

Taxes Paid by Small Business in Minnesota

A. Definition of small business

There is no single definition of a "small" business. The Small Business Administration has official definitions that vary with the type of business. For example, farms are generally "small" if sales are less than \$750,000 (but \$2.5 million for cattle feed lots and \$12.5 million for chicken egg production). For mining, manufacturing, and some other companies, SBA's definition of small is generally less than 500 employees (but up to 1000 employees for some industries in food, paper, chemicals, primary metals, computer & office machinery, electrical and transportation equipment, etc.; and up to 1500 employees in aircraft and ammunition manufacturing, passenger airlines, railroads, pipelines, telecommunications, courier service, and insurance). In wholesale, the definition is usually less than 100 employees. In retail, small generally means less than \$7 million in annual sales (but up to \$29 million for auto dealers and \$27 million for department stores, convenience stores, discount & warehouse stores and \$25 million for mail order and internet sales companies. For banks, the definition is generally based on total assets (less than \$175 million in assets). See the attached 44-page SBA publication for more detail.

To be a small business, the SBA also requires a business to be "independently owned and operated" and "not dominant in its field on a national basis." A small business can take any legal form – a sole proprietor, partnership, S-corporation, limited liability company, or C-corporation."

B. Number of small businesses

The second SBA publication attached to this email summarizes their count of businesses in Minnesota that have less than 500 employees. For 2006, their report shows a total of 121,742 Minnesota businesses with less than 500 employees, compared to only 2,495 businesses with 500 or more employees. The report shows an additional 376,864 businesses with no employees. This gives a total of 498,606 businesses with less than 500 employees (including those with no employees), compared to 2,495 businesses with 500 or more employees.

Quite a few of the companies with less than 500 employees would not meet the SBA's own technical definition of "small business," though – and a few with more than 500 employees would be defined as "small" by the SBA definition.

Tax records are not very helpful in identifying "small businesses." Some assume that all C-corporations are "large" and that all S-corporations, partnerships, sole proprietors, and farmers are "small." However, over 60 percent of the 40,000 business entities organized as C-corporations and registered in Minnesota in 2005 had less than \$500,000 in total payroll; over 80 percent had less than \$5 million in total payroll. (Note that \$5 million in payroll would allow 100 employees at an average of \$50,000 per employee.) This shows that many C-corporations are small businesses. Some S-corps and partnerships are quite large (twenty have Minnesota payroll exceeding \$50 million in 2005), but over 80 percent of the 140,000 registered in Minnesota had total payroll of less than \$500,000 in 2005. In addition, there were roughly 370,000 individual income tax returns filed by sole proprietors and 70,000 by farmers.

If we include all C-corporations, S-corporations, and partnerships with less than \$5 million in total payroll and also include all sole proprietors and farmers regardless of size, the total number of "small" businesses would total about 580,000. (This exceeds the SBA numbers for 2006, but the SBA numbers may not include the 70,000 farmers, and the definition of "small" from tax returns is based on payroll rather than the number of employees.)

C. Taxes paid by small businesses

Small businesses pay property taxes on business property and sales tax on their purchases of some equipment and supplies, along with excise taxes on motor fuels, motor vehicle registration taxes, and other forms of state and local taxes. *We have no way to determine the share of any of these taxes that are paid by “small” businesses rather than “large” businesses.* We have limited information on the small business share of individual and corporate income taxes, but it should be noted that these taxes on business income account for only about one-sixth of the total “business taxes” collected in Minnesota.ⁱ

What we know about the income taxes paid by Minnesota businesses in 2005 is as follows:

1. Sole proprietors, farmers, partnerships partners, and S-corporation shareholders reported about \$12 billion in income on Minnesota income tax returns, or 8.7% of total income reported. If their share of tax liability is also assumed to be 8.7%, that would total \$540 million in tax. An unknown fraction of this tax was paid by on earnings of “large” companies
2. S-corps and partnerships also pay “minimum fees” at the entity level – a total of about \$30 million. About two-thirds of this was paid by businesses with less than \$5 million in payroll (about \$20 million in tax)
3. Of the total corporate income tax, about 12% was paid by C-corporations with less than \$5 million in payroll (about \$120 million in 2005).
4. Summing up the three pieces listed above, the total income and corporate tax paid by these businesses (including some large ones) would be \$680 million. Total income and corporate tax collections exceeded \$7.2 billion.

D. Conclusions

There is no easy way to define a “small” business. I know of no count of small businesses in Minnesota using the detailed SBA definition. Using the category “less than 500 employees” is one possible way to define “small.” By that definition, SBA counted about 500,000 small businesses in Minnesota in 2006. Counts of small business using tax returns and assuming small generally means payroll of less than \$5 million – a stricter criteria than than the less-than-500-employee rule – shows about 600,000 (if all farmers are included).

The Department of Revenue has no information on the share of property, sales, or excise taxes paid by small business. We have limited information about the share of income and corporate taxes paid by small business. In 2005, 8.7% of total income reported on Minnesota returns was business income reported by sole proprietors, farmers, partners in partnerships, or shareholders in S-corporations. Their share of individual income tax revenue may be similar (though some of this income is from companies that are “large”). Small C-corporations (business entities with fewer than \$5 million in total payroll) paid 12% of the corporate income tax. As a rough approximation, this suggests that a bit less than 10 percent of all Minnesota income taxes are levied on the income of Minnesota small businesses.

ⁱ Andrew Phillips, Robert Cline, Thomas Neubig, and Julia Thayne, Total State and Local Business Taxes: State-by-State Estimates for Fiscal Year 2009 (Ernst & Young LLP, March 2010), p.24. This report was prepared for the Council on State Governments, and is available on-line at: [http://www.ey.com/Publication/vwLUAssets/Total-state-and-local-business-taxes-March-2010/\\$FILE/Total-state-and-local-business-taxes-March-2010.pdf](http://www.ey.com/Publication/vwLUAssets/Total-state-and-local-business-taxes-March-2010/$FILE/Total-state-and-local-business-taxes-March-2010.pdf).