Effects of Marginal Tax Rate Increases on Small Businesses

Daniel Clifton and Josh Barro

All of the major Democratic presidential candidates are proposing to repeal some or all of President Bush’s landmark tax relief legislation. Those candidates who propose to repeal only some plan to return the top marginal rate to 38.6% or higher. Therefore, all of the major Democratic presidential candidates advocate at least a 10% increase in the top marginal tax rate, from 35% to 38.6%. The candidates call these tax increases for the rich, but since more than two-thirds of top bracket filers are small business owners, they are really proposing to hike the Small Business Tax.¹

Small businesses are the engine of our economy, employing vast numbers of Americans:

- There were 22.8 million small businesses in America in 2000.
- More than 98% of American companies have fewer than 100 employees.
- These companies account for 36% of all employment.
- Half of American workers work for companies with fewer than 500 employees.

So what will happen if the Democrats raise the Small Business Tax by more than 10%? According to researchers at the National Bureau of Economic Research, such a tax hike will:²

- Reduce the likelihood of small business hiring by about 10.7%
- Reduce median wages paid by small businesses by between 3 and 4%
- Reduce small business gross receipts by about 7.7%

The Democrats’ proposed tax hike on the “wealthy” is actually a tax hike on small business owners AND the working families employed by those businesses. It will increase unemployment, decrease wages, and inhibit economic growth.

If this doesn’t sound like progress to you, you’re not alone. Sen. John Kerry (D-MA) pledges “to go backward” on taxes. His description couldn’t be more accurate.³