain pass-through entities as corporations, examining how such a proposal could be constructed and implemented and its revenue and distributional impact. Revenue and distribution estimates have been provided by the Urban-Brookings Tax Policy Center.

Contents

1. Introduction

The U.S. tax system raises insufficient revenue to meet national needs.[1] This shortfall contributes to large (and growing) national deficits, increasing national debt, and underinvestment in programs that would address critical national challenges. In this context, the erosion of taxes on business income over recent decades deserves attention. This paper examines an approach to addressing this issue that has been discussed conceptually for many years: taxing more pass-through entities as corporations. The paper outlines the challenges presented by the current system and the reasons such an approach has been attractive. It then examines a specific proposal in detail, analyzing how an administrable transition could be structured, which challenges will be difficult to avoid, and which alternatives and variations are worth considering.

Broadly speaking, businesses are currently taxed either as corporations under subchapter C (C corporations) or as some type of pass-through entity. C corporations face an entity-level federal income tax at a rate of 21 percent, with an additional layer of tax imposed on their owners when income is distributed. Pass-through entities, such as partnerships, S corporations, and sole proprietorships, generally do not pay federal income tax at the entity level; rather, their income, or loss, passes through to their owners, who then report such income or loss on their own tax returns and pay the associated taxes. (See box 1.)

Under current tax law, a business has substantial flexibility to choose whether to organize as a C corporation or as a pass-through. The choice made is often based significantly on tax consequences. The entity type that achieves the lowest overall federal tax liability will vary based on policy (including differences between the corporate and individual rates) and the characteristics of the business and its owners. In many cases, however, businesses can achieve substantial tax savings on both business and labor income by choosing pass-through treatment.

If policymakers were designing a tax system from scratch, fiscal, economic, and tax administration considerations would generally favor more uniformity in tax treatment of business entities with similar characteristics, especially in the case of large and complex entities. However, current law provides significant optionality under which rules originally written with simple business arrangements in mind[2] are increasingly applied to very large and complex organizations that have features that, historically, have been associated with corporate treatment, such as limited liability for all owners.[3] As a result, pass-through tax rules designed to achieve logical results have become increasingly difficult to understand, apply, administer, and enforce. Negative consequences include foregone revenue; tax disparities, and therefore economic distortions, across various margins such as choice of legal entity and source and timing of financing and distributions; wasteful tax planning; and significant tax administration challenges that will only worsen with recent cuts to Internal Revenue Service (IRS) staffing and resources.

To address these issues, many analysts and lawmakers have suggested reforming how business entities are taxed. In particular, many have proposed requiring a subset of large or complex pass-through entities to pay federal income tax at the entity level, like C corporations do. Such a proposal could be implemented by requiring certain pass-through entities to be treated as C corporations or by levying a new pass-through entity tax on certain entities without changing their existing tax classifications.

However, the charge to tax large or complex pass-throughs such as corporations is not simple in practice, and existing proposals have generally been light on details. Accordingly, this analysis develops and evaluates a concrete proposal (the base proposal) that would require partnerships and S corporations with gross receipts above $25 million to be treated as C corporations. In doing so, the analysis addresses design and implementation questions such as how best to define and measure whether an entity is large, whether and how groups of entities should be aggregated for this purpose, how the entity-level tax should be calculated and imposed, how transition rules would work, and how taxpayer responses are likely to affect the analysis.

Examining the base proposal brings into focus many of the key design choices and challenges involved in making such an idea workable, including their revenue, distribution, economic, and tax administration effects and trade-offs. The analysis also accounts for the fact that policymakers are not designing a tax system from scratch and must therefore navigate a complex transition from the status quo to any reformed system.

The Urban-Brookings Tax Policy Center (TPC) provides revenue and distribution estimates, which are the first set of detailed estimates for a proposal to tax

BOX 1

Overview of current US business entity tax classifications

C corporations

- *How they are taxed.* C corporations currently pay tax on their income at a federal rate of 21 percent, and their shareholders pay additional shareholder-level income tax on such income when they receive distributions (i.e., dividends) or sell their stock.
- *Types of legal entities that can be taxed as C corporations.* State-law corporations (e.g., incorporated entities) are generally taxed as C corporations by default, but they can elect to be treated as S corporations instead if certain conditions are met (see below for more detail). Other types of state-law entities not treated as C corporations by default (such as LLCs, limited partnerships, and limited liability partnerships) may also elect to be taxed as C corporations under the check-the-box regulations.

S corporations (a type of pass-through entity)

- *How they are taxed.* S corporations generally do not pay federal income tax on their own income. Rather, the S corporation's income, losses, deductions, and credits are allocated to its shareholders, in proportion to stock ownership and the shareholder report; the owners pay tax on such items on their own tax returns.
- *Types of legal entities that can be taxed as S corporations.* Domestic corporations that have 100 or fewer shareholders, have only one class of stock, and meet other eligibility criteria may elect to be treated as S corporations instead of as C corporations. Other types of state-law entities (such as LLCs, limited partnerships, and limited liability partnerships) may also elect to be taxed as S corporations if they otherwise satisfy the S corporation qualifications.

Partnerships (a type of pass-through entity)

- *How they are taxed.* Partnerships generally do not pay federal income tax on their own income. Rather, the partnership's income, losses, deductions, and credits are allocated to its partners, who report and pay tax on such items on their own tax returns. Items are shared, economically and for tax purposes, according to the agreement of the partners (subject to complex allocation rules), but partnership tax rules generally provide substantial flexibility in allowing tax consequences to follow the partners' economic arrangement.
- *Types of legal entities that can be taxed as partnerships.* Generally, state-law entities other than state-law corporations (e.g., general partnerships, limited partnerships, LLCs, and limited liability partnerships) are treated as partnerships by default. Entities formed as corporations under state law are generally prevented from electing to be taxed as partnerships.

Sole proprietorships and disregarded entities

- *How they are taxed.* A sole proprietorship or disregarded entity (DRE) reflects business or other activity carried on directly by an owner, without a separate regarded entity for federal income tax purposes. Accordingly, there is no entity-level tax, and all income, losses, deductions, credits, or other items are reflected directly on the owner's income tax return.
- *Types of legal entities that can be taxed as sole proprietorships.* Many sole proprietorships operate under state law without the formation of any legal entity at all—the sole business owner simply operates the business directly. Other state-law unincorporated entities that would normally default to partnership treatment for federal income tax purposes (e.g., general partnerships, limited partnerships, LLCs, and limited liability partnerships) are disregarded (i.e., effectively taxed as sole proprietorships) for federal income tax purposes when they have only a single economic owner. These entities (e.g., a single-member LLC) are effectively ignored, and do not exist as separate (pass-through or corporate) entities, from a federal income tax perspective.

large pass-throughs as C corporations that account for the significant changes in tax law made by both the Tax Cuts and Jobs Act (TCJA) in 2017 and the One Big Beautiful Bill Act in 2025. TPC estimates that the base proposal would raise nearly $140 billion over 10 years and would raise more than $25 billion annually by 2035. And, if paired with an increase in the corporate rate (to 30 percent), the base proposal would raise nearly $470 billion over 10 years and more than $63 billion annually by 2035, in each case over and above what the corporate rate increase would raise on its own. The policies are complementary in that the base proposal would help bolster a corporate tax rate increase by guarding against the use of pass-through entities to avoid it.

The estimates also suggest that the base proposal reduces tax disparities because it raises revenue only to the extent that firms are indeed paying lower taxes

as pass-through entities than they would as C corporations. The base proposal is highly progressive: Once fully phased in, 94 percent of the tax increase would fall on the top 10 percent of the income distribution, with the vast majority of that (66 percent) concentrated in the top 1 percent. Moreover, the base proposal would affect only the largest 0.7 percent of pass-through entities while reaching nearly half (49 percent) of all pass-through net income. And because the base proposal would determine tax treatment based on an explicit size threshold, it would generally exclude small businesses.

While it presents significant transition and implementation challenges, taxing large pass-throughs as C corporations could also provide benefits for tax administration by moving entities out of administratively challenging pass-through tax regimes. But transitioning many complex businesses onto a new regime will require a tremendous amount of work, and great care should be paid to minimize unnecessary administrative burden. Accordingly, making such a proposal workable will require policymakers to give significant attention to many detailed and complicated elements of policy design, many of which are discussed below and in Appendix 2 (the Technical Appendix). Of particular note, strong aggregation rules will be needed, both to measure entity size accurately and to prevent the use of multiple commonly owned entities to avoid the rules in form but not substance. But sound fixes to existing aggregation rules are possible, and many of these fixes would have benefits outside of this proposal.

The paper also examines some alternatives to the base proposal, including setting different gross receipts thresholds, using thresholds other than gross receipts for determining which pass-throughs are subject to corporate tax, and adopting an alternative pass-through entity tax approach. The analysis concludes that, if policymakers are interested in imposing entity-level taxes on pass-through entities based on size, applying C corporation tax treatment to firms above a particular gross receipts threshold is likely the most feasible approach.

More broadly, the paper concludes that taxing certain large or complex pass-through entities as C corporations is worth keeping on the menu of options for business tax reform, particularly given that the political constraints on the next opportunity for reform are currently unknowable. The proposal examined here functions best and yields the most revenue when paired with increases in the corporate tax rate and other complementary fixes to the business tax base.

The paper thus focuses on building a blueprint for careful policy design and moving the discussion forward on an approach that has been attractive to policymakers for decades but needs considerable additional policy design work. The paper does not unreservedly endorse taxing large or complex pass-through entities as corporations, in part because fully evaluating such a proposal against other options for raising revenue depends on policy and political considerations that are beyond the scope of this analysis. However, the clear need for additional revenue and potential obstacles to other pass-through tax reforms means the proposal warrants further consideration and development.

2. The challenge

The significant increase in the use of pass-through entities over traditional corporations, and the increasing scale of many pass-through entities, has eroded federal tax revenue on both business and labor income. For business owners, choosing pass-through tax treatment often—though not always—means a lower total federal tax liability than choosing to be taxed as a C corporation.[4] And, while pass-through tax rules aim to achieve logical and reasonable results on the whole, their continued application to an increasing set of large and complex arrangements results in administrative and compliance problems, including a lack of tax enforcement, that contributes materially to the loss of tax revenue.

(a) The rise of pass-through entities

Over the past several decades, business and economic activities have moved increasingly into pass-through entities and away from C corporations. Figure 1a shows that, as between the three primary business entity tax classifications that are treated as separate entities from a federal income tax perspective (i.e., C corporation, partnership, S corporation—leaving out sole proprietorships and disregarded entities, or DREs), the number of pass-through entities has far exceeded the number of C corporations since the late 1980s. By 1996 the number of S corporations alone exceeded the number of C corporations. And by 2002 the number of partnerships alone had overtaken the number of C corporations. The number of pass-through entities has continued to grow faster than the number of C corporations in subsequent decades.

These shifts have been matched by a shift in the distribution of business income. As shown in figure 1b, the pass-through form now captures about 60 percent of total net income—a much higher share than in 1980, when pass-throughs captured only about a fifth of total net income. The increased use of partnerships and S corporations has driven most of that growth.

The growth of the pass-through sector seems to have been accelerated in part by a series of federal and state policy changes starting in the 1970s. Federal changes to corporate and individual tax rates over this period increased the attractiveness of pass-through entities relative to C corporations.[5] And states increasingly created new types of unincorporated business entities (such as limited liability companies, or LLCs) that offer various legal benefits and that largely default to pass-through treatment for federal income tax purposes.[6] It appears that state policy and federal income tax policy were largely uncoordinated, and federal income tax rules generally sought to adapt and keep up with new legal entities.

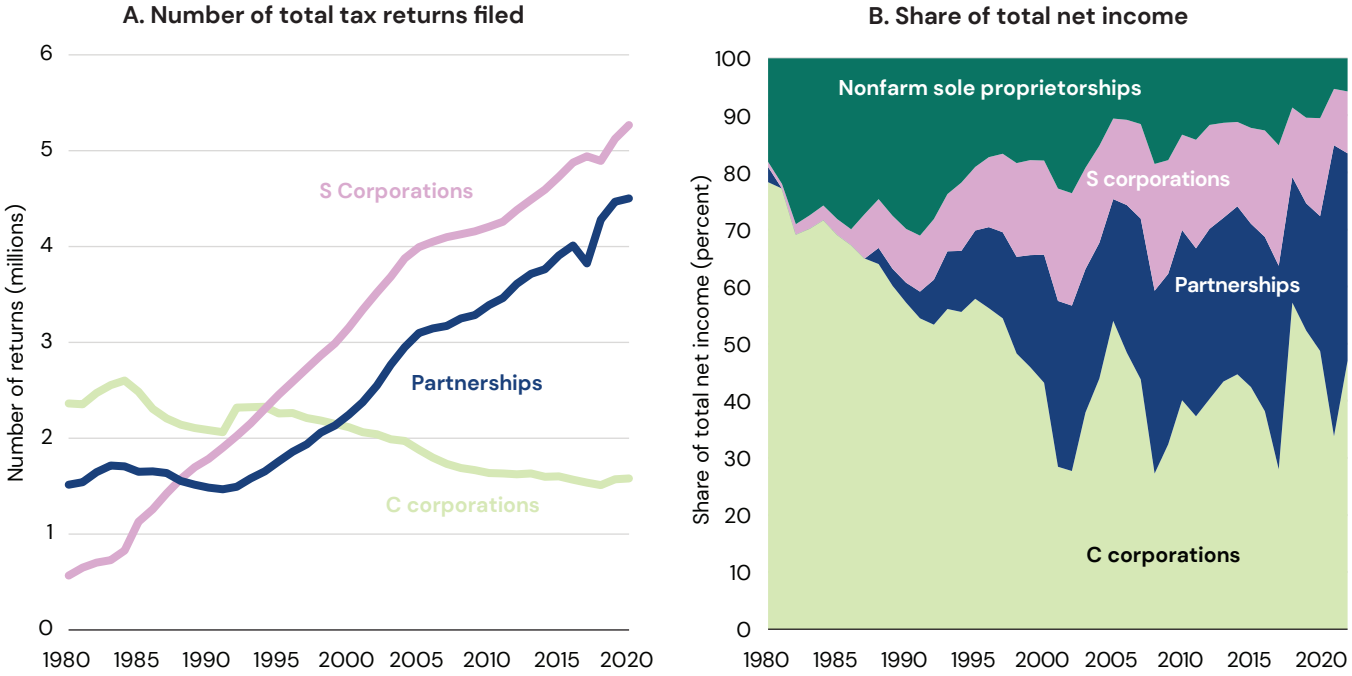
The check-the-box regulations, issued in 1996, also contributed to the overall shift toward pass-through entities by giving business owners greater certainty and flexibility when choosing their entity's federal income tax classification.[7] The check-the-box regulations allow eligible entities to choose whether they are taxed as corporations or as pass-throughs for federal purposes.[8] The rules in place prior to check-the-box had generally sought a more substance-based approach, treating entities as C corporations when they had certain corporate characteristics under a multi-factor test (even if those entities were not organized as corporations under state law).[9] This was, in part, an effort to ensure that federal income tax classification followed state legal entity classification. However, with some effort and complication, taxpayers were generally able to effectively elect corporate or pass-through treatment under these rules by complying with (or intentionally flunking) this multi-factor test. But by formalizing these taxpayer elections, the check-the-box rules thus made achieving the desired tax treatment much simpler and more certain.

(b) Revenue losses from the growth in pass-through entities

Corporate income is generally taxed twice,[10] while pass-through income is taxed only once at the owner level. For individuals, this means federal income tax is imposed on their pass-through business income once, at marginal individual tax rates up to 37 percent. Certain pass-through owners are also eligible for section 199A's qualified business income deduction, which lowers the top rate on their share of such income from 37 percent to 29.6 percent. As a result, the top rate for an individual's pass-through business income before section 199A (37 percent) is already lower than the overall effective tax rate that would apply to such income in a C corporation structure (39.8 percent), and the top rate that applies to the

FIGURE 1

Total tax returns and share of total net income, by entity type, 1980–2022



Source: Internal Revenue Service, n.d.; Joint Committee on Taxation (JCT) 2025.

Note: Panel A figure data is from Joint Committee on Taxation (JCT), Overview of the Federal Tax System as in Effect for 2025, JCX-28-25, September 5, 2025. Panel B figure data is from IRS, SOI Tax Stats Integrated business data, Table 1 (1980–2015) and IRS, Corporate Tax Returns (2016–2022).

individual's pass-through business income eligible for section 199A (29.6 percent) only widens this gap.

Aside from these general rate differentials, specific types of pass-through entities provide other unique tax advantages. (See the box 1 for a general overview of the differences between types of pass-through entities and how they are taxed.) For example, S corporation owners exploit a well-known loophole to avoid both the net investment income tax (NIIT) and employment taxes on what is effectively labor income.[11] Partnerships provide a broader range of tax benefits since they generally provide significant flexibility to structure transactions in a way that minimizes tax liability. For example, partnerships allow owners to move assets in and out of the business without triggering tax much more easily than other entities (both C corporations and other pass-throughs). They also allow partners significant flexibility in deciding how income, deductions, liabilities, and other tax items are shared, including through special allocations. These flexibilities often result in lower tax liabilities and can encourage aggressive structuring that is driven purely by minimization of the partners' overall tax liabilities.[12]

The type of entity that will deliver the lowest overall federal tax liability for a business and its owners depends on both policy (including the difference between the corporate and individual rates, and whether those rates change over time) and the specific characteristics of the entity and its owners. For example, after the TCJA lowered the corporate tax rate from 35 percent to 21 percent, the choice between corporate and pass-through treatment became a much closer call for many businesses, although, as shown in figure 1b, the share of business income flowing to pass-through entities was broadly similar in 2022 to what it was in the several years preceding the 2017 enactment of the TCJA.[13]

Use of the pass-through form also now extends to many large and complex organizations that have features traditionally associated with corporate treatment, such as centralized management, limited liability for all (rather than only some) equity owners, and public trading. Many large operating businesses now go public through a special structure (the Umbrella Partnership-C Corporation, or Up-C) designed to maintain pass-through treatment for the underlying operating business, at least for a significant period.[14]

Pass-through tax rules have struggled to keep up with these changes. Some rules are outdated and difficult to apply to real world structures, and others have become incredibly complex through piecemeal updates intended to address specific structures or strategies.[15] In particular, partnership tax rules have evolved into a network of varied and sometimes inconsistent

options that are difficult to administer and full of complexity and ambiguity, in certain cases facilitating aggressive tax planning.[16]

The result is that many businesses have been able to achieve significant tax savings by opting to use the pass-through form, which has taken a significant toll on federal tax revenues. Using 2011 data, Cooper et al. found, "The average federal income tax rate on U.S. pass-through business income is 19 percent, much lower than the average rate on traditional corporations. If pass-through activity had remained at 1980's low level, strong but straightforward assumptions imply that the 2011 average U.S. tax rate on total U.S. business income would have been 28 percent rather than 24 percent, and tax revenue would have been approximately $100 billion higher."[17] The TCJA's deep cut of the corporate tax rate from 35 percent to 21 percent—much larger than its cut to the top individual rate—reversed some of the tax advantages of the pass-through form. However, the TCJA's enactment of the section 199A deduction for certain pass-through income, as well as its tax preferences for certain categories of investment, has meant that pass-through income generally continues to be taxed at a significantly lower rate than C corporation income.[18]

The degree of flexibility found in partnerships—one of the hallmarks of partnerships[19]—also contributes to revenue loss. Tax rules that provide pass-through entities flexibility to achieve favorable tax treatment can facilitate and encourage legitimate business and economic activity, but they also cost the federal government significant tax revenue. As many have pointed out, much of this flexibility is found in the allocation rules, which are complex and sometimes vague, and that govern how partnerships allocate income and other tax items among owners.[20] One recent study estimated that the federal government lost $251 billion in revenue between 2011 and 2020 due to the flexibility found in current partnership allocation rules (relative to counterfactual scenarios where stricter rules were in place).[21]

(c) Tax administration challenges

Applying pass-through taxation to an increasing number of very complex arrangements has created substantial challenges for tax administration, compliance, and enforcement. The partnership tax rules generally seek to (1) give business owners wide latitude to write their economic deal, (2) impose one level of tax at the time income is earned, and (3) cause tax consequences to follow the owners' agreed economic arrangement. These are reasonable and logical goals in the abstract, and subchapter K (the provisions of the Internal Revenue Code that govern the tax treatment of partnerships) can often achieve these results. However, the subchapter K rules can also invite abuse, particularly in very complex arrangements[22] and especially because IRS enforcement and information-gathering capabilities have diminished.

Despite the increased prevalence of partnerships, it has become difficult to obtain some of the most basic information about them, including the number and identity of partnership owners. Research using IRS data has found that about 26 percent of partnership income could not be readily traced to known types of entities or individuals.[23]

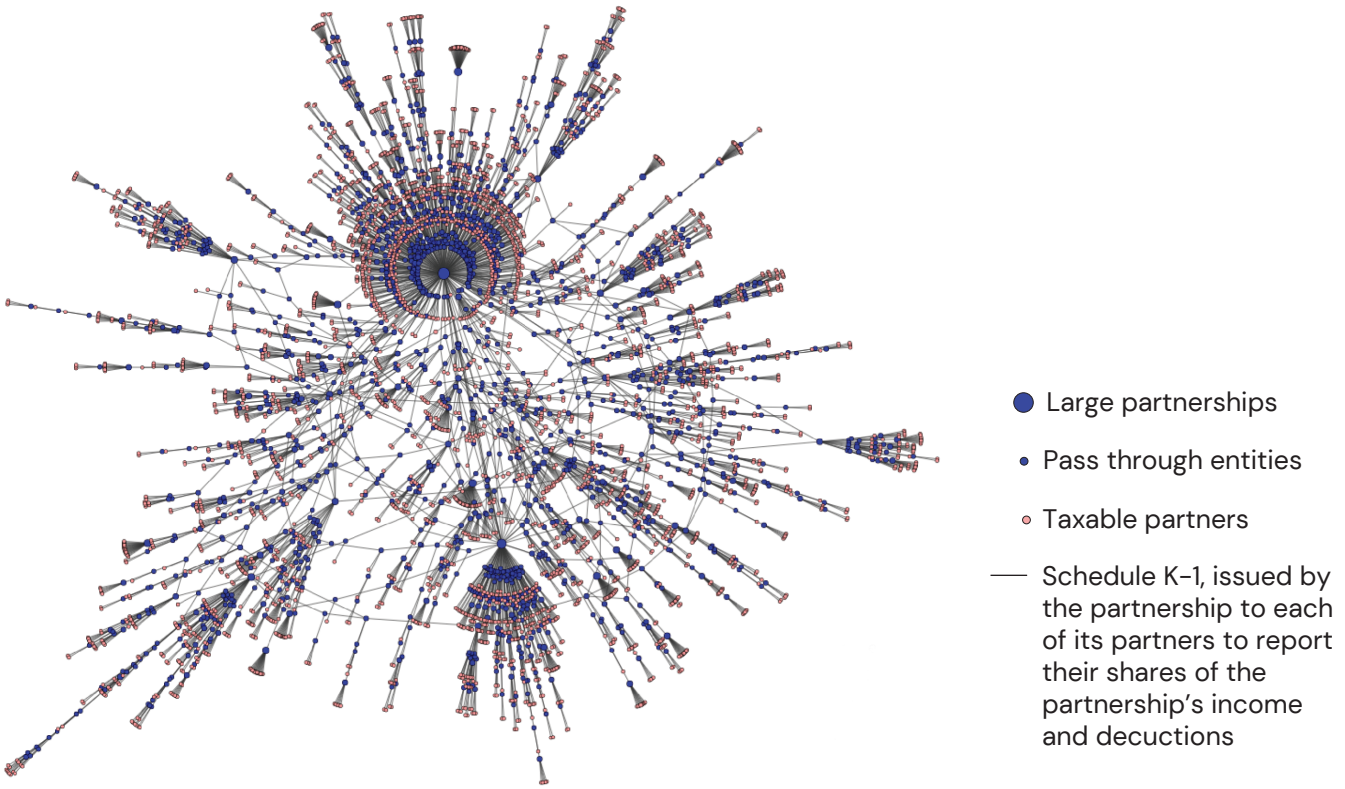
Part of the reason for these difficulties in collecting information about partnerships is that the laws governing partnership tax administration are weak in many ways. Although the network of interconnected entities has expanded, particularly in the investment fund world,[24] there is still little third-party reporting that allows the IRS to verify partnership income (and other tax attributes) independently. The reporting required with respect to partnership assets and ownership structures is limited and, in many cases, uninformative. Partnership tax reporting is also outdated and inconsistent, requiring significant information to be reported on nonuniform schedules, which increases the difficulty of deciphering partnership arrangements and tax positions from tax returns alone and thus increases the IRS's workload.[25]

Furthermore, interconnected partnerships can lead to very large and exceedingly complex structures. Complex networks can involve partnerships owned by chains of other entities (including other partnerships) and can even include circular ownership, where entity #1 owns an interest in entity #2, which in turn owns an interest in entity #1, inadvertently or intentionally creating an ownership loop. This occurs more commonly as separately managed and unrelated partnerships invest in, and transact with, each other in a complex market; many partnership networks do not consist of a single overall organization, business, or firm. Still, between 2002 and 2019 there was a staggering increase in the number of partnerships qualifying as large (i.e., $100 million or more in assets and 100 or more total partners) and complex (i.e., 20 or more tiers of ownership)—from 36 to more than 6,000 (figure 2).

The complexity and lack of clarity in many partnership structures makes it difficult for the IRS to audit them,[26] even though those same features tend to make partnerships major contributors to the "tax gap" (i.e., taxes owed legally but not paid). The IRS currently estimates that pass-through entities (including partnerships, S corporations, and some trusts and estates) contribute about $40 billion annually to the tax gap, though there is significant uncertainty in this estimate due to information gaps.[27] Nevertheless, only 0.1 percent of partnerships and S corporations were audited by the IRS in 2020—lower than the 0.7 percent audit

FIGURE 2

Complex network of partnerships in visual form



Source: Government Accountability Office 2023.

Note: Figure is from the Government Accountability Office's publication "Tax Enforcement: IRS Audit Processes Can Be Strengthened to Address a Growing Number of Large, Complex Partnerships, 2023."

rate for C corporations. Similarly, as of 2019 the IRS audit rate for large partnerships (defined as partnerships with more than $100 million in assets and more than 100 partners) had dropped to below 0.5 percent, far lower than the 5 percent audit rate for corporations of the same size ($100 million or more in assets).[28]

In sum, absent challenges in administration, there are compelling arguments for pass-through taxation. It allows tax liability to be based directly on individual owner capacity, it minimizes differential treatment based on formal distinctions (such as the use of equity or debt capitalization), and it theoretically reduces cross-border tax planning by causing tax to be based (at least in the U.S.) on owner characteristics that are difficult to change. However, the theory has become inconsistent with the practice; attempting to align taxation with owner-level characteristics becomes incredibly difficult to administer with respect to operations of significant size and complexity,[29] and the ability to mix and match pass-through and corporate treatment within specific organizations means that some of the benefits of a pure pass-through system go unrealized.[30]

(d) The wide range of approaches to pass-through tax reform

The rise in the number of pass-through entities, and the resulting revenue and tax administration challenges, have made tax policy experts increasingly concerned about the degree to which businesses can choose their own tax treatment, exploit the flexibility and complexity of existing rules, expend significant resources on complex tax planning, and engage in aggressive or unlawful tax minimization strategies. There is a wide spectrum of policy proposals that seek to address these issues by reforming how pass-through and other business entities are taxed, including the following:

Specific fixes to the pass-through (or broader business) tax base

Some proposals focus on fixing specific pass-through tax rules that pose the greatest need for clean-up and modernization or the greatest risk of abuse. The Tax Law Center and The Hamilton Project previously

published a report on many such options.[31] Reforms that close specific loopholes and gaps in the application of self-employment tax to labor income earned through pass-through entities, and proposals that would repeal or reform section 199A, also fit in this category, among many others.[32]

Reducing electivity

Some proposals would reduce the extent to which business entities can self-select among different tax classifications but would stop short of imposing a universal, or near-universal, system of business entity taxation.[33]

Fundamental business tax reform

Various proposals suggest larger reforms that would move toward a uniform taxation of all business entities. Certain of these proposals, sometimes referred to as integration proposals, would subject most or all businesses to either mandatory entity-level taxation or mandatory pass-through taxation.[34]

Proposals to tax only the largest or most-complex pass-through entities at the entity level

These proposals fit somewhere between the more-specific and the more-fundamental proposals summarized above. They would essentially turn off pass-through treatment for the largest or most-complex pass-through entities, either by requiring them to be taxed as C corporations or by creating some other mechanism to impose tax at the entity level. Section 3 examines the attractions and challenges of this approach.

3. Attractions and challenges of taxing large or complex pass-through entities as corporations

There is a long history of tax reform proposals and budget plans from across ideological lines that propose to tax a subset of pass-throughs at the entity level (see Appendix 1). Taxing large, complex, or corporate-like pass-through entities at the entity level is attractive because, in principle, it could have significant benefits.

(a) Revenue

In proposals that provide revenue estimates, the approach is typically estimated to raise anywhere from $100 billion to hundreds of billions over a decade (or up to tens of billions of dollars per year, amounting to up to about 0.1 percent of annual GDP). These estimates depend on corporate and individual tax rates and other features of then-existing tax law and policy. They are also sensitive to policy design choices.

(b) Distribution

Partnership and S corporation income is even more heavily concentrated at the top of the income distribution than income from corporate dividends. As of 2022, some 70 percent of partnership net income (less partnership net loss) and some 64 percent of S corporation net income (less S corporation net loss) flowed to filers with more than $1 million in adjusted gross income (AGI).[35] Only about 42 percent of corporate dividends accrued to the same group (figure 3).[36] Partnership and S corporation income is also a greater share of total income for high-income filers than it is for lower-income filers. In 2022, partnership net income (less partnership net loss) made up approximately 8 percent of total income for filers with more than $1 million of AGI, but less than 1 percent of total income for filers with less than $1 million of AGI.[37] Similarly, S corporation net income (less S corporation net loss) was approximately 16 percent of total income for filers with more than $1 million of AGI, but only 2 percent for filers with less than $1 million of AGI.[38] Thus, proposals that increase taxes on the income of large partnerships and S corporations have the potential to increase taxes for high-income filers with minimal effect on the tax liability of low- and middle-income filers.

Proposals to tax certain pass-throughs at the entity level can also be tailored, via the use of an explicit size threshold, to minimize tax increases on true small businesses.[39] This can help assuage concerns that small businesses face liquidity problems when their taxes are increased, even when the owners of those businesses are in the top 10 percent—or even the top 1 percent—of the income distribution.[40] This, of course, raises the question of how best to define and measure the terms "large" and "small." Some proposals may require some operating businesses that are small on a standalone basis to be considered as part of a larger group of related entities (to ensure that the tax cannot be avoided), with tax and administrative implications for those businesses. These nuances are explored below and in the Technical Appendix.[41]

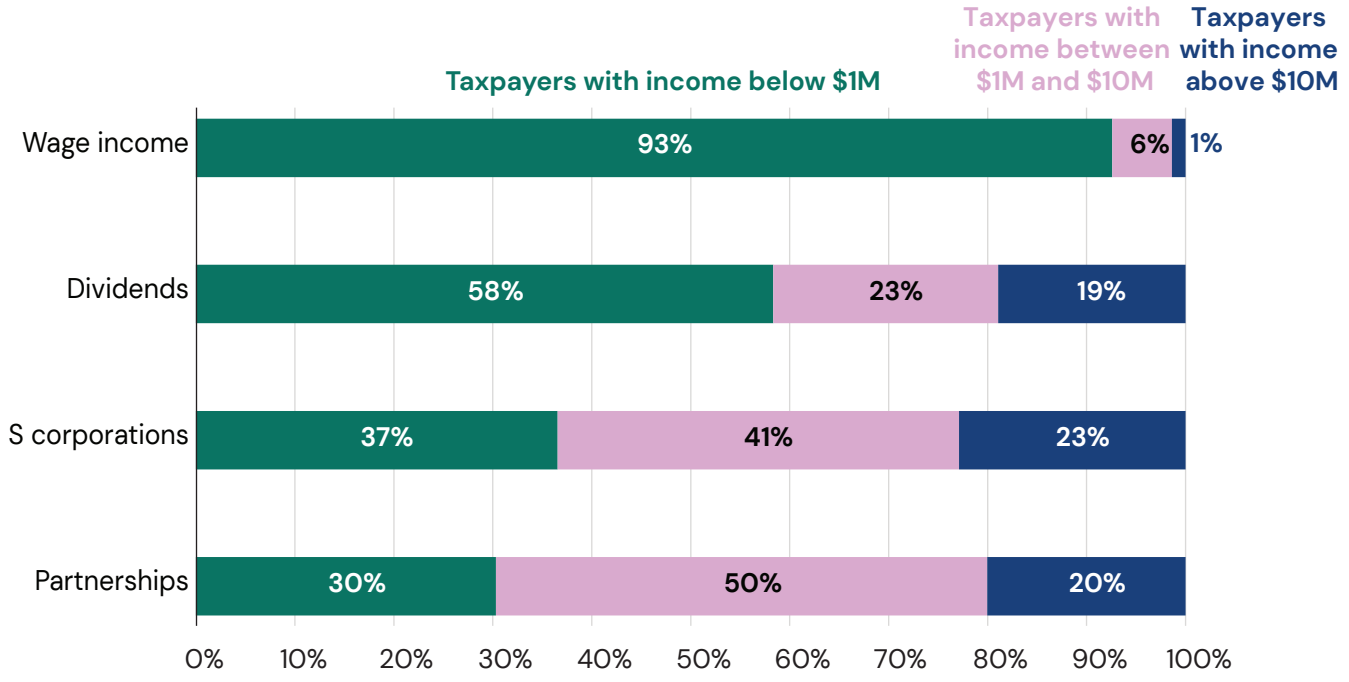
(c) Parity

Pass-through taxation has existed since the beginning of the income tax,[42] and it originally served as a relatively simple way to tax small groups of partners undertaking joint economic activity on an aggregate (rather than separate entity) basis.[43] But many large and complex pass-through entities today have most, if not all, of the hallmarks traditionally associated with separate entity (i.e., corporate) taxation, including centralized management, limited liability for all owners, and, in some cases, public trading of their equity interests.[44] This has raised the question of why pass-through income should be taxed differently (and in many cases more lightly) than the income of traditional corporations.

These considerations motivate many business tax proposals that seek to draw a clearer distinction between C corporations and pass-throughs based on their legal and substantive characteristics. Applying an entity-level tax to some large or complex pass-throughs is a rough-justice way to achieve this without taking on—and potentially getting bogged down in—a

FIGURE 3

Distribution of various types of income by adjusted gross income, 2022



Source: Internal Revenue Service 2022.

Note: Figure data are from IRS, SOI Tax Stats—Individual statistical tables by size of AGI for tax year 2022 (filing year 2023), at Table 1.4. 99.5 percent of taxpayers have income below $1 million, 0.48 percent of taxpayers have income between $1 million and $10 million, and 0.02 percent of taxpayers have income above $10 million. S corporation and partnership income is net income less net loss. Dividends includes ordinary and qualified dividend amounts. Wage income is calculated from Form W-2 wages.

THE HAMILTON PROJECT

The Tax Law Center NYU LAW

return to the entity classification rules that existed prior to the check-the-box rules or a much larger project to rewrite business taxation so that it more perfectly aligns tax treatment with substantive characteristics in every case.[45]

Taxing large or complex pass-throughs as corporations also has the advantage of automatically maintaining parity among such entities even as corporate and individual tax rates change. In recent tax debates, policymakers have sometimes argued for or against broader tax changes on the basis that they would reduce or increase disparities in the tax rates applicable to corporations relative to pass-through entities (or vice versa). If all large or complex pass-through entities were subject to the same tax treatment, many of these parity concerns would no longer constrain decisions about corporate and individual tax rates.

Notably, current law already applies corporate tax treatment to a narrow set of partnerships under section 7704, which treats most publicly traded partnerships as corporations. Current law excepts certain publicly traded partnerships from this treatment, although proposals, including a bipartisan legislative proposal from Max Baucus and Chuck Grassley (who were, at the time, the Senate Finance Committee chair and ranking member) have proposed to curtail or refine these exceptions.[46] Even without those exceptions, however, the scope of section 7704 would be limited.[47] Nonetheless, the provision is some precedent for treating a subset of pass-throughs as too much like corporations for partnership treatment.

(d) Reducing inefficient tax-induced economic distortions

Research has suggested that the incentive to use pass-through entities over C corporations due to their tax benefits may reduce access to public capital, thereby reducing investment and employment.[48] To the extent that these tax benefits are arbitrarily more accessible to some industries or businesses than others, they could also induce wasteful economic distortions in investment and ownership patterns across types of economic activity. As Martin A. Sullivan has put it,

> If some competitors in an industry are exempt from corporate tax and others are not, the tax treatment results in inefficient excess investment for the fortunate and inadequate levels

> of investment for everyone else. There is also inefficiency across industries. If the apple industry is filled with tax-favored investors and the potato industry is not, there are too many apples and too few potatoes.[49]

Thus, removing or shrinking the set of entities for whom the tax benefits of pass-through treatment are available could, all else equal, improve the allocation of economic resources. This has explicitly motivated several past proposals. For example, citing Goolsbee (2004), Mackie-Mason & Gordon (1997), and Gordon & MacKie-Mason (1994), the Obama administration's 2012 Framework for Business Tax Reform notes,

> (iii) Distorting the form of businesses. The ability of large pass-through entities to take advantage of preferential tax treatment has placed businesses organizing as C-corporations at a disadvantage. By allowing large pass-through entities preferential treatment, the tax code distorts choices of organizational form, which can lead to losses in economic efficiency; business managers should make choices about organizational form based on criteria other than tax treatment.[50]

Furthermore, requiring uniform C corporation treatment for large entities may be more attractive the more efficient the corporate tax is at raising revenue. There is a large literature about potential reforms that could make corporate taxation more efficient. Some recent research has additionally argued that cash flow taxes on businesses are a particularly efficient way to raise revenue and are best levied at the entity level.[51] In general, a business cash-flow tax (one that allows businesses to expense, or deduct, the cost of investments up front) raises revenue from only above-normal returns on investment, potentially minimizing investment disincentives.[52] However, a cash-flow tax achieves a zero tax rate on the normal return to investment only if investments are expensed at the same tax rate as the subsequent income from the investments is taxed. Pass-through income—because it is taxed directly at the pass-through owner level—may be subject to tax at different rates in different years, which could result in either negative or positive taxes on the normal returns to investment. Imposing corporate tax at a flat rate on all large businesses could go a significant way toward solving this problem.

(e) Tax administration advantages

As discussed above and elsewhere,[53] large and complex pass-through entities generate significant compliance and administrative challenges. It can be difficult for the IRS to understand their financial and economic arrangements, as well as the tax positions they take, based on existing information reporting.[54] Proposals that reform the tax treatment of large or complex pass-through entities can therefore reduce these compliance and administrative costs. As the Bush administration's 2005 President's Advisory Panel on Federal Tax Reform (Advisory Panel) explained,

> Requiring all large entities, including partnerships, to abide by the same business tax rules would provide fewer opportunities for tax shelters and less exploitation of loopholes. For example, a consistent treatment of income from large businesses would shrink opportunities to use a partnership structure to avoid taxes. Many recent tax shelters were designed to exploit the complicated partnership rules.[55]

Furthermore, requiring the largest and most complex partnerships to be taxed as C corporations, and thus carving them out of subchapter K, could address many of subchapter K's existing problems. The largest and most complex partnerships, as well as "internal" partnerships (i.e., those owned by members of a single related party group), raise some of the most difficult and high-dollar subchapter K issues. Taxing them as C corporations could help by confining existing partnership tax rules largely to smaller and simpler entities that better resemble the types of arrangements for which subchapter K was originally written.

Additionally, compared to proposals that would require a more comprehensive rewrite of business taxation, taxing large or complex pass-through entities at the entity level affects fewer businesses and may thus strike policymakers as more feasible. At the same time, the approach could complement or facilitate other meaningful reforms. For example, it could facilitate the simplification of partnership tax rules, since many of their complexities are less relevant to the types of smaller and simpler partnerships that would be left in subchapter K.[56] Indeed, several commentators have suggested a new, unified regime for these smaller pass-through entities that would meld certain features of subchapters S and K.[57] Similarly, others have proposed restricting pass-through treatment to smaller and simpler firms as part of a series of reforms that include both tax administration and enforcement changes to the pass-through tax base.[58]

These conceptual advantages must be weighed against the potential trade-offs and practical challenges of the proposal. As discussed further below, these include (1) complexity in basic design and implementation, including how to address avoidance; (2) significant transition challenges; (3) uncertainty from year to year; and (4) potential adverse impacts on domestic investment.[59]

4. The proposal

If the tax system was being designed from scratch today, revenue, equity, and tax administration considerations would support a more uniform, and less elective, treatment of business entities that have similar characteristics. Imposing entity-level tax on large or complex pass-throughs is one way to move closer to this result, which has been attractive to many policymakers. There are themes across proposals, including a desire to measure similarity based on size in order to carve out some subset of small businesses.[60] However, most prior proposals are out of date or have not been specific enough to allow policymakers to evaluate them against other options. In particular, proposals of this nature require a closer look to evaluate whether transition and ongoing implementation challenges can be adequately addressed.[61]

To fill that gap, this paper examines a concrete proposal to tax all large pass-through entities as C corporations. The proposal is similar in structure to many of the existing proposals summarized in Appendix 1, but it includes more-detailed discussion of, and recommendations regarding, many of the thorny implementation and transition issues policymakers would need to address. The intent is to enable policymakers to evaluate whether these implementation and transition challenges can be solved. Additionally, the paper provides and analyzes new revenue and distributional estimates from TPC. The Technical Appendix dives even deeper into many of the policy design and implementation details.

In general, the base proposal would require all large partnerships and S corporations—those with gross receipts exceeding $25 million—to be treated as C corporations for federal income tax purposes.[62] The overarching approach focuses on building on existing tax rules that already impose C corporation treatment on certain pass-through entities (e.g., publicly traded partnerships) as much as possible, and the size threshold tracks several of the proposals in Appendix 1.

(a) Key elements of the base proposal

Focusing on partnerships and S corporations

The base proposal would apply to partnerships and S corporations. It would not apply to certain specific types of entities or arrangements that are commonly thought of as pass-throughs, such as regulated investment companies (RICs), real estate investment trusts (REITs), and sole proprietorships. Additional considerations regarding this approach are discussed in Section 5, below.

Defining "large" and measuring size

Identifying and capturing only large pass-through entities requires defining which entities are large, and doing so in a way that tax rules can measure. For this purpose, the base proposal would use a $25 million gross receipts threshold. TPC's estimates index this $25 million threshold for inflation using the C-CPI (chained CPI).

Gross receipts would be averaged over a three-year period

A gross receipts test must not only set the dollar amount but also must establish the period over which such dollar amount is measured. Existing gross receipts tests measure average annual gross receipts over a period of three taxable years.[63] This ensures that an anomalous single year outcome does not push a business into (or out of) the regime.

The base proposal should be coupled with reforms to existing aggregation rules

Any size-based approach to the threshold, including the base proposal's gross receipts test, should incorporate aggregation rules. Aggregation rules address the circumstances in which separate entities with common ownership should be counted as a single entity for testing purposes. For example, if partnership A and partnership B each has gross receipts of $13 million, but both are owned and controlled by the exact same two partners, it is more appropriate to treat them as a combined organization with gross receipts of $26 million (and thus each would be treated as a separate corporation under the base proposal).[64]

Strong aggregation rules are needed to ensure that (1) entity size is measured accurately (including on an group-wide basis where appropriate); and (2) entities are not able to manipulate their size, and thus avoid C corporation treatment, simply by separating into multiple smaller entities. Various aggregation

rules exist under current law, but technical reforms are needed to ensure they are effective in this context. Such reforms include ensuring that commonly owned and controlled entities are aggregated regardless of the nature of their activities (i.e., whether they are engaged in business or investment activities) and ensuring that all entities (corporate or pass-through) can be aggregated due to sufficient overlapping economic ownership or control. These technical reforms are discussed further in the Technical Appendix. Several of these reforms should be pursued even outside the context of this proposal.

Aggregation rules mean some businesses with minimal receipts (if examined alone) will face administrative burdens associated with testing and proving their size.

A several-year transition timeline is likely appropriate

Implementing the base proposal will require a delayed effective date to give taxpayers and the IRS time to evaluate and implement the rules. Complying with the proposal is likely to be complex for many taxpayers, since it will include evaluating whether entities are subject to the regime (including under aggregation rules), the impact of any required conversions, and whether it is preferable to restructure economic and entity arrangements before the rules go into effect. Similarly, the U.S. Department of the Treasury (Treasury) and the IRS will need time to craft guidance necessary for compliance and administration. Thus, while the estimates here assume an immediate effective date to better understand the long-run revenue path, it is likely appropriate to provide a relatively long transition period, potentially several years.

Required conversions should be handled in the same manner as under existing rules

Existing rules require certain entities to be treated as corporations, such as certain publicly traded partnerships, and allow other entities to be treated as corporations, such as pass-through entities that elect to be treated as corporations under the check-the-box rules. These rules set out the mechanics by which such conversions occur. Under those mechanics, the relevant entity is treated as first contributing all of its assets to a new corporation in exchange for stock and then distributing that stock to its partners or owners in liquidation. Conversions required under the base proposal should also follow these mechanics.

Limited transition relief is likely appropriate for conversions that trigger immediate tax

For most entities, the deemed conversion steps above will be nonrecognition transactions (i.e., will not trigger tax). But some conversions could trigger immediate tax liabilities. Transition rules could provide relief by deferring the tax liability in some manner. One approach is to provide that all conversions required under the proposal are nonrecognition transactions regardless of other rules; those rules might then require additional basis or other adjustments. Another is to allow the resulting tax to be paid in installments, which is less complex and aligns with how tax rules and proposals have addressed similar scenarios.[65]

Guidance from Treasury will likely be needed to address the complex issue of how to impose corporate treatment on existing partnership equity arrangements

Under current law, partnership interests are characterized and taxed very differently from corporate stock. Accordingly, how partnership interests are treated once the entity is a corporation (i.e., translating partnership interests into corporate stock for tax purposes) will be a complex analysis in many cases.

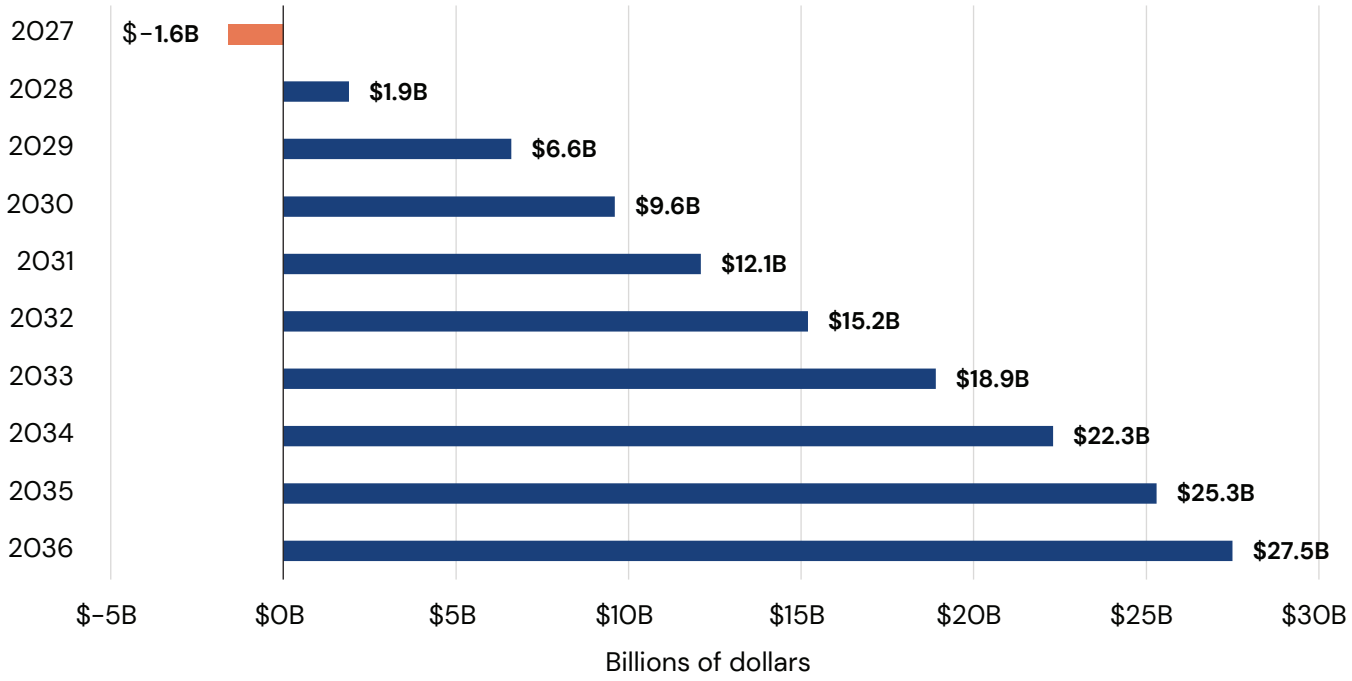
The federal tax system must already deal with this issue to some degree (e.g., because LLCs with partnership economics can, and in certain cases do, elect to be treated as corporations). But today's rules are largely elective and thus do not address the breadth of such issues that could arise under the base proposal. Given the variety in partnership economic arrangements, detailed prescriptive rules that translate partnership economics into corporate stock would be highly complex. More realistically, rules will need to provide general guidance that clarifies expected areas of confusion, such as general rules or guidelines for when differences in economic rights will create separate classes of stock. This detail is perhaps best addressed via regulation. The length of the transition period before effectiveness is also relevant here: A longer transition period could allow taxpayers to evaluate the issue and modify their arrangements accordingly ahead of the effective date, and thus lessen the need for guidance.

Entities that later fall above or below the size threshold

The rules will need to address entities that become, or cease to be, large once the system is in effect. These entities may fall into, or out of, the rules on an ongoing

FIGURE 4

Revenue raised by base proposal, 2027–36



Source: Tax Policy Center 2026.

Note: Figure shows revenue estimates for the base proposal, i.e., requiring partnerships and S corporations with gross receipts exceeding $25 million to be treated as C corporations for federal income tax purposes. Revenue and distribution estimates have been provided by the Urban-Brookings Tax Policy Center.

basis. For entities that later cross the size threshold for being large and thus fall into the rules, the considerations should be largely the same as for initial conversion, discussed below. For entities that are large but later drop below the size threshold, the base proposal would prohibit an elective conversion back to pass-through treatment under the check-the-box rules.[66]

(b) Revenue and distributional impact of the base proposal

(i) Revenue

With a current law baseline, the base proposal to treat all partnerships and S corporations with gross receipts above $25 million as C corporations would raise roughly $140 billion over the 10-year window from 2027 and 2036. This estimate assumes an effective date of January 1, 2027.

As figure 4 shows, the proposal loses revenue in the first year after enactment but then begins raising revenue in 2028. Revenues then ramp up over the course of the decade, ultimately reaching more than $25 billion per year starting in 2035.

The revenue is backloaded because the estimates assume that pass-through entities captured by the regime will seek to avoid increased tax liability in early years, such as by retaining earnings (rather than distributing them) to minimize the second layer of the corporate tax. Essentially, due to the current 21 percent corporate rate, retained corporate earnings are subject to less tax than pass-through business income allocated to individual owners. But this is the case only to the extent such earnings remain inside the corporation or shareholders retain their stock. Thus, as such, retained corporate earnings are assumed to be distributed or otherwise taxed at the shareholder level over time, while revenues from the proposal build over the 10-year window.

(ii) Distribution

The base proposal would impact nearly half (49 percent) of total pass-through entity net income but fewer than 1 percent of total partnerships and S corporations. Approximately 83,000 partnerships and S corporations would be converted into C corporations under the proposal, which represents just under 0.7 percent of all such entities (0.9 percent of S corporations and 0.4 percent of partnerships). About two-thirds of the entities that would be affected are S corporations and the remaining one-third are partnerships. Section 5 below discusses alternatives that would focus more

TABLE 1

Distributional analysis of base proposal in 2035

Expanded cash income level	Share of total federal tax change
Bottom 90 percent	6.1 percent
Top 10 percent	93.8 percent
90–95 percent	4.2 percent
95–99 percent	23.3 percent
Top 1 percent	66.3 percent

Source: Tax Policy Center 2026.

Note: Numbers for bottom 90 percent and top 10 percent may not sum to 100 percent due to rounding. Revenue and distribution estimates have been provided by the Urban-Brookings Tax Policy Center.

THE HAMILTON PROJECT

The Tax Law Center NYU LAW

TABLE 2

Impact of alternative thresholds for C corporation tax treatment

	Revenue (billions of dollars)		Shares covered by proposal	
	2027–36	2036	Pass-through entities (2036)	Pass-through net income (2036)
Gross receipt-based thresholds				
$10 million	$169.9B	$34.2B	1.34 percent	63 percent
$25 million (base proposal)	$137.8B	$27.5B	0.66 percent	49 percent
$50 million	$124.8B	$24.7B	0.30 percent	43 percent
$250 million	$58.3B	$11.5B	0.04 percent	20 percent
Asset-based thresholds				
$50 million	$115.8B	$22.1B	0.80 percent	N/A
$100 million	$98.0B	$11.8B	0.40 percent	N/A

Source: Tax Policy Center 2026.

Note: Revenue and distribution estimates have been provided by the Urban-Brookings Tax Policy Center.

THE HAMILTON PROJECT

The Tax Law Center NYU LAW

specifically on partnerships. Additionally, since TPC's estimates index the $25 million threshold for inflation, growth in the number or share of entities captured by the proposal over time is due to real growth.

Nearly all (94 percent) of the total tax increase arising under the base proposal, once fully phased in, would be borne by those in the top 10 percent of the income distribution (table 1). Furthermore, the majority of the tax increase—66 percent—would be borne by the top 1 percent. This is unsurprising given the concentration of pass-through income among high-income taxpayers.

These distributional estimates use standard TPC incidence assumptions for pass-through business income and allocate the change in tax to affected owners.[67]

(c) Revenue and distributional impact of variations to the base proposal

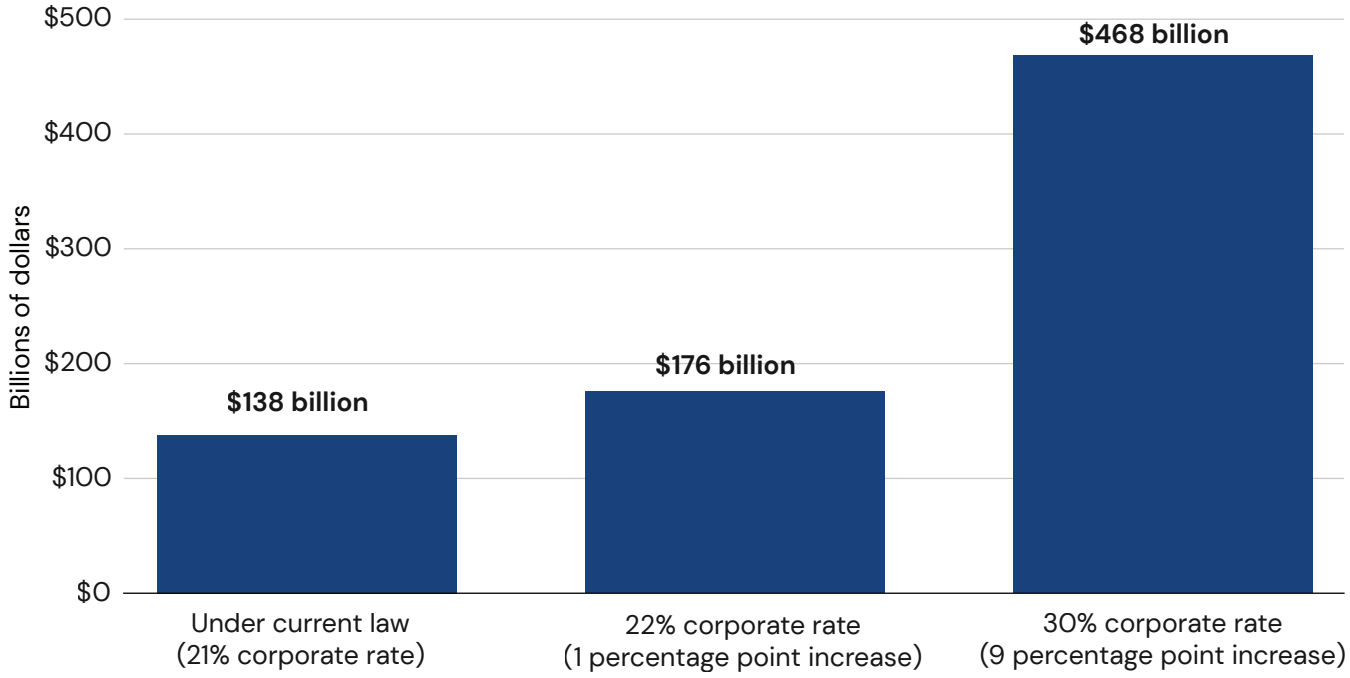
Additional estimates illustrate how revenues raised under the base proposal, and the distribution of those revenues, are sensitive to the following variations.

(i) Setting size thresholds at different dollar amounts and/or using an asset test

Table 2 shows how revenue and the share of pass-through entities and pass-through income affected by the proposal varies under alternative gross receipts thresholds or if an asset threshold is used instead.

FIGURE 5

The base proposal raises additional revenue when paired with increases to the corporate tax rate, 2027—36



Source: Tax Policy Center 2026.

Note: Figure shows revenue estimates for the base proposal, i.e., requiring partnerships and S corporations with gross receipts exceeding $25 million to be treated as C corporations for federal income tax purposes. Revenue and distribution estimates have been provided by the Urban-Brookings Tax Policy Center.

Unsurprisingly, higher dollar thresholds (e.g., $50 million or $250 million rather than $25 million) capture fewer entities and thus raise less revenue, while lower dollar thresholds (e.g., $10 million) capture more entities and raise more revenue. All else equal, however, a gross receipts threshold captures fewer entities than an asset threshold but raises more revenue. The pros and cons of an asset threshold are discussed further in Section 5, below.

Additionally, the estimates show that lower gross receipts thresholds capture a greater number of S corporations relative to partnerships. At the highest gross receipts threshold estimated ($250 million), about 60 percent of the 5,300 total entities captured are S corporations (i.e., 3,200). This proportion increases at each lower threshold—at the lowest receipts threshold estimated ($10 million), a bit more than 70 percent of the 168,800 total pass-through entities captured are S corporations (i.e., 118,900).

(ii) Revenue estimates at different corporate and individual tax rates

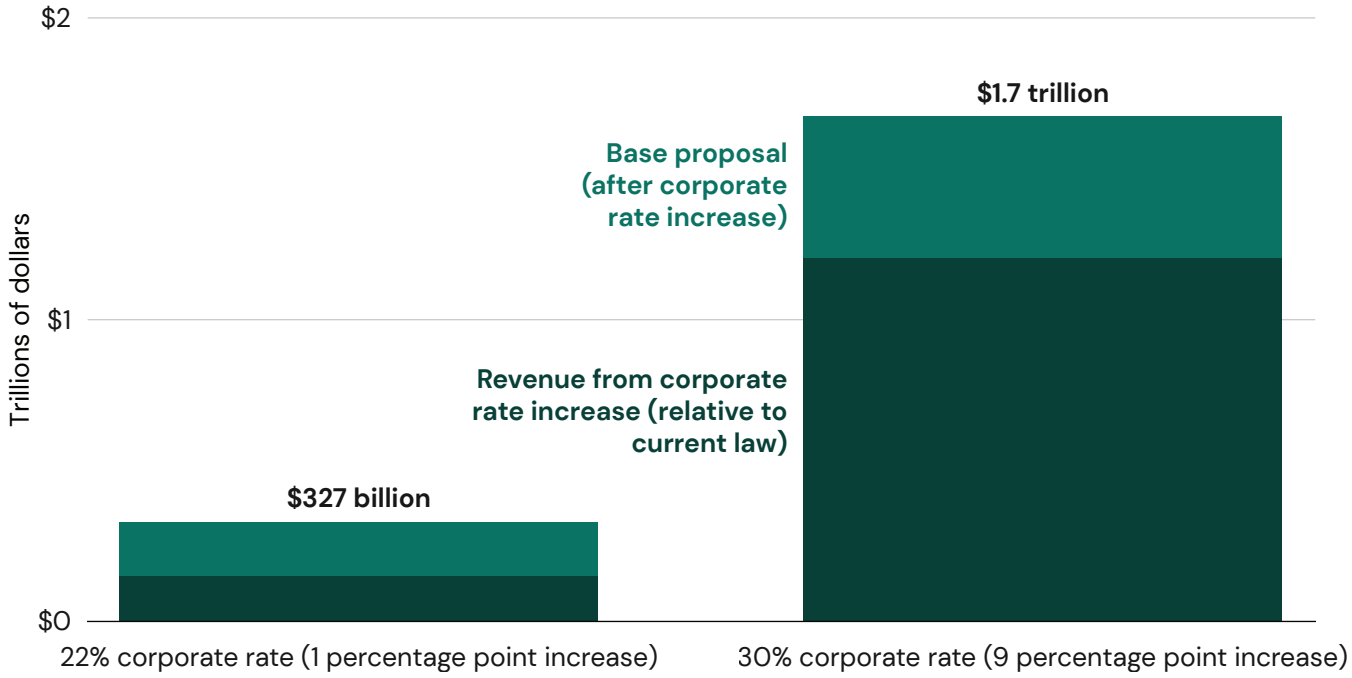
Figure 5 shows that the revenue potential of the base proposal increases significantly as the corporate tax rate increases. The base proposal would raise $138 billion over 10 years and $27.5 billion in 2036 at the current corporate rate (21 percent). However, if the corporate rate were increased by 1 percentage point (to 22 percent), the base proposal would raise $176 billion over 10 years and $32 billion in 2036. And if the corporate rate were increased to 30 percent, the base proposal would raise about $470 billion over 10 years and $67 billion in 2036. (See figure 5.) This would be in addition to the $151 billion over 10 years ($18 billion in 2036) raised by increasing the corporate rate to 22 percent on its own, or the $1.2 trillion over 10 years ($144 billion in 2036) raised by increasing the corporate rate to 30 percent on its own. (See figure 6.)

The additional revenue reflects both the mechanical effect of applying the higher corporate rate to more income and the impact of the proposal on reducing incentives for businesses to organize or restructure as pass-throughs in response to a corporate rate increase.

Reducing inefficient tax-motivated shifting between entity types is one of the primary rationales for the proposal. Ordinarily, increasing the corporate rate increases the extent of such shifting, which in turn reduces the revenue from the corporate rate increase.

FIGURE 6

Combining the base proposal with corporate rate increases would raise significant revenue, 2027–36



Source: Tax Policy Center 2026.

Note Figure shows revenue estimates for the base proposal, i.e., requiring partnerships and S corporations with gross receipts exceeding $25 million to be treated as C corporations for federal income tax purposes. Revenue and distribution estimates have been provided by the Urban-Brookings Tax Policy Center.

The base proposal reduces the ability to engage in such shifting, which helps to address the issue.[68]

While the base proposal would bolster the revenue associated with an increased corporate rate, it would conversely reduce the revenue associated with an increase in the top marginal individual rate. Thus, an increase in the top marginal individual rate from 37 percent to the pre-TCJA top rate of 39.6 percent would raise $341 billion against current law (over the 10-year window specified above), but it would raise only $251 billion over that same 10-year window when coupled with the base proposal. In other words, the base proposal would reduce the revenue associated with an increase in the top marginal individual rate by $90 billion over 10 years. This is because coupling the proposals would narrow the gap between effective tax rates on corporate income and pass-through income, and a higher individual rate would induce some existing entities to convert to corporate classification independent of the proposal. This illustrates the overlap between the base proposal and a simple increase in top marginal rates. That is, for certain pass-through entities, raising individual rates may be a cleaner and simpler way to accomplish the base proposal's goals; however, recent policy has gone in the opposite direction with provisions such as section 199A.

(d) Reasons to expect larger or smaller revenue impacts

Some aspects of the base proposal either were not modeled for simplicity or could not be modeled based on available information. Likewise, the potential impact of certain behavioral and other responses to the base proposal are particularly uncertain or could not be fully modeled. Below, we discuss these unmodeled (or partially modeled) features and responses. The Technical Appendix explores the implications of many of these choices in further detail.

(i) Unmodeled features of the base proposal

Effective date

As described above, the estimates assume an effective date of January 1, 2027. This ensures that the 10th year of the revenue estimate is useful for understanding the base proposal's long-run revenue effects. However, legislation would almost certainly need to provide a later effective date to allow adequate time for implementation and taxpayer compliance. This would

push the revenue stream out, lowering the amount of revenue that appears in the budget window, though without impacting the long-run revenue gains.

Three-year averaging

The base proposal would measure annual gross receipts based on a three-year average. This approach is not explicitly modeled; however, the revenue estimates account for this in part by adjusting the share of entities and income captured. These adjustments are imprecise, and the exact impact of this element of the base proposal is therefore uncertain, but is likely to have only modest effects on revenue and distribution.

Elective conversions back to pass-through treatment disallowed

Under the base proposal, entities that exceed the gross receipts threshold and trigger corporate tax treatment would generally remain subject to the corporate tax going forward even if gross receipts fell below the threshold. The base proposal would prohibit such entities from later electing pass-through treatment under the check-the-box rules, but most entities would be unlikely to seek a conversion to pass-through treatment anyway. Though this specific feature of the base proposal is not explicitly modeled given available data, the estimates effectively reflect this approach because they do not assume that entities falling below the threshold would convert back to pass-through treatment in any case. Accordingly, alternative approaches that allow elective conversions back to pass-through treatment are unlikely to have a significant effect on revenues.

Transition relief

The rules could provide transition relief by eliminating or deferring any immediate tax liability triggered on a required conversion. Such relief would push revenue later into, or out of, the 10-year budget window. However, while transition relief is not explicitly modeled, the estimates provided here do not assume significant revenue from tax triggered upon conversion. Thus, this type of relief should not generally have a significant effect on these estimates (or, equivalently, this type of relief is already implicitly captured).

Aggregation rules

Any size-based proposal should incorporate aggregation rules, in part to prevent efforts to avoid the size threshold in form but not substance, such as by splitting a single organization into many entities with the same ownership.[69] Rules implementing the base proposal should rely primarily on existing aggregation rules for this, but those existing rules have gaps and inconsistencies in need of reform. For example, they are often interpreted to allow companies owned and controlled by a private equity fund to avoid aggregation.

The estimates provided here assume that the base proposal would include aggregation rules similar to existing rules. If, as part of the base proposal, aggregation rules were strengthened, they could raise significant revenue on their own and would also increase the revenue raised by the base proposal. Additionally, the tightening of aggregation rules in the context of the base proposal is likely to affect the type and number of entities captured. For example, the number of partnerships captured relative to S corporations may increase from the estimates provided above.

(ii) Behavioral responses

The revenue estimates incorporate behavioral responses by making certain assumptions about how reported incomes change in response to changes in effective tax rates under the proposal. These follow TPC's standard modeling assumptions and are intended to capture various broad dimensions of potential responses, including shifts in business activity across entity types and changes in incentives to report compensation, pay dividends, and claim business losses.

The estimates reflect general responses among affected entities and owners, including shifts in business activity across organizational form. For example, under the base proposal there is a reduced incentive for new firms or activities to choose the pass-through form, and existing pass-throughs may reorganize business activity to remain below the gross receipts threshold as they expand. In addition, the estimates reflect behavioral responses to changes in tax rates across different forms of income. For example, under current law, pass-through owners generally have an incentive to minimize compensation and report more as business profits whereas corporations generally have an incentive to increase compensation (or other deductible payments) in order to reduce tax at the entity level. The estimates assume a general elasticity of 0.4, meaning that, for a 1 percentage point change in the difference between effective marginal tax rates, 0.4 percent of income would shift from a higher-taxed to a lower-taxed form.

The estimates also assume increased incentives among C corporations and their owners to defer taxable dividends and realize capital gains. The estimates assume dividend payout rates and timing of capital gains realizations similar to existing large C corporations.[70] However, many pass-through entities today make cash distributions only to the extent needed to allow their owners to pay taxes on pass-through income (i.e., "tax distributions"); accordingly, once tax is imposed at the entity level, the incentive (and need) to distribute cash may be much lower for many of these entities. If affected entities respond by distributing

less cash as dividends, or by increasing deductible payments, the revenue that the base proposal raises would be lower.

Additionally, the estimates assume a higher utilization of tax losses among pass-through entities relative to C corporations. This reflects the ability of pass-through owners to use losses from one pass-through entity to offset other sources of income in certain cases. It also reflects the greater flexibility found in partnership tax rules for allocating losses among owners. Entities that become C corporations under the proposal are, on average, assumed to utilize about half of their losses in a given year.

The magnitude of these and other possible behavioral responses is a source of uncertainty in the revenue estimates. The assumptions described here are based on historical data and empirical research with respect to prior policy changes and settings. However, because there is no exact antecedent for the specific proposals considered here, and because the modeling must necessarily simplify the policy detail, the actual impact of behavioral responses may differ from what is assumed here.

Specific behavioral responses and similar effects that may or may not be fully reflected by the broad modeling assumptions described above include the following:

Non-modeled changes in organizational form (potential to reduce revenue)

As noted above, the modeling assumptions incorporate some behavioral responses to the proposal with respect to choice of entity. However, there is additional choice-of-entity planning that is not explicitly modeled. For example, instead of accepting C corporation treatment, certain entities may seek to qualify as RICs or REITs and thus maintain a form of pass-through treatment, including by restructuring their assets or investments. Whether taxpayers can and do pursue these routes, and the resulting revenue effects, will depend on each entity's particular circumstances as well as how the proposal is constructed.

Restructuring of existing equity arrangements to avoid corporate treatment (potential to reduce revenue)

As noted above, the estimates make assumptions to incorporate responses based on the retention and payout of corporate earnings, both as dividends and as compensation. However, other specific responses aimed at avoiding corporate treatment in the first place are not explicitly modeled. For example, some businesses may begin structuring what would otherwise be equity interests as loans, licenses, or other contractual arrangements not treated as equity for tax purposes if doing so could help them avoid being converted into a C corporation under the proposal.[71]

Avoiding being large (potential to reduce revenue)

Relatedly, many entities will have a strong incentive to avoid crossing the size threshold that results in corporate tax. To limit the effect of this incentive, the base proposal would aggregate commonly owned and controlled entities for purposes of measuring size. Taxpayers are likely to respond by seeking to avoid aggregation wherever possible, such as by undertaking changes in ownership that have real economic consequences (e.g., a sale of a significant stake to an unrelated third-party). In other cases, however, taxpayers may attempt more aggressive strategies for avoiding aggregation, including (1) obscuring or recharacterizing ownership on paper to avoid aggregation in form but not substance, (2) manipulating certain business activity (e.g., when revenues arise or when assets are acquired or sold) so that it falls inside or outside a particular tax year, or (3) seeking to manipulate size by measuring receipts or asset values in particular ways.

Foreclosing unmodeled avoidance techniques that make use of pass-through tax rules (potential to increase revenue)

The estimates above generally take pass-through income as given. However, the base proposal may effectively shut down some existing tax planning or avoidance techniques that rely on partnership tax rules, such as related party basis shifting transactions. If that occurs, taxable income could increase as a result of the proposal in ways that are not captured by the estimates. Sizing these potential revenue impacts is extremely challenging (e.g., due to the information challenges noted above and in a prior report published by the Tax Law Center and The Hamilton Project), but they could be significant.[72]

Facilitating improved tax enforcement (potential to increase revenue)

As discussed below, the proposal could make it easier for the IRS to enforce tax laws against certain large or complex pass-through entities. Any revenue raised through this channel is not included in the estimates.

(e) Tax administration benefits and challenges of the base proposal

Tax administration, particularly with respect to partnerships, is in dire straits. IRS budget cuts from 2010 until the passage of the Inflation Reduction Act in 2022 have significantly limited the IRS's ability to understand

and examine large and complex partnership structures. While efforts were made to improve IRS capacity and abilities with respect to partnerships during the Biden administration, those efforts have been rolled back, and capacity has been eroded even further under the second Trump administration. Notably, the IRS has lost a quarter of its staff. This puts a premium on revenue-raising reforms that an under-resourced IRS can administer.

A key administrative benefit of the base proposal is that it would push a significant number of large, and likely complex, partnerships out of subchapter K and into subchapter C. Given the IRS's difficulty in administering subchapter K (as compared to subchapter C), this shift would likely relieve some pressure on the IRS's administrative resources.

At the same time, the shift of entities from pass-through to corporate treatment means that the base proposal would likely require additional resources and expertise in the IRS's corporate divisions. When complex entities that have previously operated as partnerships are converted into corporations, new issues and planning opportunities will undoubtedly arise, creating a need for new guidance as well as robust enforcement. This guidance and enforcement will need to come from Treasury and IRS personnel with experience in both partnership and corporate rules. Furthermore, the shift of a significant number of S corporations into subchapter C may have the countervailing effect of adding more complexity to the system: While S corporations are generally required to have simple ownership and capital structures, no such restrictions would be imposed on such entities once treated as C corporations. However, IRS corporate staffing has generally been deeper than its pass-through staffing, and so meeting these increased demands may be significantly easier to achieve than bolstering the IRS's pass-through capabilities.

The base proposal will impose new administrative and compliance burdens on taxpayers. If the policy is constructed and implemented thoughtfully, however, it is possible that the biggest administrative and compliance burden for taxpayers could be limited to evaluating whether they meet the size thresholds, including under complex aggregation rules. As discussed above, even businesses that remain below the relevant size threshold may experience some administrative burden related to this analysis. While applying such tests can be difficult, the tests will be conceptually and mechanically similar to other complex size-based tests that are familiar to many entities from other existing tax rules, such as the corporate alternative minimum tax (CAMT) or section 163(j). If anything, this conceptual similarity supports pursuing some of the aggregation reforms discussed here more broadly—the more unified existing aggregation, attribution, and related party rules are, the less taxpayers will be forced to apply many disparate, complex regimes.

Other potential burdens on taxpayers relate to effectuating a tax-efficient conversion of complex pass-through arrangements into complex corporate arrangements. However, the administrative burdens imposed on taxpayers under the base proposal will depend heavily on its design and implementation. Many of the policy design details discussed here and in the Technical Appendix are discussed with a view toward reducing these burdens and constructing a proposal that can be implemented in a workable fashion. These include delayed effective dates (allowing taxpayers to reevaluate and restructure their own arrangements), transition relief (designed to minimize the difficulty and negative tax impact of conversion), and guidance with respect to treating pass-through equity arrangements as corporate stock.

On a go-forward basis, once entities have transitioned to the regime and the rules are in place, the compliance burden of preparing a complex corporate tax return (or joining one as part of a consolidated group) may not be significantly higher than the burden of preparing complex partnership returns. In some cases, the burdens imposed by corporate tax returns may even be lower. This is particularly true for individual partners, for whom partnership tax returns typically create significant additional reporting and filing complexity.

To be sure, constructing and implementing the base proposal in a workable manner will require significant up-front work from Congress, Treasury, and the IRS. But the more that careful consideration can be given to the development of policy details at the outset, such as by working through those discussed in the Technical Appendix, the smoother implementation can be.

For a sense of the scale of the implementation challenge, the base proposal could, if well-constructed, be less burdensome from an administrative and compliance perspective than the recently enacted CAMT, at least on a per taxpayer basis. While the base proposal would apply to a subset of large entities (like CAMT), it would rely (unlike CAMT) on longstanding concepts, rules, and mechanics already in the tax code. Thus, rather than constructing a whole new tax that is based on highly complex nontax (i.e., book) concepts and integrating these nontax concepts across all substantive areas of business and entity taxation, the base proposal simply shifts entities from one existing tax classification to another. Additionally, much of the uncertainty and administrative burden of CAMT was the result of legislators leaving many key design questions to future administrative guidance, but they have the option to resolve more of these questions upfront in future legislation.

5. Questions and concerns

Is a gross receipts test the best way to measure size?

A gross receipts test may fail to capture some entities that either are large by other standard measures or that engage in other economically significant activities. Examples include entities likely to have significant assets but inconsistent income streams, such as investment entities in the financial and real estate sectors or holding companies. If policymakers wish to capture large pass-through entities regardless of the nature of their activities or the timing and nature of their revenues, they may need to explore alternative ways of measuring size, such as a threshold based on asset values rather than receipts.

An asset test would measure an entity's size based on the value of its aggregate gross assets.[73] Just as the base proposal's gross receipts test would use a three-year average, an asset test should also use a multiyear average for the measurement period.[74] Asset value is an intuitive measure of size, and such a test would capture entities that have significant economic activities but minimal receipts. Moreover, tests based on assets are reasonably widely used throughout the tax system.

This paper focuses on a gross receipts test rather than an asset test for two reasons. First, the gross receipts test is easier to administer. An asset test requires periodic valuations, which can be subject to error and manipulation (particularly in the case of illiquid or nonmarketable assets) and difficult to verify. This could put pressure on IRS enforcement capacity. Second, because gross receipts are more closely correlated with income, a gross receipts test raises more revenue while capturing fewer entities. For example, as shown in table 2, a gross receipts threshold of $50 million raises modestly more revenue than an asset threshold of $50 million while impacting far fewer pass-through entities.

Is size the best way to determine whether pass-through entities should be subject to corporate tax?

More broadly, size alone may not be the best metric for assessing the similarity of entities or imposing more uniform tax treatment. Other metrics not based on size, such as the nature of an entity's equity ownership arrangements, could be used to determine which entities are subject to corporate tax.

An ownership test is a way to focus the proposal on pass-through entities that have sufficiently complex ownership structures—in other words, those for whom pass-through taxation presents the most acute administrative and enforcement difficulties—and thus could be viewed as better tailored than a size threshold to many of the issues that pass-through entities create.[75] For example, even if very large (by receipts or assets), the significant number of S corporations captured by the base proposal will have simple ownership structures and thus may not present the administrative challenges of pass-through taxation discussed in Section 2. A relatively simple ownership-based test could also avoid the difficulties of determining where to set the size-based threshold and assessing whether particular entities meet it, including under complex aggregation rules that require testing overlapping direct and indirect ownership.

The most straightforward way to implement an ownership-based approach would be to rely on existing rules by incorporating some or all of the existing requirements for S corporation treatment. For example, such an approach could provide that any pass-through entity with (1) 100 or more equity owners,[76] (2) at least one equity owner that is not an individual, and (3) economic ownership that is not proportionate based on capital (i.e., that would not satisfy the functional equivalent of the S corporation one-class-of-stock requirement) would be subject to corporate treatment.[77]

While this type of ownership test is not estimated here, the main difference from the base proposal is that it would capture more partnerships and fewer (or perhaps zero) S corporations. That is, S corporations would generally satisfy the above test while many partnerships would not. This could be seen as an advantage: If a key reason for imposing corporate treatment on large pass-through entities is the increasing administrative impossibility of applying partnership tax rules to highly complex arrangements, then it will generally make sense to exclude S corporations even if large. On the other hand, if a primary goal is to apply similar tax treatment to similar business entities and reduce tax-motivated choice of organizational form, then it could be a disadvantage.

Additionally, because the ownership test above would generally capture any partnership with the slightest complexity in economic or ownership structure, it may be viewed as overbroad. For example, it would capture many partnership arrangements that are relatively simple, and it would not limit uniform corporate treatment to the largest entities. To address some of these issues, the ownership test could be drafted to better capture partnerships that are truly complex (e.g., those that use special allocations or have a particularly complicated distribution or allocation waterfall). However, this would make the test more difficult to draft and implement and would encourage planning aimed at achieving the economics of a disqualified (i.e., complex) capital structure by using loans or other contractual arrangements. Rules that impose a particular tax treatment based on business owners structuring their economic ownership in a particular manner are often viewed as overly restrictive and potentially arbitrary. Finally, adjusting to capture only truly complex economic arrangements, without an additional size-based threshold, may capture too many businesses that are small based on measures more directly related to their operations.

Estimates for an ownership-based threshold are not feasible using available public data. The revenue impact of applying such a test, rather than the base proposal's gross receipts threshold, would depend on how the ownership restrictions are formulated—for example, whether they capture enough additional partnerships to make up for the lost revenue from effectively excluding S corporations.

How does the base proposal compare to alternative proposals to levy a separate entity-level tax on large pass-throughs?

Policymakers may wish to consider alternatives that do not rely on the base proposal's C corporation approach. One such alternative would be to instead impose a new pass-through entity level tax on large pass-through entities. Certain existing proposals (including a 2016 Center for American Progress report) allude to this approach.[78] Additionally, some may view this as a simpler approach than requiring all large pass-through entities to fully convert into C corporations for federal tax purposes.[79]

As discussed above, the base proposal has the advantage of relying largely on existing entity classifications and familiar tax mechanics—moving existing entities from one existing tax regime to another. This alternative proposal would instead need to create an essentially new federal pass-through entity tax base and mechanics. Accordingly, close consideration of both approaches indicates that the base proposal's C corporation mechanics ultimately provide a more workable starting place for policymakers wishing to impose entity-level tax on large pass-throughs. However, the choice between the two is not entirely clear cut.

Under the alternative proposal, all covered pass-through entities would pay a new entity-level tax but would otherwise continue to be treated as pass-through entities for federal income tax purposes. The threshold used to define which entities are captured could generally be set in the same manner as under the base proposal (including any of the variations discussed above). That is, both approaches would apply only to large or complex pass-through entities.

Implementing the alternative proposal is likely to be more difficult than it sounds. At minimum, it will require crafting new and complex rules to address, among other things (1) how to determine and calculate the tax base, (2) the applicable tax rate (likely a single flat rate applied to the base), (3) how the entity-level tax is allocated and shared among partners or owners, and (4) how the tax should be calculated and paid in tiered entity structures.

None of these issues appears entirely insurmountable, but a particularly complicated aspect of the alternative proposal is how to determine the right tax base. Neither partnerships nor S corporations generally compute a single entity-level net income or loss number under current law, so the base would need to be a new number rather than an existing one. The best approach would be to construct the base from tax amounts that pass-through entities already calculate and report to their owners (e.g., a sum of all entity-level items of income, gain, loss, and deduction), but even this raises several complex questions. These (and many other) complexities are discussed in greater detail in the Technical Appendix.

How would the base proposal interact with other business tax reforms (aside from increasing the corporate rate)?

Estimates are provided above for pairing the base proposal with certain tax rate increases. However, the proposal could also be paired with, or compared to, many other sound options aimed at broadening the business tax base, including (1) closing gaps in the application of the 3.8 percent Medicare tax on active pass-through income (e.g., by expanding Self-Employed Contributions Act taxes and/or the net investment income tax [NIIT] under section 1411),[80] (2) reforming or repealing the exemption for gains on qualified small business stock under section 1202,[81] (3) curtailing tax benefits for exchange-traded funds (ETFs),[82] (4) eliminating corporate or partnership basis shifting,[83] and (5) improving tax administration and enforcement.

Such reforms are expected to raise significant revenue on their own, and their impact would be

concentrated among high-income filers. They should therefore be considered on their own merits, as discussed in prior analyses of the need for pass-through tax reform.[84] Some specific base-broadening reforms, such as ending partnership related party basis shifting, limiting nonrecognition treatment for ETF redemptions, and closing gaps in the Medicare tax base would have revenue impacts broadly similar to the base proposal (i.e., primarily affecting large and complex entities and generating significant revenue) while being generally simpler to administer than the base proposal. But many such reforms could also be highly complementary to the base proposal for several reasons:

First, a key impact of the base proposal would be to move certain entities from subchapter K to subchapter C. Subchapter K would thus apply to fewer (and likely, simpler and smaller) entities than it does today. This could facilitate reforms aimed at simplifying and rationalizing subchapter K's rules since those rules would now be focused on a set of smaller and generally simpler entities. However, any such reforms would need to be careful not to remove important detailed rules from subchapter K, even if those rules are complex, since many small partnerships still use complex economic arrangements.

Second, some of the reforms above would affect a wider population of pass-through entities than the base proposal, such as proposals to close gaps in the Medicare tax base by tightening Self-Employed Contributions Act and NIIT rules. Similarly, certain reforms above would impact only particular types of entities—for example, limiting nonrecognition treatment for ETF redemptions, which would directly apply to RICs rather than to partnerships or S corporations. That is, these proposals would address specific problems in existing tax rules and would apply to all entities of a particular type, regardless of size, thus potentially complementing the base proposal's focus on broader revenue losses attributable to large and complex pass-throughs.

Third, under the base proposal many large businesses would be shifted into subchapter C and thus generally would be subject to corporate tax, making reforms that fix the corporate tax base (e.g., restricting corporate basis shifting) even more consequential from a revenue perspective.[85] New subchapter C rules may also be needed to address taxpayer responses to the base proposal itself. Similarly, to the extent the base proposal pushes more large and complex investment entities into RIC or REIT status, it may also increase the need for fixes and reforms to those rules.[86] Some or all of these complementary reforms should be pursued alongside the base proposal; doing so would likely increase and protect the revenue that the base proposal is estimated to raise.[87]

Fourth, the base proposal would serve as a much broader backstop against the use of pass-through treatment to escape increases in the corporate tax rate than the more targeted proposals, especially given current uncertainty about the breadth and scope of tax avoidance strategies that rely on existing pass-through tax rules.

What types of firms would be expected to pay more under the base proposal?

According to IRS data, partnership receipts are concentrated in the following industries: (1) finance and insurance, (2) wholesale and retail trade, and (3) manufacturing. Additionally, two industries often closely associated with partnerships—real estate and professional services—have the next largest amount of total partnership receipts after these top three.[88] Similar data show that the majority (more than 60 percent) of large S corporation receipts are concentrated in the following industries: (1) wholesale and retail trade, (2) construction, and (3) manufacturing.[89] The different industry concentrations of S corporations and partnerships in these data matches expectations, since S corporations tend to be operating businesses and are less prevalent than partnerships in the finance and professional services industries. The foregoing statistics provide a general picture of the types of industries likely to be captured by the base proposal.

In addition, the following general summary highlights some particular types of pass-through entities that may be converted into corporations under the base proposal. This area warrants further study and analysis.

Large professional services firms (e.g., law and accounting firms)

These firms are typically organized as partnerships. The largest will have gross receipts well above the base proposal's $25 million threshold and are thus likely to be captured. These firms represent a core traditional use of the partnership form but also reflect the significant growth in pass-through business income. Many are global operations with hundreds of partners, though their ownership may not otherwise be particularly complex.

For noncomplex but large businesses such as these, a potentially simpler way of reducing their tax advantage relative to corporations would be to simply raise the top individual income tax rates. As discussed above, at the current corporate rate, the base proposal reduces the revenue from an increase in the top individual rate from 37 percent to 39.6 percent. However, this route would also require attention to the ways in which owners of some large but relatively simple pass-through businesses may not face the top individual tax rates—not because of the use of complex subchapter K rules, but because of provisions such as section 199A. Although there are income-based limitations on the

benefits of section 199A for owners of most service businesses, including law and accounting firms, owners of engineering and architecture firms, some of which are very large, are not subject to these limitations.[90]

Investment management firms, such as private equity and similar managers

Also typically organized as partnerships, these businesses should generally make up a portion of the partnership receipts that appear in the "finance and insurance" industry, per the above data. Like large professional service firms, many of the largest investment management firms are likely to have receipts above the $25 million threshold. These firms are similar to the professional services firms described above in that they primarily earn fees and are generally not capital-intensive businesses. Firms in this industry have become increasingly large and complex over time, including as a result of pursuing public offerings, minority investments, and other liquidity events. Notably, however, some of the largest firms in this group have already opted for either full or partial corporate treatment, particularly after the changes to the corporate and individual rate structures under TCJA.[91]

Investment fund partnerships (e.g., private equity funds themselves)[92]

These entities may be captured under the base proposal, but that is not certain. Private fund vehicles are typically partnerships. The largest funds can be highly complex, with hundreds of partners (including many foreign and tax-exempt partners) spread across multiple partnerships and with equity ownership shared by partners according to complicated rules. The growth of these partnerships and their investors is likely a significant contributor to the complicated network of interconnected partnership entities that makes tax administration difficult.[93] Because the base proposal is not limited to operating businesses, and thus does not carve out pure investment partnerships, these funds could be treated as corporations if they cross the relevant threshold. However, under the base proposal, they would generally be captured only if they have sufficient gross receipts (from investment realizations, dividends, etc.). The timing or nature of receipts may be easier to manipulate here than in other industries, such as by changing the timing or nature of investment realizations. In addition, the fund partnerships themselves are likely to be captured by the base proposal only if: (1) the aggregation rules are reformed as described above and in the Technical Appendix, and (2) the fund partnerships are unable to avoid such treatment by using other available tax classifications, such as validly electing RIC status.

Operating pass-through businesses, including fund portfolio companies

As noted above, pass-through receipts are heavily represented in certain operating business industries, such as wholesale trade and manufacturing. Operating pass-through businesses in these industries are likely to include many entities that are (1) large but relatively closely held businesses and (2) pass-through portfolio companies owned by the investment funds described above. Many pass-through portfolio companies in the latter group may not have sufficient gross receipts to be captured on a standalone basis, and thus may not be reflected in the TPC estimates, but they are much more likely to be captured if the aggregation rules are modified as described above and in the Technical Appendix. Furthermore, these businesses would appear to be a key example of the types of entities the base proposal is aimed at capturing, as they often: (1) are partnerships; (2) have highly complex direct and indirect ownership (e.g., they are not closely held but are owned directly or indirectly by a large and varied group of investors, including other entities); and (3) have complex economic sharing (e.g., to reflect differential sharing among an array of investment funds, direct co-investors, management, and other owners).

Real estate businesses

Many operating businesses in the real estate industry, such as real estate developers, are organized as partnerships. They can have very significant receipts and very complex ownership structures, even if they are family businesses or otherwise closely held. See, for example, the partnership structure in the recent Otay Project case.[94] Firms such as this are likely to be captured by the base proposal.

Energy-related businesses and projects

Similar to real estate, businesses and projects in the energy industry (e.g., clean energy projects, oil and gas ventures, etc.) often organize as partnerships. Historically, some of these entities have organized as "master limited partnerships," or publicly traded partnerships that are able to avoid corporate treatment under an exception for businesses with sufficient "qualifying income" from natural resource activities. Additionally, certain energy projects are undertaken and financed through "tax equity" partnerships that rely on subchapter K rules to divide the value of tax credits or other tax incentives, which may warrant further consideration.

Are there economic downsides to preventing large or complex firms from selecting pass-through and, in particular, partnership tax treatment?

Much of the complexity of partnerships arises from the fact that they provide significant flexibility to owners in constructing their business and economic arrangements. This can be highly beneficial to the partners. Rather than forcing owners to fit their desired economic sharing of ownership of the business onto a rigid "share class" model, partnerships prioritize giving business owners a clean slate on which to write the economic ownership of their business. Similarly, partnerships provide more flexibility than corporations to accomplish certain common business transactions tax efficiently, such as transferring assets into or out of the business and granting equity to service providers.

As discussed above, these sources of flexibility generate significant tax planning and revenue loss. However, they also facilitate legitimate business transactions and other real economic activity. As a result, eliminating partnership treatment for certain businesses may impair some valuable economic activity and thus partially offset the administrative and revenue benefits. Limited data make it particularly difficult to quantify these economic impacts.[95]

How does the base proposal address the cliff-effect that occurs once an entity reaches the size threshold?

Under the base proposal, once an entity crosses the size threshold, it becomes a C corporation and potentially faces a large additional tax liability. Features of the base proposal would ameliorate or mitigate the incentive to avoid crossing that threshold, whether through lawful or unlawful means. These features include measuring receipts over a rolling average of three years, incorporating and strengthening aggregation rules, and prohibiting large entities from electing out of C corporation treatment once they move in.

An additional option could be to phase in the resulting tax increase over some range, such as entity size. Changes in tax law frequently use similar phase-ins, or phase-outs, as applicable. A phase-in would further blunt incentives to avoid the cliff at the margin but would also be very complex. For example, it would mean calculating the difference between tax liability under corporate treatment and tax liability under pass-through treatment, requiring two sets of tax calculations under very different regimes. This would significantly increase the administrative burdens of the base proposal for both filers and the IRS and could decrease the revenues raised (though the impact on revenue and distribution would depend on the phase-in thresholds and rates).

Should other pass-through entities be subject to the proposal?

As described above, the base proposal would not apply to certain specific types of entities or arrangements that are commonly thought of as pass-throughs, such as RICs, REITs, and sole proprietorships. As a result, treatment of large or complex entities would not be fully uniform even under the base proposal. Whether these entities should be captured is an issue that any policymakers pursuing a proposal to tax large pass-through entities should consider carefully.

The base proposal carves out RICs and REITs because they are specific tax classifications that reflect a prior policy decision to retain a rigid form of pass-through treatment for certain investment entities with particular types of assets and income. RICs and REITs are subject to detailed income and asset testing to ensure their tax treatment. And the base proposal would not apply to sole proprietorships (including DREs, such as single-member LLCs) because they are not separate entities for U.S. federal income tax purposes. That is, if a DRE's sole owner is already a corporation, there should be no need to impose corporate treatment, and if a DRE's sole owner is a partnership or S corporation, then the sole owner would be tested for corporate treatment under the base proposal.

Carving out these, or any other, specific types of entities or businesses results in line drawing and could create distortions. For example, capturing large pass-through businesses with two or three owners (partnerships) but not those with a single owner (DREs) could cause certain businesses to be aggressive in recharacterizing equity arrangements as loans or other contracts to maintain DRE treatment. However, the base proposal's significant size threshold for corporate treatment, as well as the detailed requirements for satisfying RIC or REIT status under current law, are likely to minimize the impact of any such distortions. Nevertheless, this is an area that warrants further study and analysis.

6. Conclusion

By analyzing a concrete proposal to tax large or complex pass-throughs as C corporations in detail, this project sheds new light on both the attractions and challenges of such an approach. The proposal has the potential to raise substantial revenue (especially in combination with an increase in the corporate rate), reduce tax differentials across different types of entities, and simplify and improve tax administration and enforcement (at least in the long run). At the same time, the implementation and transition challenges associated with the proposal are real and substantial. Even with careful design, the proposal carries risk and a significant up-front burden for Congress, Treasury, the IRS, and taxpayers.

Ultimately, proposals to tax large or complex pass-throughs at the entity level belong on the menu of options for business tax reform. However, this paper does not unreservedly endorse such proposals. The merits and feasibility of pursuing such a proposal depends in significant part on (1) what other revenue-raising options are politically viable; (2) whether the proposal would be adopted alongside (or instead of) various other pass-through, corporate, and individual reforms and rate changes; and (3) many details of policy construction and implementation. But, given the clear need for additional revenue, the increasing administrative difficulties of pass-through taxation, and potential obstacles to other important tax reforms, the proposal warrants further consideration and development at minimum, and may be worth pursuing.

Endnotes

1. David Kamin, *Tax Reform After the One Big Beautiful Bill Act*, 120 Tax Notes International (November 5, 2025); Kathleen Bryant & Chye-Ching Huang, Carving Holes and Shrinking the Base: How OBBBA Weakens the Tax System, at 1-2, The Tax Law Center at NYU Law (December 2025); The Tax Law Center, Breaking out of the "Revenue Box," (January 8, 2026).
2. Partnership tax rules were developed when partnerships were largely simple entities: When the bulk of current subchapter K was written, "most partnerships were closely held enterprises whose partners were exclusively U.S. taxpayers that were active in the partnership business." McKee, Nelson, Whitmire & Brodie: Federal Taxation of Partnerships & Partners (WG&L) at ¶ 1.03. The pass-through taxation of partnerships was drawn from "the historical picture of the general partnership"—an aggregate of owners in which each owner is personally liable for partnership obligations and authority to manage and control the partnership. BNA Portfolio, Partnerships—Conceptual Overview, No. 710-3rd, Section I (Introduction). Similarly, the S corporation rules were developed specifically for small corporations with simple capital structures—i.e., small businesses that were conceptualized at the time as "little more than chartered partnerships." Eustice, Kuntz & Bogdanski: Federal Income Taxation of S corporations (WG&L) at ¶ 1.02.
3. In 1984, the American Law Institute stated in its overview of subchapter K reform proposals that partnerships remained quite distinct from traditional corporations: "what is probably the most important type of business subject to corporate tax, the large heavily capitalized entity which relies for a major source of investment capital on equity money, has no real analogue in the partnership field." American Law Institute, Federal Income Tax Project, subchapter K: proposals on the taxation of partners, adopted by the American Law Institute at Philadelphia, Pennsylvania, May 20, 1982 (1984). This assertion may be less true today.
4. Eligibility for various tax benefits (especially whether owners are eligible for the full section 199A deduction) will change the calculus for certain businesses. See, e.g., Edward G. Fox, Zachary D. Liscow, & Michael Love, How to Tax Business? Economic Rents, Legibility, and the Corporate-Pass-Through Divide, Columbia Public Law Research Paper No. 6206239, at 6-7 (February 5, 2026). Additionally, whether and when corporate income will be taxed at the shareholder level is also particularly important in determining the revenue effect of pass-through versus corporate taxation over a 10-year budget window, as discussed further below.
5. See, e.g., Fox, Liscow & Love, supra note 4, at 2, 5-6. At the federal level, the Tax Reform Act of 1986 made C corporation treatment less desirable by setting the top individual income tax rate below the corporate tax rate and repealing a mechanism that corporations previously used to avoid taxation on the appreciation of their assets. See, e.g., Bret Wells, *Pass-Through Entity Taxation: A Tempest in the Tax Reform Teapot*, 14 Hous. Bus. & Tax L. J. 1, 10-11 (2014). Congress took some steps shortly thereafter to limit the availability of pass-through treatment for certain categories of entities, including by taxing certain publicly traded partnerships as corporations. Omnibus Budget Reconciliation Act of 1987, Pub. L. 100-203, § 10211, 101 Stat. 1330-403-7 (1987). However, the overall trend by the end of the decade was toward greater availability of pass-through treatment for federal income tax purposes. See Rev. Rul. 88-76, 1988-2 C.B. 360.
6. Wyoming was the first state to create LLCs, in 1977, see Heather M. Field, *Checking in on "Check-the-Box*," 42 Loy. L.A. L. Rev. 451, 460 & n.48 (2009) (citing Wyoming Limited Liability Company Act, ch. 158, 1977 Wyo. Sess. Laws 577), and the IRS ultimately blessed the classification of Wyoming LLCs as partnerships for federal tax purposes in 1988. Rev. Rul. 88-76, 1988-2 C.B. 360. This IRS decision increased uptake of the LLC form and spurred the adoption of similar laws in other states. Field, supra, at 462. In 1991, another new form of pass-through entity providing limited liability for all owners, the LLP, emerged in Texas and subsequently spread to other states. Eventually, the check-the-box regulations ensured that these entities would default to pass-through tax treatment without an examination of their legal and other characteristics. Simplification of Entity Classification Rules, TD 8697, 61 Fed. Reg. 66584 (1997).
7. Miles Johnson et al., Modernizing Partnership Taxation 2-3, 15, The Tax Law Center and The Hamilton Project, September 2024.
8. See, e.g., Simplification of Entity Classification Rules, TD 8697, 61 Fed. Reg. 66584 (1997); Check-the-box elections (CTB), The Tealbook, Tax Law Center at NYU Law.
9. Treas. Reg. § 301.7701-2 (prior to amendment by TD 8697, Dec. 17, 1996); T.D. 6503, 1960-2 CB 409, 25 Fed. Reg. 10928 (Nov. 17, 1960).
10. But see, e.g., Eric Toder, The Incidence of the Corporate Tax, Tax Policy Center, at 44-46 (February 5, 2025) (discussing the increasing fraction of shareholders not subject to U.S. tax on corporate stock); Jane G. Gravelle, Corporate Tax Integration and Tax Reform, R44638, Congressional Research Service, at 2-5 (September 16, 2016) (same); Staff of J. Comm. on Tax'n, Overview of Approaches to Corporate Integration, JCX-44-16, at 2-3, 15-18 (May 17, 2016) (same).
11. Employment taxes on active pass-through income, The Tealbook, Tax Law Center at NYU Law. Certain other pass-through owners also take the position that they fall within a gap between self-employment tax and the NIIT, arguing that they are too active to be subject to the NIIT but are simultaneously eligible for an exception from self-employment tax for limited partners. Id.
12. Miles Johnson et al., Modernizing Partnership Taxation, supra

note 7, at 11, 18–20.

13. This is not to say that the TCJA had no effect on choice of entity form. Rather, there is evidence that "[o]n net, the TCJA [] appears to have reduced—but not eliminated—the general tax preference for pass-through status" and that, "[c]onsistent with this assessment, although entity-type switching remains rare in absolute terms, the amount of switching to C corporation status jumped after the TCJA." Fox, Liscow, & Love, supra note 4, at 7.
14. See, e.g., Gregg D. Polsky & Adam H. Rosenzweig, *The Up-C Revolution*, 71 Tax L. Rev. 415 (2018); Gladriel Shobe, *Supercharged IPOs and the Up*-C, 88 U. Colo. L. Rev. 913 (2017); Phillip W. DeSalvo, *The Staying Power of the Up-C: It's Not Just a Flash in the Pan*, Tax Notes (August 8, 2016).
15. One example of this is section 704(c), which seeks to ensure that deferred tax gains and losses are recognized in a manner that aligns with economic (i.e., book) results and thus are not shifted between partners. See Modernizing Partnership Taxation, supra note 7, at 10. In seeking to accomplish this broadly desirable goal, the section 704(c) rules have become difficult for many taxpayers to understand and administer, providing multiple elective allocation methods that achieve different results (without fully eliminating shifting) and including specific and highly complex rules aimed at particular abuses. As a result, they are burdensome to apply in complex partnerships and create planning opportunities as well as traps for the unwary.
16. Much of this also stems from the entity vs. aggregate debate regarding the treatment of partnerships. A partnership, given its unique characterization as both a conduit (an aggregation of its owners) and a separate regarded entity, carries features of both. Certain subchapter K rules embody an entity theory of partnerships, and others embody an aggregate theory, without much principled guidance on when one or the other should apply.
17. Modernizing Partnership Taxation, supra note 7, at 13.
18. See Modernizing Partnership Taxation, supra note 7; Jane G. Gravelle & Mark P. Keightley, Marginal Effective Tax Rates on Investment and the Expiring 2017 Tax Cuts, CRS Report R48153, Congressional Research Service, August 13, 2024. Compare, e.g., the 2017 (pre-TCJA), 2018, and 2024 columns for corporate and noncorporate entities shown in Tables 4 and 5 (pp. 8–11). These tables not only show that marginal effective tax rates on investments made through pass-through (i.e., noncorporate) entities are generally lower than those made through corporate entities, but also that marginal effective tax rates within the noncorporate category vary greatly across both asset and financing types both pre- and post-TCJA. See also Lucas Goodman, Quinton White, & Andrew Whitten, Taxing S Corporations as C Corporations, at 2-3, Office of Tax Analysis Working Paper Series, September 12, 2024 (examining the revenue implications of taxing S corporations as C corporations, and finding that the average tax rate gap between C corporations and S corporations "would shrink, but remain positive, if the Section 199A deduction were eliminated").
19. See William S. McKee, William F. Nelson, Robert L. Whitmire, & Sarah Brodie, Federal Taxation of Partnerships and Partners (Thomson Reuters/Tax & Accounting, 5th ed. 2024, with updates through June 2024) at ¶ 1.03.
20. See, e.g., Gregg D. Polsky & Emily Cauble, *The Problem of Abusive Related-Partner Allocations*, 16 Fla. Tex. Rev. 479 (2014).
21. See Michael Love, Who Benefits from Partnership Flexibility?, Journal of Public Economics, Volume 251, November 2025, 105493; David S. Mitchell, Tax avoidance among large, complex partnerships in the United States, Washington Center for Equitable Growth, February 2025. Notably, much of this flexibility results from the attempt to allow partners a blank slate on which to write their economic deal and then have tax allocations follow that economic deal. The more complicated and varied economic arrangements become, the more complicated it must become to apply tax rules that follow those economic arrangements.
22. See, e.g., Otay Project LP v. Commissioner, T.C. Memo. 2026-21 (Feb. 23, 2026).
23. See Michael Love, Where in the World Does Partnership Income Go? Evidence of a Growing Use of Tax Havens, 79 National Tax Journal 1 (2026).
24. See Fox, Liscow, & Love, supra note 4.
25. See Modernizing Partnership Taxation, supra note 7, at notes 120–22.
26. See Fox, Liscow & Love, supra note 4, at 26–29.
27. See IRS Research, Applied Analytics & Statistics, Tax Gap Projections for Tax Year 2022, Pub. 5869 (Rev. 10-2024), at 15. IRS projections "do not fully represent noncompliance in some components of the tax system, particularly as relates to corporation income tax, income from flow-through entities, foreign or illegal activities, digital assets, and pandemic credits, because data are lacking." Id. at 6 (emphasis added).
28. See Government Accountability Office, Tax Enforcement: IRS Audit Processes Can Be Strengthened to Address a Growing Number of Large, Complex Partnerships 22, Fig. 9, GAO-23-106020, July 2023.
29. Pass-through taxation in general has long been recognized as difficult to implement in practice. For example, the American Law Institute's partnership tax reform project, while generally concluding that pass-through treatment was appropriate for partnerships, also stated that a "pure pass-through model can only be achieved in practice at an intolerable cost in complexity." American Law Institute, supra note 3, at 7.
30. See also, Fox, Liscow, & Love, supra note 4, at 30 (pointing out that entity-level taxation [(such as under subchapter C)] cuts off much of the administrative complexity of pass-through entities by making tax collection simpler: " . . . entity-level taxation performs a critical corrective function. It breaks the chain of complexity by forcing information to consolidate at a fixed point: the entity's own return. An entity-level tax requires the entity to compute and pay tax on its own income, regardless of the structure or identity of its owners, and this provides a natural administrative foothold").
31. Modernizing Partnership Taxation, supra note 7.
32. See Employment taxes on active pass-through income, The Tealbook, Tax Law Center at NYU Law; Pass-through deduction—§ 199A, The Tealbook, Tax Law Center at NYU Law.
33. See Curtis J. Berger, W(h)ither Partnership Taxation, 47 Tax L. Rev. 105 (1991) (proposing that all large business entities should be taxed at the entity level, while small entities should continue to receive pass-through treatment); Jeffrey L. Kwall, Taxing Private Enterprise in the New Millennium, 51 Tax Law. 229 (1998) (proposing to preserve pass-through treatment only for simple privately held entities, and subject complex private entities and public firms to an entity-level tax); Lawrence Lokken, Taxation of Private Business Firms: Imagining a Future Without Subchapter K, 4 Fla. Tax Rev. 249 (1999) (limiting subchapter K to firms in the service sector, limiting subchapter S to firms in capital-intensive industries, and subjecting all other business entities to subchapter C).
34. See, e.g., George K. Yin & David J. Shakow, Reforming and Simplifying the Income Taxation of Private Business Enterprises (1999); George K. Yin, The ALI Reporters' Study on the Taxation of Private Business Enterprises, Tax Notes (1999) (special report adapted from the "Introduction and Summary" of the "ALI Reporters' Study on the Taxation of Private Business Enterprises) (endorsing a "system whereby all private business firms, no matter what their form of organization and organizational characteristics, are taxed as [pass-throughs]"). See also

Edward D. Kleinbard, Rehabilitating the Business Income Tax, The Hamilton Project (June 2007); Alan J. Auerbach, A Modern Corporate Tax, Center for American Progress and The Hamilton Project (December 2010). While the term "integration" in this context can refer to the integration of the pass-through and corporate tax system into a single system, the term "corporate integration" typically refers to the related but distinct concept of integrating corporate entity- and shareholder-level tax into a single level of tax. Some proposals seek to achieve both of these ends—and thus to provide for a uniform system of business taxation with a single level of tax—but many other proposals strive to do only one or the other (i.e., to integrate corporate taxation into a single level of tax that is still distinct from pass-through taxation, or to integrate business taxation into a single tax system that broadens the reach of, rather than removes, dual layers of tax).

35. These statistics and the accompanying text are drawn from Modernizing Partnership Taxation, supra note 7, at 3 & ns. 13-14, but updated for 2022 statistics of income and to provide figures for S corporations. See IRS, SOI Tax Stats—Individual statistical tables by size of AGI for tax year 2022, at Table 1.4.

36. These statistics and the accompanying text are drawn from Modernizing Partnership Taxation, supra note 7, at 3 & ns. 13-14, but updated for 2022 statistics of income. See IRS, SOI Tax Stats—Individual statistical tables by size of AGI for tax year 2022, at Table 1.4. Dividends includes ordinary and qualified dividends.

37. These statistics and the accompanying text are drawn from Modernizing Partnership Taxation, supra note 7, at 3 & ns. 13-14, but updated for 2022 statistics of income. See IRS, SOI Tax Stats—Individual statistical tables by size of AGI for tax year 2022, at Table 1.4.

38. These statistics and the accompanying text are drawn from Modernizing Partnership Taxation, supra note 7, at 3 & ns. 13-14, but updated for 2022 statistics of income and to provide figures for S corporations. See IRS, SOI Tax Stats—Individual statistical tables by size of AGI for tax year 2022, at Table 1.4.

39. See, e.g., The President's Framework for Business Tax Reform, at 10, February 2012 (noting that, in "[e]stablishing greater parity between large corporations and large non-corporate counterparts[,]" "[i]t is essential that any changes in this area should not affect small businesses."); Mark P. Keightley, The Corporate Income Tax System: Overview and Options for Reform, Pub. No. R42726, at 29, December 1, 2014.

40. Cf. Hearing on the Treatment of Closely-Held Businesses in the Context of Tax Reform, Hearing Before the Committee on Ways and Means, No. 112-23, March 7, 2012 (Comm. Print) (remarks of Mr. Tucker) (discussing the fact that pass-through "owners are taxed irrespective of whether they receive distributions").

41. Not all proposals to tax certain pass-throughs at the entity level do so for only large entities. Indeed, current law taxes most publicly traded partnerships at the entity level, see section 7704, and such entities are not required to be large. See, e.g., Berger, supra note 33, at 162 (explaining that whether an entity is publicly traded "is both underinclusive and overinclusive, as well as inefficient, as a standard for 'bigness.'"). An alternative option discussed in Section 5 (Questions & concerns) and the Technical Appendix is adopting an ownership-based test (which could be similar to the criteria necessary to qualify for S corporation treatment) rather than a size-based threshold to determine which entities should be covered. Finally, certain proposals determine whether entities should be taxed on an entity level based in part on the activities of the entity. E.g., Lokken, supra note 33 (taxing only non-service firms that meet certain additional criteria under subchapter C); Berger, supra note 33, at 106, 164, ns. 3, 253 (discussing which subchapter M pseudo pass-through regimes to maintain), or one of the corporate characteristics of the entity. E.g., Jeremy Bearer-Friend, Restoring Democracy Through Tax Policy, The Great Democracy Initiative, at 5-7 (December 2018) (proposing to tax LLCs and LLPs as corporations and to repeal subchapter S "so that entity-level tax applie[s] to all incorporated firms whose owners enjoy limited liability"). In any case, the base proposal discussed here would impose an entity-level tax (via corporate treatment) on a pass-through entity only when it is large (by a certain metric).

42. Subchapter K dates to 1954, Pub. L. 83-591, 68A Stat. 3, 239-254, and Subchapter S dates to 1958, Technical Amendments Act of 1958, Pub. L. 85-866, 72 Stat. 1606, 1650-57. However, even before subchapter K, individuals were taxed on their share of partnership income. See, e.g., George K. Yin, The Future Taxation of Private Business Firms, 4 Fla. Tax Rev. 141, 145-48 (1999).

43. See, e.g., Yin, supra note 42, at 144-53; see also, e.g., Hearing on the Treatment of Closely-Held Businesses in the Context of Tax Reform, supra note 40 (Remarks of Ranking Member Levin) ("It used to be that pass-throughs were a reasonable proxy for small businesses. But with the growth both in number and size of S corporations and especially LLCs, this identity is breaking down").

44. Under section 7701(a)(3), "associations" are taxable as corporations. A 1935 Supreme Court case, Morrissey v. Commissioner, established four factors for determining when an unincorporated entity was taxable as a corporation. 296 U.S. 344, 359 (1935). These factors were continuity of life, centralized management, free transferability of interests, and limited liability for all owners. See id.; see also, e.g., Gregg D. Polsky, Can Treasury Overrule the Supreme Court?, 84 B.U. L. Rev. 185, 216 (2004). Although Morrissey originally applied a "facts and circumstances standard" for this determination, Treasury entity classification adopted in 1960 (the Kintner regulations) adopted these same factors but applied a "mechanical, bright-line test". Polsky, supra, at 216-17; T.D. 6503, 1960-2 CB 409, 25 Fed. Reg. 10928 (Nov. 17, 1960). As discussed in notes 6-9 and the accompanying text, the formalism of these regulations allowed entities to plan around corporate treatment. Furthermore, as new entity types arose that blurred the traditional lines between incorporated and unincorporated entities, Treasury and the IRS ultimately chose to replace the Kintner regulations with the CTB regime, which is largely elective by design, not just as a practical matter. Because of these changes in both entity form and law, it is unsurprising that many modern pass-throughs have many hallmarks that would traditionally be associated with corporations; for the most part, both state law and federal tax law now allow this. But cf. Polsky, supra (questioning whether the check-the-box regulations are valid under section 7701(a)(3)).

45. Cf. Christopher H. Hanna, Corporate Tax Integration: Past, Present, and Future, 75 Tax L. 307, 310-11 (2022) ("Although corporate integration was a substantial part of the discussion leading up to the enactment of the Tax Cuts and Jobs Act, given the 14-percentage point reduction in the corporate tax rate and a substantially revised U.S. international tax system, integration ideas simply fell by the wayside."); id. at 313 (discussing the "graveyard near the White House full of prior [corporate] integration proposals") (quoting Senator Orrin Hatch); id. at 320 (discussing lack of benefit to most corporations from corporate integration).

46. See, e.g., S.1624, 110th Cong. (as referred to S. Comm. on Fin., June 14, 2007); U.S. Senate Committee on Finance, Baucus-Grassley Bill Addresses Publicly Traded Partnerships (March 14, 2007); The President's Economic Recovery Advisory Board, The Report on Tax Reform Options: Simplification, Compliance, and Corporate Taxation, August 2010, at 75-76.

47. See Congressional Budget Office (CBO), Taxing Businesses Through the Individual Income Tax, Pub. No. 4298, at 25, December 2012 (suggesting that subjecting "all publicly traded

firms" to the corporate income tax "would affect few firms not already subject to the corporate tax."); Berger, supra note 33, at 161.

48. See Katarzyna Bilicka and Sepideh Raei, *Output distortions and the choice of legal form of organization*, Economic Modelling, Volume 119, February 2023; see also David S. Mitchell, Factsheet: What the research says about taxing pass-through businesses, Washington Center for Equitable Growth, April 30, 2024 (providing a discussion of emerging research in this space more generally).
49. Martin A. Sullivan, *Economic Analysis: Why Not Tax Large Passthroughs as* Corporations, Tax Notes (June 6, 2011). Sullivan was until recently the chief economist and a contributing editor for Tax Analysts. He previously taught economics at Rutgers University and served as a staff economist at the U.S. Department of the Treasury (Treasury) and the Joint Committee on Taxation (JCT).
50. The President's Framework for Business Tax Reform, supra note 39, at 7 & n.10 (citing Austan Goolsbee, *The Impact of the Corporate Income Tax: Evidence from State Organizational Form Data*, 88 J. Pub. Econ. 2283 (2004); Jeffrey K. MacKie-Mason & Roger H. Gordon, *How Much Do Taxes Discourage Incorporation?*, 52 J. Fin. 477 (1997); Roger H. Gordon & Jeffrey K. MacKie-Mason, *Tax Distortions to the Choice of Organizational Form*, 55 J. Pub. Econ. 279 (1994). To be sure, a solution short of full integration—and especially one that maintains some electivity—cannot fully solve distortions caused by choice of entity form. Nonetheless, the proposal could still result in significant improvement relative to the current-law baseline.
51. Fox, Liscow, & Love, supra note 4.
52. But see Lily L. Batchelder, *The Shaky Case for a Business Cash-Flow Tax Over a Business Income Tax*, National Tax Journal, December 2017.
53. See Modernizing Partnership Taxation, supra note 7.
54. See Modernizing Partnership Taxation, supra note 7, at 8-13; see also Love, supra note 21. Note, however, that not all pass-through compliance concerns are limited to businesses large enough to meet the thresholds for the proposals discussed in this paper. Certain tax planning may be especially concentrated among pass-through entities that are large enough (or that have wealthy enough owners) to support sophisticated tax planning but that may lack the risk aversion of most of the largest pass-through businesses, which often have a clear business purpose divorced from tax-planning. Similarly, the webs of pass-through entities that can support money laundering and other crimes are, in some cases, unlikely to consist of large pass-throughs covered by this proposal, cf. 31 U.S.C. § 5336(a)(11)(B)(xxi) (carving out most large, domestic entities from the Corporate Transparency Act's beneficial ownership information reporting provision); Tax Law Center, Comments on Beneficial Ownership Information Reporting Requirement Revision, Docket No. FINCEN-2025-0001, OMB Control No. 1506-0076, RIN 1506-AB49, at 15-21 (May 27, 2025)—though, in some cases, robust aggregation rules might mean that certain large criminal operations reliant on pass-throughs could be covered entities under this proposal.
55. President's Advisory Panel on Federal Tax Reform, Simple, Fair, and Pro-Growth: Proposals to Fix America's Tax System, at 129 (November 2005).
56. Some commentators theorize that much of the complexity and revenue loss from current partnership tax rules arises from the application of a regime initially intended to apply mostly to small and simple entities to much more complex ones. However, in some cases, the most aggressive tax planning (and even tax evasion) may not be by the largest taxpayers, but rather medium-sized taxpayers with resources to afford sophisticated tax-planning but less risk-aversion than the largest entities. See note 54, supra. To the extent that this is true, it may mean that, even after taking the largest entities out of the pass-through tax regime, there is still need for fairly complex rules to prevent avoidance and abuse. On the other hand, to the extent that rules needed to make the regime workable for larger entities were what created the grounds for avoidance and abuse, simplification and preventing any ongoing opportunities for avoidance and abuse may go hand in hand.
57. E.g., Berger, supra note 33.
58. Fox, Liscow, & Love, supra note 4, at 35-36.
59. See, e.g., Hearing on the Treatment of Closely-Held Businesses in the Context of Tax Reform, supra note 40 (remarks of Mr. Smetana) (suggesting that a proposal to tax more pass-throughs as corporations would "decrease [] opportunities in terms of reinvestment and growth").
60. Determining entity tax treatment based solely on size creates significant complexity. Imposing uniform tax treatment of similar businesses based on a different measure of similarity could reduce some of this complexity (and may reduce other distortions) but would present other trade-offs. This is discussed further below and in the Technical Appendix. Accordingly, the base proposal adopts a size-only threshold to align with many existing proposals of this nature, because it can be tailored to more directly exclude small businesses, and because of the infeasibility of estimating the revenue effects of proposals based on certain other criteria from public data.
61. Certain prior proposals have examined some of these questions in detail, but these are in need of updating. See, e.g., Berger, supra note 33. Other proposals make certain determinations in order to provide revenue estimates but examine fewer legal details. See, e.g., Jason Furman, How to Increase Growth While Raising Revenue: Reforming the Corporate Tax Code, The Hamilton Project, January 2020, The Hamilton Project, at 302 (building on the President's Advisory Panel on Federal Tax Reform, supra note 55, recommendation as to which types of entities should be covered, and at what size, but suggesting revising the gross receipts threshold upwards to $25 million based on inflation).
62. The base proposal would not apply to some specific entities or arrangements commonly thought of as pass-throughs, such as REITs, RICs, and sole proprietorships. See Section 5 (Questions & concerns), below, and the Technical Appendix.
63. See section 448(c).
64. In applying corporate treatment, the base proposal would not treat the two entities as a single corporation, but rather as two separate corporations that may be aggregated together in circumstances where relatedness rules apply. Additionally, a modification to the aggregation rules under the base proposal means that if both entities are domestic, the two entities now treated as corporations will generally be eligible for consolidated group treatment (i.e., to file consolidated rather than separate tax returns).
65. See, e.g., section 965(h) and S. 2095, § 11(c), 119th Cong., as introduced in Senate (June 17, 2025) (providing or proposing a similar installment payment mechanism for similar tax liabilities arising as a result of a change in law).
66. As under current law, a covered entity could undertake an actual liquidation or other asset transfer (e.g., a merger) to effectively convert back into a pass-through entity. However, there are often significant business or other nontax obstacles to such transactions, and, where such a transaction is feasible, it would generally be fully taxable.
67. See Tax Policy Center n.d., Microsimulation Model FAQ.
68. See, e.g., Furman, supra note 61, at 310.
69. Some commentators have suggested that it impossible to do this in a workable way, however. See, e.g., Hearing on the Treatment of Closely-Held Businesses in the Context of Tax Reform,

supra note 40 (Remarks of Mr. Nichols) (suggesting that structures with, "let's say, two dozen affiliated entities" could result in rules "at least as complicated and probably many more times more complicated" than the already complex consolidated return rules for corporations).

70. Specifically, the estimates assume that about 45 percent, on average, of after-tax profits are distributed in the year earned among entities that become C corporations under the base proposal. They further assume that about 60 percent of retained earnings are realized in the form of capital gains over the 10-year budget window.

71. This would be similar to some planning that occurs today around the S corporation one-class-of-stock requirement. That is, to remain eligible for S corporation treatment, entities today may engage in creative planning to characterize what might otherwise be treated as a second class of stock as a loan or other contractual arrangement. Under the base proposal, some entities may engage in similar planning designed to treat an entity as having only a single owner for tax purposes (i.e., planning that turns all but one owner's equity interests into non-equity arrangements) to remain a sole proprietorship or DRE.

72. Modernizing Partnership Taxation, supra note 7.

73. Note that certain existing tax rules evaluate an entity's size based on an asset test that looks to the tax basis of assets rather than their fair market value. See section 1202. However, tax basis generally does not reflect any untaxed gain or loss in asset value and is thus generally a poor measure of current asset value, especially for start-up businesses. Thus, an asset test for Covered Entity status should in any case avoid following section 1202's lead.

74. See, e.g., section 856(c)(4)(A) (the asset test for REIT qualification); sections 851(b)(3) and 851(c) (the diversification test for RIC qualification); sections 1297(a)(2) and 1297(e) (the passive asset tests for PFIC status). REITs also must satisfy additional asset tests under section 856(c)(4)(B)); what is most relevant here, though, is not the criteria to qualify for REIT status, but rather the existing method for measuring total assets.

75. To be sure, number of partners is correlated with size, though there are large partnerships with as few as two partners, as well as partnerships with more than 100 or even 1,000 partners that do not meet certain measured size thresholds. See Partnership Returns, Tax Year 2023, at 3.

76. "Partnerships with 100 or more partners accounted for only 0.4% of all partnerships, but 35.5% of all partners in 2023." See Ron DeCarlo et al., Partnership Returns, Tax Year 2023, at 1, IRS Statistics of Income Bulletin, Fall 2025.

77. The requirement that ownership be proportionate, or pro rata, would be somewhat difficult to draft for partnerships, but existing proposals provide a starting point. For example, Senator Wyden's recent proposal to require certain partnerships with related party partners to use a "consistent allocation" method, see PARTNERSHIPS Act, S. 2095, § 2, 119th Cong. (as referred to S. Comm. on Fin., June 17, 2025), is conceptually similar to imposing an S corporation-style one-class-of-stock requirement on a partnership.

78. The report states that Congress could require large pass-throughs "to pay a separate entity-level tax, without necessarily requiring them to alter their organizational form if they choose to keep it for other reasons." Alexandra Thornton & Brendan V. Duke, Ending the Pass-Through Tax Loophole for Big Businesses, Center for American Progress, August 2016, at 21. This may just be a reference to the fact that the entity need not change its organizational form for state-law purposes, or it may be alluding to the fact that Congress could impose an entity-level tax on certain pass-throughs but otherwise allow them to remain within subchapter K or S.

79. Furthermore, certain other taxes or proposals either are, or initially seem like they may be, helpful in designing such a tax. For example, certain states and localities have long had—and many states and localities now have, as a workaround to the federal cap on deductions for state and local taxes—entity-level taxes on pass-throughs. These taxes are somewhat informative here in that they define a tax base for a pass-through entity-level tax and in that they make determinations about how to apply the tax in tiered entity structures. However, these taxes do not depend on the size of the entity, so they do not require a determination of how to define size or what threshold to set, and, furthermore, do not require aggregation rules to determine when that size threshold is met or to prevent entities from splitting apart to avoid that threshold. Similarly, fundamental business reform proposals that propose to tax all entities, including pass-throughs, once at the entity level, see, e.g. Fox, Liscow, & Love, supra note 4, at 39 (discussing proposals to tax "all businesses . . . as entities and on a cash flow basis"), must make certain determinations that are relevant here but do not implicate certain of the design questions relevant to imposing an entity-level tax on a business that otherwise remains a pass-through.

80. See Tax Law Center, Employment taxes on active pass-through income, The Tealbook: Options to Broaden the US Tax Base.

81. See Tax Law Center, Qualified Small Business Stock, The Tealbook: Options to Broaden the US Tax Base.

82. See section 852(b)(6); Tax Law Center, Exchange-traded funds (ETFs), The Tealbook: Options to Broaden the US Tax Base; Tax-free swap fund exchanges, The Tealbook: Options to Broaden the US Tax Base.

83. See Miles Johnson, Taxing the Step-up: A Logical Approach to Related-Party Basis Shifting, Tax Notes (July 7, 2025); Tax Law Center & Miles Johnson, How large businesses use partnerships to create tax deductions out of thin air: An explainer on related party basis shifting (July 26, 2024); Duncan Hardell, How some corporations manipulate losses using *Granite Trust* transactions to avoid tax, Tax Law Center (December 2, 2024), Duncan Hardell et al., *Uncovering the Cracks in* Granite Trust *Transactions*, Tax Notes (November 18, 2024); Duncan Hardell, Michael Kaercher, & Thalia T. Spinrad, *More Cracks in the Bedrock: Section 304 Tactics Beyond* Granite Trust, Tax Notes (June 2, 2025). .

84. See, e.g., Modernizing Partnership Taxation, supra note 7.

85. The literature proposing reforms to the corporate tax is large, including longstanding debate on the merits of reforms that move toward or away from cash-flow taxation.

86. For example, the desire to qualify for pass-through treatment under the RIC or REIT rules could push a greater number of existing investment vehicles, currently structured as partnerships, to take aggressive positions on whether they satisfy the asset and income tests for RIC or REIT treatment. This could require a further tightening of the RIC or REIT qualification rules or could require the IRS to devote further administration and enforcement resources to RICs and REITs.

87. Note however that some of the complementary pass-through reforms may raise less revenue after implementation of the base proposal, which narrows the pass-through base, than they do under current law. This is similar to how an increase in the top individual rate raises less revenue after implementation of the base proposal.

88. Derived from IRS SOI data for 2022 found here: SOI Tax Stats—Partnership statistics by sector or industry | Internal Revenue Service.

89. Derived from IRS SOI data for 2022 found at Table 6.1, here: SOI Tax Stats—Corporation Income Tax Returns Complete Report (Publication 16) | Internal Revenue Service. This distribution appears to be largely consistent over time, since data for 2013 (found here: SOI Tax Stats—Table 4—Returns of active

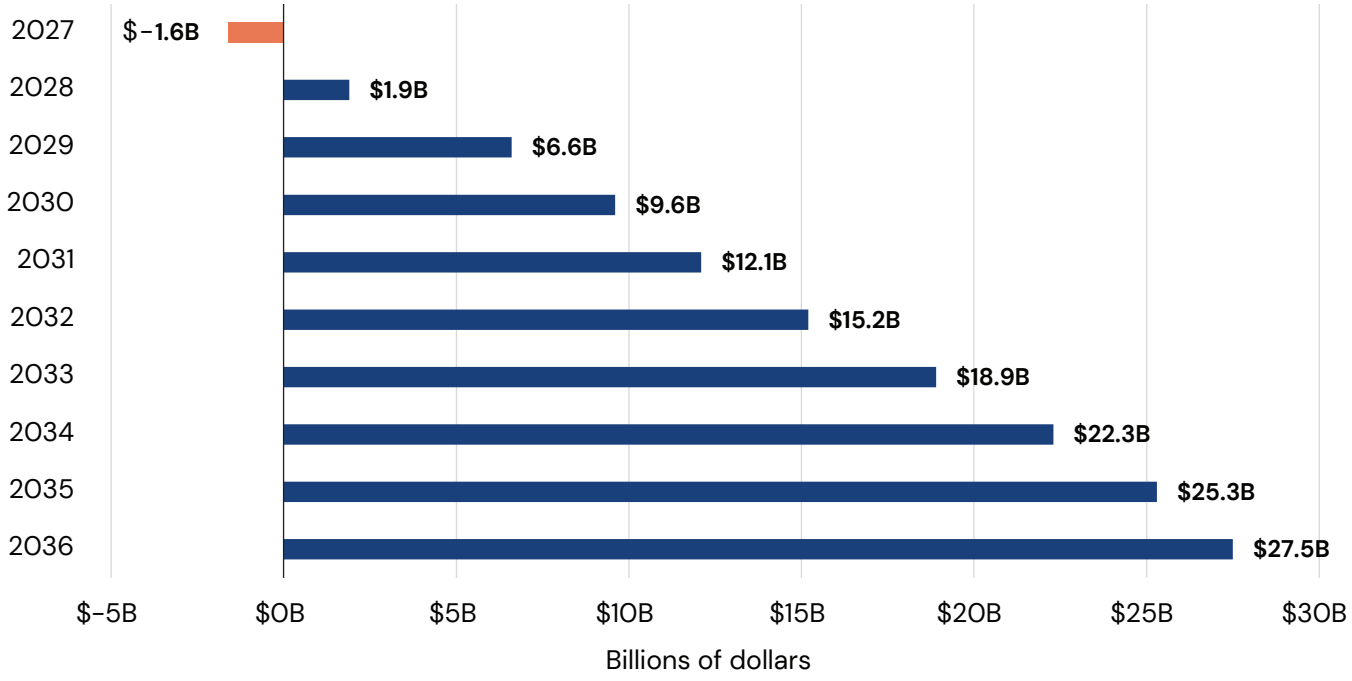
corporations, Form 1120s | Internal Revenue Service) also indicate that the gross receipts of the largest S corporations are concentrated in the industries of (1) wholesale and retail trade, (2) manufacturing, and (3) construction.

90. See section 199A(d)(2)(A); Justin Elliott & Robert Faturechi, *Secret IRS Files Reveal How Much the Ultrawealthy Gained by Shaping Trump's "Big Beautiful Tax Cut,"* ProPublica (August 11, 2021) (discussing lobbying by a large pass-through entity for the treatment engineering and architecture firms receive under section 199A).
91. Large private equity firms that have converted to full or partial corporate treatment before or after the TCJA include Blackstone, KKR, Ares, the Carlyle Group, TPG, and Blue Owl. See Blackstone, Blackstone Completes Conversion to a Corporation (July 01, 2019); Reuters, Private equity firm KKR opts to become C-Corps after U.S. tax reform (noting that KKR was listed on the NYSE in 2010, and on Euronext Amsterdam in 2009); Axios, Ares to convert from partnership to C-Corp (February 16, 2018); Carlyle, The Carlyle Group Announces Conversion to Full C-Corporation, Reports Second Quarter 2019 Financial Results (July 31, 2019); TPG Partners, LLC, SEC Form S-1 (Dec. 16, 2021); Blue Owl Capital Inc., SEC Form S-1 (Oct. 4, 2021).
92. Private equity funds are one type of investment fund that primarily invests in the equity of operating companies, often under a "buyout" strategy that is focused on acquiring majority or control positions in such companies. The private equity funds themselves are typically organized as partnerships for tax purposes. Other types of investment funds, such as hedge funds (which invest primarily in public securities) and private credit funds (which primarily make loans or otherwise invest in debt instruments) are also often organized as partnerships and could therefore be captured by the proposal if they satisfy the relevant threshold.
93. Ryan Hess et al., *The Spiderweb of Partnership Tax Structures*, Washington Center for Equitable Growth, Working Paper (February 2025).
94. Otay Project LP v. Commissioner, T.C. Memo. 2026-21 (Feb. 23, 2026); Walter D. Schwidetzky, The *Otay* Sham, Tax Notes (Aug. 19, 2025).
95. See Modernizing Partnership Taxation, supra note 7, and appendix thereto for a more detailed discussion of the information gaps with respect to partnership taxation, including the lack of information and concrete data regarding the broader economic benefits or detriments of existing partnership tax rules

THE HAMILTON PROJECT ADVISORY COUNCIL

The U.S. tax system raises insufficient revenue to meet national needs. The erosion of taxes on business income, including as a result of both the increasing use of pass-through entities and the growth in size and complexity of such entities, has been a significant driver of these revenue losses. Furthermore, applying pass-through taxation to an increasing number of complex arrangements has created substantial challenges for tax administration, compliance, and enforcement. This paper examines an approach that many policymakers have offered to address these issues: requiring large or complex pass-through entities to pay federal income tax at the entity level, as corporations do. This paper outlines the challenges that the current system presents and the reasons such an approach has been attractive. It then develops and evaluates a concrete proposal to treat certain pass-through entities as corporations, examining how such a proposal could be constructed and implemented and its revenue and distributional impact. Revenue and distribution estimates have been provided by the Urban-Brookings Tax Policy Center.

Revenue raised by base proposal, 2027–36



Source: Tax Policy Center 2026.

Note: Figure shows revenue estimates for the base proposal, i.e., requiring partnerships and S corporations with gross receipts exceeding $25 million to be treated as C corporations for federal income tax purposes. Revenue and distribution estimates have been provided by the Urban-Brookings Tax Policy Center.

THE HAMILTON PROJECT

The Tax Law Center NYU LAW

THE HAMILTON PROJECT
BROOKINGS

www.hamiltonproject.org
1775 Massachusetts Ave., NW
Washington, DC 20036
202-238-3649

Printed on recycled paper