Taxes and the Choice of Organizational Form: Quasi-Experimental Evidence from the Passthrough Entity Tax

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Abstract:

We examine the extent to which taxes affect the choice of organizational form. Although prior research has long debated the role of taxes in this fundamental decision, much of the existing literature faces identification challenges that limit causal inference. We overcome these limitations using the staggered implementation of state-level passthrough entity taxes (PTETs), which increase the after-tax rates of return to operating as a partnership or S corporation relative to a sole proprietorship or C corporation. Following PTET adoption, we find a 1.9% increase in establishments of qualifying entities relative to non-qualifying entities in the same industry and state. This effect is stronger for more profitable businesses, for which PTET benefits are greater. Overall, our quasi-experimental evidence suggests that taxes meaningfully affect organizational form choice. These findings inform policymakers about how changes in U.S. tax policy can shape organizational form, and hence, the economic behavior of businesses.

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I. INTRODUCTION

The extent to which taxes influence the choice of organizational form is a key policy question, as form type affects both firm behavior and public finances. For example, organizational form impacts firm governance structure, ability to raise capital, liability protection, and overall tax treatment (Erickson, Hanlon, Maydew, and Shevlin 2020). Moreover, certain organizational forms are associated with stronger firm performance (Stiglitz and Weiss 1981; Harhoff, Stahl, and Woywode 1998; Almus and Nerlinger 1999), and thus the amount of tax revenue collected by governments also varies across form type. While an extensive literature examines the choice between passthrough businesses (which face a single level of income tax paid by the owners of the business) and C corporations (which face income tax at both the business and shareholder levels), "whether the choice of organizational form is affected by tax incentives remains an open empirical question" (Tazhitdinova 2020, p. 1).[1] One reason this question remains unresolved is a lack of research settings that enable strong empirical identification, making it difficult to isolate tax from nontax factors.[2] However, as Leuz (2022) emphasizes, when it comes to research findings used to inform policy decisions, "recovering causal relations is crucial" (p. 2).

The strongest settings available to prior research involve a single shock to the tax law, making the findings susceptible to correlated, unobserved factors. For example, numerous papers examine organizational choice around TRA86—the Tax Reform Act of 1986 (Terando and Omer 1993; Plesko 1994; Beatty, Berger, and Magliolo 1995; Plesko 1995; Omer, Plesko, and Shelley 2000; Plesko and Henry 2011; Henry, Plesko, and Utke 2019). Many of these papers predict that

[1] Passthrough businesses include sole proprietorships, partnerships, and S corporations.

[2] Nontax factors that affect organizational form choice include ownership flexibility, legal liability, and financing options. For example, C corporations can have unlimited shareholders, whereas S corporations are generally limited to 100 U.S. owners. Regarding legal liability, a sole proprietorship exposes the owner's personal assets to business debt, while S and C corporations, and some partnership types, do not. Also, generally only C corporations can access public capital markets. Business owners consider both nontax and tax factors when making the organizational form choice. Importantly, in our setting nontax factors are not changing, helping isolate the tax effect.

because TRA86 reduced personal income tax rates relative to corporate tax rates, S corporations (where the income is taxed using personal rates) will increase relative to C corporations (where the income is taxed at both corporate and shareholder rates). These papers document results consistent with this prediction (Plesko 1994; Plesko 1995; Omer et al. 2000; Plesko and Henry 2011; Henry et al. 2018). However, around the same time as TRA86, California (the seventh largest economy in the world in 1986), Massachusetts, and Ohio began allowing C corporations to convert to S corporations for the first time, while Hawaii and Kentucky favorably updated their S corporation rules. Consequently, it is unclear whether TRA86 drove the spike in S corporation conversions after 1986 or whether these other changes played a role.[3]

We view this prior research as important as it provides a collection of suggestive evidence on the extent to which tax considerations influence the choice of organizational form. However, this question continues to be examined because extant research has yet to offer compelling evidence in a generalizable setting. Our goal is to address this question using a well-identified setting with a generalizable sample where causal treatment effects can be recovered. In doing so, we hope to not only resolve an open question in the literature, but also inform policymakers, who may be concerned about the unintended consequences of tax rules (like passthrough entity taxes) on organizational form, given the downstream impact that organizational form choices have on

[3] As additional evidence that the increase in S corporations relative to C corporations around TRA86 may be due to nontax factors, Henry et al. (2018) find that C corporations with positive taxable income did not convert to S corporations following the adoption of the law (which would be expected if the reduction in personal income tax rates relative to corporate tax rates in TRA86 were driving the switches). Rather, the switches are driven by businesses with negative taxable income, "in order to pass losses through to shareholders" (Henry et al. 2018, p. 642). However, S corporations have been able to pass losses through to shareholders since 1958, making it unclear why TRA86, which does not change the ability to pass losses through (other than making it harder by introducing passive activity loss rules), would induce only C corporations with negative taxable income to switch. However, the new-found ability in 1986 for C corporations to convert to S corporations in various large states (California, Massachusetts, and Ohio) could explain why C corporations with negative taxable income switch to S corporations to take advantage of the opportunity to pass future losses through to the owners.

policy-relevant outcomes like firm performance and risk-taking incentives (e.g., Stiglitz and Weiss 1981; Harhoff et al. 1998; Almus and Nerlinger 1999).

In this paper, we provide evidence on the relation between taxes and the choice of organizational form using a quasi-experimental setting where taxes are plausibly the only factor that changes. Specifically, we examine the effect of the staggered implementation of the state-level passthrough entity tax (PTET) on organizational form choice. The PTET was adopted by state legislators after the federal government limited the deductibility of state and local taxes (the "SALT cap") as part of the 2017 Tax Cuts and Jobs Act (TCJA). Prior to the TCJA, individuals could deduct an unlimited amount of qualifying state and local taxes as an itemized deduction on their federal tax returns. This included state and local income or general sales taxes, plus real and personal property taxes. Following the enactment of the TCJA, the maximum itemized deduction for all qualifying state and local taxes combined is capped at $10,000 per year (or $5,000 if married filing separately).[4] The cap applies to state and local taxes paid on all types of income, including income that flows to individual taxpayers from passthrough businesses, thereby decreasing the after-tax rates of return to operating a business as a sole proprietorship, partnership, or S corporation.[5]

Commentators suggest that Congress did not intend for the SALT cap to limit the itemized deduction for owners of passthrough businesses (Leddy 2025). Consistent with this, as states began adopting the PTET to work around the SALT cap (by shifting the state and local taxes from the

[4] The SALT cap was relaxed under the 2025 One Big Beautiful Bill Act (Public Law 119-21), which temporarily raises the cap to $40,000 (or $20,000 for married individuals filing separately), with a potential phase-down to $10,000 for higher-income taxpayers. The SALT cap is set to increase by 1% per year, before returning to $10,000 in 2030. Nonetheless, this cap remains a substantial constraint compared with the pre-2018 rules.

[5] Because the TCJA contained many provisions affecting different types of entities (e.g., large income tax rate cut for C corporations, deduction for passthrough entities under IRC §199A), it is unclear how it will change organizational choice (Henry et al. 2018; Repetti 2018). However, the state-level adoption of the PTET has a clear prediction for many taxpayers: it will increase the after-tax rates of return to operating a business as a partnership or S corporation.

individual to the entity level), the IRS approved the move (Leddy 2025; Internal Revenue Service 2020).[6] The PTET is available for businesses taxed as partnerships and S corporations, but not sole proprietorships or C corporations. This means that, all else equal, when a state adopts a PTET, the after-tax rates of return to partnerships and S corporations increase relative to sole proprietorships and C corporations. We are unaware of any other systematic tax or nontax factors changing at the same time states adopt the PTET, nor of any systematic adoption patterns across states (e.g., high-tax or Democrat-leaning states adopting first), making this a useful setting to quantify the relation between taxes and organizational form choice. Specifically, we expect that when a state adopts a PTET, partnerships and S corporations will become more popular relative to sole proprietorships and C corporations.[7]

We exploit the staggered introduction of the PTET across 24 states from 2018 to 2023 to examine our predictions. Our primary data source is the U.S. Census Bureau County Business Patterns database. Our unit of analysis is the count of establishments at the level of state-industry-organizational form-year, where the organizational form is sole proprietorship, partnership, S corporation, or C corporation (e.g., one observation in our dataset is the count of all partnerships in the professional services industry (NAICS 541) in California in 2022). Each model includes year and state-industry-organizational form fixed effects. We limit our main sample to states that adopt the PTET at some point during our period of analysis; thus, changes in organizational form are identified by comparing the number of eligible organizations (partnerships and S corporations)

[6] Another attempt to bypass the SALT cap by New York, New Jersey, and Connecticut involved trying to use the federal charitable contribution deduction to work around the cap by permitting taxpayers to contribute to state-administered charitable funds and claim federal charitable, rather than SALT, deductions. The Treasury Department did not approve this scheme, and the offending states' workarounds were disallowed (Woolley and Francis 2025).
[7] Our data do not allow us to distinguish whether increases in S corporations and partnerships are driven by new business formations or by conversions among existing businesses. We address potential concerns regarding the independence of treatment and control observations in Section V.

to non-eligible organizations (sole proprietorships and C corporations) within the same state and industry around the adoption of the PTET.[8]

In our first test, we find strong evidence that taxes affect organizational form choice. Specifically, we find a 1.9% increase in the number of partnership and S corporation establishments, relative to sole proprietorship and C corporation establishments in the same industry and state, following the adoption of a state-level PTET. In aggregate, this represents an increase of 22,613 PTET-eligible establishments across the 24 states we study. Importantly, our model controls for local economic conditions, state individual and corporate tax rates, and the severity of the COVID pandemic in a state (i.e., school, work, and transit closings, and COVID deaths). In robustness tests, we confirm our main finding using an inverse hyperbolic sine (IHS) transformation of the dependent variable, to ensure our findings are not susceptible to skewness in the data; a Poisson pseudo-maximum likelihood regression (i.e., a count model that allows for high-dimensional fixed effects and clustered standard errors, see Correia, Guimarães, and Zylkin 2020); a stacked regression framework to address the early-versus-late reference group problem common in staggered difference-in-differences designs (e.g., Baker, Larcker, and Wang 2022; Sun and Abraham 2021); and a regression weighted by the number of employees to ensure observations with low employment are not driving the results. We also predict and find that our results are stronger for S corporations than for partnerships.

To validate our empirical strategy, we employ an event-study framework to test for violations of the parallel trend assumption across treated and untreated organizational forms, and to identify when, in event time, treatment effects emerge. This approach helps ensure that the

[8] In additional tests, we obtain similar inferences when using an alternative research design that compares PTET-eligible organizational forms in adopting and non-adopting states. For further discussion, see Section V – Alternative Research Design.

estimated effects arise only after treatment begins, rather than reflecting pre-existing trends—both of which are essential for a causal interpretation. Notably, the treatment effect appears only following the adoption of a PTET, confirming it is not a continuation of prior trends.

We also explore whether the relation between organizational form and tax varies by profitability, as the after-tax return for partnerships and S corporations taking advantage of the PTET increases as an enterprise becomes more profitable. We use industry classification to measure profitability. Specifically, we follow the U.S. government and classify industries designated as a Specified Service Trade or Business (SSTB) as being especially profitable. SSTB industries include health, law, accounting, and financial and brokerage services, among many others, and have been targeted with limitations on certain deductions because they are seen as being lucrative businesses (e.g., the Section 199A qualified business income (QBI) deduction is phased out for businesses classified as SSTBs). Relying on this government classification allows us to avoid an ad hoc approach to picking profitable industries. We find, consistent with our prediction, that establishments in SSTB industries are even more likely to organize as partnerships and S corporations in the aftermath of PTET adoption.

Our work makes several contributions. First, we use a quasi-experimental setting to provide strong evidence that taxes affect organizational form choice. Our setting also allows us to accurately estimate magnitudes. Such evidence is scarce due to the absence of suitable settings accessible to researchers. Prior studies have often relied on single shocks, leaving them vulnerable to correlated, unobserved factors (Guenther 1992; Hodder, McAnally, and Weaver 2003; Henry et al. 2018). Other research in this area relies on time-series or cross-sectional data (where identification of the tax effects is limited) without a shock to the tax law, making it difficult to

disentangle tax from nontax reasons for entity choice.[9] In addition, prior research faces other limitations such as examining only a subset of U.S. organizational forms, using small samples, and analyzing a single industry—all of which may limit external validity and magnify noise in estimates (Shevlin 1987; Gentry 1994; Gordon and MacKie-Mason 1994; Beatty et al. 1995; Petroni and Shackelford 1995; Damodaran, John, and Liu 1997; MacKie-Mason and Gordon 1997; Goolsbee 1998; Goolsbee 2004; Liu 2014; Donohoe, Lisowsky, and Mayberry 2019; Giroud and Rauh (2019); Utke 2019; Tazhitdinova 2020). Further, some papers find only limited support that taxes matter in entity choice (Beatty et al. 1995; Ayers, Cloyd, and Robinson 1996; Goolsbee 1998; Allen, Allen, Raghavan, and Solomon 2023).[10]

We advance this research by using the staggered adoption of the PTET across states to overcome these limitations (i.e., a setting with multiple shocks that holds the nontax considerations constant with a large, multi-industry sample that includes all major organizational form types). Understanding the impact of taxes on organizational form choice is important for reasons such as assessing the effect of U.S. tax legislation on economic behavior (Ayers et al. 1996; Tazhitdinova 2020). For example, prior research finds that entities that provide owners with liability protection encourage risk taking and higher firm performance (Stiglitz and Weiss 1981; Harhoff et al. 1998; Almus and Nerlinger 1999). Therefore, a tax law change that favors the choice of organizational forms that provide liability protection may have the unintended consequence of boosting growth in the economy. Accordingly, in our setting, the PTET may have positive economic effects as it

[9] As described by Romanov (2006, p. 1939), "The use of aggregate time-series data poses an identification issue because a considerable variation in the corporate and personal income tax rates is produced in the course of major overhauls of the tax code, simultaneously altering many tax provisions, which often coincide with other significant changes of economic policy that may bring about swift changes in the macroeconomic environment."

[10] Leuz (2022) argues that "it is a fallacy to think that "piling up" many studies with weak identification eventually allows us to draw causal inferences or leads to sound evidence that justifies strong priors against which we can gauge new work" (p. 2).

especially encourages businesses to organize as S corporations, which provide limited liability protection, rather than as sole proprietorships, which do not provide limited liability protection.

We also contribute to research in accounting on the real effects of taxes. Specifically, we add to a recent stream of research that pushes for causal evidence using well-identified settings (Hasan, Hoi, Wu, and Zhang 2017; Armstrong, Glaeser, Huang, and Taylor 2019; Belnap 2023; Asay, Hoopes, Thornock, and Wilde 2024; Belnap, Hoopes, Maydew, and Turk 2024; Brown, Casas-Arce, Kenchington, and White 2025). We contribute to this literature by providing quasi-experimental evidence that taxes affect organizational form choice.

II. SETTING

Mechanics of the Passthrough Entity Tax

The PTET was introduced to help passthrough business owners circumvent the SALT cap. While each state's PTET has nuances, we briefly illustrate how the tax works in the state of California. In Appendix 1, we present two scenarios that compare total business and individual income taxes when an enterprise is operated as a sole proprietorship, which does not qualify for the PTET (Scenario 1), versus when the same enterprise is operated as an S corporation, which does qualify for the PTET (Scenario 2). We note that the income tax calculations in Scenario 2 would be similar if the business were organized as a partnership rather than an S corporation, though the earnings would be allocated to more than one owner, which may affect the individual tax rates applied to the passthrough income.

In each scenario, we assume that the enterprise is a service business, has one owner (who is single), and we use the federal and California tax rates for 2024. Further, the enterprise has net income of $1,500,000 before taxes and salary. In Scenario 1, the owner of the sole proprietorship cannot pay herself a salary as she and the business are considered to be the same entity for tax

purposes. In Scenario 2, where the business is organized as an S corporation, the owner is also considered an employee and needs to pay herself a reasonable salary. We assume a reasonable salary is $500,000 for the work she performs in the business.[11]

In Scenario 1, there is no entity-level tax, so the full $1,500,000 is passed through to the owner to be taxed at her individual federal and California tax rates, giving her taxable income of $1,500,000. The federal tax on this income is $513,188, while the California tax is $165,895, for a total income tax of $679,083.[12]

In Scenario 2, the business is operated as an S corporation and elects to pay the PTET. Because the owner receives a salary of $500,000, the federal and California taxable income for the S corporation is $1,000,000, before consideration of the PTET. The PTET is calculated as the corporation's California taxable income multiplied by 9.3% (the California PTET tax rate). The resulting $93,000 of PTET tax is taken as a deduction against the entity's income before that income is passed through to the owner and taxed at the federal level. In Scenario 2, therefore, the amount of income passed through to the owner for individual federal tax purposes is $907,000 (compared to $1,500,000 in Scenario 1), which, when combined with the $500,000 of salary, results in taxable income of $1,407,000 and a tax liability of $478,778. In contrast to the federal treatment, the income passed through for California taxation is the full $1,000,000 of earnings

[11] What constitutes a "reasonable salary" depends on the facts and circumstances of the taxpayer (e.g., what are the taxpayer's duties and responsibilities, time spent working in the business, industry norms and local pay rates, training and experience, and company size and profitability). The IRS requires a reasonable salary to be paid to mitigate a tax strategy that minimizes payroll tax obligations. Without this requirement, owner-employees of an S corporation would pay themselves a low salary (which is subject to payroll taxes) and pay themselves high distributions from the remaining earnings (which are not subject to payroll taxes). We ignore the impact of organizational form choice on payroll taxes, as these differences were in place and remain largely unchanged before and after the adoption of a PTET. Inferences are similar when we incorporate payroll taxes.

[12] We ignore the standard/itemized deduction because it does not vary across scenarios (because the non-PTET state taxes would lead to a capped itemized deduction of $10,000 under either scenario and the deductibility of any other itemized deductions would not vary), and the enterprise does not qualify for the Section 199A Qualified Business Income (QBI) deduction because it is a service business with high income. Further, for simplicity we ignore the 1.5% California Franchise Tax (which would lower the PTET savings by roughly $13,000) and assume no California adjustments to federal taxable income.

before the PTET deduction. This amount plus the $500,000 salary lead to an individual California income tax liability of $165,895 (the same as Scenario 1), but the taxpayer receives a credit of $93,000 for the amount of PTET paid. This results in an individual California income tax liability of $72,895. Overall, when the enterprise is organized as an S corporation, the various components of income tax paid total $644,673, which is $34,410 less than when the enterprise operates as a sole proprietorship (an increase in after-tax income of 4.2%).

In summary, our example shows that when using the PTET the business owner pays the same amount of income tax to the state of California (combining the business and individual taxes), but pays less income tax to the federal government.[13] To the extent that business owners are sensitive to the magnitude of the tax benefits provided by eligible organizational forms under PTET regimes, we expect that S corporations and partnerships will become more attractive and more popular (relative to non-eligible organizational forms) once a state adopts the PTET.

III. RESEARCH DESIGN AND SAMPLE SELECTION

Research Design

To test the effect of the PTET on the choice of organizational form, we estimate the following equation:

$$Log(Establishments_{sijt}) = \alpha + \beta_1 PTET\ Org.\ Form_i \times Post_{st} + \beta_2 Log(Adj.\ State\ Establishments_{sijt}) + \Sigma Economic\ Controls_{st} + \Sigma COVID\ Controls_{st} + \varepsilon_{sijt} \quad (1)$$

where subscript *s* indicates the state, *i* indicates the 3-digit NAICS industry, *j* indicates the organizational form type, and *t* represents the year. The dependent variable is *Log(Establishments)*, the natural logarithm of the number of establishments for each organizational form-industry-state-year. We obtain data for the dependent variable from the United States Census Bureau County

[13] In the online appendix, we provide an additional example showing that varying the level of income generated still leads to the expectation that if taxes matter in the choice of organizational form, S corporations and partnerships should increase relative to sole proprietorships and C corporations once a state adopts the PTET.

Business Patterns (CBP) dataset.[14] The CBP dataset reports the aggregate number of establishments by organizational form-industry-state-year. The organizational form types included in the CBP dataset are sole proprietorships, C corporations, S corporations, partnerships, non-profits, governmental, and other. We retain the PTET-eligible organizational forms (partnerships and S corporations) and the comparable, non-eligible, for-profit organizational forms (C corporations and sole proprietorships).[15] We identify industry using three-digit NAICS codes to ensure sufficient data coverage.[16] Our identification strategy compares the total number of establishments of same-industry PTET-eligible and PTET-ineligible organizational forms in PTET-adopting states before and after the implementation.

PTET Org. Form is an indicator variable equal to one for partnership and S corporation organizational forms, and equal to zero otherwise. *Post* is an indicator variable set equal to one starting in the year a state adopts a PTET, and equal to zero otherwise. We define PTET adoption as the later of the effective or enactment date. Due to our fixed effects structure, defined later in this section, the main effect of *PTET Org. Form* is subsumed (the main effect of *Post* is not subsumed due to variation in the timing of PTET adoptions).

[14] The Census defines an establishment as a "single physical location where business is conducted" (Giroud and Rauh 2019), that has at least one paid employee.

[15] The Census describes the CBP dataset as containing the *legal* form of organization. However, based on correspondence with the Census, it appears the dataset actually contains *organizational* form—that is, the classification used for federal tax purposes. Specifically, these data are constructed by linking establishment Employer Identification Numbers from the Business Register to tax forms filed with the Internal Revenue Service. Hence, throughout the paper, we refer to organizational form, rather than legal form. Although the Census relies on establishment-level organizational form information when constructing the dataset, the CBP ultimately reports only aggregated establishment counts at the level of organizational form-industry-state-year. We considered several alternative datasets that have information at the establishment level (e.g., Data Axle and YourEconomy), but these datasets do not provide details about organizational form type.

[16] Due to confidentiality concerns, the Census Bureau does not publish data that would disclose the operations of individual employers (U.S. Census Bureau 2024). Thus, using more granular industry definitions (such as 4-digit NAICS) greatly reduces the sample size.

We account for regional trends in the number of establishments by including the control variable *Log(Adj. State Establishments)*.[17] This control variable is computed as the natural logarithm of the average number of establishments for the associated organizational form-industry-year in adjacent states. We include a vector of state-year-level control variables, including the unemployment rate (*UE Rate*), the natural logarithm of the population (in millions) (*Log(Population)*), the natural logarithm of the gross domestic product (GDP) per capita (*Log(GDP per capita)*), and the top marginal corporate and individual tax rates (*Corporate Tax Rate* and *Individual Tax Rate*).

We include additional control variables to account for the potential impacts of the COVID-19 pandemic. We include multiple control variables to capture geographic variation in both the severity of the COVID-19 pandemic and the stringency of related government restrictions, all measured at the state-year level. To control for the severity of the pandemic, we include the cumulative number of COVID-related deaths (*Log(COVID Deaths)*), as compiled by the Centers for Disease Control and Prevention (CDC). To control for the associated governmental restrictions, we include COVID-related governmental restrictions on schools (*School Closing*), workplaces (*Work Closing*), and public transit (*Transit Closing*), as identified by the University of Oxford COVID-19 Government Response Tracker. For each closing measure (i.e., schools, workplaces, and public transit), a value of zero to three is assigned, where zero represents no COVID closures, one represents some *recommended* closures, two represents some *required* closures, and three represents *broadly required* closures.[18]

[17] We define adjacent states using the NBER County Adjacency file. See https://www.nber.org/research/data/county-adjacency.
[18] The data and codebook are available here: https://github.com/OxCGRT/covid-policy-dataset.

Our staggered difference-in-differences design includes organizational form-industry-state and year fixed effects.[19] This design controls for all time-invariant characteristics within each organizational form-industry-state, as well as time-series variation that may impact all units. By comparing changes in establishment counts across organizational forms in the same industry and state before and after the PTET adoption, we isolate the impact of the PTET on the choice of organizational form. While this approach compares PTET-eligible and PTET-ineligible organizational forms, the fixed effects structure ensures that the identification of the treatment effect comes from *within*-organizational form-industry-state variation over time, rather than from time-invariant differences *across* these groups. Lastly, our standard errors are clustered by organizational form-state, as this is the level at which our treatment is assigned (in line with the guidance from Abadie, Athey, Imbens, and Wooldridge 2023). Appendix 2 provides definitions for all of the variables in this study.

Sample Selection

The sample spans calendar years 2018 through 2023. We begin in 2018 to avoid comparing the pre-TCJA and post-TCJA periods and end in 2023, the most recent year of available data. Our sample includes all 3-digit NAICS code observations in the Census CBP database for the sole proprietorship, partnership, S corporation, and C corporation organizational forms. Additionally, we retain observations for states that adopted a PTET in 2020, 2021, or 2022 to ensure that each state has observations for a minimum of two years in the pre- and post-PTET periods, which allows for sufficient time to assess pre-period trends and dynamic post-event analyses. Our sample, therefore, includes organizational form-industry-state-year observations for the 24 states adopting the PTET in 2020, 2021, and 2022 (out of 36 states that adopt PTETs during the 2018 to 2023

[19] Econometric concerns about difference-in-differences regression where treatment is staggered through the sample period are addressed in Section V.

sample period). Table 1 lists the PTET adoption years for all 50 states and the District of Columbia. We identify the year of PTET adoption using several sources, including the "Pass-Through Entity Elective Tax Table" from Bloomberg Tax, Table 1 in Comey, Gallagher, and Gorman (2025), Table 1 in Finley, Luchs-Nuñez, and Stekelberg (2025), and hand collection.[20] Lastly, we drop singleton observations. This results in 45,828 organizational form-industry-state-year observations (e.g., one observation in our dataset consists of all partnerships in the professional services industry (NAICS 541) in California in 2022), as shown in Table 2.

Figures 1 and 2 provide a visual depiction of all states that adopted a PTET during the sample period and a timeline of states adopting a PTET, respectively. These figures do not suggest any regional trends—for example, high-tax states adopting before low-tax states—that could undermine the quasi-experimental nature of our setting. Most adoptions occur after 2020, the year the IRS signaled it did not oppose states' adopting the PTET as a way to work around the SALT cap for S corporations and partnerships (Internal Revenue Service 2020).

IV. RESULTS

Descriptive Statistics

Table 3 reports summary statistics. The average number of establishments per organizational form-industry-state-year is 529, while the median is 105. The right-skewness of the raw values for this measure motivates our use of the natural logarithm of establishment counts as our primary dependent variable. However, we assess the sensitivity of our results to this research design choice by employing two alternative dependent variables in Section V. Approximately 51% of our observations relate to PTET eligible organizational forms (*PTET Org. Form* = 1).

[20] We hand-collect official state government documentation to reconcile differences in adoption dates across sources. Specifically, the adoption dates differ between Bloomberg Tax and Comey et al. (2025) for Illinois, Missouri, and Wisconsin. The adoption dates differ between Bloomberg Tax, Comey et al. (2025) and Finley et al. (2025) for Colorado, Indiana, Illinois, Iowa, Kentucky, Nebraska, and West Virginia.

Turning to our control variables, we observe substantial variation in our COVID-related control variables. School closures are the most heavily imposed restriction, followed by work closings, then transit closings. The average top marginal corporate and individual state tax rates are approximately 6%. Organizational forms within a given industry have an average (median) of 495 (116) establishments in adjacent states of the same organizational form and industry.

Results of Main Test

Table 4 reports the results of estimating Equation (1). Column (1) reports results without control variables, Column (2) reports results with control variables but excludes *PTET Org. Form* × *Post* and *Post,* and Column (3) reports results for the full model. Across all specifications, the coefficient on *PTET Org. Form* × *Post* is positive and statistically significant, indicating that PTET adoption is associated with an increase in establishments organized as PTET-eligible organizational forms (S corporations and partnerships). In terms of economic significance, the coefficient on *PTET Org. Form* × *Post* in Column (3) (coeff = 0.019; $p < 0.001$) suggests that the number of establishments taxed as PTET-eligible organizational forms grew by 1.9% following the implementation of a PTET, relative to establishments taxed as PTET-ineligible organizational forms in the same industry-state-year.[21] This magnitude is comparable to estimates in the existing literature. For example, Giroud and Rauh (2019) find that a one percentage point decrease in the individual income tax rate is associated with an increase in the number of passthrough entity establishments of approximately 0.4%.[22] Evaluated at the average number of PTET-eligible establishments per state-industry in year *t-1* of 585 (untabulated), our estimate corresponds to an

[21] We compute the effect size as the exponent of the coefficient minus one.
[22] Giroud and Rauh (2019) exploit cross-state and over-time variation in state corporate and personal income tax rates to examine how taxes affect business activity among C corporations and passthrough entities. Because their analysis is limited to large multistate firms, it excludes smaller single-state firms, which are more likely to operate as passthrough entities, limiting the generalizability of their estimates to the broader population of businesses.

increase of approximately 11.2 additional PTET-eligible establishments per state-industry. Aggregating across the 2,019 state-industries in our sample (untabulated), this implies an increase of 22,613 PTET-eligible establishments overall.[23]

Event Study Framework

We next re-examine our main analysis in an event study framework. Specifically, we re-estimate Equation (1) after replacing *Post* with yearly indicator variables. The year before the PTET adoption (year *t-1*) serves as the benchmark period (see Table 1).[24] This analysis provides an examination of the parallel trends assumption underlying the difference-in-differences design and identifies when, in event time, the treatment effects appear. Table 5 reports the results of this analysis, with coefficients of interest visually summarized in Figure 3 (where the coefficients for the treatment and control groups are plotted separately). The findings do not suggest a violation of the parallel trends assumption, as the evolution of the number of establishments is similar for PTET-eligible and PTET-ineligible organizational forms during the pre-treatment period. In Figure 3, this is reflected in the plotted treatment and control group effects, which remain close to zero and largely flat in the years before PTET adoption.

Importantly, once the tax planning opportunity created by the PTET becomes available to certain organizational form types, our model shows that the number of establishments formed as PTET-eligible organizations increases by approximately 2% to 4% during the three years following treatment. In contrast, the number of PTET-ineligible organizational forms in the control

[23] To the extent that our results capture entities switching from non-qualifying to qualifying organizational forms rather than net changes in economic activity, our estimated magnitudes may be overstated, as the difference-in-differences estimator would capture both increases in treated observations and corresponding declines in control observations. However, Figures 3 and 4 do not indicate systematic declines in non-qualifying organizational forms following PTET enactment, suggesting that such switching is unlikely to drive the results, on average. We further address the potential for organizational form switching in Section V.

[24] We bin t-3 and t-4 in this analysis because research suggests this improves estimate precision (see McCrary 2007; Schmidheiny and Siegloch 2023) and because this is common in accounting research. Due to limitations on data availability, we do not have any observations in t+4, so we do not bin t+3 with any other event year.

group remains relatively stable throughout the post-adoption period. This finding is consistent with the prediction that businesses respond to the new tax planning opportunity and, importantly, suggests that our estimated treatment effects reflect a response to the PTET, rather than a pre-existing upward trend in PTET-eligible establishments.

Analysis of Treatment Effect Heterogeneity

Building on the previous results, we next examine how the relative increase in PTET-eligible organizational forms is distributed across S corporations and partnerships, with the expectation that the increase will be larger for S corporations. Several factors motivate this expectation. First, most new businesses start as one-person operations (Richardson 2025). The organizational forms available to a business with a single owner are sole proprietorship, single-member limited liability company (taxed like a sole proprietorship), S corporation, or C corporation. Forming a partnership, by contrast, would require adding at least one additional owner, which would require a significant shift in ownership structure.[25] Thus, S corporations are the only available option to establish a new sole-owner PTET-eligible business. A similar logic applies if a current single-owner business wants to switch to a PTET-eligible organizational form—S corporation is the only choice. Further, if the owner of a new small business anticipates converting to a C corporation in the future, it is generally easier to begin operations as an S corporation and later transition to a C corporation, since both are corporate entities.

To perform the treatment heterogeneity analysis, we re-estimate Equation (1) after restricting the treatment group to one type of PTET-eligible organizational form (S corporations

[25] A single-member limited liability company (LLC) that is treated as a disregarded entity for tax purposes does not qualify to elect the PTET. Recent IRS data suggests approximately 10% of nonfarm sole proprietorship returns are LLCs (Dungan 2023). Alternatively, a single-member LLC can elect to be taxed as a C or S corporation. LLCs with more than one member are generally taxed as partnerships, but can elect to be taxed as S corporations or C corporations.

or partnerships). Table 6 reports the results of re-estimating Equation (1) with S corporations as the treatment group in Column (1) and partnerships as the treatment group in Column (2). We find that the effect of the PTET on entity choice appears to be largely driven by the decision to organize as S corporations rather than partnerships. Specifically, Column (1) of Table 6 reports a positive and statistically significant coefficient on *PTET Org. Form* × *Post* ($p < 0.001$), while the corresponding coefficient in Column (2) is positive but insignificant ($p = 0.212$).

Figure 4 reports these analyses in event time using S corporations as the treatment group in Panel A and partnerships as the treatment group in Panel B. In both panels, the coefficient point estimates for control observations remain close to zero. In Panel A, the number of S corporations increases in the years following the adoption of a PTET. In Panel B, we do not observe an increase in the number of partnerships. Overall, the results in Tables 4, 5, and 6 and Figures 3 and 4 provide strong evidence that taxes influence the choice of organizational form.

V. ADDITIONAL ANALYSES

Robustness Tests

In this section, we conduct additional analyses to ensure the robustness of our inferences to alternative dependent variables, stacked corrections for staggered events, sample selection, and the definition of our control groups. We present the results of these tests using our full sample (that is, S corporations and partnerships as the treatment group), but note that inferences drawn from these analyses are similar if we instead limit the treatment group to S corporations.

First, we assess the sensitivity of our main results to our choice of dependent variable. Recent literature in econometrics suggests using alternative approaches when using right-skewed or count(like) data beyond the natural logarithm of the raw values. Two commonly suggested alternatives are the inverse hyperbolic sine (IHS) transformation of the raw value and Poisson

pseudo-maximum likelihood regression (PPML). IHS accounts for the skewness in the data and handles zeros and small counts more smoothly than log transformations (Aihounton and Henningsen 2021; Bellemare and Wichman 2020). In addition, a PPML regression with the raw value as the dependent variable allows for the inclusion of high-dimensional fixed effects and clustered standard errors (Correia et al. 2020). As shown in Table 7, Panel A, our inferences remain unchanged (and economic magnitudes are similar) when using the IHS-transformed version of the raw value (Column 1) or PPML regression (Column 2).

Second, we employ a stacked regression framework to address the early-versus-late reference group problem in staggered difference-in-differences designs (e.g., Baker et al. 2022; Sun and Abraham 2021). Unlike most staggered difference-in-differences designs that compare effects across treatment and control units that are affected at different points in time, our research design compares treatment and control entity types *within the same state* (thus, our treatment occurs at the same time for treatment and control observations in each particular state). Accordingly, we do not expect our analyses to be as affected by the early-versus-late comparison issues documented in recent work. Nonetheless, we implement the stacked regression correction used in Cengiz, Dube, Lindner, and Zipperer (2019). For this purpose, we construct three separate subsample cohorts, one for each adoption year (2020, 2021, and 2022). We then stack these cohorts to form the sample used in our regression estimation. Our model includes state-industry-organizational form-cohort and year-cohort fixed effects. Due to the structure of our data and sample (comparing treatment and control observations within the same state), the number of observations in the stacked sample is the same as in the main sample. The key difference between the stacked analysis and our main analysis is that the stacked design clusters the standard errors at a more granular level (state-organizational form-cohort) as compared to our main tests (state-

organizational form). The results for this robustness test are reported in Table 7, Panel B. Our inferences are robust to this alternative design.

Third, we assess the sensitivity of our results to requiring two years of data pre- and post-PTET implementation. In this robustness check, we expand our sample to include states that adopt a PTET in 2019 or 2023. We continue to exclude states that adopt a PTET in 2018, as these states lack a post-TCJA pre-period. We re-estimate Equation (1) using this expanded sample and report the results in Table 7, Panel C. We continue to obtain similar inferences with this broader sample, as the coefficient on *PTET Org. Form* × *Post* remains positive and statistically significant.

Next, we conduct a robustness test to provide assurance that our results are not driven by economically unimportant sectors of the U.S. economy. In our primary analysis, each observation is given equal weight, regardless of the economic importance of the state-industry-organizational form-year observation. However, we acknowledge that different state-industry-organizational form buckets have varying importance to the U.S. economy. To ensure that our results are not driven by smaller, less consequential state-industry-organizational forms, we re-estimate Equation (1) using regression weights based on the number of employees for each state-industry-organizational form (under the assumption that sectors of the economy with higher employment are more policy-relevant). Panel D of Table 7 reports the results of this analysis. We find consistent results: the coefficient on *PTET Org. Form* × *Post* is positive, significant, and of a similar magnitude as those reported for our main tests. This suggests that our results are not driven by small, potentially less important, sectors of the economy.

Lastly, we turn our attention to the control group in our main analysis. We conduct additional tests by restricting the control group to either C corporations or sole proprietorships. An advantage of this approach is that it addresses concerns that our control group could be indirectly

affected by the PTET if entities switch organizational forms when the PTET election becomes available. For example, to become an S corporation, an entity must first be formed as a C corporation (making it more plausible for a C corporation to convert to S status than for a partnership). To the extent that entity switching occurs, the number of establishments for qualifying organizational forms should increase while the number of establishments for non-qualifying forms should decline simultaneously. However, Figures 3 and 4 do not show a decline in establishments of non-qualifying organizational forms following PTET enactment, suggesting that entity switching is not a primary driver of our results. Nevertheless, to the extent that switching occurs, we expect it to be much less likely among existing C corporations than among sole proprietorships. For example, C to S corporation conversions are costly, as they can trigger built-in gains taxes and passive investment income, and because S corporations are subject to restrictive ownership rules. Accordingly, we view it as unlikely that C corporations would respond to the PTET by electing S corporation status. Thus, specifications using C corporations alone as the control group (rather than C corporations and sole proprietorships combined, as in our main tests) are less subject to concerns about potential Stable Unit Treatment Value Assumption (SUTVA) violations (e.g., the possibility that the treatment affects both qualifying and non-qualifying organizational forms).

Table 8 reports the results of re-estimating Equation (1) with C corporations as the control group in Column (1) and sole proprietorships as the control group in Column (2). In both columns, we observe positive and significant coefficients on *PTET Org. Form* × *Post* that are of comparable magnitude to those of our main tests. In addition, the magnitude of the coefficient on *PTET Org. Form* × *Post* when using C corporations as the control group in Column (1) (coeff = 0.022; $p <$

0.001) is larger than that reported in Table 4 (coeff = 0.019; $p < 0.001$), providing further evidence that our estimates are not materially biased by entity switching.

Cross-Sectional Tests

In this section, we conduct a cross-sectional analysis to explore whether the relation between organizational form and tax varies with the profitability of the business. We expect such variation because the tax benefit of organizing as a partnership or S corporation to take advantage of the PTET increases as a business becomes more profitable (see Appendix 1). We rely on the U.S. government's designation of a Specified Service Trade or Business (SSTB) as a proxy for the profitability of a business. Specifically, we create an indicator variable, *SSTB*, which is set equal to one for industries classified as an SSTB (e.g., accounting, law, health, financial and brokerage services, among others), and equal to zero otherwise.[26] SSTBs have been previously targeted with limitations on certain deductions because they are viewed as profitable enterprises (e.g., the Section 199A qualified business income (QBI) deduction is phased out for SSTBs), thus further motivating firms in these industries to take advantage of new tax planning opportunities. Taking this approach allows us to avoid an ad hoc process of identifying profitable industries.

To conduct this cross-sectional test, we interact the profitability indicator variable, *SSTB*, with *PTET Org. Form* × *Post* in Equation (1) (and its associated main effects). We present the results of this analysis in Table 9. Consistent with our prediction, we find that the effect of taxes on organizational form choice is even stronger for establishments in SSTB industries. In terms of effect size, the difference-in-differences estimate for SSTB establishments (the sum of the coefficients on *PTET Org. Form* × *Post* × *SSTB* and *PTET Org. Form* × *Post*) is 0.049 ($p < 0.001$), whereas the difference-in-differences estimate for non-SSTB establishments (the coefficient on

[26] As additional evidence that SSTBs are some of the most profitable industries, three of the top five most profitable industries (based on nonfarm sole proprietorship tax returns) are likely classified as SSTBs (Dungan 2023).

PTET Org. Form × *Post*) is 0.017 ($p < 0.001$). This suggests that the preference for eligible organizational forms is almost three times greater in SSTB industries, as compared to eligible organizational forms in less profitable industries, relative to their respective non-eligible control groups. These results indicate that the tax benefit of the PTET is especially salient to the choice of organizational form in high-profit industries. We view this as a particularly helpful test of our predicted mechanism, as it offers clear evidence in support of our prediction that taxes influence business owners' choice of organizational form.

Alternative Research Design

Finally, we employ an alternative research design to assess whether our results are sensitive to the model used in our primary analysis. Specifically, we use a stacked difference-in-differences design that compares PTET-eligible establishments in adopting states to PTET-eligible establishments in non-adopting states using the following models:

$$PTET\ Org.\ Form\ Ratio_{csit} = \alpha + \beta_1 PTET\ State_s \times Post_{ct} + \beta_2 Adj.\ State\ PTET\ Org.\ Form\ Ratio_{sit} + \Sigma Economic\ Controls_{st} + \Sigma COVID\ Controls_{st} + \varepsilon_{csit} \quad (2a)$$

$$S\ Corp\ Org.\ Form\ Ratio_{csit} = \alpha + \beta_1 PTET\ State_s \times Post_{ct} + \beta_2 Adj.\ State\ S\ Corp\ Org.\ Form\ Ratio_{sit} + \Sigma Economic\ Controls_{st} + \Sigma COVID\ Controls_{st} + \varepsilon_{csit} \quad (2b)$$

$$PTET\ Org.\ Form\ Ratio_{csit} = \alpha + \beta_1 PTET\ State_s \times Post_{ct} + \beta_2 PTET\ State_s \times Post_{ct} \times SSTB_i + \beta_3 Post_{ct} \times SSTB_i + \beta_4 Adj.\ State\ PTET\ Org.\ Form\ Ratio_{sit} + \Sigma Economic\ Controls_{st} + \Sigma COVID\ Controls_{st} + \varepsilon_{csit} \quad (2c)$$

where *c* represents the subsample cohort (defined below), *s* represents state, *i* represents industry, and *t* represents year. For purposes of this alternative research design, the unit of observation is at the level of industry-state-year, and the control group consists of industries in non-adopting states with individual income taxes. The dependent variables are *PTET Org. Form Ratio* and *S Corp Org. Form Ratio*, the percentage of PTET-qualifying establishments or S corporation establishments for each industry-state-year observation. For example, when estimating Equation

(2a), one observation consists of the total number of partnership and S corporation establishments, as a percentage of the total sole proprietorship, partnership, S corporation, and C corporation establishments, in the professional services industry (NAICS 541) in California in 2022. *PTET State* is an indicator variable equal to one if the state adopts a PTET at any point during the sample period, and equal to zero otherwise. *Post* is an indicator variable set equal to one starting in the cohort's adoption year (for both treatment and control observations), and equal to zero otherwise. Consistent with our main model, we continue to define industry at the 3-digit NAICS code level. The control variables are as previously described, with one exception: due to the different dependent variables, we exclude *Log(Adj. State Establishments)* and instead include *Adj. State PTET Org. Form Ratio* (Equations 2a and 2c) or *Adj. State S Corp Org. Form Ratio* (Equation 2b), which capture the outcome variable computed across adjacent states.

We estimate Equations (2a), (2b), and (2c) using the Cengiz et al. (2019) staggered event correction. Specifically, we create separate subsample cohorts for each adoption year. In each cohort, the treatment sample includes industries in states that adopt a PTET for that particular event year, and the control group includes industries in all non-adopting states. This approach results in using industries in non-PTET states as a repeated control group (i.e., the control group is the same for each cohort). Due to our fixed effects structure (which includes state-industry-cohort and year-cohort fixed effects), the main effects of *PTET State, SSTB, Post*, and *PTET* × *SSTB* are subsumed.

This alternative approach allows us to address two potential issues with our primary research design. First, because choosing a PTET-eligible organizational form inherently implies *not* choosing a PTET-ineligible form, our main analysis may violate the assumption of independence across observations, which can lead to biased estimates. By abstracting to the state-industry-year level of analysis, we avoid this potential independence issue. Second, in our main

analysis, we examine states that adopt a PTET, which may limit the generalizability of our results if adopting states are fundamentally different from non-adopting states. Including non-PTET adopting states allows us to address this potential concern and assess the sensitivity of our main results to the choice of states. A limitation of this research design is that it does not as effectively control for broader macroeconomic conditions as our main specification, which compares qualifying and non-qualifying organizational forms within the same state-industry. Additionally, PTET-adopting states may have systematically different tax regimes than non-adopting states, which can independently influence the relevance and prevalence of certain organizational forms.

Table 10 reports the results of estimating Equations (2a), (2b), and (2c). Columns (1) and (2) report results of the *PTET Org. Form Ratio* and *S Corp Org. Form Ratio* tests, respectively. In Column (1), the coefficient on *PTET State* × *Post* in Column (3) (coeff = 0.003; p = 0.096) indicates that the percentage of total establishments organized as PTET-eligible forms increased by 0.003 percentage points following a state adopting a PTET, relative to states that do not adopt a PTET. Relative to the mean of *PTET Org. Form Ratio* in PTET adopting states in year *t-1* of 0.560 (untabulated), this represents an increase of 0.5%. Additionally, the effect of the PTET is statistically stronger when limiting our analysis to S corporations, as evidenced by the positive and significant coefficient on *PTET State* × *Post* in Column (2) (coeff 0.004; p = 0.015).

In Column (3), we examine the differential effect of PTETs on SSTBs. We again find that the effects of PTETs are greater for SSTBs than other types of businesses, further supporting inferences drawn from Table 9. In terms of economic magnitude, the difference-in-differences estimate for SSTB establishments (the sum of the coefficients on *PTET State* × *Post* × *SSTB* and *PTET State* × *Post*) is 0.011 (p = 0.004), whereas the difference-in-differences estimate for non-SSTB establishments (the coefficient on *PTET State* × *Post*) is 0.003 (p = 0.188). These results

support that the effect of a state adopting a PTET on the choice of organizational form is largely driven by more profitable industries. Overall, these results provide assurance that our main results are not influenced by potential issues with independence between observations or the states included in the analysis.

VI. CONCLUSION

This paper provides new evidence on how taxes affect the choice of organizational form. Although prior research has long debated the extent to which taxes matter to this fundamental business decision, much of the literature has faced significant identification challenges that limit the strength of causal inferences. Limitations of previously used settings include being centered around a single shock to the tax law (e.g., TRA86 or TCJA), only including certain organizational forms (e.g., including S corporations and C corporations while excluding partnerships and sole proprietorships), or only examining certain industries (e.g., conducting analyses only within the banking industry). We overcome these limitations by exploiting the staggered adoption of state-level passthrough entity taxes—a policy designed to mitigate the effects of the federal SALT deduction cap—across 24 states. Because PTETs were adopted in a non-systematic manner across multiple years and applied only to certain organizational forms (S corporations and partnerships), this setting isolates taxes as the sole factor driving changes in organizational choice. Moreover, our empirical approach allows us to compare all four major organizational forms (i.e., C corporation, S corporation, partnership, and sole proprietorship) and include a broad range of 3-digit NAICS level industries, enhancing both internal validity and generalizability.

We find strong evidence that taxes impact organizational form choice. Specifically, our findings demonstrate that following PTET adoption, businesses are 1.9% more likely to form as PTET-eligible entities (i.e., partnerships and S corporations) than non-eligible organizational

forms (i.e., sole proprietorships and C corporations). Further, we find our results are concentrated in S corporation establishments, for which the PTET is more salient for single-owner businesses. This effect is robust across multiple specifications, alternative estimation strategies, and validation tests designed to rule out pre-existing trends and confounding factors. Additionally, we find that the effect of taxes on the choice of organizational form is greater among more profitable industries, for which the benefit of the PTET is greater. We view this as an important result that confirms our suggested channel: business owners who stand to realize greater tax savings from using certain organizational forms are more likely to adopt those forms once PTET regimes are introduced.

These results have potentially important implications. From a policy perspective, they highlight how relatively targeted tax provisions can meaningfully alter the organizational form landscape, with potential downstream effects on risk-taking, capital formation, and firm performance. Because organizational form is closely tied to governance and liability structures, tax policies that unintentionally discourage certain forms could carry broader economic consequences. Conversely, policies such as the PTET, which enhance the attractiveness of limited liability passthrough entities, may support entrepreneurship and economic growth. Our study underscores the value of quasi-experimental designs in uncovering these types of real effects of taxation and contributes to a growing body of literature that emphasizes causal identification in accounting and tax research, which, as Leuz (2022) points out, is particularly important for policymaking.

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Figure 1: Map of All PTET-Adopting States

This figure reports a map of the United States, with shaded states representing those that adopted a PTET during our sample period (2018 – 2023). See Table 1 for the states included in our analyses.

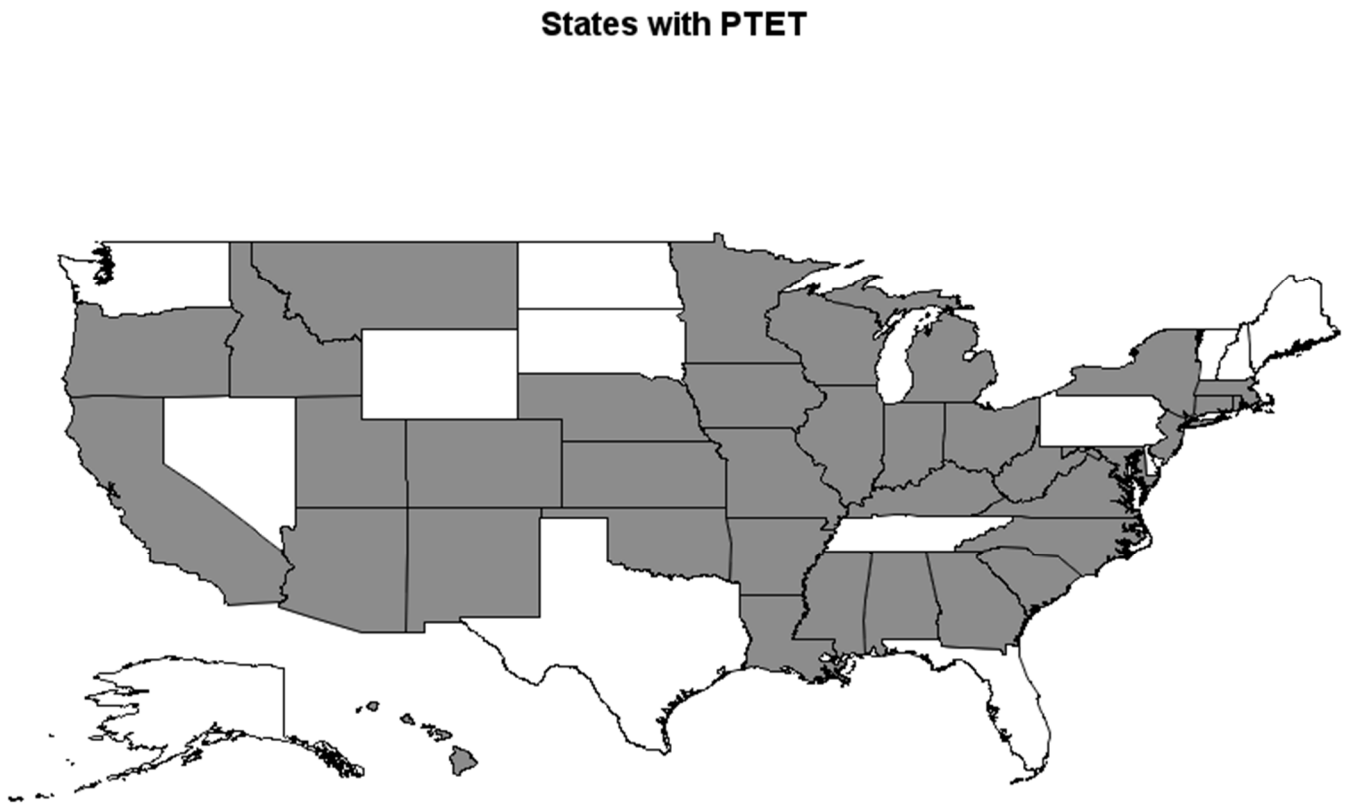


Figure 2: Timeline of States Adopting PTETs

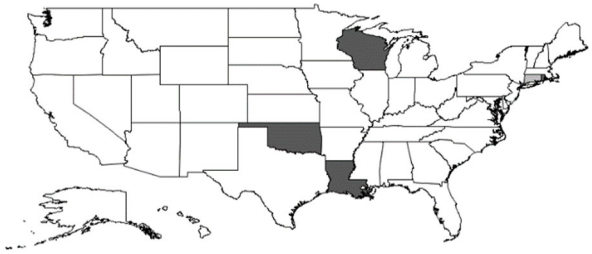
This figure reports maps of PTET-adoptions by year. Dark shaded states are those that adopt a PTET in the focal year (i.e., new adoptions). Light-shaded states are those that adopted a PTET in the years before the focal year (i.e., previous adoptions).

Panel A

States with PTET in 2018

Panel B

States with PTET in 2019

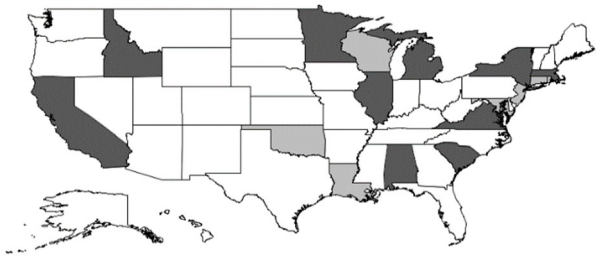


Panel C

States with PTET in 2020

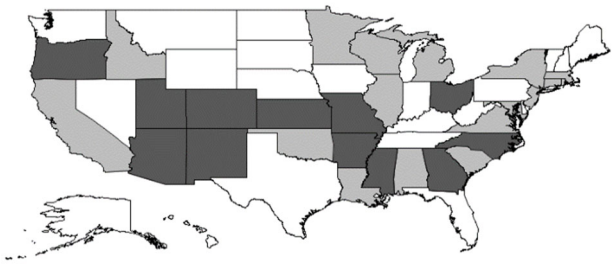
Panel D

States with PTET in 2021



Panel E

States with PTET in 2022



Panel F

States with PTET in 2023

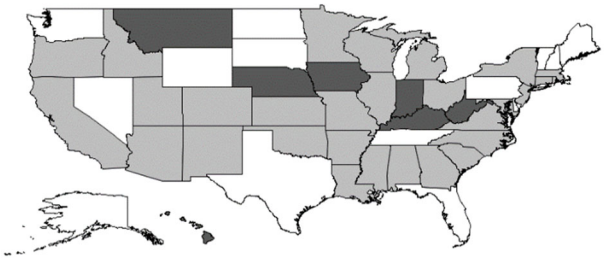


Figure 3: Change in Eligible Passthrough Entities Around State PTET Adoption

This figure plots an event study of the change in PTET-ineligible entities (the control group, which consists of sole proprietorships and C corporations) and PTET-eligible entities (the treatment group, which consists of S corporations and partnerships) around the adoption of state-level PTETs. The bars represent 90% confidence intervals.

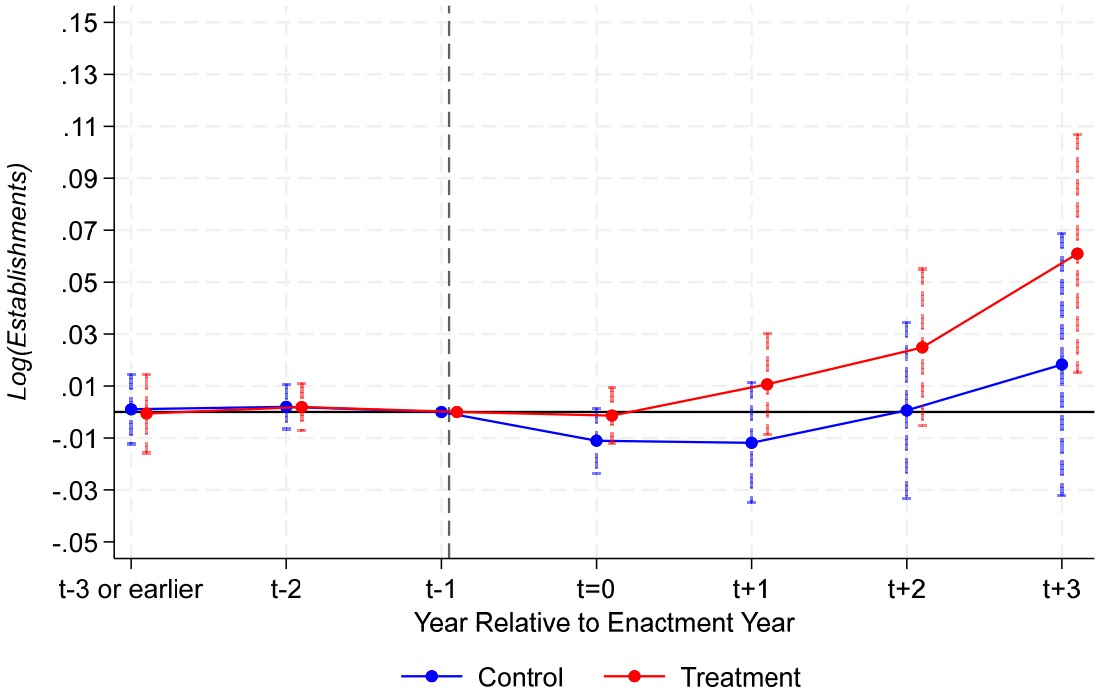
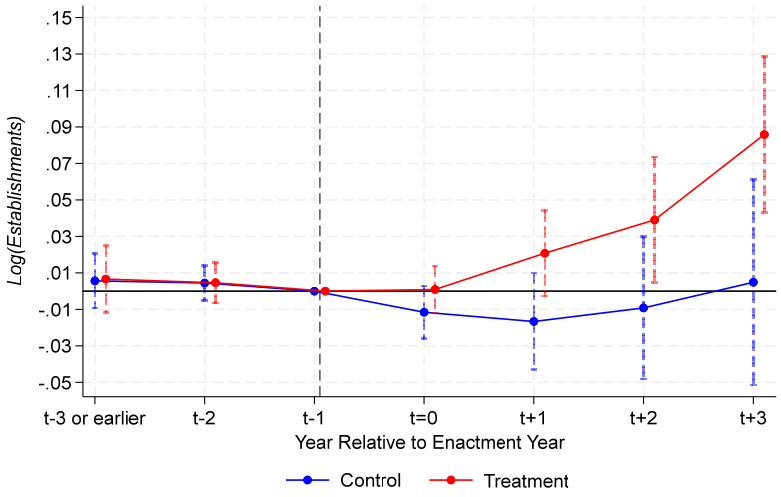


Figure 4: Change in Eligible Passthrough Entities Around State PTET Adoption by Treatment Group

This figure plots an event study of the change in PTET-ineligible entities (the control group, which includes sole proprietorships and C corporations) and, separately, the PTET-eligible passthrough entities (the treatment group, which includes S corporations in Panel A and partnerships in Panel B) around the adoption of state-level PTETs. The bars represent 90% confidence intervals.

Panel A – S Corporations as the Treatment Group



Panel B – Partnerships as the Treatment Group

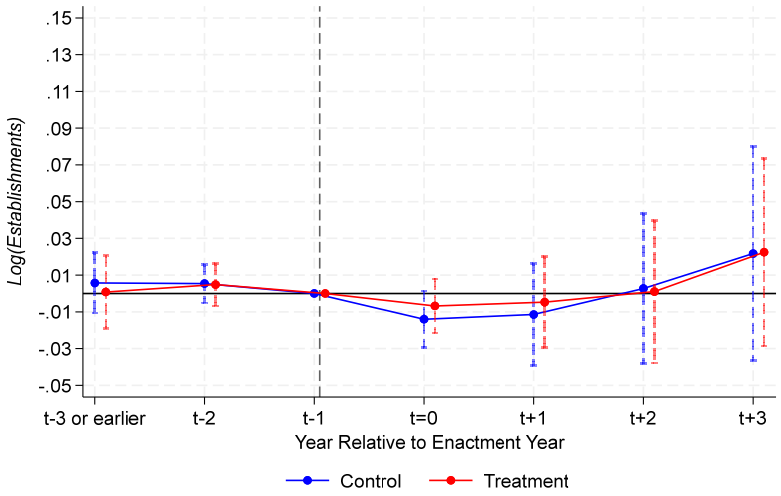


Table 1: PTET Adoption Dates

This table details the PTETs adopted during our sample period (2018 – 2023). We define PTET adoption as the later of the effective or enactment date. States with sufficient pre- and post-PTET periods to be included in our main analysis are shown in bold.

State	PTET Adoption Date	State	PTET Adoption Date
Alabama	**1/1/2021**	Montana	1/1/2023
Alaska	N/A	Nebraska	1/1/2023
Arizona	**1/1/2022**	Nevada	N/A
Arkansas	**1/1/2022**	New Hampshire	N/A
California	**1/1/2021**	**New Jersey**	**1/1/2020**
Colorado	**1/1/2022**	**New Mexico**	**1/1/2022**
Connecticut	1/1/2018	**New York**	**1/1/2021**
Delaware	N/A	**North Carolina**	**1/1/2022**
District of Columbia	N/A	North Dakota	N/A
Florida	N/A	**Ohio**	**1/1/2022**
Georgia	**1/1/2022**	Oklahoma	1/1/2019
Hawaii	1/1/2023	**Oregon**	**1/1/2022**
Idaho	**1/1/2021**	Pennsylvania	N/A
Illinois	**1/1/2021**	Rhode Island	1/1/2019
Indiana	1/1/2023	**South Carolina**	**1/1/2021**
Iowa	1/1/2023	South Dakota	N/A
Kansas	**1/1/2022**	Tennessee	N/A
Kentucky	1/1/2023	Texas	N/A
Louisiana	1/1/2019	**Utah**	**1/1/2022**
Maine	N/A	Vermont	N/A
Maryland	**1/1/2020**	**Virginia**	**1/1/2021**
Massachusetts	**1/1/2021**	Washington	N/A
Michigan	**1/1/2021**	West Virginia	1/1/2023
Minnesota	**1/1/2021**	Wisconsin	1/1/2019
Mississippi	**1/1/2022**	Wyoming	N/A
Missouri	**1/1/2022**		

Table 2: Sample Selection

This table details the sample selection procedure to arrive at our final sample.

Sample Selection	Observations
All 3-digit NAICS code observations from 2018 – 2023 in the Census CBP database	93,122
Less: States without a PTET	(25,979)
Less: States adopting a PTET before 2020 or after 2022	(21,238)
Less: Singleton observations	(77)
Total observations	45,828

Table 3: Summary Statistics

This table reports descriptive statistics. Variable descriptions are available in Appendix 2.

Variable	N	Mean	SD	p25	p50	p75
$Establishments_{sijt}$	45,828	528.724	1,237.779	26.000	105.000	414.000
$Log(Establishments_{sijt})$	45,828	4.677	1.871	3.258	4.654	6.026
$IHS(Establishments_{sijt})$	45,828	5.372	1.869	3.952	5.347	6.719
$PTET\ Org.\ Form_j$	45,828	0.510	0.500	0.000	1.000	1.000
$Post_{st}$	45,828	0.432	0.495	0.000	0.000	1.000
$UE\ Rate_{st}$	45,828	4.446	1.739	3.200	3.900	5.100
$Population_{st}$	45,828	8.618	7.779	4.233	6.175	10.371
$Log(Population_{st})$	45,828	1.888	0.697	1.443	1.821	2.339
$GDP\ per\ capita_{st}$	45,828	0.059	0.012	0.050	0.058	0.066
$Log(GDP\ per\ capita_{st})$	45,828	-2.843	0.203	-2.998	-2.842	-2.711
$School\ Closing_{st}$	45,828	0.559	0.776	0.000	0.000	1.178
$Work\ Closing_{st}$	45,828	0.367	0.565	0.000	0.000	0.753
$Transit\ Closing_{st}$	45,828	0.122	0.275	0.000	0.000	0.000
$COVID\ Deaths_{st}$	45,828	12,248.480	17,024.080	0.000	5,339.000	19,750.500
$Log(COVID\ Deaths_{st})$	45,828	6.221	4.485	0.000	8.583	9.891
$Corporate\ Tax\ Rate_{st}$	45,828	6.128	2.231	4.950	6.000	8.000
$Individual\ Tax\ Rate_{st}$	45,828	6.460	2.442	4.950	5.700	7.000
$Adj.\ State\ Establishments_{sijt}$	45,828	494.930	1,269.853	33.000	116.400	414.267
$Log(Adj.\ State\ Establishments_{sijt})$	45,828	4.807	1.675	3.526	4.766	6.029
$SSTB_i$	45,828	0.063	0.243	0.000	0.000	0.000

Table 4: Change in Establishments Following PTET Adoption

This table reports OLS estimates of the effect of state-level PTET adoption on the number of establishments. *Log(Establishments)* is the natural logarithm of the number of establishments by state-year-industry-organizational form. *PTET Org. Form* is an indicator variable set equal to one for partnerships and S corporations, and zero otherwise. *Post* is an indicator variable set equal to one for the year of and years following a state adopting a PTET. Standard errors are clustered at the state-organizational form level; t-statistics are reported in brackets beneath coefficients. *, **, and *** denote two-tailed statistical significance at the $p < 0.10$, $p < 0.05$, and $p < 0.01$ levels, respectively. Variable descriptions are available in Appendix 2.

	(1)	(2)	(3)
Variables	$Log(Establishments_{sijt})$	$Log(Establishments_{sijt})$	$Log(Establishments_{sijt})$
$\mathbf{PTET\ Org.\ Form_j \times Post_{st}}$	**0.044*** **		**0.019*** **
	[6.016]		**[3.809]**
$Post_{st}$	-0.034***		-0.022***
	[-5.439]		[-4.486]
$Log(Adj.\ State\ Establishments_{sijt})$		0.517***	0.510***
		[29.264]	[29.784]
$UE\ Rate_{st}$		-0.003	-0.003
		[-0.967]	[-0.918]
$Log(Population_{st})$		0.870***	0.887***
		[5.983]	[6.506]
$Log(GDP\ per\ capita_{st})$		0.031	0.008
		[0.279]	[0.071]
$Corporate\ Tax\ Rate_{st}$		0.003	0.004
		[1.044]	[1.394]
$Individual\ Tax\ Rate_{st}$		0.002	0.003
		[0.946]	[1.108]
$School\ Closing_{st}$		-0.006	-0.003
		[-1.076]	[-0.550]
$Work\ Closing_{st}$		-0.009	-0.010*
		[-1.621]	[-1.838]
$Transit\ Closing_{st}$		0.005	0.004
		[1.138]	[0.899]
$Log(COVID\ Deaths_{st})$		0.008*	0.009**
		[1.914]	[2.169]
State-Industry-Org. Form FE	Yes	Yes	Yes
Year FE	Yes	Yes	Yes
N	45,828	45,828	45,828
Adjusted R^2	0.9948	0.9954	0.9954
Within R^2	0.0077	0.1358	0.1375
Cluster	State-Org. Form	State-Org. Form	State-Org. Form

Table 5: Change in Establishments Following PTET Adoption – Dynamic Specification

This table reports dynamic OLS estimates of the effect of state-level PTET adoption on the number of establishments. *Log(Establishments)* is the natural logarithm of the number of establishments by state-year-industry-organizational form. *PTET Org. Form* is an indicator variable set equal to one for partnerships and S corporations, and zero otherwise. *Post* is an indicator variable set equal to one for the year of and years following a state adopting a PTET. The *Post* indicator variable from Table 4, Column (3), is replaced by relative time period indicators (*t-3 or earlier, t-2, etc.*). The time period *Pre 1* is the benchmark period. Standard errors are clustered at the state-organizational form level; t-statistics are reported in brackets beneath coefficients. *, **, and *** denote two-tailed statistical significance at the $p < 0.10$, $p < 0.05$, and $p < 0.01$ levels, respectively. Variable descriptions are available in Appendix 2.

Variables	(1) *Log(Establishments$_{sijt}$)*
PTET Org. Form$_j$ × t-3 or earlier$_{st}$	-0.002
	[-0.248]
t-3 or earlier$_{st}$	0.001
	[0.129]
PTET Org. Form$_j$ × t-2$_{st}$	-0.000
	[-0.020]
t-2$_{st}$	0.002
	[0.386]
PTET Org. Form$_j$ × t$_{st}$	**0.010****
	[2.566]
t$_{st}$	-0.011
	[-1.453]
PTET Org. Form$_j$ × t+1$_{st}$	**0.023*****
	[3.251]
t+1$_{st}$	-0.012
	[-0.844]
PTET Org. Form$_j$ × t+2$_{st}$	**0.024****
	[2.398]
t+2$_{st}$	0.001
	[0.030]
PTET Org. Form$_j$ × t+3$_{st}$	**0.043***
	[1.737]
t+3$_{st}$	0.018
	[0.597]
Control Variables	Yes
State-Industry-Org. Form FE	Yes
Year FE	Yes
N	45,828
Adjusted R^2	0.9955
Cluster	State-Org. Form

Table 6: Treatment Heterogeneity Analysis

This table reports OLS estimates of tests examining heterogeneity in the effect of PTET adoption on the number of establishments across S corporations and partnerships. *Log(Establishments)* is the natural logarithm of the number of establishments by state-year-industry-organizational form. *PTET Org. Form* is an indicator variable set equal to one for partnerships and S corporations, and zero otherwise. *Post* is an indicator variable set equal to one for the year of and years following a state adopting a PTET. Column (1) restricts the treatment group to only S corporations. Column (2) restricts the treatment group to only partnerships. Standard errors are clustered at the state-organizational form level; t-statistics are reported in brackets beneath coefficients. *, **, and *** denote two-tailed statistical significance at the $p < 0.10$, $p < 0.05$, and $p < 0.01$ levels, respectively. Variable descriptions are available in Appendix 2.

Treatment Group	S Corporations	Partnerships
	(1)	(2)
Variables	$Log(Establishments_{sijt})$	$Log(Establishments_{sijt})$
$\boldsymbol{PTET\ Org.\ Form_j \times Post_{st}}$	**0.029*** **	**0.007**
	[5.802]	**[1.258]**
$Post_{st}$	-0.022***	-0.018***
	[-3.835]	[-3.288]
Control Variables	Yes	Yes
State-Industry-Org. Form FE	Yes	Yes
Year FE	Yes	Yes
N	34,338	33,924
Adjusted R^2	0.9960	0.9944
Cluster	State-Org. Form	State-Org. Form

Table 7: Robustness of Main Results

This table reports robustness tests of the effect of state-level PTET adoption on the number of establishments using alternative dependent variables (Panel A), a stacked DiD design (Panel B), an expanded sample (Panel C), and weighted OLS (Panel D). Across all panels, *PTET Org. Form* is an indicator variable set equal to one for partnerships and S corporations, and zero otherwise. *Post* is an indicator variable set equal to one for the year of and years following a state adopting a PTET. In Panel A, Column (1) reports OLS estimates for a model that uses the inverse hyperbolic sine (IHS) of establishments (*IHS(Establishments)*) as the dependent variable (following Aihounton and Henningsen 2021 and Bellemare and Wichman 2020). Column (2) reports Poisson pseudo-likelihood estimates and the count of establishments (*Establishments*) as the dependent variable, following Correia et al. (2020). Panel B reports results using the Cengiz et al. (2019) stacked difference-in-differences correction for staggered event settings. Panel C reports results using a sample that includes states that adopted a PTET in 2019 or 2023. Panel D reports results from OLS regressions weighted by the number of employees. Standard errors are clustered at the state-organizational form level; t-statistics are reported in brackets beneath coefficients. *, **, and *** denote two-tailed statistical significance at the $p < 0.10$, $p < 0.05$, and $p < 0.01$ levels, respectively. Variable descriptions are available in Appendix 2.

Panel A: Alternative Dependent Variables

Variables	(1) $IHS(Establishments_{sijt})$	(2) $Establishments_{sijt}$
$\boldsymbol{PTET\ Org.\ Form_j \times Post_{st}}$	**0.019*** **	**0.017*** **
	[3.834]	**[3.133]**
$Post_{st}$	-0.022***	-0.013***
	[-4.494]	[-2.881]
Control Variables	Yes	Yes
State-Industry-Org. Form FE	Yes	Yes
Year FE	Yes	Yes
N	45,828	45,828
Adjusted R^2	0.9955	
Pseudo R^2		0.9944
Cluster	State-Org. Form	State-Org. Form

Panel B: Stacked Correction for Staggered Event Settings

Variables	(1) $Log(Establishments_{sijt})$
$\boldsymbol{PTET\ Org.\ Form_j \times Post_{st}}$	**0.019*** **
	[3.850]
Control Variables Included	Yes
State-Industry-Org. Form-Cohort FE	Yes
Year-Cohort FE	Yes
N	45,828
Adjusted R^2	0.9955
Cluster	State-Org. Form-Cohort

Panel C: Including 2019 and 2023 PTET-Adopting States	
	(1)
Variables	*Log(Establishments$_{sijt}$)*
PTET Org. Form$_j$ × Post$_{st}$	**0.024*** **
	[5.126]
Post$_{st}$	-0.015***
	[-3.882]
Control Variables Included	Yes
State-Industry-Org. Form FE	Yes
Year FE	Yes
N	65,188
Adjusted R^2	0.9950
Cluster	State-Org. Form

Panel D: Weighted by Employment	
	(1)
Variables	*Log(Establishments$_{sijt}$)*
PTET Org. Form$_j$ × Post$_{st}$	**0.020*** **
	[4.474]
Post$_{st}$	-0.008**
	[-2.006]
Control Variables Included	Yes
Weighted by Number of Employees	Yes
State-Industry-Org. Form FE	Yes
Year FE	Yes
N	45,814
Adjusted R^2	0.9989
Cluster	State-Org. Form

Table 8: Alternative Control Groups

This table reports OLS estimates of the effect of state-level PTET adoption on the number of establishments using alternative control groups. *Log(Establishments)* is the natural logarithm of the number of establishments by state-year-industry-organizational form. *PTET Org. Form* is an indicator variable set equal to one for partnerships and S corporations, and zero otherwise. *Post* is an indicator variable set equal to one for the year of and years following a state adopting a PTET. Column (1) restricts the control group to only C corporations. Column (2) restricts the control group to only sole proprietorships. Standard errors are clustered at the state-organizational form level; t-statistics are reported in brackets beneath coefficients. *, **, and *** denote two-tailed statistical significance at the $p < 0.10$, $p < 0.05$, and $p < 0.01$ levels, respectively. Variable descriptions are available in Appendix 2.

Control Group	C Corporations	Sole Proprietorships
	(1)	(2)
Variables	$Log(Establishments_{sijt})$	$Log(Establishments_{sijt})$
$\boldsymbol{PTET\ Org.\ Form_j \times Post_{st}}$	**0.022*** **	**0.014***
	[5.037]	**[1.842]**
$Post_{st}$	-0.021***	-0.027***
	[-3.921]	[-3.824]
Control Variables	Yes	Yes
State-Industry-Org. Form FE	Yes	Yes
Year FE	Yes	Yes
N	35,154	34,068
Adjusted R^2	0.9963	0.9948
Cluster	State-Org. Form	State-Org. Form

Table 9: Cross-Sectional Effects – PTET Adoption and Profitability

This table reports OLS estimates of how entity profitability moderates the effect of state-level PTET adoption on the number of establishments. *Log(Establishments)* is the natural logarithm of the number of establishments by state-year-industry-organizational form. *PTET Org. Form* is an indicator variable set equal to one for partnerships and S corporations, and zero otherwise. *Post* is an indicator variable set equal to one for the year of and years following a state adopting a PTET. *SSTB* is an indicator variable set equal to one for the industries identified in the variable definition in Appendix 2, and zero otherwise. Standard errors are clustered at the state-organizational form level; t-statistics are reported in brackets beneath coefficients. *, **, and *** denote two-tailed statistical significance at the $p < 0.10$, $p < 0.05$, and $p < 0.01$ levels, respectively. Variable descriptions are available in Appendix 2.

Variables	(1) $Log(Establishments_{sijt})$
$\mathbf{PTET\ Org.\ Form_j \times Post_{st} \times SSTB_i}$	**0.032***** **[3.886]**
$PTET\ Org.\ Form_j \times Post_{st}$	0.017*** [3.267]
$Post_{st} \times SSTB_i$	-0.014** [-2.055]
$Post_{st}$	-0.021*** [-4.276]
Control Variables	Yes
State-Industry-Org. Form FE	Yes
Year FE	Yes
N	45,828
Adjusted R^2	0.9954
Cluster	State-Org. Form

Table 10: Alternative Research Design

This table reports OLS estimates of the effect of state-level PTET adoption on the percentage of establishments that are PTET-eligible. These models are estimated using the Cengiz et al. (2019) stacked difference-in-differences correction for staggered event settings. The dependent variables are *PTET Org. Form Ratio* and *S Corp Org. Form Ratio*, which are the percentage of establishments in a state-industry-year that are classified as PTET-eligible or S corporation establishments, respectively. *PTET State* is an indicator variable equal to one if the state adopts a PTET at any point during the sample period, and equal to zero otherwise. *Post* is an indicator variable set equal to one starting in the cohort's adoption year (for both treatment and control observations), and equal to zero otherwise. *SSTB* is an indicator variable set equal to one for Specified Service Trade or Businesses, and zero otherwise. The control sample includes non-adopting states with individual income taxes. Standard errors are clustered at the state-cohort level; t-statistics are reported in brackets beneath coefficients. *, **, and *** denote two-tailed statistical significance at the $p < 0.10$, $p < 0.05$, and $p < 0.01$ levels, respectively. Variable descriptions are available in Appendix 2.

Variables	(1) *PTET Org. Form Ratio$_{csit}$*	(2) *S Corp Org. Form Ratio$_{csit}$*	(3) *PTET Org. Form Ratio$_{csit}$*
PTET State$_s$ × Post$_{ct}$	**0.003***	**0.004****	**0.003**
	[1.696]	**[2.507]**	**[1.332]**
PTET State$_s$ × Post$_{ct}$ × SSTB$_i$			**0.008***
			[1.766]
Post$_{ct}$ × SSTB$_i$			0.001
			[0.157]
Adj. State PTET Org. Form Ratio$_{sit}$	0.377***		0.374***
	[6.476]		[6.410]
Adj. State S Corp Org. Form Ratio$_{sit}$		0.407***	
		[7.407]	
UE Rate$_{st}$	-0.001	-0.002***	-0.001
	[-0.812]	[-2.809]	[-0.812]
Log(Population$_{st}$)	-0.081*	-0.056	-0.081*
	[-1.923]	[-1.607]	[-1.920]
Log(GDP per capita$_{st}$)	-0.064*	-0.090***	-0.064*
	[-1.897]	[-2.984]	[-1.895]
Corporate Tax Rate$_{st}$	-0.003**	-0.003**	-0.003**
	[-2.039]	[-2.342]	[-2.039]
Individual Tax Rate$_{st}$	-0.001	-0.000	-0.001
	[-0.821]	[-0.126]	[-0.822]
School Closing$_{st}$	0.001	-0.003	0.001
	[0.471]	[-1.385]	[0.467]
Work Closing$_{st}$	0.003	0.003	0.003
	[1.150]	[1.460]	[1.150]
Transit Closing$_{st}$	0.001	0.001	0.001
	[0.785]	[0.436]	[0.785]
Log(COVID Deaths$_{st}$)	0.000	0.001	0.000
	[0.366]	[1.012]	[0.371]

State-Industry-Cohort FE	Yes	Yes	Yes
Year-Cohort FE	Yes	Yes	Yes
N	27,929	27,929	27,929
Adjusted R^2	0.9280	0.9210	0.9280
Cluster	State-Cohort	State-Cohort	State-Cohort

Appendix 1: PTET Example Calculation

This appendix presents two scenarios that compare total business and individual taxes when an enterprise is operated as a sole proprietorship (Scenario 1) versus an S corporation (Scenario 2). We assume the enterprise is a service business, has one owner who is a single taxpayer, uses the 2024 federal and California tax brackets and rates, and there are no California adjustments to federal taxable income. We ignore the standard/itemized deduction as it does not vary across scenarios, and the enterprise does not qualify for the Section 199A Qualified Business Income deduction because it is a service business with high income. We ignore payroll taxes as they were in place and remain largely unchanged before and after the adoption of a PTET.

	Scenario 1 Sole Proprietorship No PTET Election	Scenario 2 S Corporation With PTET Election
California Entity-Level		
Taxable Income	-	1,000,000
PTE Tax (9.3%)	-	93,000
Total California Tax	-	93,000
Federal Individual-Level		
Salary	-	500,000
Passthrough Income	1,500,000	907,000
Taxable Income	1,500,000	1,407,000
Total Federal Tax	513,188	478,778
California Individual-Level		
Salary	-	500,000
Passthrough Income	1,500,000	1,000,000
Taxable Income	1,500,000	1,500,000
Total Tax	165,895	165,895
Less: PTE Tax Credit	-	(93,000)
Total California Tax	165,895	72,895
Federal and California Taxes		
Total California Entity Tax	-	93,000
Total Federal Individual Tax	513,188	478,778
Total California Individual Tax	165,895	72,895
Total Tax	679,083	644,673
After-tax income	820,917	855,327
PTET tax savings		**34,410**
Increase in after-tax income		**4.2%**

Appendix 2: Variable Definitions

Variable	Source data unit of observation	Description
Adj. State Establishments	State-year-industry-organizational form	The average number of establishments for the given state-year-industry-organizational form for adjacent states.
Adj. State PTET Org. Form Ratio	State-year-industry	The percentage of establishments that are classified as *PTET Org. Form* establishments in adjacent states.
Adj. State S Corp Org. Form Ratio	State-year-industry	The percentage of establishments that are classified as S corporation establishments in adjacent states.
Corporate Tax Rate	State-year	The top marginal corporate tax rate for the given state-year. Data is obtained from the Tax Foundation.
COVID Controls	State-year	A vector of control variables including *Log(COVID Deaths)*, *School Closing*, *Transit Closing*, and *Work Closing*.
COVID Deaths	State-year	The number of COVID-related deaths by state-year as identified by the CDC case surveillance data series.
Economic Controls	State-year	A vector of control variables including *Log(GDP per capita)*, *Log(Population)*, and *UE Rate*.
Establishments	State-year-industry-organizational form	The number of establishments by state-year-industry-organizational form from the Census CBP data series.
GDP per capita	State-year	GDP per capita by state-year. GDP data is obtained from the BEA table "SAGDP9N: Real GDP by state. We compute *GDP per capita* by dividing GDP, in millions, by the population.
IHS(Establishments)	State-year-industry-organizational form	The inverse hyperbolic sine of *Establishments*.
Individual Tax Rate	State-year	The top marginal individual tax rate for the given state-year. Data is obtained from the Tax Foundation.
Log(Adj. State Establishments)	State-year-industry-organizational form	The natural logarithm of *Adj. State Establishments*.
Log(COVID Deaths)	State-year	The natural logarithm of *COVID Deaths*.
Log(Establishments)	State-year-industry-organizational form	The natural logarithm of *Establishments*.
Log(GDP per capita)	State-year	The natural logarithm of *GDP per capita*.
Log(Population)	State-year	The natural logarithm of *Population*.
Population	State-year	Population, in millions, by state-year. Population data is obtained from the BEA table "SAINC1: State annual personal income summary: personal income, population, per capita personal income".
Post	State-year (main analysis) or cohort-year (additional analysis)	In the main analyses, *Post* an indicator variable set equal to one for the year of and years following a state adopting a PTET. In our additional

		analysis (see Section V), *Post* is an indicator variable set equal to one starting in the cohort's adoption year (for both treatment and control observations), and equal to zero otherwise.
PTET Org. Form	Organizational form	An indicator variable set equal to one for partnerships and S corporations, and zero otherwise.
PTET Org. Form Ratio	State-year-industry	The percentage of establishments that are classified as *PTET Org. Form* establishments.
PTET State	State	An indicator variable equal to one if the state adopts a PTET at any point during the sample period, and equal to zero otherwise.
S Corp Org. Form Ratio	State-year-industry	The percentage of establishments that are classified as S corporation establishments.
School Closing	State-year	A rank variable ranging from zero to three, where zero indicates there are no COVID-19 school closures, one indicates there are some *recommended* school closures, two indicates there are some *required* school closures, and three indicates there are *widespread required* school closures. Data to construct this variable is obtained from the Oxford University COVID-19 Government Response Tracker.
SSTB	Industry	An indicator variable set equal to one if the industry is in the following 3-digit NAICS codes: 523 (Securities, Commodity Contracts, and Other Financial Investments and Related Activities), 524 (Insurance Carriers and Related Activities), 541 (Professional, Scientific, and Technical Services), 621 (Ambulatory Health Care Services), 711 (Performing Arts, Spectator Sports, and Related Industries). The indicator variable is set equal to zero otherwise.
Transit Closing	State-year	A rank variable ranging from zero to three, where zero indicates there are no COVID-19 transit closures, one indicates there are some *recommended* transit closures, two indicates there are some *required* transit closures, and three indicates there are *widespread required* transit closures. Data to construct this variable is obtained from the Oxford University COVID-19 Government Response Tracker.
UE Rate	State-year	Unemployment rate by state-year. Unemployment rate data is obtained from the BLS LAUS data series.
Work Closing	State-year	A rank variable ranging from zero to three, where zero indicates there are no COVID-19 work closures, one indicates there are some *recommended* work closures, two indicates there are some *required* work closures, and three indicates there are *widespread required* work closures. Data to construct this variable is obtained from the Oxford University COVID-19 Government Response Tracker.

Online Appendix for

Taxes and the Choice of Organizational Form: Quasi-Experimental Evidence from the Passthrough Entity Tax

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This appendix provides supplemental analyses reported but not tabulated in the paper.

Contents:

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OA1: Additional Example of the PTET and Entity Choice

In this section, we provide an additional example of how the PTET can affect entity choice.

OA Figure 1

OA Figure 1 presents two scenarios that compare total business and individual taxes when an enterprise is operated as a sole proprietorship (Scenario 1) versus an S corporation (Scenario 2). We assume the enterprise is a service business, has one owner who is a single taxpayer, uses the 2024 federal and California tax brackets and rates, and there are no California adjustments to federal taxable income. We ignore the standard/itemized deduction as it does not vary across scenarios, but the enterprise does qualify for the Section 199A Qualified Business Income deduction (20% x Passthrough Income). We ignore payroll taxes as they were in place and remain largely unchanged before and after the adoption of a PTET.

	Scenario 1 Sole Proprietorship - No PTET Elective Tax	Scenario 2 S Corporation - With PTET Elective Tax
California Entity-Level		
Taxable Income	-	260,000
PTE Tax (9.3%)	-	24,180
Total California Tax	-	24,180
Federal Individual-Level		
Salary	-	100,000
Passthrough Income	360,000	235,820
QBI Deduction	(52,000)	(47,164)
Taxable Income	308,000	288,656
Total Federal Tax	60,005	55,362
California Individual-Level		
Salary	-	100,000
Passthrough Income	360,000	260,000
Taxable Income	360,000	360,000
Total Tax	26,565	26,565
Less: PTE Tax Credit	-	(24,180)
Total California Tax	26,565	2,385
Federal and California Taxes		
Total California Entity Tax	-	24,180
Total Federal Individual Tax	60,005	55,362
Total California Individual Tax	26,565	2,385
Total Tax	86,570	81,927
After-tax income	273,430	278,073
PTET savings		**4,643**
Increase in after-tax income		**1.3%**