The Impact of Tax Law Changes on
Bank Payout and Performance

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Abstract

We investigate the effect of a 1996 tax law change allowing commercial banks to elect S-corporation status. At the end of 2019 about 40 percent of all banks were organized as S-corporation. We analyze the effect of this conversion on dividend payouts, bank business model, performance, as well as the factors that contribute to the likelihood of conversion from C- to S-Corporation. We find that dividend payouts increase substantially after the conversion, and that banks in S-Corporation status are less risky and more profitable. Overall, our results provide evidence that the application of Subchapter S status to commercial banks had significant effects on banks' conduct and outcomes.

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"The corporate tax should be abolished. Whether this is done or not, corporations should be required to attribute to individual stockholders earnings which are not paid out as dividends. That is, it should also send a statement saying, 'In addition to this dividend of ____ cents per share, your corporation also earned ____ cents per share which was reinvested.' The individual stockholder would then be required to report the attributed earnings on his tax return as well as the dividend. Corporations would still be free to plough back as much as they wish, but they would have no incentive to do so except the proper incentive that they could earn more internally than the stockholder could earn externally. Few measures would do more to invigorate capital markets, to stimulate enterprise, and to promote effective competition."

Milton Friedman, *Capitalism and Freedom*, 1962

1.   Introduction

Perhaps no law or regulation in recent times has had as great an effect on the operation of small banks in the U.S. as the Small Business Job Protection Act of 1996. This provision, which was signed into law by President Bill Clinton, allowed commercial banks, beginning in 1997, to elect S-corporation (instead of C-corporation) as their legal form of organization (LFO).[1] Choosing to organize as an S-corporation rather than as a C-corporation has two direct effects on corporate taxation: 1) it prevents double taxation of bank income (at the corporate level and personal level), and 2) it decreases the taxable gain on any sale of a share in the banking firm. Like the tax treatment proposed by Friedman in the quotation above, S-corporations are pass-through entities, meaning their

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[1] Each type of corporation is named after a section of the U.S. tax laws that addresses the tax treatment of that type of corporation: Subchapters C and S to Subtitle A, Chapter One of the Internal Revenue Code (Title 26 of the United States Code).

income is taxed at the shareholder level, regardless of the size of dividends. In contrast, income of C-corporations is subject to the corporate income tax, and then any distributions are taxed again at the personal income tax rates of shareholders.

Within the first decade of the new regulation, one in three banks had adopted the S-corporation form of organization, which is particularly prevalent among community banks. Commercial banks provide a useful laboratory for investigating the effects of S-corporation policy because of the availability of firm-level data. In addition, commercial banks are ineligible to take on non-corporate forms (i.e., partnerships, sole proprietorships, and limited liability companies). This allows one to better measure a firm's responsiveness to tax rate changes, by reducing the confounding influence of non-tax considerations like free transferability of shares.

S-corporations also play an important role in other industries, where the organizational form has existed since 1958. In fact, a substantial majority of corporations in the United States are now S-corporations (e.g., Cooper et al., 2023). The organizational form was introduced to allow small businesses to choose the tax status most appropriate for them, separate from nontax considerations such as limited liability. As with its later application to banks, S-corporation law is part of a legislative effort to promote small business. It is prudent to ask whether S status serves this purpose, particularly considering the complicated aspects of this organizational form, such as implicit constraints on growth as well as explicit incentives for sell-off.

While previous research has looked at why only certain banks choose S status (e.g., Hodder et al. 2003), this paper focuses on banks after their conversion. The overarching goal of this research is to evaluate the success of this policy for promoting

community banks. We collected quarterly commercial bank financial statements (including S-corporation status) and other supportive data from various regulatory databases. Our analysis of these data show that S status encourages increased payouts to shareholders, which shifts the compensation mix from salary towards dividends, especially for smaller banks. This aligns with Christoffersen et al. (2023) who connect compensation in small firms in Denmark with earnings management incentives. We also find that converted banks are more profitable than their comparable C-corporation counterparts. Although they are slightly more levered and carry lower levels of Tier 1 capital, they are less involved in risky lending, including commercial real estate loans and construction and development loans, thus providing better risk-adjusted return to their investors.

In light of our findings, we conclude that allowing S-corporation election does benefit smaller banks by increasing their profitability without a commensurate increase in risk. Understanding all these results together is important for informing the use of tax-law changes to achieve business policy goals.[2]

The paper proceeds as follows. Section 2 outlines the inception and evolution of laws concerning S-corporations and the special treatment of depository institutions. Section 3 describes the aggregate banking industry trends toward consolidation and S-corporation status for community banks. Section 4 describes the data and methodology of the analysis. Section 5 contains results of our estimation of payout changes for converting banks. Section 6 concludes and provides the policy implications of our findings.

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[2] The Tax Cuts and Jobs Act of 2017 allows S-corporation bank owners (and other pass-through entities) to deduct 20% of their business income, subject to some limits.

2.   Legislative history and taxation of S-corporations and banks

In 1958, a period prior to the advent of the limited liability company (LLC),

concerns about high marginal tax rates from double taxation on corporate earnings of

small privately held firms led the U.S. Congress to add Subchapter S to Subtitle A,

Chapter One of the Internal Revenue Code (Title 26 of the U.S. Code), which created the

S-corporation.[3] The profits from an S-corporation are not taxed at the corporate level;

instead, they are passed through the corporate entity to shareholders on a pro rata basis

and taxed only at the personal level.[4] In 2015, some 13 percent of businesses were S-

corporations, corresponding to over 73 percent of all corporations.[5]

Both new and existing corporations may elect to become S-corporations. Like

those of C-corporations, shareholders of S-corporations enjoy free transferability of their

interests, a major distinction from LLCs or other partnerships. However, S-corporations

are subject to a number of restrictions that do not apply to C-corporations, including

limits to one class of stock and the type of shareholders allowed and, most notably,

restrictions on the number of shareholders. Originally, this shareholder limit was set in

1958 at 10 but subsequently was raised to 15 in 1976, to 25 in 1981, to 35 in 1982, to 75

in 1996, and to 100 in 2004. Higher shareholder limits, besides making more businesses

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[3] S-corporations require the same corporate formalities as C corporations, including articles of incorporation, a board of directors, an annual shareholders' meeting, corporate minutes, and shareholder votes on major corporate decisions.

[4] If state corporate income tax rates are higher than individual rates, a business organized as a regular corporation that is taxed as a corporation may pay higher state taxes than if it is organized as a partnership or S-corporation and is taxed at a lower personal tax rate. However, this difference may not be significant in the few states that tax unincorporated businesses.

[5] Internal Revenue Service, Statistics of Income, https://www.irs.gov/statistics/soi-tax-stats-integrated-business-data.

immediately eligible, also facilitate raising equity capital and the bequeathing of stock to multiple heirs. Community bankers lobbied Congress to increase the shareholder limit to 150, and to allow S-corporations to issue preferred stock in addition to common stock, but were unsuccessful.[6] According to *American Banker*, Cynthia Blankenship, chairwoman of the Independent Community Bankers of America, testified that community banks "could better compete with the likes of larger banks, credit unions, and Farm Credit lenders if more changes were made."[7] Despite the efforts, the number of shareholders of S-corporations remains at 100 and only common shares are allowed.[8] This proved problematic when the Trouble Asset Relief Program (TARP) was enacted in 2008 to stabilize the U.S. financial system. Initially, TARP sought to bolster the capital adequacy of banks by government investments in preferred shares of banks, which precluded investments in S-corporations that could not issue such instruments. As a workaround, the government chose to invest in S-corporations via subordinated debentures.

As a general rule, the higher the percentage of corporate income to be distributed, the more beneficial S-election is. The S-corporation LFO benefits an existing profit-making corporation that does not reinvest earnings, or cannot do so because of an accumulated earnings problem, and expects to distribute a significant percentage of its income to shareholders.

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[6] The inability of S-corporation banks to issue preferred stock became a roadblock when the government's Troubled Asset Relief Program (TARP) was introduced, as hundreds of mutual thrifts and roughly 2,500 banks structured as Subchapter S-corporations could not participate in TARP (*American Banker,* October 15, 2008).

[7] *American Banker*, "Shareholder Cap Increase Key Goal in S Corp Effort," June 19, 2008.

[8] The Capital Access for Small Business Banks Act, introduced in 2017, would have raised the shareholder limit for depository institution S corporations to 500 and allowed for the issuance of preferred stock, but was not passed (https://www.congress.gov/bill/115th-congress/house-bill/2339).

Most states follow the federal example, exempting S-corporations from the corporate income tax. Two states, California and Illinois, recognize the pass-through nature of S-corporations, but still impose a tax at the entity level. Still others, like New Hampshire and Tennessee, do not recognize S status at all and treat any corporation operating in their jurisdiction as a regular corporation, subjecting the entity to a corporate tax and its shareholders to a personal income tax on any dividends received.

S status provides a significant advantage over other corporate forms if a business is operating at a loss, particularly if most or all of the owners are in the highest tax brackets. So long as the losses are not generated by passive activities, shareholders can use those losses to shelter other personal income. In contrast, C-corporation status does not provide an immediate tax benefit from operating losses unless a business can use a provision permitting carry-back of losses against profits during the three most recent tax years. However, if a new business loses money in the first years of operation, the carry-back provision does not provide any current benefit. Losses not used in the current tax year or carried back can be carried forward and used to offset profits in future years, but several years may pass before the firm's profits are large enough to realize the full tax benefit of the early losses.

When Congress granted the choice of tax regime to small corporations in 1958, commercial banks were excluded from the list of eligible institutions. Not until the adoption of the Small Business Job Protection Act of 1996 were banks allowed to choose the S-corporation as their organizational form for tax purposes. Initially, the exclusion of banks was motivated by the tax benefits banks already derived from using the reserve method of accounting for bad debt (see, for example, Goldstein [1997] and Levy et al.

[1997]). This special tax benefit was granted to depository institutions as early as 1947, in recognition of their crucial role in the economy (and the adverse consequences of bank runs) and, therefore, to confine their failures.

In 1993, the ineligibility of banks to organize themselves as S-corporations was challenged on the grounds that their previous tax benefits eroded (see Kummer [2004], p. 329). Over time, the tax benefits to depository institutions for loan-loss reserves had become more limited, and by 1996, when the law was passed, depository institutions effectively had very small tax benefits relative to nonfinancial firms. In addition, community banks were perceived as disadvantaged relative to credit unions, which are tax exempt, and at risk of being acquired by national banks benefiting from various economies of scale and scope.[9]

Starting in 1997, depository institutions could organize themselves as S-corporations if they did not violate the cap on the number of shareholders, except for thrifts and commercial banks having assets of less than $500 million and employing the reserve method of accounting for bad debts.[10] Multiple subsequent legislative changes then changed the calculus for depository institutions that had become S-corporations or were considering doing so. The Economic Growth and Tax Relief Reconciliation Act of 2001 reduced personal marginal tax rates, lowering the highest bracket to 35 percent by 2003. The Jobs and Growth Tax Relief and Reconciliation Act of 2003 reduced the tax rate on qualified dividends and capital gains to 15 percent. The American Jobs Creation

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[9] As reported in *American Banker*, "6% of Banks Said to Become S-corporations During '97," December 19, 1997. The article also cites the need to pay estate taxes out of earnings so that family banks will not be sold upon the owner's death.
[10] See Goldstein [1997] p. 649, for a discussion on the gradual removal of tax benefits to depository institutions.

Act of 2004 raised the maximum number of allowable shareholders for S-corporations to 100 from 75. The American Taxpayer Relief Act of 2012 raised the top personal marginal tax rate back to 39.6%. The Tax Cuts and Jobs Act of 2017 lowered the corporate tax rate to 21% while also lowering the top personal marginal tax rate to 37% and introducing a deduction for 20% of pass-through business income. As Denis and Sarin [2002] demonstrate, lower personal marginal tax rates relative to corporate marginal tax rates make S-corporations more attractive. In contrast, the reduction in dividend and capital gains tax rates reduced the tax advantage of pass-through entities relative to C-corporations. Increasing the number of allowable shareholders for S-corporations expanded the pool of eligible commercial banks and made it easier for existing banks to raise new equity. In the next section, we document S-conversion trends and commercial bank consolidation occurring before and after this legislation was passed.

3. The rise of S-corporation banks and the consolidation of the banking industry

3.1 The rise of S-corporation banks

Banks welcomed the opportunity to convert from C-corporation to S-Corporation status. As shown in Figure 1, the number of banks electing S-corporation status rose quickly. In 1997, the first year that commercial banks could file as S-corporations, 596, or almost seven percent of all banks chose to do so. While we cannot observe eligibility of banks for S-Corporation status because data on the number of the shareholders are not publicly available, we limit our sample at the asset size of the largest S-corporation ($2 billion) to establish some plausible proxy of the eligibility criteria. By the end of the

period of rapid growth in S-corps, the number of banks electing S-Corporation status peaked at 2,379 banks, representing more than 35 percent of commercial banks with less than $2 billion in assets. At that time, S-corporations accounted for 3.6 percent of total banking industry assets and 5.1 percent of deposits (see Figures 2a and 2b). However, among privately held commercial banks, S-corporations represent a much more economically significant 32.5 percent of aggregate assets and 32.7 percent of deposits in the same year. These percentages continued to rise and peaked at 40 and 39.1 percent, respectively in 2017.

Figures 3a and 3b show the geographic distribution of S-corporation banks by state in 2007 and 2019, respectively. S-corporations are most heavily concentrated in the South and Midwest, reflecting the higher prevalence of unit banks (very small banks serving local communities) and other smaller banks in these regions.

3.2   Trends in consolidation in the banking industry

The past three decades have seen considerable consolidation in the banking industry, with much of it occurring at the expense of community banks. Since the inception and during the period of rapid rise of S-Corporation banks between 1996 and 2007, the number of commercial banks of any size fell from 12,370 to 7,339, a drop of about 40 percent. Over the same period, community banks, which we define as commercial banks owned by an organization with less than $1 billion in total banking assets, declined in number from 10,415 to 6,351, or about 39 percent.[11] The consolidation continued through the global financial crisis and the 2010s. The number of banks

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[11] This definition follows, "The Role of Community Banks in the U.S. Economy," *Federal Reserve Bank of Kansas City Economic Review*, Second Quarter 2003. More recently, as a result of consolidation, the definition used by the Federal Reserve has changed to banks with less than $10 billion in assets. See: https://www.federalreserve.gov/supervisionreg/community-and-regional-financial-institutions.htm

declined by more than half, from 8,663 to only 4,183 over our sample period 1997 – 2019.

Figure 4 plots the fraction of commercial banks that are community banks and their share of total commercial banking assets. During the period between 1993 and 2019, community banks accounted for approximately 90 percent of all commercial banks, but their share of total industry assets declined steadily from just under 90 percent in 1993 to only 75 percent in 2019. In 1996, the year our focal legislation passed, there were 8,190 community banks, but, by 2019, this number had dropped to only 3,741.

Figures 5a and 5b break down the distribution of S-corporation banks by asset-size groupings. At the end of the active period of conversions in 2007, only 1.3 percent of S-corporation banks had assets greater than $1 billion, while more than half had assets of less than $100 million (Figure 5a). By the end of the study period in 2019, the share of the largest S-corporations increased to almost 3 percent and the share of smallest had declined to less than 30 percent, leaving the majority of S-corporation banks (59 percent) in the $100 million - $500 million category.

Though S-corporations banks have predominately been conversions from pre-existing C-corporations, there have been a small number of newly chartered, or *de novo*, banks that chose to organize as S-corporations. Figure 6a shows the change in the number of S-corporation banks by year decomposed into conversions from C-corporations, *de novo* S-corporations, and reverse conversions from S-corporations to C-corporations. While there were more than 3,000 conversions from C-corporations, there were fewer than 200 de novo S-corporation banks chartered during the 1997-2019 period.

In contrast, there were more than 400 reverse conversions from S-corporations to C-corporations during this time period.

Choosing to charter a *de novo* S-corporation bank has two main opposing considerations. If the young bank loses money, then the shareholders can pass through these losses to offset income from other sources. On the other hand, *de novo* banks generally could not pay dividends during their first three years of operations.[12] Because the earnings of an S-corporation are passed through to shareholders for tax purposes, this created a situation where, the shareholders of a profitable S-corporation bank would face a tax liability that could not be covered by dividend distributions from the bank (see Weinstock [2007]).

Figure 6b shows by year the number of S-Corporation banks as a percentage of all banks in the sample and provides a breakdown of the detailed data behind the metrics shown graphically in Figure 6a. As we can see, about half of the conversions occurred during the first five years after the legislation was passed, with the percentage dropping from 6.8 percent in 1997 to 2.6 percent in 2000. From 2000 through 2007, the percentage fluctuated in the range of 2.1 to 2.9. During the global financial crisis years of 2008-2011, the percentage dropped each year to below zero, as reverse conversions exceeded new conversions and de novos. From 2012 through 2019, the percentage of net conversions has not exceeded 0.4 percent.

Figure 7 plots the ratio of *de novo* community banks to all community banks in our sample, with the contributions from C- and S-corporations shown separately. This

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[12] In 2009, during the global financial crisis, bank regulators increased the number of years that a *de novo* bank could not distribute earnings as dividends from three to seven years. This onerous restriction essentially shut down the market for *de novo* banks until it was reversed in 2014. Even after the reversal, the number of newly chartered banks has remained at historical lows.

chart shows that the ratio of *de novo* community banks to all community banks rose sharply from 1995 through 2000, plateaued from 2000 through 2008, and then declined precipitously from 2008 through 2014. From 2014 through 2019, this ratio was close to zero. *De novo* S-corporation banks did not play a significant role in these trends.

A part of the debate about the availability of the S-corporation option to banking institutions was related to uncertainty about the impact of such form of business organization on bank performance. Most banks in our sample are quite traditional in their operation and lending activities, which constitute a primary portion of their business. To shed light on this issue, we chart in Figure 8 the S-Corporation bank lending portfolio composition in relation to their C-corporation counterparts and compare their post-conversion position to the pre-conversion standing. We find that S-corporations allocate a smaller percentage of their loan portfolio to Construction & Development loans and to Commercial Real Estate mortgages, which generally are regarded as the highest risk loan categories.[13] When we chart the ratio of nonperforming loans to total loans, we also find that S-corporation banks have significantly lower NPL ratios during the year leading up to, during, and after the global financial crisis.

Next, we chart these same three ratios for banks converting from C-corporation to S-corporation LFO during the three years before and after conversion. As shown in Figure 9, each of these three ratios decline post-conversion to S-corporation status— evidence of a post-conversion reduction in portfolio risk. Interestingly, the decline in risk does not come at the cost of a decrease in profitability. Figure 10 charts the profitability of S-corporation and C-corporation banks by years as measured by ROA and ROE. This

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[13] Cole and White [2012], among others, find that C&D loans and CRE mortgages were disproportionately represented in the portfolios of banks that failed during the global financial crisis.

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figure shows that both ROA and ROE are consistently greater at S-corporation banks

than at C-corporation banks, including during the global financial crisis. The difference

shown in the graphs is for the mean values of ROA and ROE of the two groups' samples

winsorized at 1%, the difference in mean ROA reaches up to 0.72% and mean ROA up to

2.6%. Moreover, S-Corporation banks remain profitable during 2009 when their C-

corporation counterparts suffer losses. These observations are further confirmed by

regression analysis with numerous controls for a broad spectrum of bank characteristics

and by the results of the Heckman model analysis with instrumental variables.

In summary, these charts show that S-corporation election has been a popular

choice and appears to validate the law's effectiveness in promoting community banks. In

the following sections, we look at how conversion impacts banks' performance to explore

the topic further.

4.   Data and methodology

4.1.   Data

We obtain year-end data on commercial banks from the Federal Financial

Institution Examination Council (FFIEC) Reports of Condition and Income, informally

know among bank researchers as the Call Reports.[14] Beginning in 1997, these data have

included a variable indicating S-corporation status.

We obtain annual data on the number of branches and number of states in which

each bank operates from the FDIC's Summary of Deposits database.[15] We compute a

number of key variables from this data. The detailed definitions of the variables,

including call reports fields and the logic of the calculation, are provided in Table 1. We

are specifically interested in the variables that describe S-corporations' compensation and

payout policy, particularly *Dividend Payout Ratio*, *Salary*, and *Compensation Mix* – the

ratio of dividends to the total amount of compensation. We measure performance of the

banks both around the time of the conversion and in general for S-corporation vs. C-

corporation banks with *Return on Assets* (*ROA)* and *Return on Equity (ROE).* We also

look at the capital structure via *Equity Capital Ratio* and regulatory capital holdings, *Tier

1 Capital* of the S-corporation banks compared to their C-corporation peers. We consider

a number of important factors as determinants of banks' decision to declare S-corporation

status. Among those are the metrics of bank performance, business model, and incentives

to take advantage of the special tax treatment: *Asset Growth, Log Asset, Gross Income

growth, Allowance for Loan Loss, Agri Loans, C&I Loans, Alternative Minimum Tax*

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[14] For periods beginning March 2000, the quarterly Reports of Condition and Income can be downloaded
from the FFFIEC's Central Data Repository (CDR) website at:
https://cdr.ffiec.gov/public/PWS/DownloadBulkData.aspx   (Last accessed July 31, 2023).
For periods from March 1976 through December 2010, this information can be downloaded from the
website of the Federal Reserve Bank of Chicago at:
https://www.chicagofed.org/banking/financial-institution-reports/commercial-bank-data
(Last accessed July 31, 2023).
PDF file images of the reporting forms are available from the FFIEC's website at:
https://www.ffiec.gov/ffiec_report_forms.htm
(Last accessed July 31, 2023).
[15] The annual Summary of Deposits data files can be downloaded from the FDIC's website at:
https://www5.fdic.gov/sod/dynaDownload.asp?barItem=6
(Last accessed Juy 31, 2023)

(AMT), Built In Gains, Loss Carry-Forward (LCF), S-state, Regulatory, Age, DeNovo dummy, Rural dummy, Liquidity, Equity Capital, ROA, ROE, NPATA, CD Loans, Residential_RE, Commercial_RE. There are approximately 2,200 - 2,500 observations available for analysis of the S-corporation conversions events. The broader sample, where we include both S-corporations and C-corporations during the whole study periods, offers roughly 70,000 – 90,000 observations for various variables.

The summary statistics of the variables are provided Table 2 for the C-corporations part of the sample (Panel A) and, separately, for S-corporations (Panel B). The compensation structure for the S-corporation is notably skewed towards dividend payout at the cost of salary. Return on equity is significantly higher for S-corporation banks on average, they are significantly less involved in construction and development loans and in commercial real estate lending. S-corporation banks are somewhat older; there are fewer *de-novo* banks among them. They are slightly smaller than average banks in the sample that is already capped in size, grow more slowly and carry less equity, while the amount of risk-weighted capital does not differ from C-corporation banks as measured by the median, or even higher on average. Gross Income growth of S-corporation banks is significantly lower.

4.2. Methodology

We begin our analysis exploring factors that contribute to the decision of the banks to convert into S-corporations with equation (1) below.

$$SCorp_{ij} = \varphi\left(\alpha + \sum \beta_k X_{kij} + \sum Year_j + \sum SizeQ_n + \sum Year_j * SizeQ_n + \varepsilon_{ij}\right) \quad (1)$$

Where :

- *SCorp $_{i,j}$* is an indicator variable that is equal to one for S-corporation status and zero otherwise;

- *$X_{k,i,j}$* is vector of control variables that includes lagged values of asset growth, log (assets), Gross Income growth, Loan Losses, Agricultural Loans, C&I Loans, AMT, Built-In Gains, S-state, Age, DeNovo, Rural Dummy, Liquidity, Equity Capital, ROA, ROE, Non-Performing Assets, C&D Loans, Residential RE, and Commercial RE;

- *Year $_j$* is a vector of year fixed effects;

- *SizeQ $_n$* is a vector of size fixed effects; and

- *$\varepsilon_{i,j}$* is an i.i.d. error term.

In the next step, we run simple univariate OLS regressions of the post-conversion values of the variables of interest on their pre-conversion values using equation (2) below.

$$Y_{post\ i,j} = \alpha + \beta * Y_{pre\ ij} + \varepsilon_{ij} \tag{2}$$

where $Y_{i,j}$ is payout, salary, compensation mix, ROA, ROE, Equity Capital, or Tier1 Capital for bank i in year j. $Y_{i,j}$ is measured as a three-year mean before or after the year of conversion and also is benchmarked against either the mean or median of the same measure for all banks in the same period. Further, we modify the benchmark value to match banks' size decile. In this model, the intercept α measures the post-conversion change in the variable of interest.

Our initial identification strategy only includes banks that decided to declare S-corporation status, so we strengthen our results by using a broader sample of banks that

could plausibly be eligible for conversion judged by their asset size (actual eligibility criteria is set by the number of shareholders, which is unobservable for us). We also introduce quarter and size quintile fixed effects and most of the predictor variables identified as potential factors contributing to the S-corporation status election – see equation (1). The fixed effects model is presented as defined in equation (3).

$$
Y_{post\,ij} = \alpha + \beta_1 * SCorp_{ij} + \beta_2 * Y_{pre\,ij} \\
+ \sum \partial_k X_{kij} + \sum Year_j + \sum SizeQ_n + \sum Year_j * SizeQ_n + \varepsilon_{ij}
$$
(3)

Finally, we recognize that even our broad set of predictors and fixed effects may have omitted some factors that determine banks' self-selection in the S-corporation category. Consequently, we turn to a two-step Heckman (1979) selection model to help us address this concern. We implement it as a combination of specifications (1) and (3), as shown below. Specification 4(a) is for Stage 1 of the Heckman model and Specification 4(b) is for Stage 2. We use the results from estimating equation (4a) to calculate the Inverse Mills Ratio (IMR), which we then include as an additional regressor in equation (4b).

$$
SCorp_{ij} = \alpha + \beta_1 * IV_{Regulatory\,ij} + \beta_2 * IV_{LCF\,ij} + \\
+ \sum \partial_k X_{kij} + \sum Year_j + \sum SizeQ_n + \sum Year_j * SizeQ_n + \varepsilon_{ij};
$$
(4a)

$$
Y_{post\,ij} = \alpha + \beta_1 * SCorp_{ij} + \beta_2 * IMR_{ij} + \beta_3 * Y_{pre\,ij} \\
+ \sum \partial_k X_{kij} + \sum Year_j + \sum SizeQ_n + \sum Year_j * SizeQ_n + \varepsilon
$$
(4b)

While the Heckman selection model is technically identified from a functional form assumption in the first stage, the inclusion of instruments underpins a stronger case for causal estimation. We employ two variables, *Regulatory* and *Loss Carry-Forward (LCF)*, as instruments. As shown in Table 3, both variables are relevant predictors and

are negatively correlated with the S conversion decision. Importantly though, to be valid instruments they should not be associated with the future performance of the firm, except through their influence on S election. Because both the *Loss Carry-Forward* and *Regulatory* are variable triggered by exogenous tax and capital regulations and with the bank's past performance, the exclusion restriction is arguably met. Converting banks appear only once, while nonconverters appear every year. Only banks with three years of pre-conversion data are included. Conversion years go from 1997 until 2020, to allow for three years of post-conversion data (banks lacking three years of post-conversion data owing to merger or failure are still included). The model is estimated using full information maximum likelihood.

We also execute some of the models for the subsample of banks above and below median size to highlight heterogeneity in the impact of S-corporation status on banks introduced by size.

Finally, we confirm our results using alternative estimation for treatment effects, propensity score matching (PSM), using the greedy nearest neighbor selection algorithm (see for example Stuart, 2010), where banks that convert to S-Corporation are matched with those that do not convert on size and data year. We use one, three and five neighbors for robustness.

5.   The decision of banks to convert to S-corporations

We assume that banks convert to S-corporation status if the net benefit from conversion is positive. A vector of bank characteristics as defined in specification (2) in the methodology section is expected to predict the conversion decision; the error term in the model includes unobservable information bearing on the conversion decision. We

draw on the prior work of Hodder et al. [2003] and Cyree et al.[2005] in specifying the conversion equation and use fixed effects to control for conversion year, the asset quartile in which the bank fits, and the interaction between these two parameters.

The results from estimating eq. (1) are shown in Table 3. This table shows that older and more profitable banks, as well as those heavy on agricultural loans and having greater rural presence, are more likely to convert. Banks less likely to convert are those that are larger and growing, with heavy use of loan loss reserves that are unavailable under the S-form of organization. Other factors that make conversion less likely are higher levels of non-performing assets and higher probability of attracting regulatory attention as a result of the conversion, greater investments in construction and development and real estate loans, and fraction of equity capital in the total assets. *De novo* banks rarely convert into S-Corporations. The results are largely consistent with the previous literature on the topic.

6.   The effect of S-corporation choice on bank performance, capital structure and compensation practices

As noted in the earlier quotation from Friedman, when shareholders face taxes on the entirety of a firm's income, they will want that income paid out and invested where they see the most profit. They will want gains plowed back into the firm only if this promises higher rates of return than their outside investment options. Shareholders also must pay taxes on their pro-rata share of income, so they usually will want dividends covering at least this expense. Thus, dividends are expected to increase substantially. Dividends also may increase owing to the reduction of the tax rate on dividend, postponement of payouts until after conversion, and the prevalence of owner-managers

who substitute dividends for salary to avoid payroll taxes.[16] The summary statistics of

the S-corporation banks reveal the most significant difference is in the dividend payout

ratio post-conversion, compared to pre-conversion. We also see a shift in the

compensation mix towards dividend and away from payroll. While S-corporation status

provides a tax advantage to investors and promotes payouts, it is not so clear how the

new status impacts banks on the risk-return tradeoff spectrum of metrics. To provide new

evidence on this issue, we examine various measures of profitability (ROA and ROE) and

leverage (equity-to-asset ratio and Tier 1 Capital ratio) around the time of the conversion.

We also compare S-corporations to C-corporations across the whole sample.

6.1   *Impact of S-corporation election on the compensation structure*

Tables 4, 5, and 6 report the results from regressions at the individual bank level

for dividend payout (ratio of dividends to net income), salary (ratio of salary expense to

operating income) and compensation mix (ratio of dividends to the sum of salary and

dividends), respectively. Following the methodology in Healey et al. (1992) and Cole and

Mehran (1998), we estimate univariate regressions of a bank characteristic post-

conversion on the same bank characteristic pre-conversion. All characteristics are taken

net of a benchmark value computed each year. This adjustment is made to account for

peer-group trends. The estimated coefficient captures the correlation between a bank

characteristic before and after conversion. The intercept is then a measure of the

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[16] In the U.S., salary payments to owner-managers were subject to a combined 15% payroll tax (half paid
by the firm and half paid by the employee). When the same amount is paid as a dividend instead of salary,
this 15% tax is avoided, increasing shareholder wealth and after-tax compensation.

conversion's impact on a bank characteristic that is independent of pre-conversion levels

of that characteristic (see equation (2) in methodology section 4.2 above).

We use two alternative benchmarks so account for peer-group effects: the median

value for all commercial banks that never became S-corporations (model 1: All Banks)

and the median value for all commercial banks in the same asset decile that never became

S-corporations (model 2: Asset Decile). The dependent variable is either the mean or

median of the characteristic net of the benchmark value, from the three years after the

year of conversion to S status. The independent variable is either the mean or median of

the characteristic net of the benchmark value, from the three years before the year of

conversion to S status.[17]

As shown in Panel A of Table 4, dividend payout increases substantially after

conversion. Our regressions indicate an industry-adjusted increase of about 32 percent

against comparably sized firms (30 percent when benchmarked against the allsample

banks).

While these results characterize the payout experience of banks after conversion,

it is also of interest to estimate how much of this change in payout is directly attributable

to the conversion to S-corporation. In other words, we would like to estimate the

treatment effect, the difference in outcome for a bank that converted against the outcome

if that same bank had not converted. This requires dealing with sample selection issues,

which we address with a Heckman two-step selection model as specified by equations

(4a) and (4b) in Methodology Section 4.2.

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[17] For this analysis, we restrict our sample to banks for which at least three years of pre-conversion data and at least one-year of post-conversion data are available.

In contrast to C-corporation banks, S-corporation banks simultaneously experience lower tax rates, different tax incidence, and significant shareholder constraints. It is clear that banks self-select into the S-corporation form and that the decision is highly nonrandom.

We employ a two-stage Heckman selection model with treatment effects, a technique used previously in the corporate finance literature to measure effects such as the diversification discount of multi-segment firms (see Campa and Kedia [2002]). The selection framework allows us to explicitly model the choice to convert and use this information to estimate unbiased conversion treatment effects. Our discussion of the selection model follows that of Li and Prabhala [2007].

In particular, the selection model assumes that private information plays a significant role in the conversion decision—something that is particularly relevant in the S-conversion framework. The conversion decision involves comparing the benefits of operating as an S-corporation against the constraints of the S form and the explicit conversion costs. We do not observe the number or type of shareholders a bank has or the other business interests of the shareholders. We also have no direct information on management's beliefs regarding prospects for the bank's growth and its need for additional future capital. The importance of this unobserved information dictated our choice of a selection model instead of a matching model, where each S-corporation bank would be paired with a similar C-corporation bank, for estimating the impact of conversion to S status. The first stage of the selection model is a probit regression on conversion to S-corporation by bank i in year j as specified by equation (4a) in the methodology section.

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In Panels B, C and D of Table 4, we analyze our full sample of banks plausibly eligible for conversion (assets less than $2 billion), banks below the full sample median size, and banks above the full-sample median size, respectively. In this analysis, we estimate equation (3) with a full set of control variables. Our focus is the coefficient on the indicator variable for S-corporations. First, we estimate our OLS model as shown in equation (3) with fixed effects and an extensive set of controls, and then we estimate a treatment-effects model as described above in Methodology Section 4.2. In each of these three panels and for both models in each panel, the coefficient on S-corp is positive[18], statistically significant and in the range of 0.18 – 0.20, indicating that the payout ratio for S-corporation banks is about 20 percent higher than for C-corporation banks. While results with more stringent controls and self-selection correction show slightly lower impact than simple univariate regression, it is still sizable and significant. The reduction in effect size by about one third relative to the univariate regressions indicates that converters are systematically different and were set to increase dividends somewhat even in a counterfactual world where they remained C corporations. The effect estimated by the two-stage Heckman regression (model 4 in Table 4) is almost identical to model 3 implying that for this outcome observable differences between converters and nonconverters are fully capturing the counterfactual trajectory.

Because many S-corporation owners are also managers, we next analyze compensation measures to identify substitution of dividends for salary, using the same set of regression models used in Table 4 to analyze the dividend payout ratio. In Table 5, we use the ratio of salary expense to operating income as our dependent variable. As shown

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[18] The full set of results for these and other tests are available from the corresponding author upon request.

in Panel A of Table 5, which analyzes only those banks that converted to S-corporation, we find a statistically significant decline in industry-adjusted salary, albeit small in magnitude. In Panels B, C, and D of Table 5 are the results for our full sample of banks, for sample banks below the median size and for banks above the median size, respectively, using equation (3) above. In these regressions, only the coefficient of S-corp for smaller banks is statistically significant, and, again, the magnitude of the effect is small.

In Table 6, we perform a similar analysis to that in Table 5, but here we use the ratio of dividend to the sum of salary expense and dividends to provide evidence on how the compensation mix is affected by conversion to S-corporation. In Panel A of Table 6, we estimate equation (2) including only banks that converted to S-corporation. In each of four regressions, we find a positive and statistically significant coefficient on Alpha of about 0.20, indicating that, post-conversion, banks increased the portion of dividends in the compensation mix by about 20 percent. In Panels B, C and D of Table 6, we present the results for our full sample of banks, for sample banks below the median size and for banks above the median size, respectively, using equation (3) above. In each of the six regressions, the coefficient on *S-corp* is positive, statistically significant, and in the range of 0.12 – 0.14, indicating that the portion of dividends in the compensation mix is about 12 – 14 percent higher at S-corporation banks than at C-corporation banks.

6.2 *Profitability of S-corporation banks*

We know that most of the increase in payout is due to the changing tax incidence, where shareholders must treat bank profits as personal income. To get a sense of whether tax incidence is the only factor affecting payouts, we estimate the same set of models

shown in Tables 4, 5, and 6, but using the profitability measures of return on assets

(ROA) and return on equity (ROE) as our dependent variables. The results are presented

in Tables 7 and 8, respectively.

In Table 7, both versions of univariate OLS (Models 1 and 2), OLS with fixed

effects and extended controls performed on a broader sample (models 3, 5 an 7) and

Heckman selection regression (models 4, 6 and 8) show a statistically significant increase

in ROA of about 40 basis points, which also is economically significant, given the mean

ROA of 100 basis points.

In Table 8, each of the eight regression models indicate a statistically significatn

increase in ROE of approximately 5 percentage point. This also is economically

significant, as the mean ROE is about 7 percent for the full sample of banks, and about 10

percent for S-corporation banks). These findings align with the prediction that pass-

through taxation, coupled with elimination of the tax on dividends, should increase a

firm's efficiency.

6.3   *Capital structure and regulatory capital of banks that converted to S-corporation status*

An increase in payouts may erode retained earnings and further exacerbate

capital-raising constraints of the S form of business that is already a concern due to the

number of shareholders limitations. If S-corporation banks wish to expand without the

current owners adding more capital, they will need to rely upon retained earnings.

Massive lobbying for legislative change increasing the shareholder limit to at least 150

for S-corporation banks did not materialize. During the financial crisis of 2007-2009, S-

corporation banks were a concern for the regulators not only because of tighter conditions

for increasing capital but also because of their inability to participate in the initial round

of TARP that required preferred shares of stock disallowed for S-corporations.
Consequently, we next examine bank leverage as measured by equity capital ratio and
Tier 1 capital ratio, using the same set of regression models as in Tables 4 - 8.

In Table 9 are the results for the ratio of total equity to total assets, which is a
close proxy for the regulatory leverage ratio. In each of the eight models, we find a
negative and statistically significant coefficient, but the coefficients are small in
magnitude, indicating a decline of between 15 and 41 basis points relative to the sample
average of 11 percent.

In Table 10 are the results for the Tier 1 Capital ratio, which is the ratio of Tier 1
equity to total risk-weighted assets. We find a negative and statistically significant
coefficient in seven of the eight models, but again the coefficients are small in magnitude,
indicating a decline of between 40 and 100 basis points relative to the sample average of
16 percent.

6.4 Size of the banks and conversion effect

Size is a key determinant of bank business model and performance. While our
sample is restricted by size and we also control for bank size in some versions of our
models, we still check for heterogeneity in our findings in the below-median and above-
median size groups. The results are presented in Tables 4-10 (Models 5 - 8 There is clear
heterogeneity in the impact of conversion by bank size, with smaller banks realizing a
smaller increase in profitability and reducing capital more than larger banks; they
increase dividend payout slightly less than larger banks in the sample, and they also
appear to be the source of the small reduction in salary at conversion to S-corporation,
picked up by some of the models in our study.

6.5 Robustness of the results to the change in methodology: 2-stage Heckman model with instrumental variables and propensity score matching model.

The effects presented in Tables 4 - 10 and highlighted in the previous sections are remarkably robust to changes in specifications. We use different benchmarks when computing our independent and dependent variables, including mean and median values of the effect of interest for the whole sample and in size deciles when regressing the post-conversion value of the effect on the pre-conversion value. In the additional models, we introduce an S-Corporation dummy variable that allows us include banks that did not yet choose to convert in the analysis. Further, we account for unobservable differences in banks that chose to convert using two instrumental variables as a part of the Heckman model. We select *Regulatory* and *loss carry forward (LCF)* as instruments. The two instrumental variables that we choose are correlated with the choice of conversion to S-Corporation as evident from the results presented in Table 3. They also meet exclusion restriction because both of them are not correlated with the variables that represent post-conversion performance, payout and capital structure of the banks, particularly after the change of the form of business organization.

Finally, we estimate a series of propensity score matching models, using greedy nearest neighbor selection to pick one, three and five matching banks. We match based upon size and data year. Table 11 presents the estimated treatment effects for each of our seven dependent variables. In all versions of these models, the estimated treatment effects of conversion to S-Corporation are statistically significant with the expected sign. IV estimates are consistently smaller in magnitude than those from the matching comparisons though. This implies that banks who chose to convert were poised to

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increase profitability and payout relative to observably similar non-converters, even in the absence of pass-through election.

7.   Discussion and conclusion

The application of Subchapter S status to commercial banks has significant effects at the firm and industry levels. On average, banks that convert to S status significantly increase their dividend payout ratios; smaller banks also reduce salary, further shifting their compensation mix towards dividends. Increased payout appears to reduce capital holdings of banks, but these reductions do not seem to be economically significant. S-Corporation banks are more profitable than their C-corporation counterparts, and profitability increases for converting banks within the three-year horizon of the conversion event. Greater profitability and higher distributions as well as small changes in capital structure do not appear to shift S-Corporation banks' business into more risky assets.

Most of the banks eligible for S-Corporation status are community banks. Since passage of the law, community banks have maintained their share in the count of all commercial banks but have seen further significant declines in their aggregate share of assets. Our investigation shows that S-corporation tax laws can be effective at achieving business policy goals, such as promoting small businesses in the banking industry through indirect boosts to their operating efficiency. Given that small banks in general have more difficulty raising capital in times of crisis, S-corporations, because they face significant capital-raising constraints, also give regulators some concern.[19]

While previous research has documented the many characteristics leading banks

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[19] *American Banker*, "Small Banks Find Capital Faucet Tapped," February 25, 2008.

to convert to S status, one key datum, a bank's number of shareholders, is not publicly available. According to the trade press, the shareholder limit is the main reason some community banks have not become S-corporations. The second most important reason is the limits on types of shareholders allowed, and the third reason is that some states do not recognize S-corporations. Buying out excess shareholders is potentially very costly, and small banks also tend to have more shareholders than small businesses in other industries.[20] For banks that do not meet all the criteria, S conversion can be a costly proposition that may overwhelm future benefits.

Our research suggests that, if preserving community banks is a worthy goal, then policies to enable more of them to become S-corporations are advisable. These policies could involve encouraging more states to fully recognize S-corporations, as well as implementing direct federal legislative changes. The most obvious way to achieve this would be to raise the current shareholder limit. A more prudent course might involve imposing different criteria on depository institutions for S-status eligibility, such as a direct restriction on asset size instead of a shareholder limit.

Given the prevalence of the S-corporation form of business organization among banks and corporations in general, more work on the subject is warranted. Avenues for future research include investigating the role that shareholder restrictions play in influencing S-corporation behavior and exploiting discrete legislative changes to further investigate the economic importance of community banks.

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[20] *GAO Report to Congressional Committees,* "Banking Taxation: Implications of Proposed Revisions Governing S-Corporations on Community Banks," GAO/GGD-00-159, June 2000.

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"Banking Taxation: Implications of Proposed Revisions Governing S-Corporations on Community Banks." *GAO Report to Congressional Committees*. Order Code GAO/GGD-00-159. June 2000.

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Figure 1. Number of S-Corporation Banks and their share in the Total Number of All Commercial Banks as of year-end.
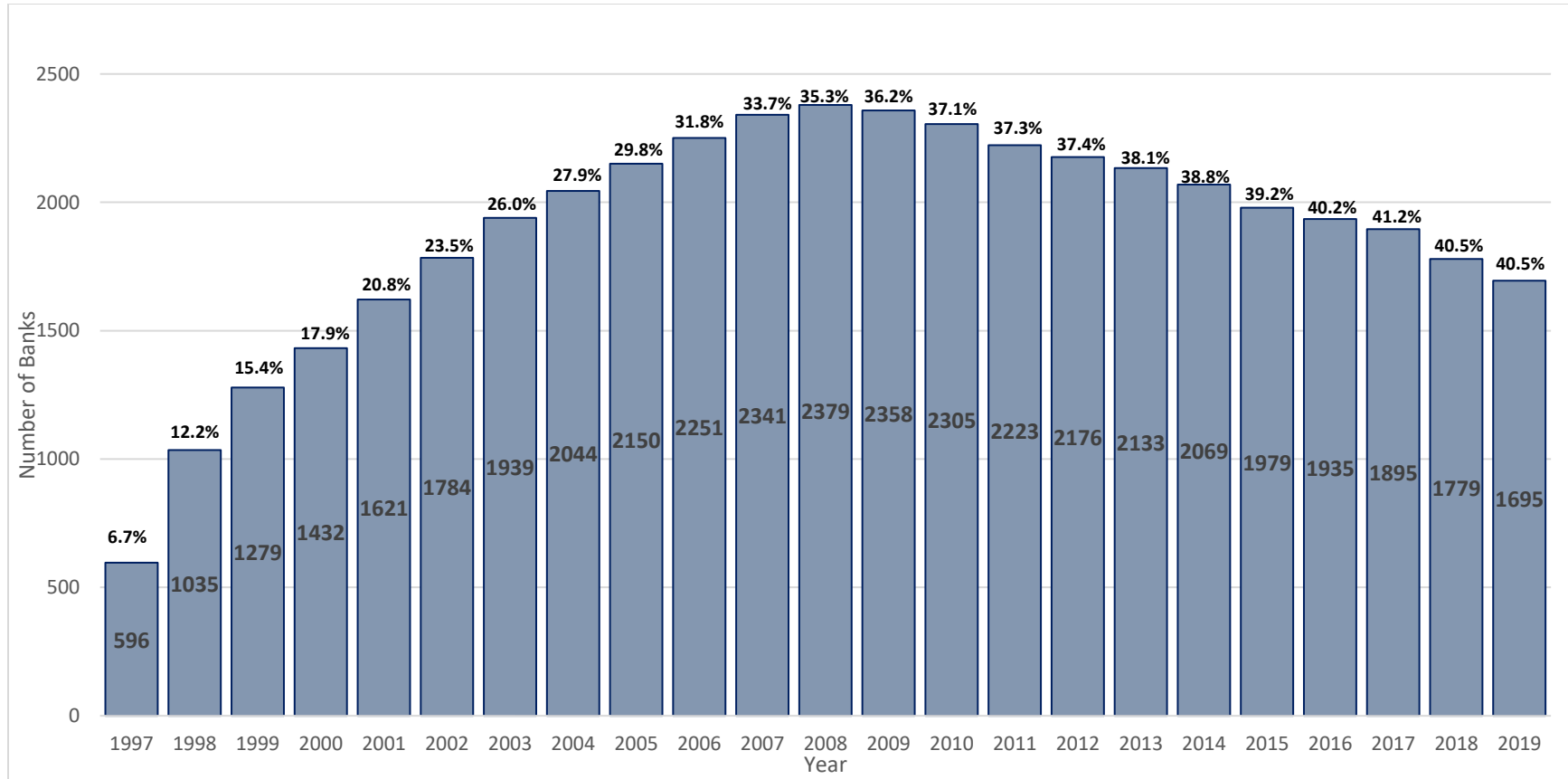
Figure 2a. Assets of S-Corporation banks relative to other banks.
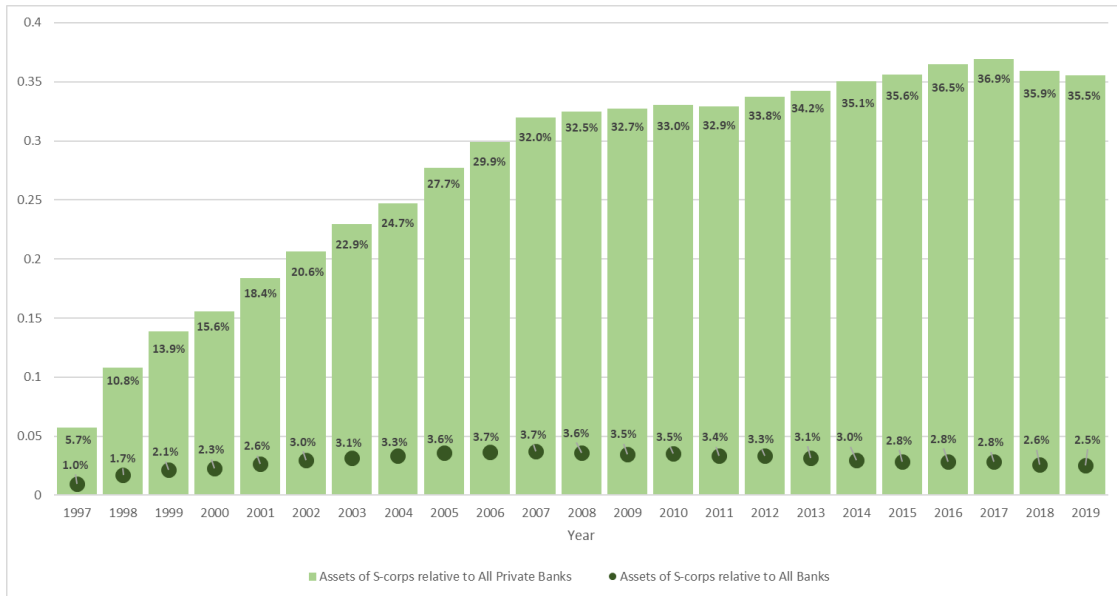
Figure 2b. Deposits of S-Corporation banks relative to other banks.
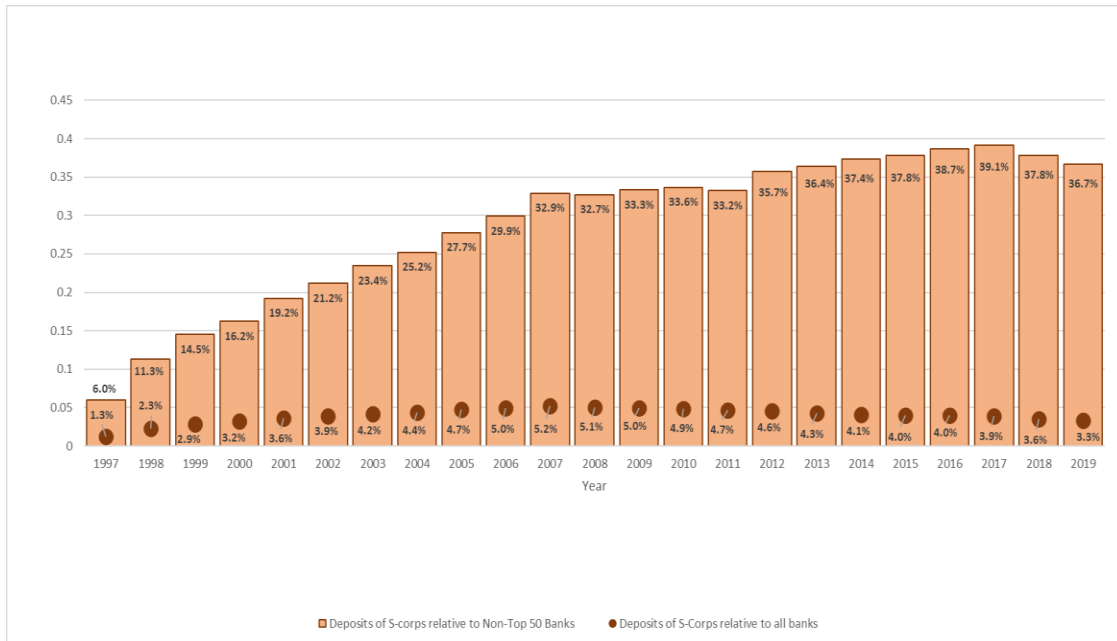
Figure 3a. S-Corporation banks by state in 2007.

Figure 3. Commercial Banks S Corporations by State in 2019
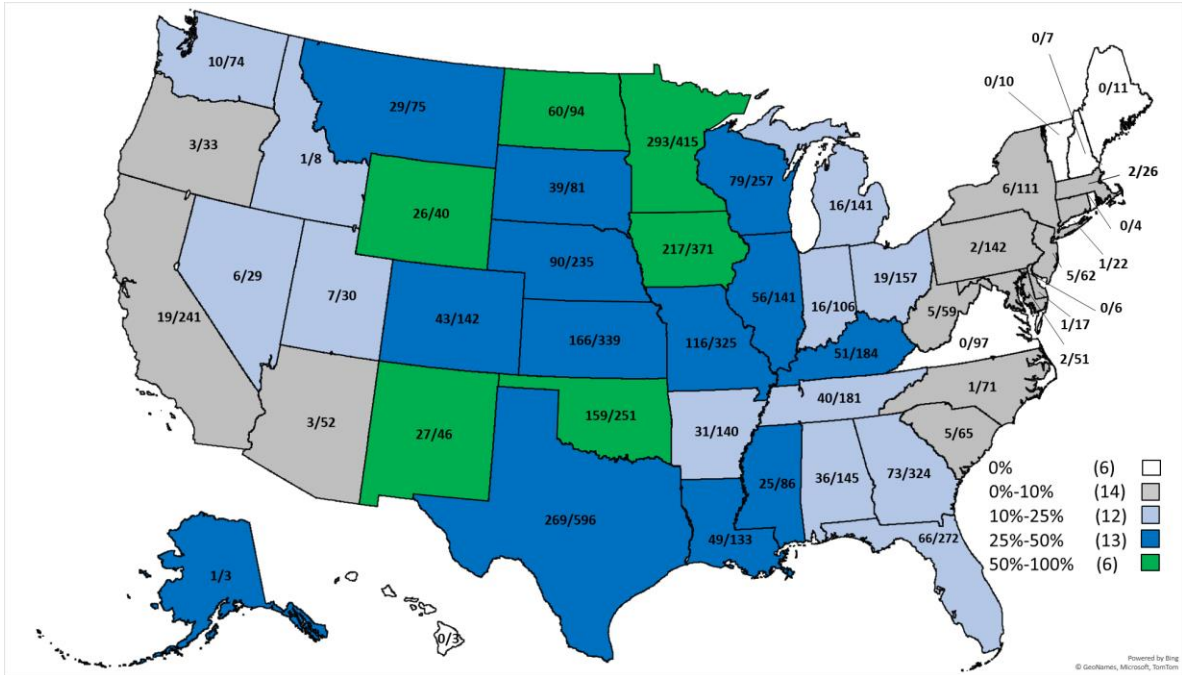
Figure 3b. S-Corporation banks by state in 2019.

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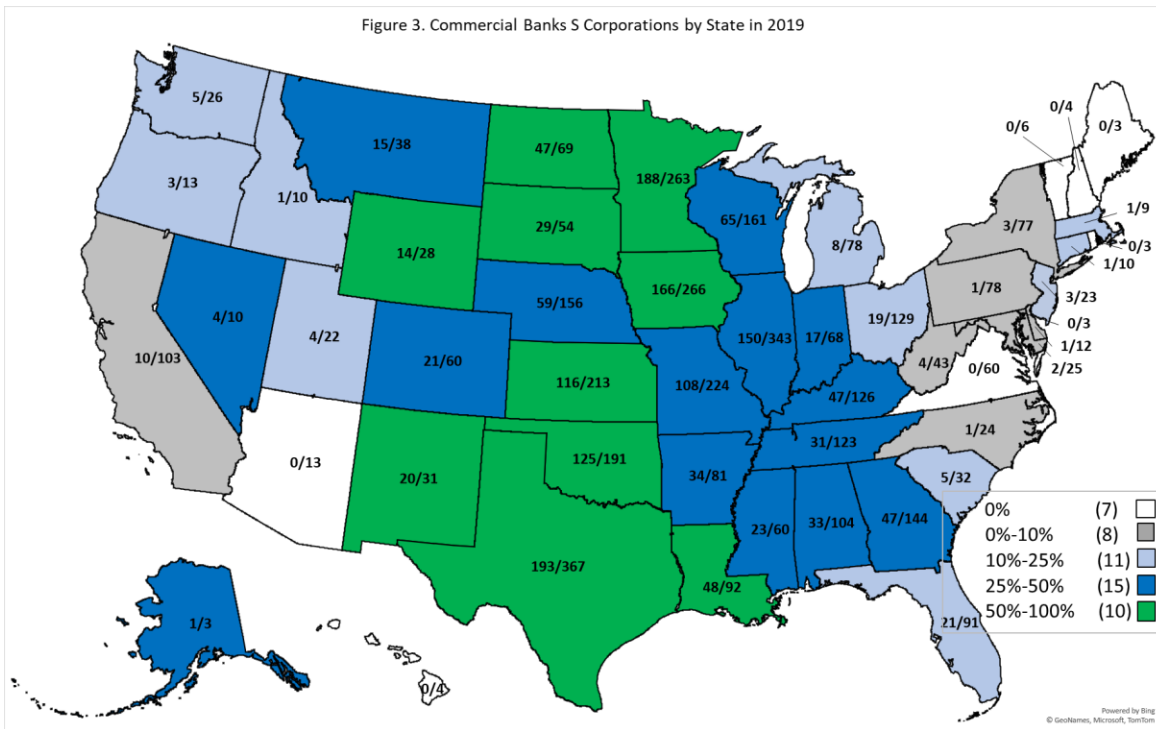
Figure 4. Subchapter S: Impact on Community Banks.
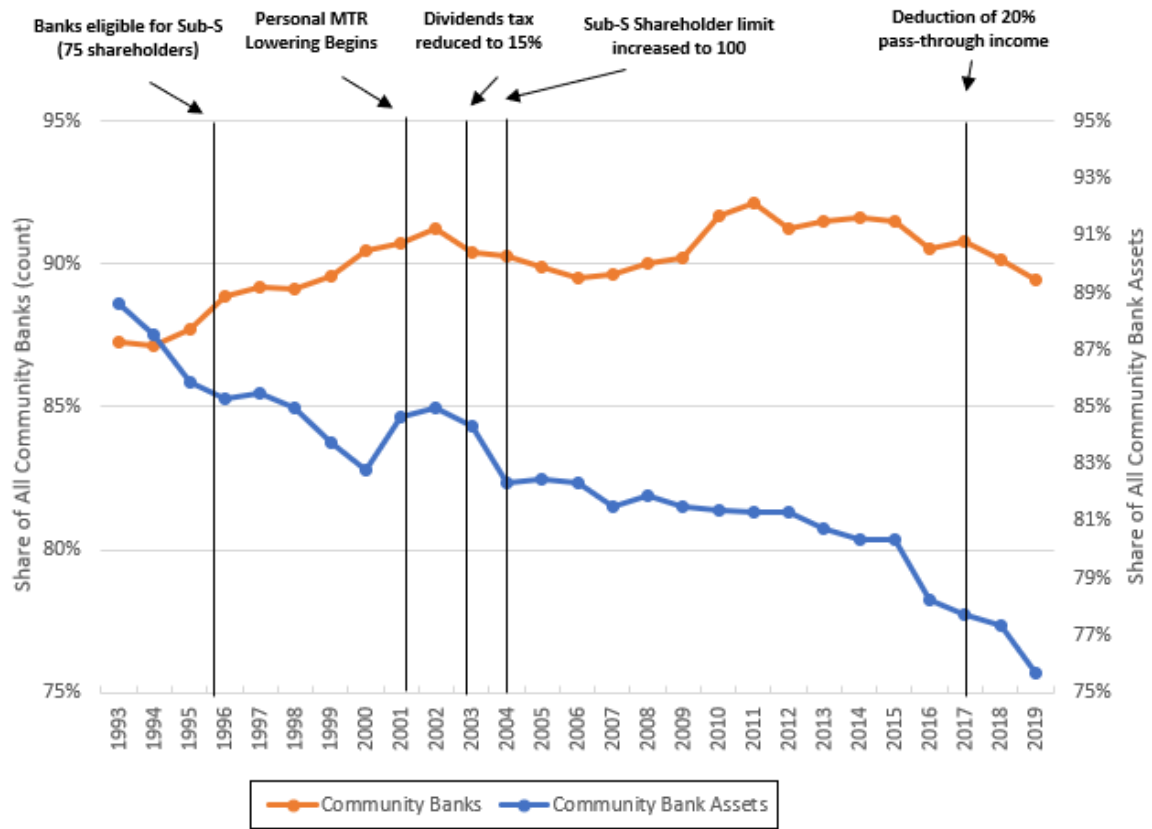
Figure 5a. S-corporation banks - 2341 banks Q4 - 2007.
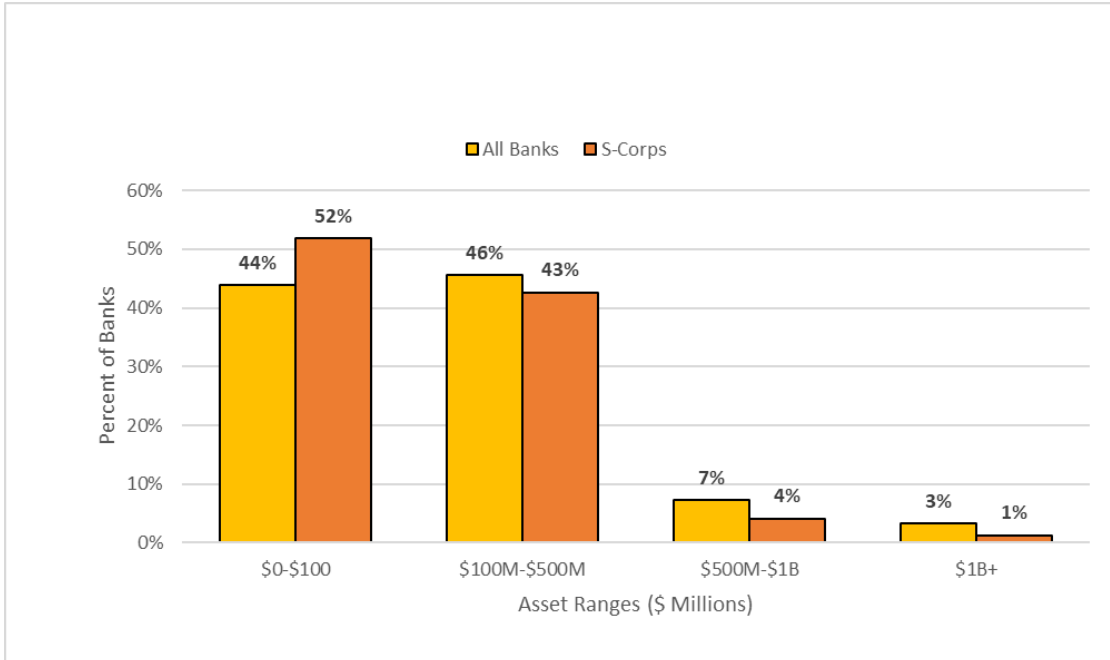
Figure 5b. S-corporation banks Asset Distribution - 1695 banks - Q4 2019.
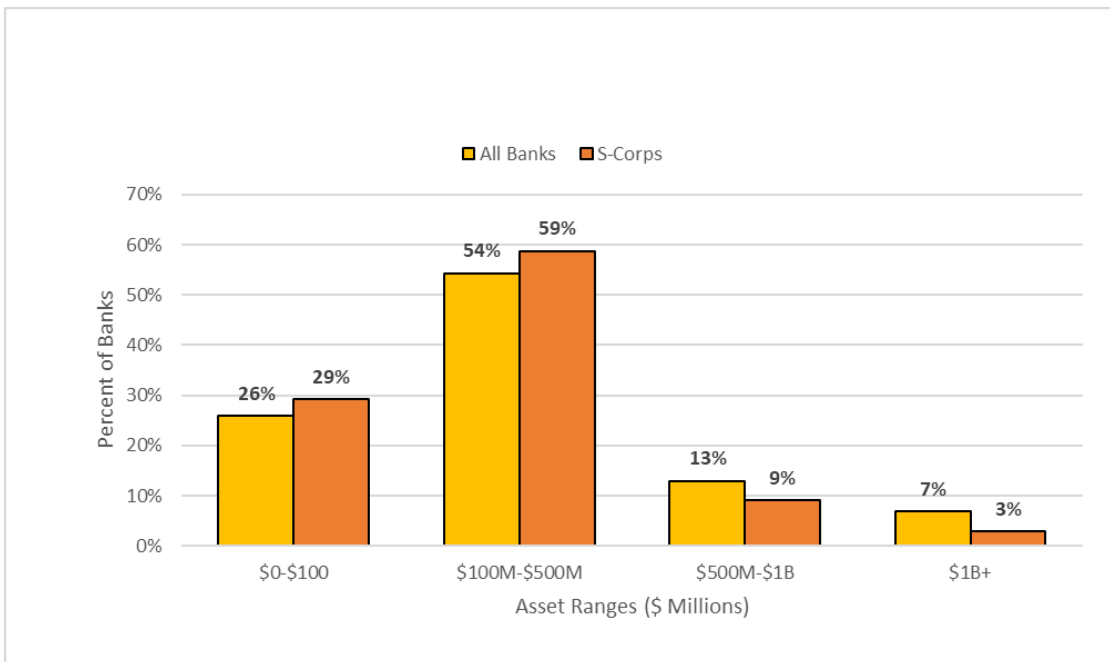
Figure 6a. Banks S-Corporations dynamics by Year: 1997-2019.
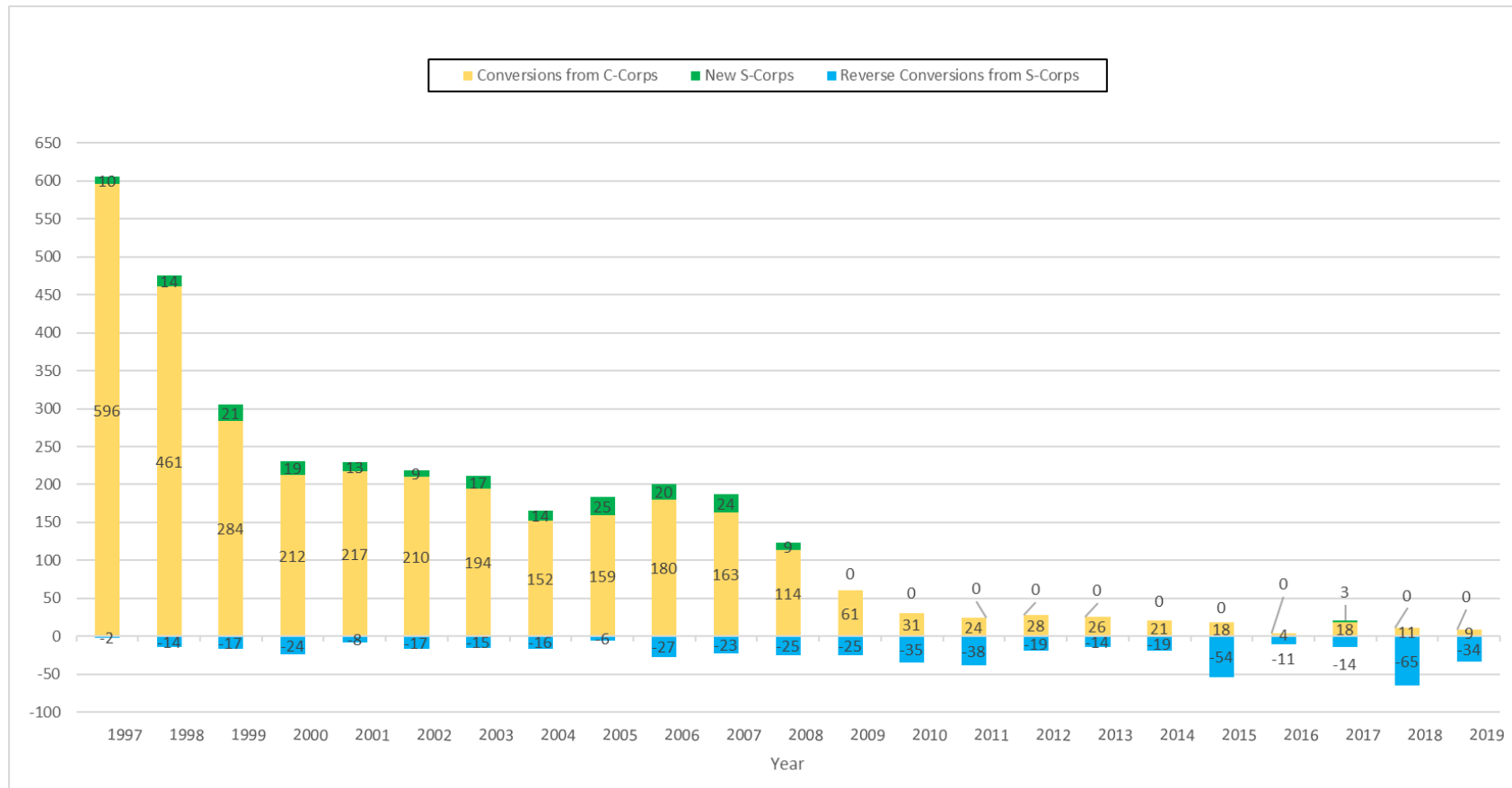
Figure 6b. Net New S-Corporation Banks by Year: 1997-2019.

Figure 6b. Net New S-Corps by Year: 1997-2019
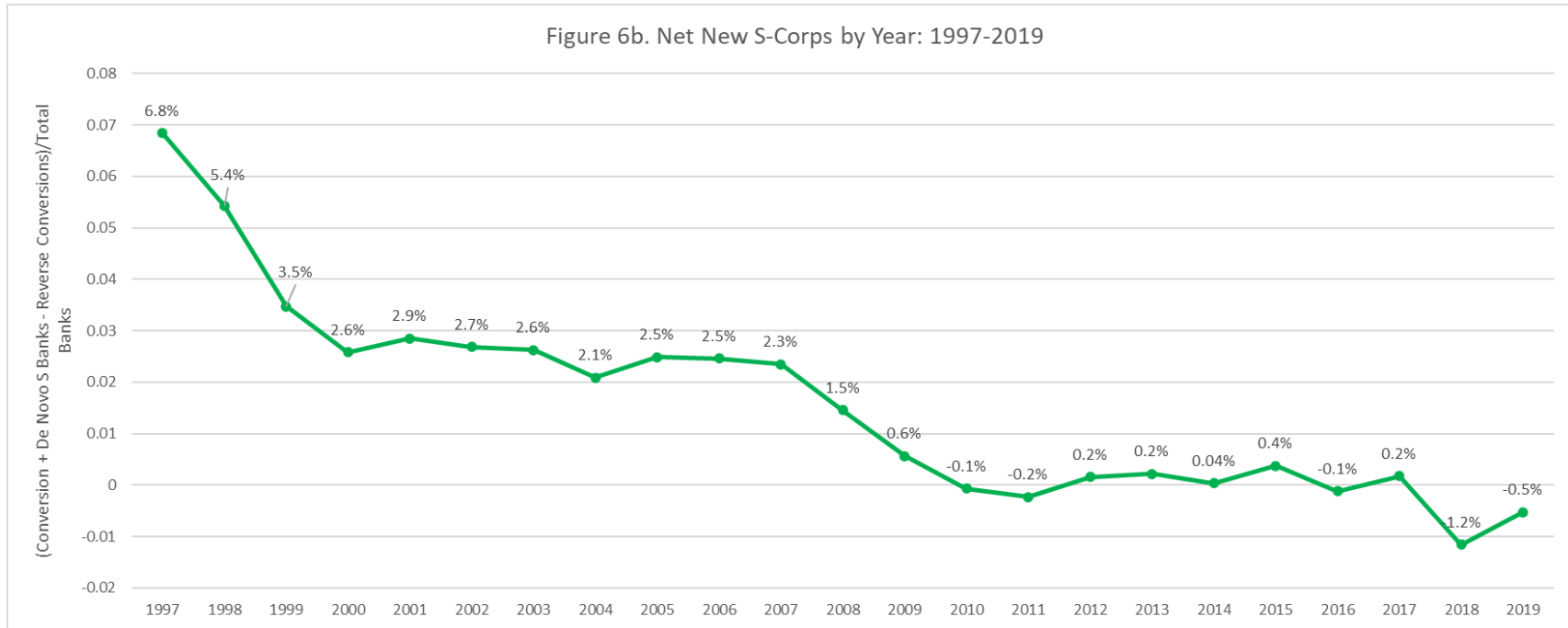
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
All Banks	8863	8489	8288	8020	7789	7595	7475	7334	7208	7076	6949	6745	6518	6216	5968	5816	5595	5331	5052	4811	4602	4397	4183
Conversion	598	461	284	212	217	212	194	155	160	181	162	114	62	31	24	28	26	21	73	4	18	11	9
De Novo	10	14	21	19	13	9	17	14	25	20	24	9	0	0	0	0	0	0	0	0	3	0	0
Reverse Conversions	-2	-14	-17	-24	-8	-17	-15	-16	-6	-27	-23	-25	-25	-35	-38	-19	-14	-19	-54	-10	-13	-62	-31
Total	606	461	288	207	222	204	196	153	179	174	163	98	37	-4	-14	9	12	2	19	-6	8	-51	-22
% S-Corps	6.8%	5.4%	3.5%	2.6%	2.9%	2.7%	2.6%	2.1%	2.5%	2.5%	2.3%	1.5%	0.6%	-0.1%	-0.2%	0.2%	0.2%	0.04%	0.4%	-0.1%	0.2%	-1.2%	-0.5%

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Figure 7. Ratio of De Novo Banks to All Community Banks.
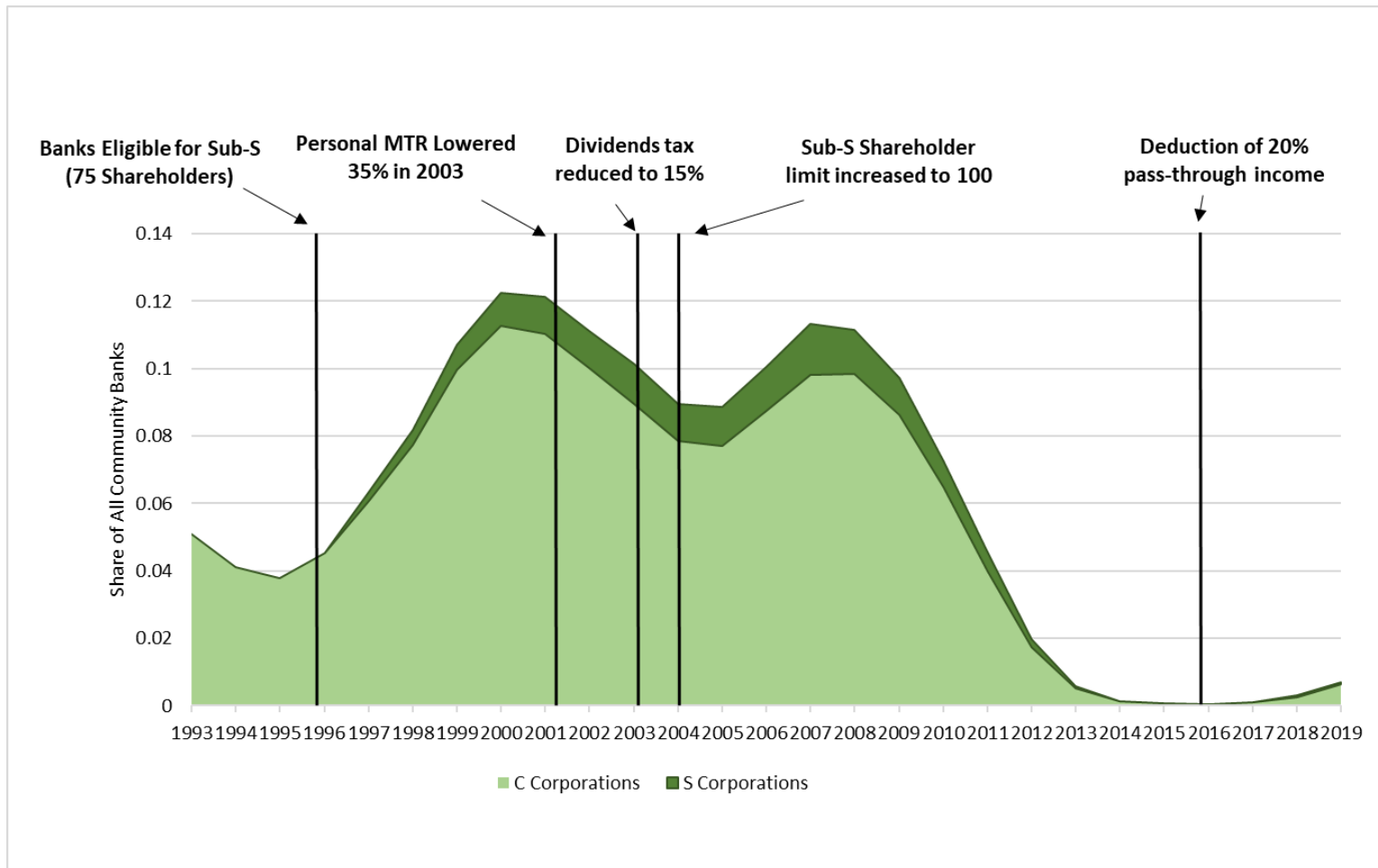
Figure 8. Risky loans in Bank Portfolio of S-Corporation Banks and C-Corporation Banks: Construction and Development (CD), Commercial Real Estate (CRE), and Non-Performing Loans (NPL).

Figure 9. Risky loans in Bank Portfolio before and after conversion to S-Corporation: Construction and Development (CD), Commercial Real Estate (CRE), and Non-Performing Loans (NPL).
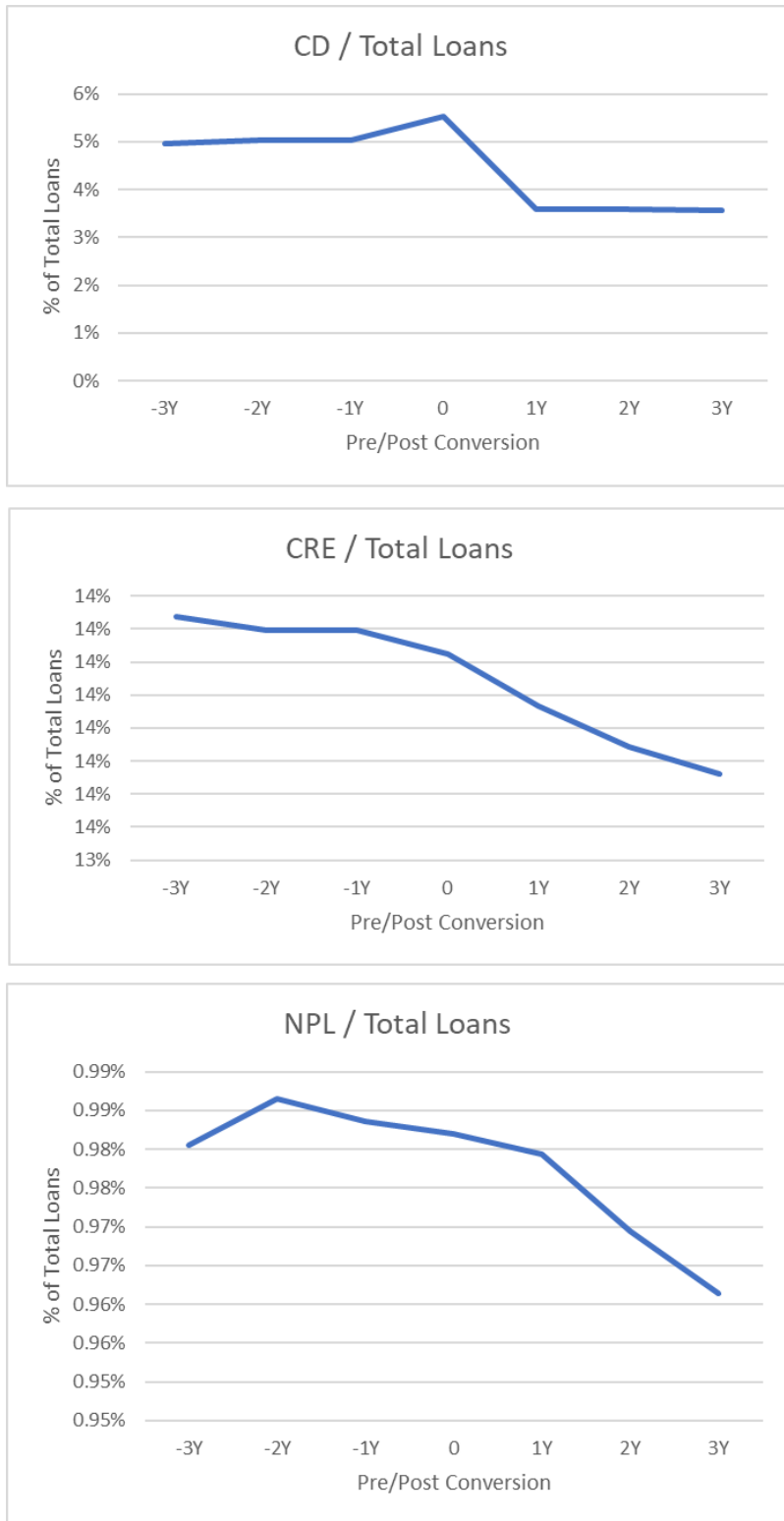
Figure 10. Profitability of S-Corporation Banks and C-Corporation Banks.
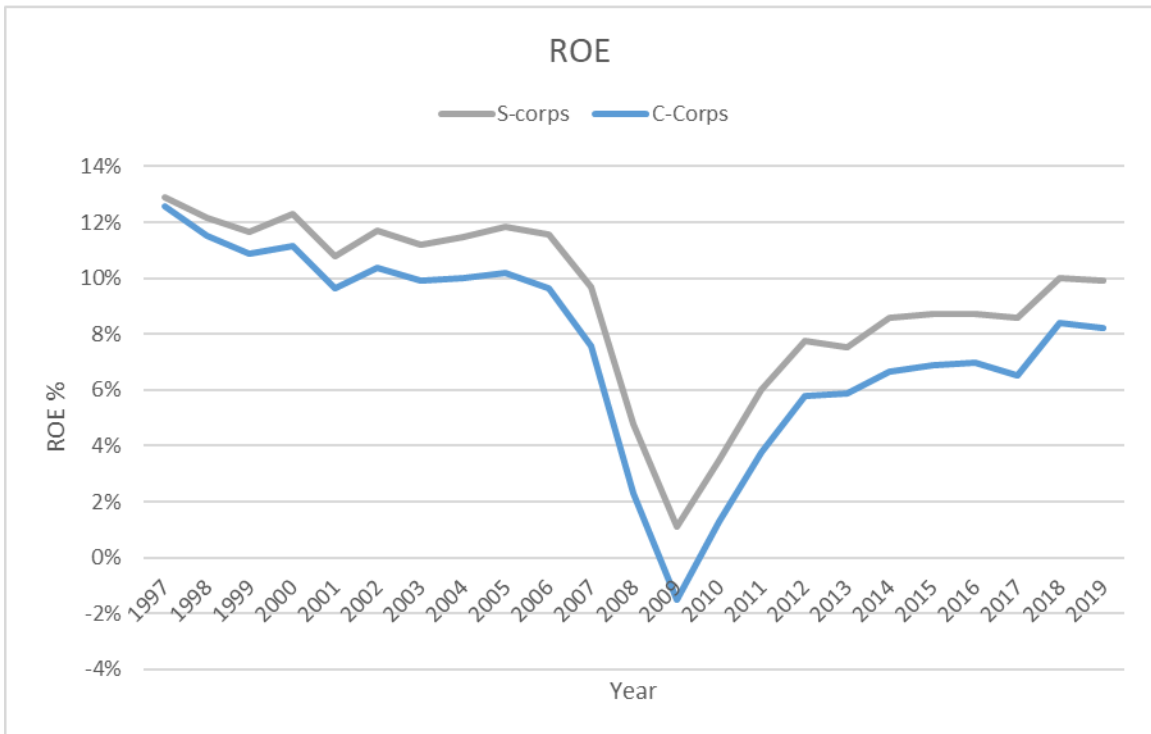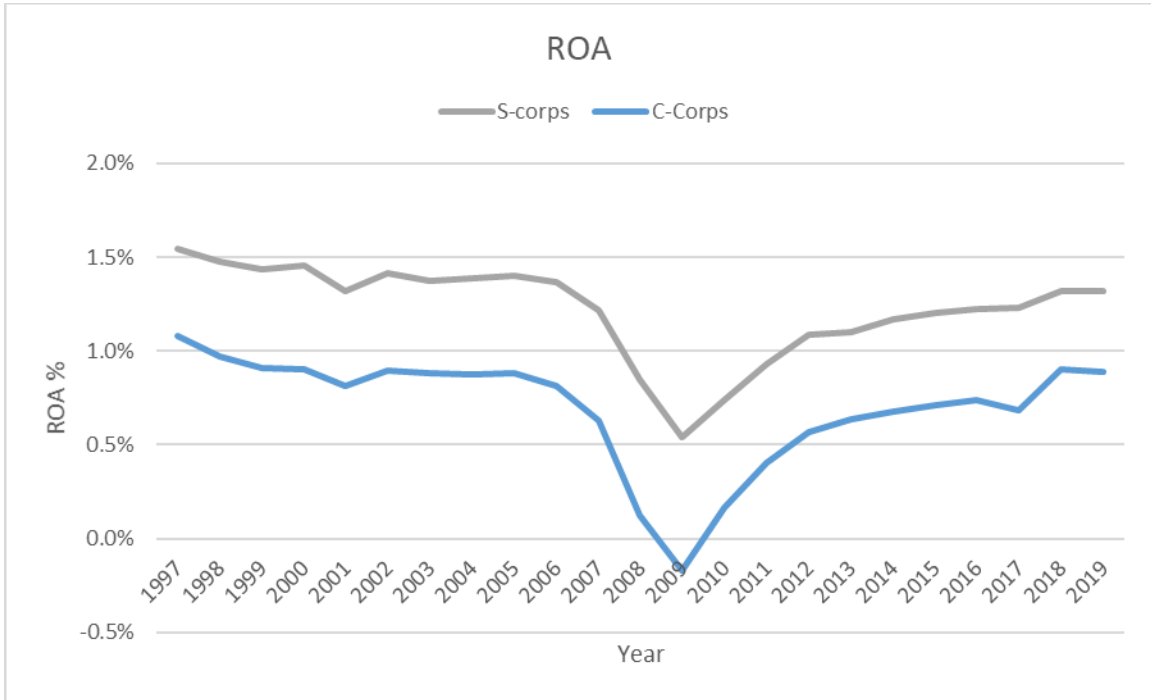
Table 1. Definitions of the Variables.

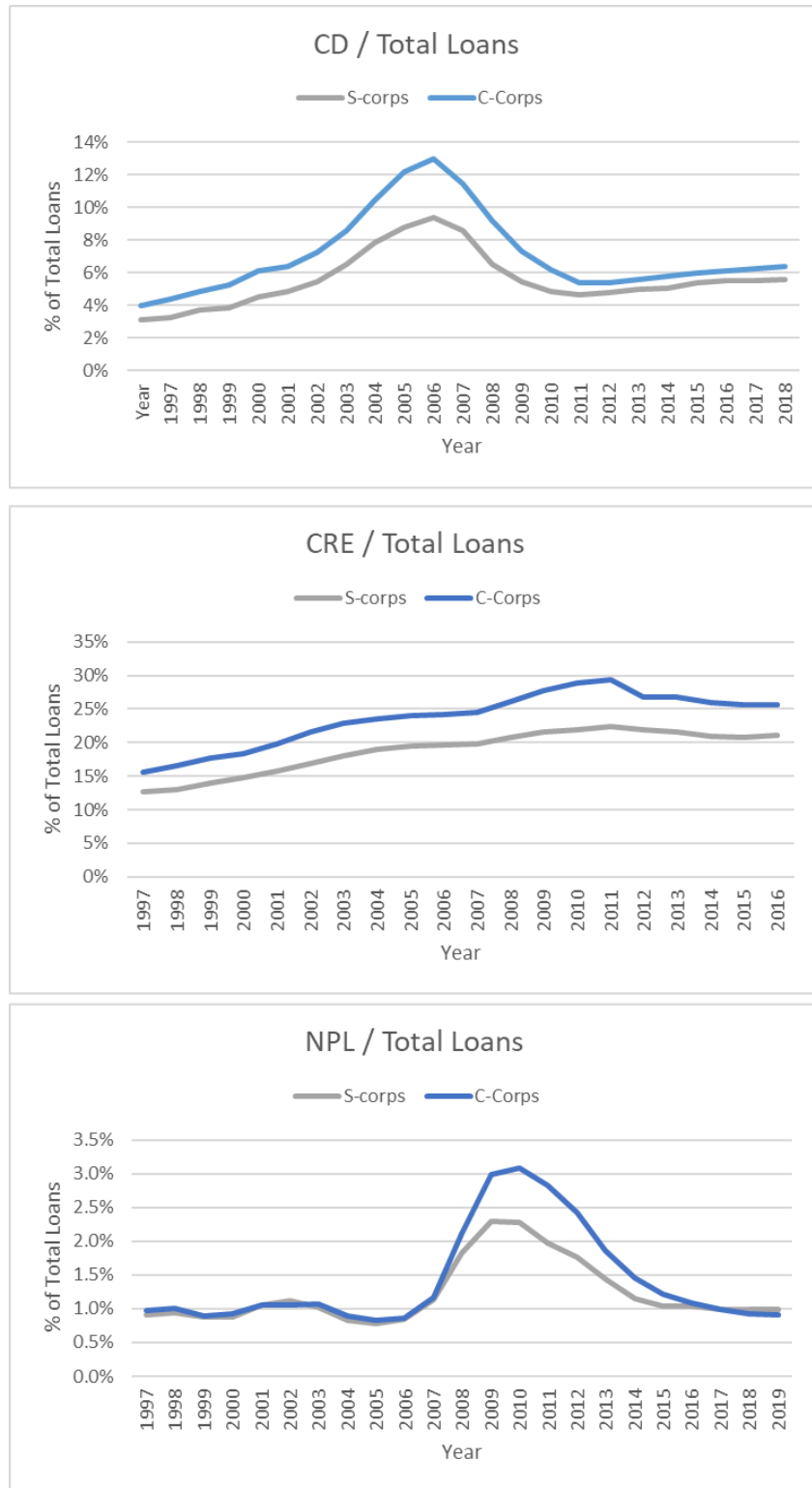| Variable	Definition
Key Dependent Variables	
Median_Salary_post	Median value of salary cost, calculated as Salaries [RIAD4135]/Operating Income [RIAD4079+RIAD4107], of the three years following current report year.
Mean_Salary_post	Mean value of salary cost, calculated as Salaries [RIAD4135]/Operating Income [RIAD4079+RIAD4107], of the three years following current report year.
Median_Payout_post	Median value of payout ratio, calculated as Common Dividends [RIAD4460]/Net Income [RIAD4340], of the three years following current report year.
Mean_Payout_post	Mean value of payout ratio, calculated as Common Dividends [RIAD4460]/Net Income [RIAD4340], of the three years following current report year.
Median_Compensation_post	Median value of compensation mix, calculated as Common Dividends [RIAD4460]/(Common Dividends [RIAD4460]+Salaries [RIAD4135]), of the three years following current report year.
Mean_Compensation_post	Mean value of compensation mix, calculated as Common Dividends [RIAD4460]/ (Common Dividends [RIAD4460]+Salaries [RIAD4135]), of the three years following current report year.
Median_ROA_post	Median value of return on assets, calculated as Net Income [RIAD4460]/Assets [RCFD2170] (1994-03-31 to 2010-12-31); [RCON2170] (starting 2011), of the three years following current report year.
Mean_ROA_post	Mean value of return on assets, calculated as Net Income [RIAD4460]/Assets [RCFD2170] (1994-03-31 to 2010-12-31); [RCON2170] (starting 2011), of the three years following current report year.
Median_ROE_post	Median value of return on equity, calculated as Net Income [RIAD4460]/((Assets [RCFD2170] (1994-03-31 to 2010-12-31); [RCON2170] (starting 2011))-Liabilities [RCON2948]), of the three years following current report year.
Mean_ROE_post	Mean value of return on equity, calculated as Net Income [RIAD4460]/((Assets [RCFD2170] (1994-03-31 to 2010-12-31); [RCON2170] (starting 2011))-Liabilities [RCON2948]), of the three years following current report year.
Median_Equity_post	Median value of equity capital, calculated as Total Equity Capital [RCON3210]/(Assets [RCFD2170] (1994-03-31 to 2010-12-31); [RCON2170] (starting 2011), of the three years following current report year.
Mean_Equity_post	Mean value of equity capital, calculated as Total Equity Capital [RCON3210]/(Assets [RCFD2170] (1994-03-31 to 2010-12-31); [RCON2170] (starting 2011), of the three years following current report year.
Median_Tier1CapRatio_post	Median value of Tier 1 Capital Ratio of the three years following current report year, calculated as Tier 1 Capital Ratio, [RCON7206] (2001-03-31 to 2014-12-31); [RCOA7206] (starting 2014) for reporting periods following 2001-03-31. Prior to 2001, calculated as Tier 1 Capital [RCON8274]/Weighted Assets [RCFDA223].
Mean_Tier1CapRatio_post	Mean value of Tier 1 Capital Ratio of the three years following current report year, calculated as Tier 1 Capital Ratio, [RCON7206] (2001-03-31 to 2014-12-31); [RCOA7206] (starting 2014) for reporting periods following 2001-03-31. Prior to 2001, calculated as Tier 1 Capital [RCON8274]/Weighted Assets [RCFDA223].
Key Independent Variables	
Median_Salary_pre	Median value of salary cost, calculated as Salaries [RIAD4135]/Operating Income [RIAD4079+RIAD4107], of the three years prior to current report year.
Mean_Salary_pre	Mean value of salary cost, calculated as Salaries [RIAD4135]/Operating Income [RIAD4079+RIAD4107], of the three years prior to current report year.

Median_Payout_pre	Median value of payout ratio, calculated as Common Dividends [RIAD4460]/Net Income [RIAD4340], of the three years prior to current report year.
Mean_Payout_pre	Mean value of payout ratio, calculated as Common Dividends [RIAD4460]/Net Income [RIAD4340], of the three years prior to current report year.
Median_Compensation_pre	Median value of compensation mix, calculated as Common Dividends [RIAD4460]/(Common Dividends [RIAD4460]+Salaries [RIAD4135]), of the three years prior to current report year.
Mean_Compensation_pre	Mean value of compensation mix, calculated as Common Dividends [RIAD4460]/(Common Dividends [RIAD4460]+Salaries [RIAD4135]), of the three years prior to current report year.
Median_ROA_pre	Median value of return on assets, calculated as Net Income [RIAD4460]/Assets [RCFD2170] (1994-03-31 to 2010-12-31); [RCON2170] (starting 2011), of the three years prior to current report year.
Mean_ROA_pre	Mean value of return on assets, calculated as Net Income [RIAD4460]/Assets [RCFD2170] (1994-03-31 to 2010-12-31); [RCON2170] (starting 2011), of the three years prior to current report year.
Median_ROE_pre	Median value of return on equity, calculated as Net Income [RIAD4460]/((Assets [RCFD2170] (1994-03-31 to 2010-12-31); [RCON2170] (starting 2011))-Liabilities [RCON2948]), of the three years prior to current report year.
Mean_ROE_pre	Mean value of return on equity, calculated as Net Income [RIAD4460]/((Assets [RCFD2170] (1994-03-31 to 2010-12-31); [RCON2170] (starting 2011))-Liabilities [RCON2948]), of the three years prior to current report year.
Median_Equity_pre	Median value of equity capital, calculated as Total Equity Capital [RCON3210]/(Assets [RCFD2170] (1994-03-31 to 2010-12-31); [RCON2170] (starting 2011), of the three years prior to current report year.
Mean_Equity_pre	Mean value of equity capital, calculated as Total Equity Capital [RCON3210]/(Assets [RCFD2170] (1994-03-31 to 2010-12-31); [RCON2170] (starting 2011), of the three years prior to current report year.
Median_Tier1CapRatio_pre	Median value of Tier 1 Capital Ratio of the three years prior to the current report year, calculated as Tier 1 Capital Ratio, [RCON7206] (2001-03-31 to 2014-12-31); [RCOA7206] (starting 2014) for reporting periods following 2001-03-31. Prior to 2001, calculated as Tier 1 Capital [RCON8274]/Weighted Assets [RCFDA223].
Mean_Tier1CapRatio_pre	Mean value of Tier 1 Capital Ratio of the three years prior to the current report year, calculated as Tier 1 Capital Ratio, [RCON7206] (2001-03-31 to 2014-12-31); [RCOA7206] (starting 2014) for reporting periods following 2001-03-31. Prior to 2001, calculated as Tier 1 Capital [RCON8274]/Weighted Assets [RCFDA223].
Asset Growth	Value of yearly growth in Total Assets, calculated as current year Assets [RCFD2170] (1994-03-31 to 2010-12-31); [RCON2170] (starting 2011)/Prior year assets [same calculation].
Log Assets	Log of Total Assets [RCFD2170] (1994-03-31 to 2010-12-31); [RCON2170] (starting 2011).
Gross Income growth	Value of yearly growth in income calculated as current period income [RIAD4079+RIAD4107] / prior period income [same calculation].
Loan Loss	Loan Loss Reserves as a percentage of Assets. Loan Loss Reserves ([RCFD3123] (1993-03-31 to 2010-12-31); [RCON3123] (starting 2011))/Assets [RCFD2170] (1994-03-31 to 2010-12-31); [RCON2170] (starting 2011).
Agri Loans	Agricultural loans as a percentage of Total Loans. Calculated as Agricultural Loans [RCFD1590] (1993-03-31 to 2010-12-31); [RCON1590] (starting 2011)/Total Loans [RCON2122].

CI Loans	Commercial and Industrial Loans as a percentage of Total Loans. Calculated as Commercial and Industrial Loans [RCFD1766] (1993-03-31 to 2010-12-31); [RCON1766] (starting 2011)/Total Loans [RCON2122].
AMT	Alternate Minimum Tax as a percentage of Assets. Calculated as Alternate Minimum Tax [RIAD4307+RIAD4504+RIAD4507]/ Assets [RCFD2170] (1994-03-31 to 2010-12-31); [RCON2170] (starting 2011).
Built In Gains	Built In Gains as a percentage of Assets. Calculated as Built In Gains ((Available for Sale Debt Securities [RCFD1773] (1993-03-31 to 2010-12-31); [RCON1773] (starting 2011))-(Total Amortized Cost of Available for Sale Securities [RCFD1772] (1993-03-12 to 2010-12-31); [RCON1772] (starting 2011))/Assets [RCFD2170] (1994-03-31 to 2010-12-31); [RCON2170] (starting 2011).
Loss Carry-Forward (LCF)	Entity's Loss Carry Forward. If entity's prior year's Net Income [RIAD4340] is less than zero and the sum of both the current and prior year's Net Income is less than zero, then Loss Carry Forward is equal to "1". Otherwise, Loss Carry Forward is equal to "0".
S-state	Banks headquartered within the following states, AL, AR, DE, FL, IA, MD, MA, MS, NJ, OK, RI, SC, VT, WI, S-State was set equal to "1". Otherwise, S-State was set equal to "0".
Regulatory	Regulatory utilizes Deferred Tax [RCON2148], Tier 1 Capital Ratio [RCON7206] (2001-03-31 to 2014-12-31); [RCOA7206] (starting 2014), and Tier 1 Capital [RCON8274] (1993-03-31 to 2014-12-31); [RCOA8274] (starting 2015). If a bank's Deferred Tax as a percentage of Tier 1 Capital fell within the top 5 percent of all banks, Regulatory was set equal to "1". Banks were placed into brackets depending on their Tier 1 Capital Ratio: >10%, 8%-6%, 6%-2%, <2%. For banks with Tier 1 Capital Ratios below 8%, Regulatory was set equal to "1". Capital ratios for all banks were re-calculated with the exclusion of deferred taxes [(Tier 1 Capital-Deferred Tax)/(Tier 1 Capital/Tier 1 Capital Ratio)]. Utilizing this new ratio, banks were placed into the same brackets previously described. If a bank's original bracket was greater than the bank's new bracket, then Regulatory was set equal to "1". If none of the previously described conditions were met, then Regulatory was set equal to "0".
Age	Entity's age, calculated as the difference between the current report year and the entity's Establishment Date [RSSD9950].
DeNovo	Entity's Denovo status. If the age of the entity is greater than 5 years old, then Denovo is equal to "0". If the age of the entity is less than 5 years old, then Denovo is equal to"1".
Ruraldummy	Utilizing Summary of Deposit Data, banks are evaluated on the population densities of the areas within which their branches operate. If the number of a bank's branches located in urban areas exceeds 50 percent of the total number of branches, then Rural Dummy is set to "1". Otherwise, a bank with a percentage of rural branches less than 50 percent has Rural Dummy set to "0".
Liquidity	Measure of an entity's liquidity as a percentage of Assets. Calculated as [RCON0010 (If RCON0010=. Then RCON0081+RCON0071) +RCON2365+RCON1773+RCON1754]/Assets [RCFD2170] (1994-03-31 to 2010-12-31); [RCON2170] (starting 2011).
Equity Capital	Equity Capital as a percentage of Assets. Calculated as Total Equity Capital [RCON3210]/Assets [RCFD2170] (1994-03-31 to 2010-12-31); [RCON2170] (starting 2011).
ROA	Return on Assets, calculated as Net Income [RIAD4340]/Assets [RCFD2170] (1994-03-31 to 2010-12-31); [RCON2170] (starting 2011).
ROE	Return on Equity, calculated as Net Income [RIAD4340]/((Assets [RCFD2170] (1994-03-31 to 2010-12-31); [RCON2170] (starting 2011))-(Liabilities [RCON2948])).

NPATA	Nonperforming assets as a percentage of Assets. Calculated as NPA [RCFD1403+RCFD1407+RCON2150]/Assets[RCFD2170] (1994-03-31 to 2010-12-31); [RCON2170] (starting 2011).
CD Loans	Construction and Development Loans as a percentage of Total Loans. Calculated as Construction and Development Loans [RCON1415] (1993-03-31 to 2011-12-31); [RCONF160+RCONF161] (starting 2012)/Total Loans [RCON2122].
Residential_RE	Residential Real Estate loans as a percentage of Total Loans, calculated as Residential Real Estate [RCON5367+RCON5368]/Total Loans [RCON2122].
Commercial_RE	Commercial Real Estate Loans as a percentage of Total Loans, calculated as Commercial Real Estate Loans [RCON1480] (1993-03-31 to 2011-12-31); [RCONF160+RCONF161]/Total Loans [RCON2122].

Table 2. Summary Statistics.

Panel A. C-Corporations						
Variable	**mean**	**p50**	**sd**	**p25**	**p75**	**N**
Key Dependent Variables						
Median_Salary_post	0.28	0.27	0.09	0.21	0.33	67,324
Mean_Salary_post	0.28	0.27	0.30	0.22	0.33	67,324
Median_Payout_post	0.32	0.30	0.27	0.02	0.51	65,398
Mean_Payout_post	0.33	0.31	0.26	0.08	0.52	65,398
Median_Compensation_post	0.16	0.13	0.15	0.00	0.25	67,310
Mean_Compensation_post	0.16	0.14	0.14	0.03	0.26	67,310
Median_ROA_post	0.01	0.01	0.01	0.01	0.01	67,307
Mean_ROA_post	0.01	0.01	0.01	0.01	0.01	67,307
Median_ROE_post	0.08	0.09	0.08	0.06	0.12	67,324
Mean_ROE_post	0.08	0.09	0.11	0.05	0.12	67,324
Median_Equity_post	0.11	0.10	0.03	0.09	0.12	67,024
Mean_Equity_post	0.11	0.10	0.03	0.09	0.12	67,024
Median_Tier1CapRatio_post	0.16	0.14	0.07	0.11	0.18	67,024
Mean_Tier1CapRatio_post	0.16	0.14	0.07	0.12	0.18	67,024
Key Independent Variables						
Median_Salary_pre	0.26	0.25	0.09	0.20	0.31	78,734
Mean_Salary_pre	0.27	0.25	0.18	0.20	0.31	78,734
Median_Payout_pre	0.31	0.29	0.26	0.02	0.49	76,264
Mean_Payout_pre	0.31	0.30	0.26	0.07	0.50	76,264
Median_Compensation_pre	0.15	0.13	0.14	0.00	0.25	78,723
Mean_Compensation_pre	0.16	0.14	0.14	0.03	0.25	78,723
Median_ROA_pre	0.01	0.01	0.01	0.01	0.01	78,732
Mean_ROA_pre	0.01	0.01	0.01	0.01	0.01	78,732
Median_ROE_pre	0.09	0.09	0.08	0.06	0.13	78,731
Mean_ROE_pre	0.08	0.09	0.09	0.06	0.13	78,731
Median_Equity_pre	0.11	0.10	0.03	0.09	0.12	78,412
Mean_Equity_pre	0.11	0.10	0.04	0.09	0.12	78,412
Median_Tier1CapRatio_pre	0.17	0.14	0.07	0.12	0.19	78,409
Mean_Tier1CapRatio_pre	0.17	0.15	0.09	0.12	0.19	78,409
AssetGrowth	0.11	0.06	0.23	0.01	0.13	81,363
ThreeYearLogassets	11.56	11.55	1.00	10.84	12.27	79,037
GrossIncomeGrowth	0.23	0.06	1.09	-0.01	0.16	81,358
ThreeYearLoanLoss	0.01	0.01	0.00	0.01	0.01	79,013
ThreeYearAgriLoans	0.09	0.02	0.14	0.00	0.11	78,988
ThreeYearCILoans	0.15	0.13	0.14	0.08	0.20	78,988
ThreeYearAMT	0.0019	0.0013	0.0021	0.0002	0.0031	79,037
ThreeYearBuiltInGains	0.0006	0.0001	0.0036	-0.0006	0.0016	79,013
Loss Carry-Froward (LCF)	0.07	0.00	0.26	0.00	0.00	81,365
S-state	0.25	0.00	0.43	0.00	0.00	81,730
Regulatory	0.08	0.00	0.27	0.00	0.00	81,730
Age	3.76	4.33	1.17	3.04	4.62	81,531
DeNovo	0.06	0.00	0.25	0.00	0.00	81,730
Ruraldummy	0.29	0.00	0.45	0.00	1.00	81,730
Liquidity	0.32	0.30	0.14	0.21	0.40	81,443
EquityCapital	0.11	0.10	0.03	0.09	0.12	81,384
ROA	0.01	0.01	0.01	0.01	0.01	81,730
ROE	0.07	0.08	0.09	0.05	0.11	81,730
NPATA	0.01	0.01	0.02	0.00	0.01	81,730
CDLoans	0.07	0.04	0.08	0.01	0.09	81,672
ResidentialRE	0.25	0.23	0.16	0.13	0.35	81,672
CommercialRE	0.23	0.20	0.16	0.10	0.32	81,672

Table 2. Continued.

Panel B. S-Corporations						
Variable	Mean	p50	sd	p25	p75	N
Key Dependent Variables						
Median_Salary_post	0.24	0.24	0.07	0.20	0.28	2,196
Mean_Salary_post	0.24	0.24	0.07	0.20	0.28	2,196
Median_Payout_post	0.61	0.63	0.22	0.48	0.76	2,131
Mean_Payout_post	0.61	0.63	0.21	0.49	0.75	2,131
Median_Compensation_post	0.34	0.36	0.15	0.25	0.45	2,196
Mean_Compensation_post	0.35	0.35	0.15	0.25	0.45	2,196
Median_ROA_post	0.01	0.01	0.01	0.01	0.02	2,196
Mean_ROA_post	0.01	0.01	0.01	0.01	0.02	2,196
Median_ROE_post	0.14	0.15	0.08	0.10	0.19	2,196
Mean_ROE_post	0.14	0.14	0.09	0.10	0.19	2,196
Median_Equity_post	0.10	0.09	0.03	0.08	0.11	2,195
Mean_Equity_post	0.10	0.09	0.03	0.08	0.11	2,195
Median_Tier1CapRatio_post	0.15	0.14	0.06	0.11	0.17	2,195
Mean_Tier1CapRatio_post	0.15	0.14	0.06	0.11	0.17	2,195
Key Independent Variables						
Median_Salary_pre	0.23	0.22	0.06	0.18	0.26	2,406
Mean_Salary_pre	0.23	0.22	0.06	0.19	0.26	2,406
Median_Payout_pre	0.40	0.40	0.27	0.19	0.61	2,381
Mean_Payout_pre	0.41	0.41	0.26	0.21	0.60	2,381
Median_Compensation_pre	0.22	0.21	0.15	0.10	0.32	2,406
Mean_Compensation_pre	0.23	0.23	0.14	0.12	0.33	2,406
Median_ROA_pre	0.01	0.01	0.00	0.01	0.01	2,406
Mean_ROA_pre	0.01	0.01	0.00	0.01	0.01	2,406
Median_ROE_pre	0.12	0.11	0.05	0.09	0.15	2,406
Mean_ROE_pre	0.12	0.11	0.05	0.09	0.15	2,406
Median_Equity_pre	0.10	0.10	0.03	0.08	0.11	2,406
Mean_Equity_pre	0.10	0.10	0.03	0.08	0.11	2,406
Median_Tier1CapRatio_pre	0.16	0.14	0.07	0.12	0.19	2,406
Mean_Tier1CapRatio_pre	0.16	0.14	0.07	0.12	0.19	2,406
Asset Growth	0.09	0.06	0.17	0.02	0.11	2,406
ThreeYearLogassets	11.08	11.03	0.85	10.49	11.62	2,406
GrossIncomeGrowth	0.18	0.06	0.91	0.00	0.14	2,406
ThreeYearLoanLoss	0.01	0.01	0.00	0.01	0.01	2,406
ThreeYearAgriLoans	0.15	0.09	0.16	0.01	0.24	2,406
ThreeYearCILoans	0.16	0.14	0.09	0.09	0.20	2,406
ThreeYearAMT	0.0023	0.0019	0.0021	0.0006	0.0034	2,406
ThreeYearBuiltInGains	0.0006	0.0003	0.0028	-0.0005	0.0016	2,406
Loss Carry-Froward (LCF)	0.01	0.00	0.10	0.00	0.00	2,406
S-state	0.26	0.00	0.44	0.00	1.00	2,406
Regulatory	0.00	0.00	0.06	0.00	0.00	2,406
Age	4.16	4.43	0.69	3.99	4.58	2,406
DeNovo	0.01	0.00	0.07	0.00	0.00	2,406
Ruraldummy	0.42	0.00	0.49	0.00	1.00	2,406
Liquidity	0.33	0.31	0.13	0.23	0.41	2,405
Equity Capital	0.10	0.10	0.03	0.08	0.11	2,405
ROA	0.01	0.01	0.01	0.01	0.02	2,406
ROE	0.13	0.13	0.07	0.09	0.17	2,406
NPATA	0.01	0.00	0.01	0.00	0.01	2,406
CD Loans	0.05	0.02	0.07	0.00	0.06	2,406
Residential_RE	0.24	0.23	0.14	0.13	0.33	2,406
Commercial_RE	0.16	0.13	0.12	0.06	0.23	2,406

Table 3. Determinants of the Decision of the Plausibly Eligible Banks to Convert to the S-Corporations form of organization.

In this table we present results that identify explanatory variables for the decision of banks to change their form of organization from C-Corporation to S-Corporation. The results are obtained from multivariable probit regression that includes all listed variables simultaneously and univariate regressions that include one variable of interest at a time. The definitions of the independent variables are provided in Table 1. We have also computed marginal effects to ease the interpretation of coefficient magnitude. Each regression includes year and asset quartile fixed effects as well as their interaction.

The models are specified as follows:

multivariable: $SCorp_{ij} = \varphi\left(\alpha + \sum \beta_k X_{kij} + \sum Year_j + \sum SizeQ_n + \sum Year_j * SizeQ_n + \varepsilon_{ij}\right)$
univariate: : $SCorp_{ij} = \varphi\left(\alpha + \sum \beta_1 X_{kij} + \sum Year_j + \sum SizeQ_n + \sum Year_j * SizeQ_n + \varepsilon_{ij}\right)$

	Share of Observations by Banks Converting to S-Corp 2.91%				
	Multivariate		**Univariate**		**Marginal Effects**
Asset Growth	-0.0549		-0.3735	***	-0.0033
	(-0.8268)		(-7.2104)		
Log(Assets)	0.0049		-0.0844	***	0.0003
	(0.1750)		(-3.9439)		
Gross Income growth	0.0056		-0.0836	***	0.0003
	(0.3613)		(-5.3590)		
Loan Loss	-13.7086	***	-15.5273	***	-0.8336
	(-4.8624)		(-6.6504)		
Agri Loans	0.3378	***	0.8356	***	0.0205
	(3.0053)		(14.1868)		
CI Loans	0.1075		-0.1646	*	0.0065
	(0.8655)		(-1.7989)		
AMT	5.6818		28.4517	***	0.3455
	(1.1605)		(7.2446)		
Built In Gains	-5.0487		1.5939		-0.3070
	(-1.5578)		(0.5548)		
LCF	-0.2956	***	-0.8854	***	-0.0180
	(-3.0010)		(-10.0614)		
S-State	0.0311		0.0210		0.0019
	(1.4601)		(1.0145)		
Regulatory	-0.1423	**	-0.3279	***	-0.0087
	(-2.3796)		(-5.9402)		
Log(Age)	0.1151	***	0.1615	***	0.0070
	(8.2214)		(15.9901)		
DeNovo	-0.2231	***	-0.8362	***	-0.0136
	(-2.5792)		(-11.9799)		

Table 3. Continued.

RuralDummy	0.0100		0.1489	***	0.0006
	(0.4717)		*(7.7552)*		
Liquidity	-0.1764	**	0.1292	**	-0.0107
	(-2.2189)		*(1.9755)*		
Equity Capital	-2.6914	***	-2.2777	***	-0.1637
	(-4.5401)		*(-7.5696)*		
ROA	9.818		21.1349	***	0.5970
	(1.5693)		*(12.9877)*		
ROE	0.4743		2.5834	***	0.0288
	(0.8102)		*(14.9676)*		
NPATA	-2.391	**	-4.8897	***	-0.1454
	(-2.1826)		*(-5.4102)*		
C&D Loans	-0.1767		-1.1483	***	-0.0107
	(-1.0309)		*(-7.7483)*		
Residential RE	-0.435	***	-0.3044	***	-0.0265
	(-4.1429)		*(-5.2034)*		
Commercial RE	-0.1169		-0.6657	***	-0.0071
	(-1.0560)		*(-8.5237)*		
Year, Asset Quartile, interaction FE	Yes		Yes		
Bank-Year Observations	86,598				
Log likelihood	-10,256.02				

Table 4. Compensation – Dividend Payout Policy at S-Corporation Banks.

In this table we present results of the regressions that identify heterogeneity in dividend payout policy (measured as Dividend/Net Income) depending on banks' organizational form. The first two models only use samples of converted banks and are specified as follows: $Y_{post\ ij} = \alpha + \beta * Y_{pre\ ij} + \varepsilon_{ij}$, where a 3-year mean of the post-conversion value of the variable of interest is regressed on the 3-year mean of the pre-conversion value, thus the intercept captures any differences associated specifically with the conversion event. The value of dividend payout is also de-meaned (or similarly adjusted to the median) of the whole sample for specification (1) and for the same asset decile for specification (2). Further, we use a broad sample of banks that can plausibly be eligible for conversions and include S-Corporation dummy as a main independent variable of interest. Specifications (3), (5), and (7) are OLS models for the full sample, larger banks, and smaller banks. $Y_{post\ ij} = \alpha + \beta_1 * SCorp_{ij} + \beta_2 * Y_{pre\ ij} + \sum \partial_k X_{kij} + \sum Year_j + \sum SizeQ_n + \sum Year_j * SizeQ_n + \varepsilon_{ij}$ In the above regressions X_k is array of control variables that include lagged asset growth, log (assets), Gross Income growth, Loan Losses, Agricultural Loans, C&I Loans, AMT, Built-In Gains, S-state, Age, DeNovo, Rural Dummy, Liquidity, Equity Capital, ROA, ROE, Non-Performing Assets, C&D Loans, Residential RE, Commercial RE. Specifications (4), (6), and (8) are the results of the second stage of the Heckman regressions. The models are specified as follows: Stage 1: $SCorp_{ij} = \alpha + \beta_1 * IV_{Regulatory\ ij} + \beta_2 * IV_{LCF\ ij} + + \sum \partial_k X_{kij} + \sum Year_j + \sum SizeQ_n + \sum Year_j * SizeQ_n + \varepsilon_{ij}$; Stage 2: $Y_{post\ ij} = \alpha + \beta_1 * SCorp_{ij} + \beta_2 * IMR_{ij} + \beta_3 * Y_{pre\ ij} + \sum \partial_k X_{kij} + \sum Year_j + \sum SizeQ_n \sum Year_j * SizeQ_n + \varepsilon$.

Conversions			All Banks (1)			Asset Decile (2)			
			Alpha	LaggedValue	RSQ	Alpha	LaggedValue	RSQ	Banks
Mean Benchmark Value Post	0.6028	mean	**0.2962***	0.2250***	0.0762	**0.3124***	0.2348***	0.0816	2,519
			66.53	14.41		66.20	14.96		
		median	**0.2989***	0.2130***	0.0684	**0.3155***	0.2198***	0.0720	2,519
			64.86	13.59		64.93	13.97		

All Banks		OLS (3)			Treatment Effects (4)		
		S-corp	Lagged Value	RSQ	S-corp	Lagged Value	Bank-Years
Pre-Conversion Mean	0.3253	**0.1923***	0.5145***	0.4375	**0.1909***	0.5132***	66,709
Post-Conversion Mean	0.5714	(45.06)	(151.75)		(44.40)	(150.94)	

Banks Below Median Size	OLS (5)			Treatment effects (6)		
	S-corp	Lagged Value	RSQ	S-corp	Lagged Value	Bank-Years
	0.1840*	0.5236***	0.4293	**0.1824***	0.5219***	32,719
	(32.09)	(110.53)		(32.00)	(111.04)	

Banks Above Median Size	OLS (7)			Treatment effects (8)		
	S-corp	Lagged Value	RSQ	S-corp	Lagged Value	Bank-Years
	0.2042*	0.4952***	0.4506	**0.2032***	0.4945***	34,000
	(31.51)	(100.87)		(31.26)	(100.92)	

Table 5. Compensation – Salary Component at S-Corporation Banks.

In this table we present results of the regressions that identify heterogeneity in salary (measured as Salary/Operating Income) depending on banks' organization form. The first two models only use a sample of converted banks and are specified as follows: $Y_{post\ ij} = \alpha + \beta * Y_{pre\ ij} + \varepsilon_{ij}$, where a 3-year mean of the post-conversion value of the variable of interest is regressed on the 3-year mean of the pre-conversion value, thus intercept captures any differences associated specifically with the conversion event. The value of dividend payout is also de-meaned (or similarly adjusted to the median) of the whole sample for specification (1) and for the same asset decile for specification (2). Further, we use broad sample of banks that can plausibly be eligible for conversions and include S-Corporation dummy as a main independent variable of interest. Specifications (3), (5), (7) are OLS models for the full sample, larger banks, and smaller banks. $Y_{post\ ij} = \alpha + \beta_1 * SCorp_{ij} + \beta_2 * Y_{pre\ ij} + \sum \partial_k X_{kij} + \sum Year_j + \sum SizeQ_n + \sum Year_j * SizeQ_n + \varepsilon_{ij}$ In the above regressions X_k is array of control variables that include lagged asset growth, log (assets), Gross Income growth, Loan Losses, Agricultural Loans, C&I Loans, AMT, Built-In Gains, S-state, Age, DeNovo, Rural Dummy, Liquidity, Equity Capital, ROA, ROE, Non-Performing Assets, C&D Loans, Residential RE, Commercial RE. Specifications (4), (6), (8) are the results of the stage 2 of Heckman regressions. The models are specified as follows: Stage 1: $SCorp_{ij} = \alpha + \beta_1 * IV_{Regulatory\ ij} + \beta_2 * IV_{LCF\ ij} + + \sum \partial_k X_{kij} + \sum Year_j + \sum SizeQ_n + \sum Year_j * SizeQ_n + \varepsilon_{ij}$; Stage 2: $Y_{post\ ij} = \alpha + \beta_1 * SCorp_{ij} + \beta_2 * IMR_{ij} + \beta_3 * Y_{pre\ ij} + \sum \partial_k X_{kij} + \sum Year_j + \sum SizeQ_n \sum Year_j * SizeQ_n + \varepsilon$.

Conversions		All Banks (1)			Asset Decile (2)			
		Alpha	LaggedValue	RSQ	Alpha	LaggedValue	RSQ	Banks
Mean Benchmark Value Post	0.2838	mean **-0.0024***	0.7278***	0.4958	**-0.0061***	0.7617***	0.5179	2,614
		(-3.05)	(50.68)		(-8.04)	(52.97)		
		median **-0.0025***	0.7565***	0.5062	**-0.0060***	0.7870***	0.5263	2,614
		(-3.21)	(51.74)		(-7.88)	(53.87)		

All Banks		OLS (3)			Treatment Effects (4)		
		S-corp	Lagged Value	RSQ	S-corp	Lagged Value	Bank-Years
Pre-Conversion Mean	0.2729	**-0.0035**	0.0969***	0.0484	**-0.0012**	0.0972***	70,335
Post-Conversion Mean	0.2928	(-0.56)	(14.46)		(-0.20)	(14.51)	

Banks Below Median Size	OLS (5)			Treatment effects (6)		
	S-corp	Lagged Value	RSQ	S-corp	Lagged Value	Bank-Years
	-0.0043	0.0673***	0.4733	**-0.0031***	0.0670***	34,853
	(-2.36)	(38.74)		(-1.72)	(39.41)	

Banks Above Median Size	OLS (7)			Treatment effects (8)		
	S-corp	Lagged Value	RSQ	S-corp	Lagged Value	Bank-Years
	0.0010	0.2207***	0.0369	**0.0018**	0.2212***	35,492
	(0.07)	(10.80)		(-0.13)	(10.84)	

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Table 6. Compensation Mix at S-Corporation Banks.

In this table we present results of the regressions that identify heterogeneity in compensation mix (ratio of Dividends/(Dividends+Salary)) depending on banks' organization form. The first two models only use sample of converted banks and are specified as follows: $Y_{post\ ij} = \alpha + \beta * Y_{pre\ ij} + \varepsilon_{ij}$, where a 3-year mean of the post-conversion value of the variable of interest is regressed on the 3-year mean of the pre-conversion value, thus intercept captures any differences associated specifically with the conversion event. The value of dividend payout is also de-meaned (or similarly adjusted to the median) of the whole sample for specification (1) and for the same asset decile for specification (2). Further, we use a broad sample of banks that can plausibly be eligible for conversions and include a S-Corporation dummy as a main independent variable of interest. Specifications (3), (5), (7) are OLS models for the full sample, larger banks, and smaller banks. $Y_{post\ ij} = \alpha + \beta_1 * SCorp_{ij} + \beta_2 * Y_{pre\ ij} + \sum \partial_k X_{kij} + \sum Year_j + \sum SizeQ_n + \sum Year_j * SizeQ_n + \varepsilon_{ij}$ In the above regressions X_k is the array of control variables that include lagged asset growth, log (assets), Gross Income growth, Loan Losses, Agricultural Loans, C&I Loans, AMT, Built-In Gains, S-state, Age, DeNovo, Rural Dummy, Liquidity, Equity Capital, ROA, ROE, Non-Performing Assets, C&D Loans, Residential RE, Commercial RE. Specifications (4), (6), (8) are the results of the stage 2 of Heckman regressions. The models are specified as follows: Stage 1: $SCorp_{ij} = \alpha + \beta_1 * IV_{Regulatory\ ij} + \beta_2 * IV_{LCF\ ij} + + \sum \partial_k X_{kij} + \sum Year_j + \sum SizeQ_n + \sum Year_j * SizeQ_n + \varepsilon_{ij}$; Stage 2: $Y_{post\ ij} = \alpha + \beta_1 * SCorp_{ij} + \beta_2 * IMR_{ij} + \beta_3 * Y_{pre\ ij} + \sum \partial_k X_{kij} + \sum Year_j + \sum SizeQ_n \sum Year_j * SizeQ_n + \varepsilon.$

Conversions			All Banks (1)			Asset Decile (2)			
			Alpha	LaggedValue	RSQ	Alpha	LaggedValue	RSQ	Banks
Mean Benchmark Value Post	0.3304	mean	**0.1947***	0.4067***	0.1637	**0.2071***	0.4315***	0.1825	2,614
			(65.91)	(22.61)		(63.18)	(24.15)		
		median	**0.2024***	0.3679***	0.1366	**0.2162***	0.3946***	0.1554	2,614
			(67.56)	(20.33)		(65.68)	(21.92)		

All Banks		OLS (3)			Treatment Effects (4)		
		S-corp	Lagged Value	RSQ	S-corp	Lagged Value	Bank-Years
Pre-Conversion Mean	0.1776	**0.1271***	0.5613***	0.5534	**0.1261***	0.5565***	70,330
Post-Conversion Mean	0.3215	(61.45)	(172.81)		(60.05)	(168.64)	

Banks Below Median Size	OLS (5)			Treatment effects (6)		
	S-corp	Lagged Value	RSQ	S-corp	Lagged Value	Bank-Years
	0.1204*	0.5768***	0.5522	**0.1191***	0.5701***	34,849
	(45.49)	(127.33)		(45.81)	(123.93)	

Banks Above Median Size	OLS (7)			Treatment effects (8)		
	S-corp	Lagged Value	RSQ	S-corp	Lagged Value	Bank-Years
	0.1361*	0.5373***	0.5547	**0.1355***	0.5355***	35,491
	(41.15)	(114.53)		(41.06)	(113.94)	

Table 7. Profitability – Return on Assets at S-Corporation Banks.

In this table we present results of the regressions that identify heterogeneity in ROA depending on banks' organization form. The first two models only use sample of converted banks and are specified as follows: $Y_{post\ ij} = \alpha + \beta * Y_{pre\ ij} + \varepsilon_{ij}$, where a 3-year mean of the post-conversion value of the variable of interest is regressed on the 3-year mean of the pre-conversion value, thus intercept captures any differences associated specifically with the conversion event. The value of dividend payout is also de-meaned (or similarly adjusted to the median) of the whole sample for specification (1) and for the same asset decile for specification (2). Further, we use a broad sample of banks that can plausibly be eligible for conversions and include a S-Corporation dummy as a main independent variable of interest. Specifications (3), (5), (7) are OLS models for the full sample, larger banks, and smaller banks. $Y_{post\ ij} = \alpha + \beta_1 * SCorp_{ij} + \beta_2 * Y_{pre\ ij} + \sum \partial_k X_{kij} + \sum Year_j + \sum SizeQ_n + \sum Year_j * SizeQ_n + \varepsilon_{ij}$ In the above regressions X_k is the array of control variables that include lagged asset growth, log (assets), Gross Income growth, Loan Losses, Agricultural Loans, C&I Loans, AMT, Built-In Gains, S-state, Age, DeNovo, Rural Dummy, Liquidity, Equity Capital, ROA, ROE, Non-Performing Assets, C&D Loans, Residential RE, Commercial RE. Specifications (4), (6), (8) are the results of the stage 2 of Heckman regressions. The models are specified as follows: Stage 1: $SCorp_{ij} = \alpha + \beta_1 * IV_{Regulatory\ ij} + \beta_2 * IV_{LCF\ ij} + + \sum \partial_k X_{kij} + \sum Year_j + \sum SizeQ_n + \sum Year_j * SizeQ_n + \varepsilon_{ij}$; Stage 2: $Y_{post\ ij} = \alpha + \beta_1 * SCorp_{ij} + \beta_2 * IMR_{ij} + \beta_3 * Y_{pre\ ij} + \sum \partial_k X_{kij} + \sum Year_j + \sum SizeQ_n \sum Year_j * SizeQ_n + \varepsilon$.

Conversions				All Banks (1)			Asset Decile (2)			
			Alpha	LaggedValue	RSQ	Alpha	LaggedValue	RSQ	Banks
Mean Benchmark Value Post	0.0127	mean	0.0042***	0.6262***	0.1297	0.0045***	0.6201***	0.1239	2,614
			(31.71)	(19.73)		(32.61)	(19.22)		
		median	0.0043***	0.7071***	0.1695	0.0046***	0.6906***	0.1587	2,614
			(35.95)	(23.09)		(36.07)	(22.2)		

All Banks		OLS (3)			Treatment Effects (4)		
		S-corp	Lagged Value	RSQ	S-corp	Lagged Value	Bank-Years
Pre-Conversion Mean	0.1047	0.0039***	0.2070***	0.2941	0.0037***	0.1955***	70,332
Post-Conversion Mean	0.0122	(30.53)	(43.26)		(37.00)	(40.73)	

Banks Below Median Size	OLS (5)			Treatment effects (6)		
	S-corp	Lagged Value	RSQ	S-corp	Lagged Value	Bank-Years
	0.0037***	0.1870***	0.2643	0.0035***	0.1766***	34,853
	(22.34)	(29.31)		(17.50)	(27.59)	

Banks Above Median Size	OLS (7)			Treatment effects (8)		
	S-corp	Lagged Value	RSQ	S-corp	Lagged Value	Bank-Years
	0.0041***	0.2376***	0.3219	0.0039***	0.2242***	35,489
	(20.66)	(31.77)		(19.50)	(29.89)	

Table 8. Profitability – Return on Equity at S-Corporation Banks.

In this table we present results of the regressions that identify heterogeneity in ROE depending on banks' organization form. The first two models only use a sample of converted banks and are specified as follows: $Y_{post\ ij} = \alpha + \beta * Y_{pre\ ij} + \varepsilon_{ij}$, where a 3-year mean of the post-conversion value of the variable of interest is regressed on the 3-year mean of the pre-conversion value, thus intercept captures any differences associated specifically with the conversion event. The value of dividend payout is also de-meaned (or similarly adjusted to the median) of the whole sample for specification (1) and for the same asset decile for specification (2). Further, we use broad sample of banks that can plausibly be eligible for conversions and include S-Corporation dummy as a main independent variable of interest. Specifications (3), (5), (7) are OLS models for the full sample, larger banks, and smaller banks. $Y_{post\ ij} = \alpha + \beta_1 * SCorp_{ij} + \beta_2 * Y_{pre\ ij} + \sum \partial_k X_{kij} + \sum Year_j + \sum SizeQ_n + \sum Year_j * SizeQ_n + \varepsilon_{ij}$ In the above regressions X_k is the array of control variables that include lagged asset growth, log (assets), Gross Income growth, Loan Losses, Agricultural Loans, C&I Loans, AMT, Built-In Gains, S-state, Age, DeNovo, Rural Dummy, Liquidity, Equity Capital, ROA, ROE, Non-Performing Assets, C&D Loans, Residential RE, Commercial RE. Specifications (4), (6), (8) are the results of the stage 2 of Heckman regressions. The models are specified as follows: Stage 1: $SCorp_{ij} = \alpha + \beta_1 * IV_{Regulatory\ ij} + \beta_2 * IV_{LCF\ ij} + + \sum \partial_k X_{kij} + \sum Year_j + \sum SizeQ_n + \sum Year_j * SizeQ_n + \varepsilon_{ij}$; Stage 2: $Y_{post\ ij} = \alpha + \beta_1 * SCorp_{ij} + \beta_2 * IMR_{ij} + \beta_3 * Y_{pre\ ij} + \sum \partial_k X_{kij} + \sum Year_j + \sum SizeQ_n \sum Year_j * SizeQ_n + \varepsilon$.

Conversions			**All Banks (1)**			**Asset Decile (2)**			
			Alpha	LaggedValue	RSQ	Alpha	LaggedValue	RSQ	Banks
Mean Benchmark Value Post	0.1250	mean	**0.0476***	0.4921***	0.0299	**0.0525***	0.4256***	0.0220	2,614
			(16.02)	(8.98)		(17.01)	(7.67)		
		median	**0.0476***	0.7047***	0.1499	**0.0501***	0.6622***	0.1304	2,614
			(34.3)	(21.46)		(33.82)	(19.79)		

All Banks		**OLS (3)**			**Treatment Effects (4)**			
		S-corp	Lagged Value	RSQ	S-corp	Lagged Value		Bank-Years
Pre-Conversion Mean	0.0885	**0.0457***	0.0620***	0.1560	**0.0431***	0.0526***		65,400
Post-Conversion Mean	0.1298	(20.04)	(9.86)		(358.30)	(69.85)		

Banks Below Median Size	**OLS (5)**			**Treatment effects (6)**			
	S-corp	Lagged Value	RSQ	S-corp	Lagged Value		Bank-Years
	0.0421*	0.05626***	0.2123	**0.0393***	0.0458		32,323
	(19.09)	(9.80)		(319.33)	(63.66)		

Banks Above Median Size	**OLS (7)**			**Treatment effects (8)**			
	S-corp	Lagged Value	RSQ	S-corp	Lagged Value		Bank-Years
	0.0509*	0.0699	0.1259	**0.0480***	0.0588***		33,090
	(11.72)	5.22		(122.28)	(19.28)		

Table 9. Capital Structure of S-Corporation Banks.

In this table we present results of the regressions that identify heterogeneity in capital structure (Total Equity/Total Assets Ratio) depending on banks' organization form. The first two models only use a sample of converted banks and are specified as follows: $Y_{post\ ij} = \alpha + \beta * Y_{pre\ ij} + \varepsilon_{ij}$, where a 3-year mean of the post-conversion value of the variable of interest is regressed on the 3-year mean of the pre-conversion value, thus intercept captures any differences associated specifically with the conversion event. The value of dividend payout is also de-meaned (or similarly adjusted to the median) of the whole sample for specification (1) and for the same asset decile for specification (2). Further, we use a broad sample of banks that can plausibly be eligible for conversions and include S-Corporation dummy as a main independent variable of interest. Specifications (3), (5), (7) are OLS models for the full sample, larger banks, and smaller banks. $Y_{post\ ij} = \alpha + \beta_1 * SCorp_{ij} + \beta_2 * Y_{pre\ ij} + \sum \partial_k X_{kij} + \sum Year_j + \sum SizeQ_n + \sum Year_j * SizeQ_n + \varepsilon_{ij}$ In the above regressions X_k is the array of control variables that include lagged asset growth, log (assets), Gross Income growth, Loan Losses, Agricultural Loans, C&I Loans, AMT, Built-In Gains, S-state, Age, DeNovo, Rural Dummy, Liquidity, Equity Capital, ROA, ROE, Non-Performing Assets, C&D Loans, Residential RE, Commercial RE. Specifications (4), (6), (8) are the results of the stage 2 of Heckman regressions. The models are specified as follows: Stage 1: $SCorp_{ij} = \alpha + \beta_1 * IV_{Regulatory\ ij} + \beta_2 * IV_{LCF\ ij} + + \sum \partial_k X_{kij} + \sum Year_j + \sum SizeQ_n + \sum Year_j * SizeQ_n + \varepsilon_{ij}$; Stage 2: $Y_{post\ ij} = \alpha + \beta_1 * SCorp_{ij} + \beta_2 * IMR_{ij} + \beta_3 * Y_{pre\ ij} + \sum \partial_k X_{kij} + \sum Year_j + \sum SizeQ_n \sum Year_j * SizeQ_n + \varepsilon$.

Conversions			All Banks (1)			Asset Decile (2)			
			Alpha	LaggedValue	RSQ	Alpha	LaggedValue	RSQ	Banks
Mean Benchmark Value Post	0.0986	mean	**-0.0015***	0.6879***	0.5928	**-0.0037***	0.6781***	0.5798	2,612
			(-4.04)	(61.64)		(-10.5)	(60.01)		
		median	**-0.0016***	0.6890***	0.5806	**-0.0038***	0.6729***	0.5622	2,612
			(-4.34)	(60.11)		(-10.69)	(57.9)		

All Banks		OLS (3)			Treatment Effects (4)		
		S-corp	Lagged Value	RSQ	S-corp	Lagged Value	Bank-Years
Pre-Conversion Mean	0.1130	**-0.0041***	0.5409***	0.5350	**-0.0028***	0.5026***	70,317
Post-Conversion Mean	0.1071	(-9.32)	(218.32)		(-7.00)	(193.31)	

Banks Below Median Size	OLS (5)			Treatment effects (6)		
	S-corp	Lagged Value	RSQ	S-corp	Lagged Value	Bank-Years
	-0.0041*	0.5526***	0.5605	**-0.0031***	0.5263***	34,852
	(-7.01)	(166.44)		(-5.17)	(150.37)	

Banks Above Median Size	OLS (7)			Treatment effects (8)		
	S-corp	Lagged Value	RSQ	S-corp	Lagged Value	Bank-Years
	-0.0037*	0.5375***	0.4891	**-0.0025***	0.5070***	35,475
	(-5.66)	(141.57)		(-3.57)	(130.00)	

Table 10. Regulatory Capital of S-Corporation Banks.

In this table we present results of the regressions that identify heterogeneity in Tier 1 Capital depending on banks' organization form. The first two models only use a sample of converted banks and are specified as follows: $Y_{post\,ij} = \alpha + \beta * Y_{pre\,ij} + \varepsilon_{ij}$, where a 3-year mean of the post-conversion value of the variable of interest is regressed on the 3-year mean of the pre-conversion value, thus intercept captures any differences associated specifically with the conversion event. The value of dividend payout is also de-meaned (or similarly adjusted to the median) of the whole sample for specification (1) and for the same asset decile for specification (2). Further, we use a broad sample of banks that can plausibly be eligible for conversions and include a S-Corporation dummy as a main independent variable of interest. Specifications (3), (5), (7) are OLS models for the full sample, larger banks, and smaller banks. $Y_{post\,ij} = \alpha + \beta_1 * SCorp_{ij} + \beta_2 * Y_{pre\,ij} + \sum \partial_k X_{kij} + \sum Year_j + \sum SizeQ_n + \sum Year_j * SizeQ_n + \varepsilon_{ij}$ In the above regressions X_k is the array of control variables that include lagged asset growth, log (assets), Gross Income growth, Loan Losses, Agricultural Loans, C&I Loans, AMT, Built-In Gains, S-state, Age, DeNovo, Rural Dummy, Liquidity, Equity Capital, ROA, ROE, Non-Performing Assets, C&D Loans, Residential RE, Commercial RE. Specifications (4), (6), (8) are the results of the stage 2 of Heckman regressions. The models are specified as follows: Stage 1: $SCorp_{ij} = \alpha + \beta_1 * IV_{Regulatory\,ij} + \beta_2 * IV_{LCF\,ij} + + \sum \partial_k X_{kij} + \sum Year_j + \sum SizeQ_n + \sum Year_j * SizeQ_n + \varepsilon_{ij}$; Stage 2: $Y_{post\,ij} = \alpha + \beta_1 * SCorp_{ij} + \beta_2 * IMR_{ij} + \beta_3 * Y_{pre\,ij} + \sum \partial_k X_{kij} + \sum Year_j + \sum SizeQ_n \sum Year_j * SizeQ_n + \varepsilon$.

Conversions				All Banks (1)			Asset Decile (2)			
			Alpha	LaggedValue	RSQ		Alpha	LaggedValue	RSQ	Banks
Mean Benchmark Value Post	0.1410	mean	**0.0001**	0.6940***	0.6614		**-0.0054***	0.6824***	0.6641	2,612
			(0.11)	(71.41)			(-7.5)	(71.83)		
		median	**0.0002**	0.6850***	0.6433		**-0.0055***	0.6685***	0.6397	2,612
			(0.22)	(68.61)			(-7.36)	(68.08)		

All Banks		OLS (3)			Treatment Effects (4)			
		S-corp	Lagged Value	RSQ	S-corp	Lagged Value		Bank-Years
Pre-Conversion Mean	0.2126	**-0.0092***	0.3619***	0.5301	**-0.0059***	0.3345***		70,317
Post-Conversion Mean	0.1641	(-8.99)	(151.09)		(-5.90)	(139.38)		

Banks Below Median Size	OLS (5)			Treatment effects (6)			
	S-corp	Lagged Value	RSQ	S-corp	Lagged Value		Bank-Years
	-0.0098*	0.3510***	0.5414	**-0.0069***	0.3303***		34,852
	(-7.06)	(111.32)		(-4.93)	(103.22)		

Banks Above Median Size	OLS (7)			Treatment effects (8)			
	S-corp	Lagged Value	RSQ	S-corp	Lagged Value		Bank-Years
	-0.0071*	0.3866***	0.4703	**-0.0042***	0.3649***		35,475
	(-4.76)	(100.89)		(-2.80)	(93.56)		

Table 11. Effects of S-Corporation election identified using propensity score matching.

In this table we present the results of propensity score matching analysis of the difference in the effects of S-Corporation election post-conversion for banks that converted as compared to the matching non-converts. The PSM method used in this analysis is greedy nearest neighbor matching with replacement. We perform one, three, and five neighbors selection for robustness. The estimated treatments effect (conversion to S-Corp) is presented in the table along with indication of statistical significance and standard error in parentheses below each coefficient. *** indicates statistical significance at 1%.

	Number of Matched Neighbors					
Effect (outcome)	1		3		5	
Compensation – Dividend	0.2620	***	0.2568	***	0.2561	***
	(0.0072)		(0.0071)		(0.0068)	
Compensation – Salary	-0.0079	***	-0.0092	***	-0.0081	***
	(0.0032)		(0.0027)		(0.0028)	
Compensation Mix	0.1646	***	0.1633	***	0.1631	***
	(0.0052)		(0.0049)		(0.0048)	
Profitability - ROA	0.0046	***	0.0043	***	0.0044	***
	(0.0003)		(0.0003)		(0.0002)	
Profitability – ROE	0.0522	***	0.0493	***	0.0504	***
	(0.0030)		(0.0028)		(0.0027)	
Capital Structure	-0.0043	***	-0.0040	***	-0.0039	***
	(0.0009)		(0.0008)		(0.0008)	
Regulatory Capital	-0.0110	***	-0.0106	***	-0.0104	***
	(0.0020)		(0.0016)		(0.0017)	