# WHAT'S AT STAKE: PASS-THROUGH DEDUCTION AND INDIVIDUAL INCOME TAX RATES

**96%** of U.S. businesses are organized as pass-throughs

**93%** of manufacturers have fewer than 100 employees

**93%** of pass-through manufacturers say losing the pass-through deduction will cost jobs, growth and investment

## › What is a pass-through?

The defining feature of a pass-through is that its business profits are "passed through" to the business owners, who pay income tax on those earnings on their personal returns. Pass-throughs can be structured as S-corporations, partnerships, limited liability companies or sole proprietorships.

More than 96% of businesses in America are organized as pass-throughs. In the manufacturing industry, pass-throughs are typically small, family-owned businesses. Across the sector, 93% of manufacturers have fewer than 100 employees, while 75% have fewer than 20 employees.

## › How are pass-through manufacturers taxed?

Because pass-throughs' earnings flow to the owners of the business, they pay tax at individual income tax rates based on their income each year. Most pass-through manufacturers pay tax at or near the top individual rate. They are not subject to corporate income taxation.

Critically, while a pass-through's owners are responsible for its tax obligations, the business's earnings do not go into the owners' pockets—but rather are reinvested in employees, equipment, machinery, facilities and more.

## › How did tax reform impact pass-through manufacturers?

Tax reform instituted a new deduction to help pass-throughs invest in their businesses. The Section 199A pass-through deduction allows pass-through manufacturers to deduct up to 20% of their qualified business income, decreasing their effective tax rate.

Tax reform also lowered the top individual income tax rate from 39.6% to 37% while adjusting the top tax bracket, further reducing pass-throughs' tax obligations.

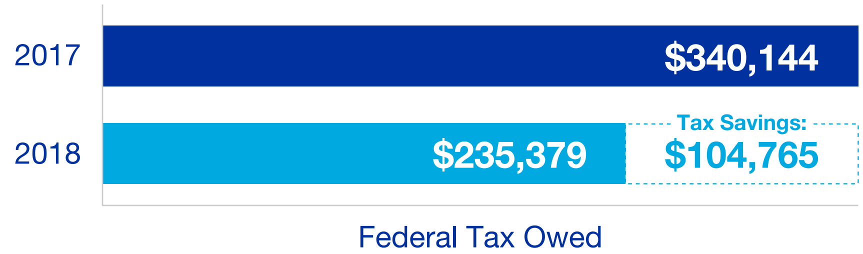
## What did these changes mean for pass-through manufacturers?

In combination, the pass-through deduction and the lower individual rates freed up significant capital for pass-through manufacturers to invest in their businesses. Across the manufacturing industry, 2018 saw the best year for manufacturing job creation in 21 years and the best year for wage growth in 15 years.

This progress was driven by small manufacturers' ability to use more of their hard-earned income for capital equipment purchases, R&D and other job-creating investments. For example, thanks to the pass-through deduction and the individual rate reductions, a small pass-through manufacturer with $1 million in taxable income saw its tax obligations reduced by more than $100,000 from 2017 to 2018.

### Tax Reform's Pass-Through Changes Free Up Capital for Job Creation and Growth

*Chart illustrates federal tax owed before and after pass-through deduction and individual rate changes for pass-through manufacturer with $1 million taxable income*




## What's at stake for pass-through manufacturers in 2025?

The 20% pass-through deduction is set to expire at the end of 2025. Additionally, individual income tax rates and brackets are scheduled to revert to their pre-tax reform levels.

The combination of these changes will be a one-two punch for pass-throughs across the country. A recent NAM survey found that 93% of pass-through manufacturers said that the loss of the pass-through deduction will harm their ability to grow, create jobs and invest in their business.

If Congress allows the pass-through deduction to expire and individual income tax rates to rise, pass-throughs' effective tax rate will increase by at least 10 percentage points—a drastic tax hike for small businesses across the country.

## What should Congress do to protect pass-through manufacturers?

Congress must make the pass-through deduction permanent and keep the individual income rates as low as possible. The 96% of American businesses organized as pass-throughs are depending on Congress to protect them from devastating tax increases.