

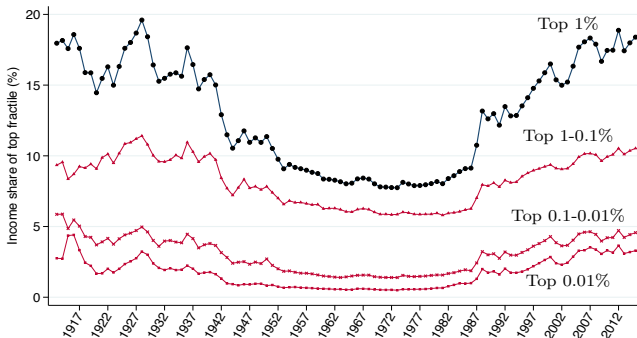
Discussion: Capitalists in the Twenty-First Century

Matthew Smith Danny Yagan Owen Zidar Eric Zwick

Claudio Michelacci, 2nd BdE Annual Research

Motivation I: Rise in Inequality

A. The Rise in Income Inequality

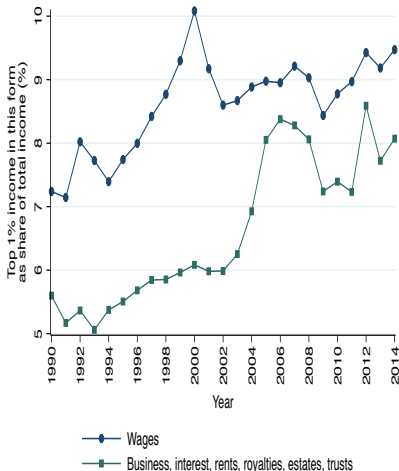


Income = **Wages** + **Total business income** (of S-corp.)
+ **Dividend payments** (of C-corp.) + **Other**

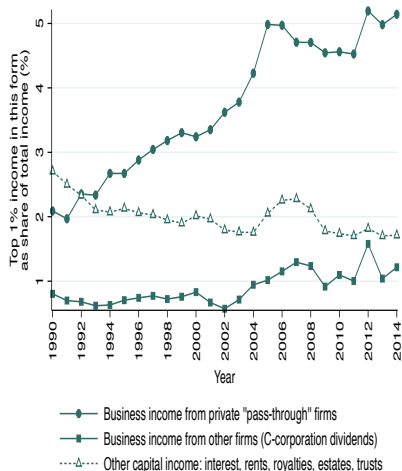
Capital gains (realized/unrealized) are excluded

Motivation II: The role of business income

B. Wage Income vs. Capital Income

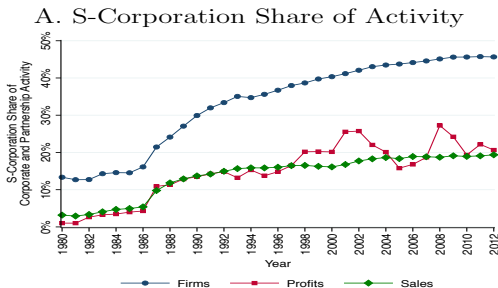


C. Types of Capital Income



Second Reagan tax cut of 1986

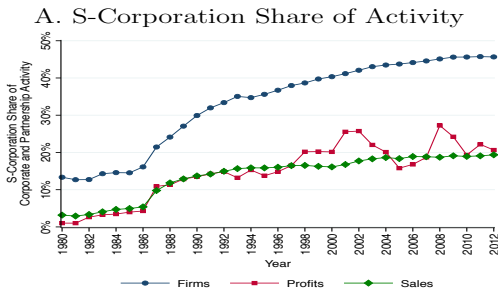
- Dividends of C-corp. subject to double taxation
Marginal tax rate: 50% $= 1 - (1 - 0.35) \times (1 - 0.238)$
- Income of S-corp. taxed as personal income: **39.6%**
- Some restrictions to claim as S-corp.



- Warning** on **retained earnings**: mature businesses
- Act of January 1st, 2018 fixed this: now marginal tax on C-income is 40% $= 1 - (1 - 0.21) \times (1 - 0.238)$

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What they show

- Income tax data to link firms to their owners over 2001-2014. They show:
- **Premature owner's death** causes a substantial decline in firm performance
- Top owned firms are **more profitable**
- **Rising profitability** (rather than rising scale) explains rising top business income
- Top business owners concentrated in labor intensive/ high skilled sectors

What they conclude

- ① No support for **rentier hypothesis**
 - ① **Firm performance** independent of owner
 - ② **Top business income** due to scale of business
- ② Some S-corp. income is labor income, so **decline of labor share is overestimated** (quantitatively small)
- ③ **Marginal tax rate can fall** at high income levels (claiming as S-corp. saves 2.9% of additional federal labor income tax)

Evaluation

- 100 pages of **great empirical evidence** with the side benefit of a crash course on US tax policy
- Discuss some issues related to
 - ① **Capital gains** and retained earnings
 - ② **Rentier hypothesis**

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Which income is missing?

- Realized/unrealized **capital gains** are excluded
- **Reasonable** (though debatable) if income includes retained earnings
- But just **two possibilities**: including either retained earnings or capital gains, but one should be in.
- Firm life cycle model under financial constraints and idiosyncratic risk: **zero income** (if C-corp)
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Bill, Mark and Steve



Microsoft funded in 1975, public in 1986, dividends in 2004;

Facebook has never paid out any dividends;

Apple funded in 1976, public in 1980, dividends in 2012

This issue is particularly relevant here

- Retained earnings are part of income **only if S-corp.** (no if C-corp.)

① Tax changes have increased the value of filing as S-corp.: some **unreported income** appears

② Owner death can lead to **IPO**: exit could be a **blessing** rather than a **curse**

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Rentier hypothesis: passive rentiers

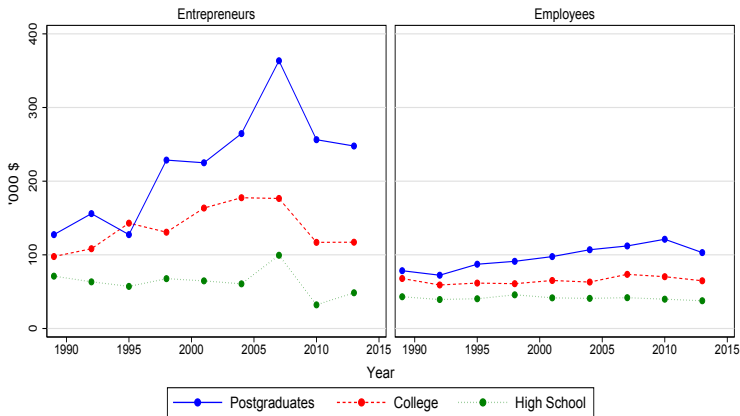
- It could be dismissed by just observing that **business income is undiversified**
- **Scale is endogenous** and typically correlated with profitability: mark-ups up scale down, TFP high scale up.
- **Higher business income** could well be due to **greater rents**
- Not sure about the meaning of the **rentier hypothesis**.

Has the Return to skill of entrepreneurs increased?

Survey of Consumer Finances (SCF)

Entrepreneur: as a main job, owns business [X3103] and actively manages it [X3104]

$$\text{Income} = y + w + \lambda(M - k) - \rho k$$



Two notes for the literature

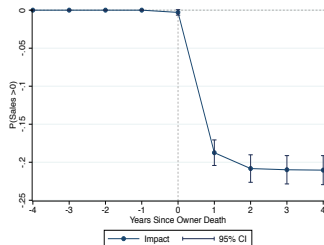
- I do believe that **return to skill in entrepreneurship** has increased but this is not informative about **existence of business rents**
- **Capital gains** probably matter more than currently acknowledged by literature on income inequality

Conclusions

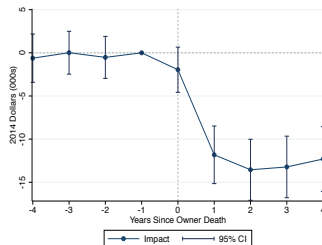
Great work!

The effects of business owner death

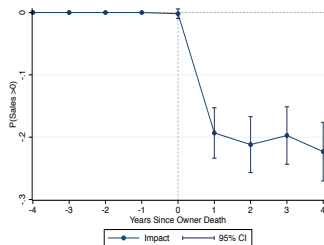
A. Firm Survival of Top 1% Owned



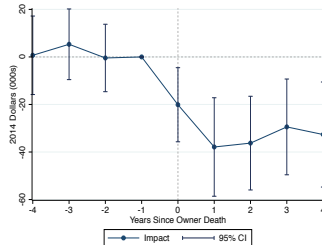
B. Profits per Worker of Top 1% Owned (\$K)



C. Firm Survival of Top 0.1% Owned

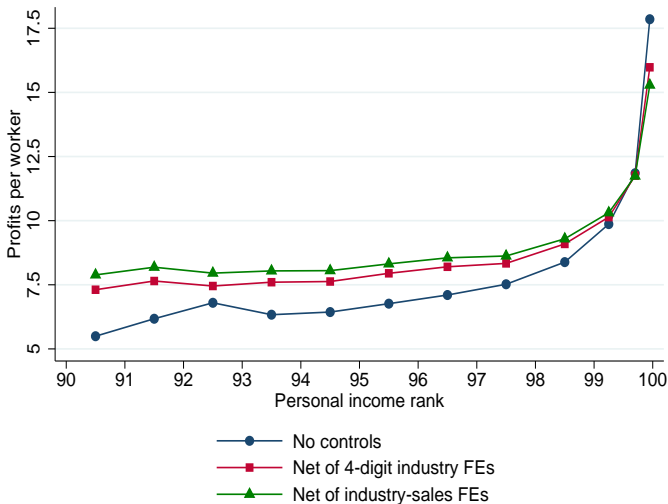


D. Profits per Worker of Top 0.1% Owned (\$K)



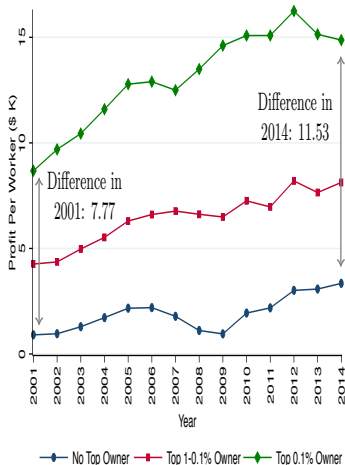
Top income firms are highly profitable

A. Profitability Increases with Owner Income Rank (All Firms)



Rising profitability at constant scale

A. Profitability Differences are Diverging



B. Firm Size Differences are Not

