

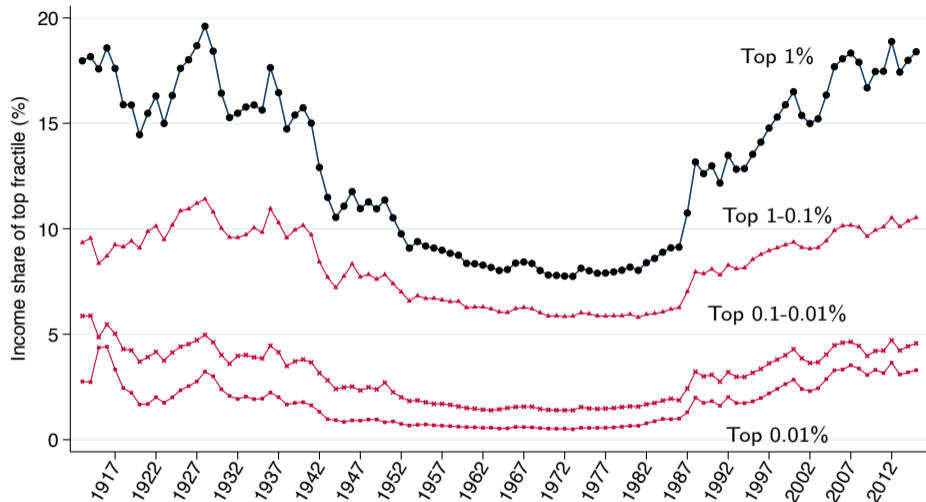
Capitalists in the Twenty-First Century

Matthew Smith, US Treasury Department
Danny Yagan, UC Berkeley and NBER
Owen Zidar, Princeton and NBER
Eric Zwick, Chicago Booth and NBER

June 2019

*The views expressed here are the authors' and do not necessarily reflect those of the Treasury Department.

What is the nature of top incomes in the 21st century?

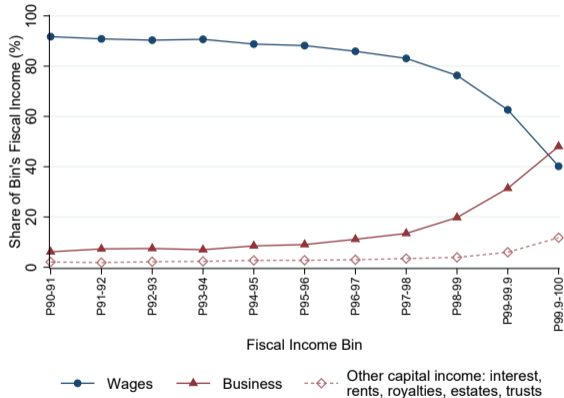


Thresholds: Top 1% \approx \$400K. Top 0.1% \approx \$1.5M. Top 0.01% \approx \$6.8M.

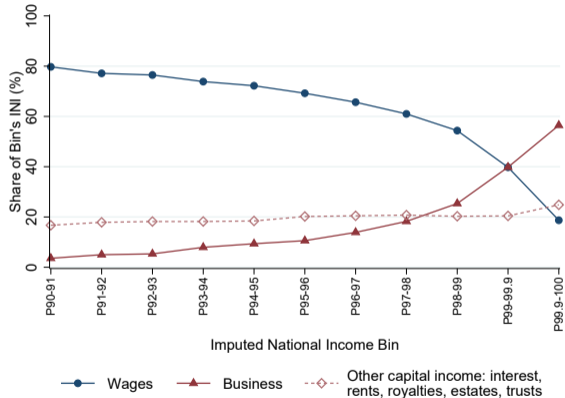
Source: Piketty Saez (2003, 2016)

Are the richest Americans human-capital or financial-capital rich?

Fiscal Income (FI)

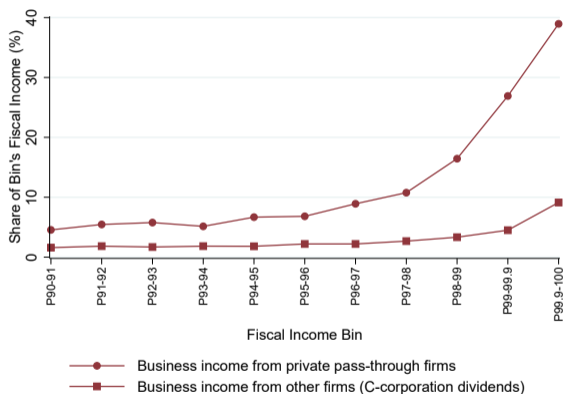


Imputed National Income (INI)

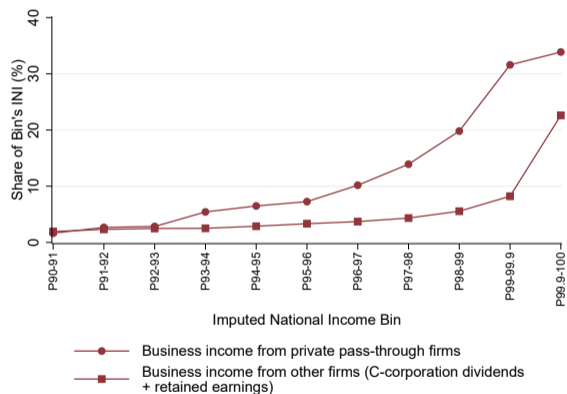


Pass-through business income makes up most of top capital income

Fiscal Income (FI)



Imputed National Income (INI)



Key: Even in INI, most top business income is pass-through income

This paper

Fact: Pass-through business income is the main source of top incomes

Question: What is the nature of pass-through income and why is it rising?

Data: Link 11 million firms to their owners and workers

Approach: Provide facts and assess the idle rich/capital hypothesis

1. Most top earners are human-capital rich: they derive most of their income from human capital, not physical or financial capital.
2. The human capital income of private business owners exceeds top wage income and top public equity income.

Linked firm-owner-worker data

S-corporations/Partnerships: Private “pass-through” businesses

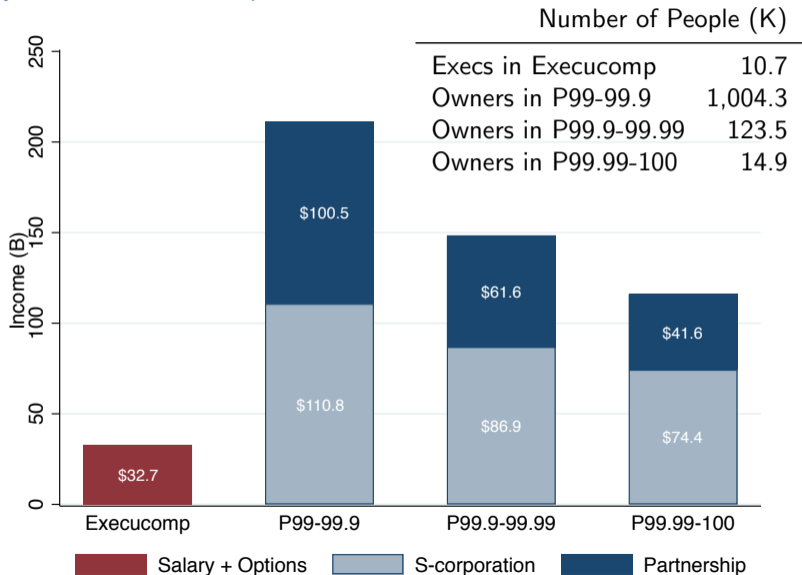
- Taxed only at owner level, lower taxes
- S-corporations: Dominant form, ≤ 100 U.S. individual owners
- More S-corps than C-corps, even with >500 M sales
- Nearly all public companies are C-corps

Pass-through taxation → **firm-owner-worker paper trail**

- Forms 1120S/1065 + 1120S/1065 K1 + 1040 + W-2
- 11M firms, 23M owners, 159M firm-owner-years 2001-2014

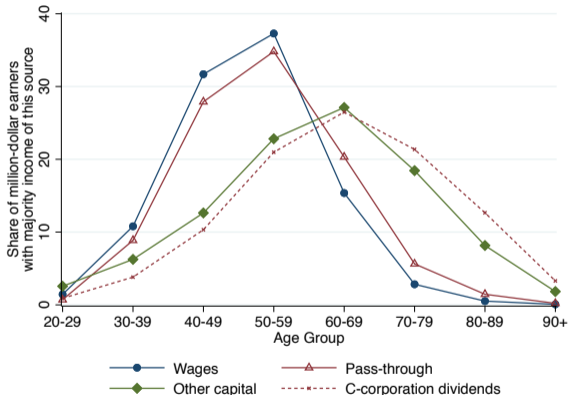
Pass-through income in top 1% is large

Tax units ranked by fiscal income, full sample in 2014.

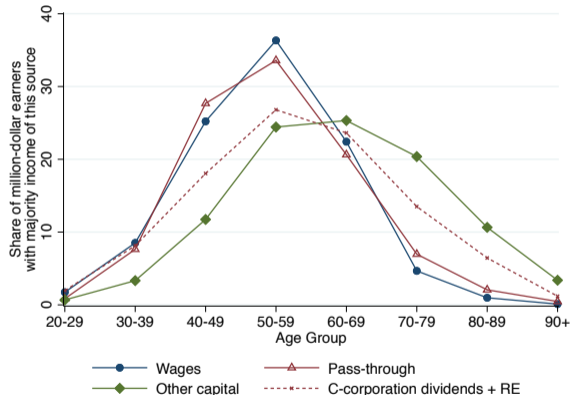


Millionaire Pass-through Owners are Working Age

Fiscal Income (FI)



Imputed National Income (INI)



Result: Non-pass-through capital earners look older, more like idle rich

S-corporation industries: Diverse, skill-intensive

2014 S-corporation sample. Statistics in millions of 2014 USD.

S-corporation Industry (NAICS)	Top 1-0.1 π (\$M)	S-corporation Industry (NAICS)	Top 0.1 π (\$M)
1 Offices of physicians (6211)	9063	1 Other financial investment actvty (5239)	5786
2 Other professional/technical svc (5419)	4778	2 Automobile dealers (4411)	5176
3 Offices of dentists (6212)	4317	3 Oil/gas extraction (2111)	4820
4 Other specialty trade cntrctr (2389)	3893	4 Other professional/technical svc (5419)	4186
5 Legal svc (5411)	3485	5 Offices of physicians (6211)	3621
6 Insurance agencies/brokerages (5242)	2678	6 Computer sys design/related svc (5415)	3206
7 Computer sys design/related svc (5415)	2662	7 Management/techncl consulting svc (5416)	3185
8 Architectural/engineering svc (5413)	2642	8 Other specialty trade cntrctr (2389)	3086
9 Building equipment cntrctr (2382)	2595	9 Legal svc (5411)	2847
10 Restaurants (7225)	2421	10 Misc. durable goods merch whsl (4239)	2836
11 Management/techncl consulting svc (5416)	2196	11 Other fabricated metal prod mfg. (3329)	2727
12 Nonresidential building constr (2362)	1906	12 Other miscellaneous mfg. (3399)	2477
13 Offices of other health practitioners (6213)	1886	13 Activities related to real estate (5313)	2286
14 Misc. durable goods merch whsl (4239)	1684	14 Other heavy constr (2379)	2248
15 Other fabricated metal prod mfg. (3329)	1670	15 Nonresidential building constr (2362)	1940

Partnership industries: Skill-intensive, concentrated in law + finance

Partnership sample. Statistics in millions of 2014 USD.

Partnership Industry (NAICS)	Top 1-0.1 π (\$M)	Partnership Industry (NAICS)	Top 0.1 π (\$M)
1 Legal svc (5411)	21320	1 Other financial investment actvty (5239)	20220
2 Offices of physicians (6211)	5923	2 Legal svc (5411)	18200
3 Accounting/bookkeeping svc (5412)	5316	3 Activities related to real estate (5313)	2534
4 Other financial investment actvty (5239)	3395	4 Other professional/technical svc (5419)	2254
5 Other professional/technical svc (5419)	1641	5 Oil/gas extraction (2111)	2035
6 Outpatient care centers (6214)	1449	6 Management/techncl consulting svc (5416)	1637
7 Activities related to real estate (5313)	1357	7 Security contracts broker (5231)	1485
8 Management/techncl consulting svc (5416)	1263	8 Other investment pools/funds (5259)	1372
9 Oil/gas extraction (2111)	1139	9 Accounting/bookkeeping svc (5412)	1166
10 Restaurants (7225)	694	10 Offices of physicians (6211)	1026
11 Offices of other health practitioners (6213)	670	11 Automobile dealers (4411)	693
12 Offices of dentists (6212)	574	12 Residential building constr (2361)	689
13 Insurance agencies/brokerages (5242)	573	13 Lessors of real estate (5311)	685
14 Computer sys design/related svc (5415)	563	14 Computer sys design/related svc (5415)	585
15 Architectural/engineering svc (5413)	550	15 Fruit/tree nut farming (1113)	482

Natural Experiments

Question: What share of pass-through profit is actually a return to human capital?

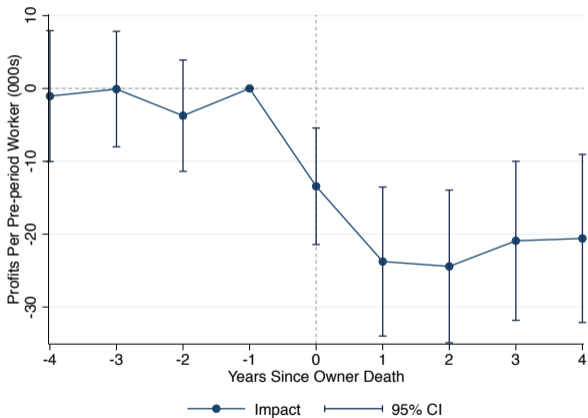
- Labor supply, network, recruiting/retention prowess, rent-seeking ability

Ideal experiment: Measure profit impact of exogenously forcing pass-through owners to withdraw their human capital from their firms

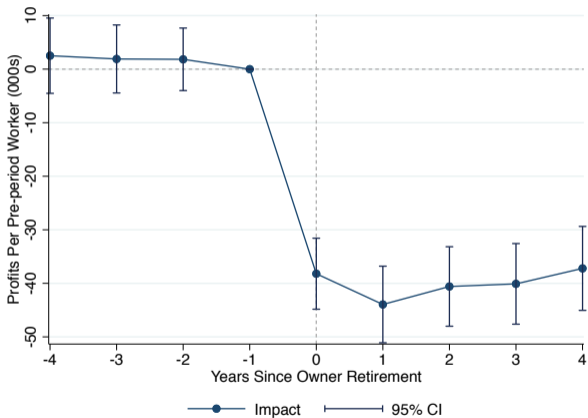
Implementation: Impact of premature owner deaths and retirements

Million-dollar-earning owner deaths (and retirements) → large declines in profits

A. Deaths

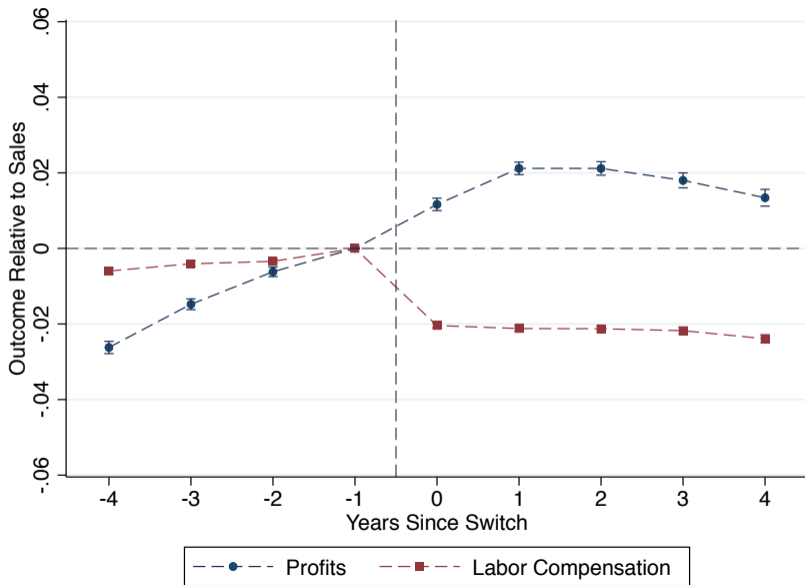


B. Retirements



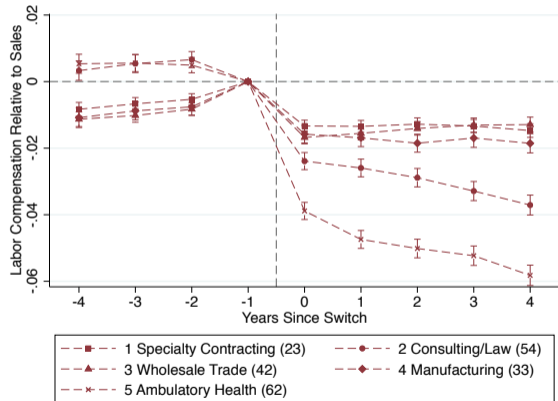
Takeaway: 75% of pass-through profits are payments to owner human capital

Impact of C-to-S switch on labor payments and profits

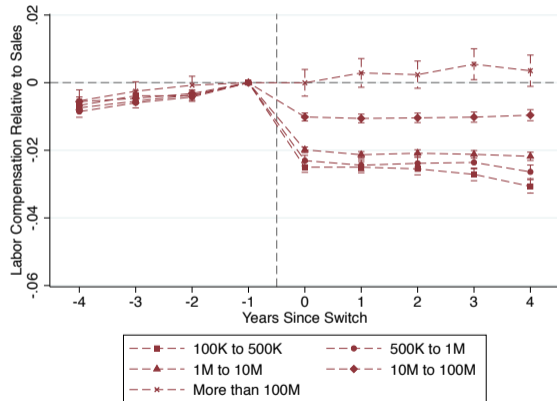


Heterogeneity by industry and firm size

Largest 2-digit Industries

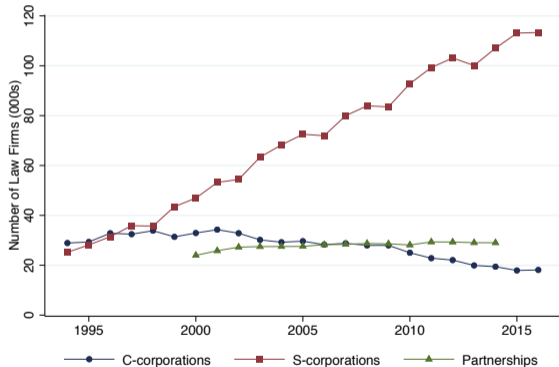


Firm Size (Average Sales)

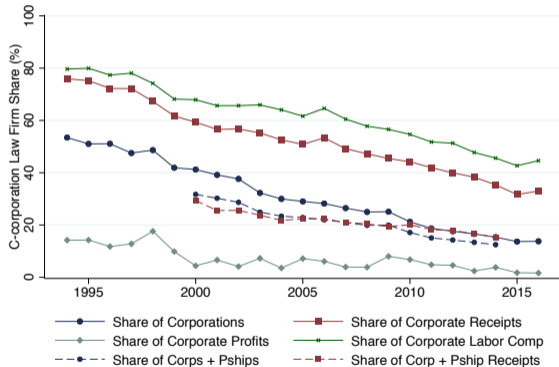


The evolution of organizational form choice for lawyers

Number of Law Firms

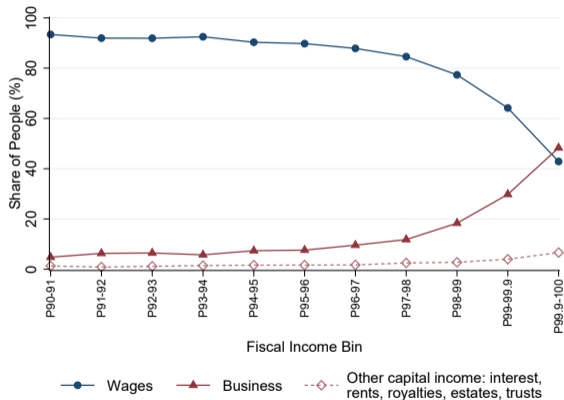


Share of Activity

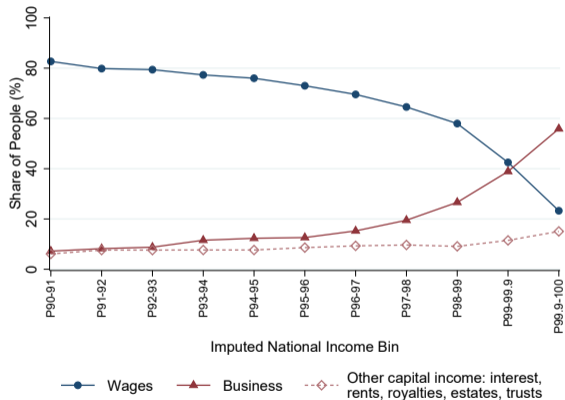


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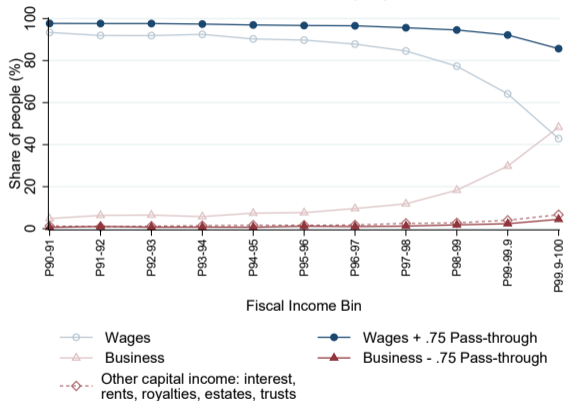


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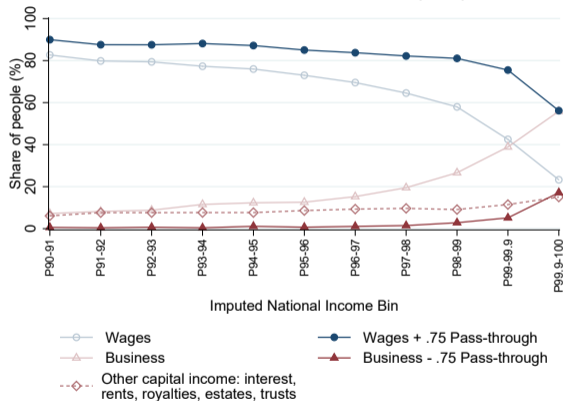


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Bottom Line: Human capital approach to pass-through income transforms one's view