Why *Not* to Eliminate Taxation of Dividends

By Greg Anrig and Bernard Wasow

The Bush administration has proposed eliminating corporate stock dividends from taxable household income. The justification for the idea is that it would stimulate the economy by putting more money in the pockets of consumers while reforming the tax code by eliminating "double taxation" of corporate profits. But the economy has done well for years with "double taxation," and the proposal would almost exclusively benefit the richest households while doing little to help the economy.

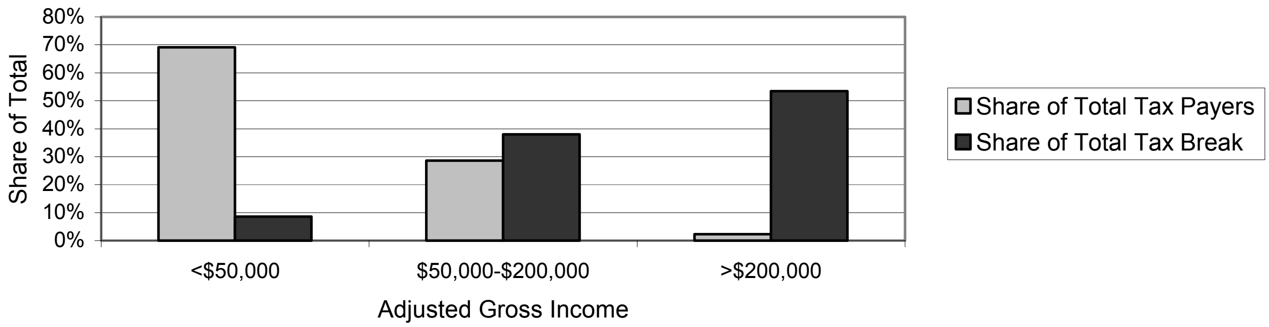
Dividend income is highly skewed toward the top of the income distribution, as the table and the figure below confirm.[1] Households with incomes above $200,000 per year (a scant two percent of the total) would enjoy 53 percent of the tax cut from eliminating dividend income from the tax base. Moreover, 84 percent of households with incomes below $50,000 a year and 59 percent of household earnings between $50,000 and $100,000 would receive no tax break at all because they don't collect a dime in dividends.[2] The total cost to the government would be substantial -- $42 billion in 2003 dollars – significantly adding to future budget deficits.[3]

Distribution of Potential Tax Breaks by Household Income Level

Adjusted Gross Income	Total Returns (1000s of households)	Share of Grand Total Returns	Average Tax Break per Household	Total Tax Break (mil $)	Share of Grand Total Tax Break
<$50k	91,842	69.1%	$39	$3,577,637	8.5%
$50-$100k	28,098	21.1%	$255	$7,153,056	17.1%
$100-$200k	9,906	7.5%	$885	$8,766,810	20.9%
$200-$500k	2,395	1.8%	$3,463	$8,293,885	19.8%
$500k-$1mil	418	0.3%	$9,372	$3,917,496	9.3%
>$1 mil	226	0.2%	$45,098	$10,192,148	24.3%

The very concentration of tax breaks at high income levels explains why the proposal would be ineffective in stimulating the economy. How many households with incomes above $200,000 are going to go on a spending spree because their dividends go untaxed? It is low- and middle-income people who spend their extra after-tax income, which would stimulate the economy. Yet the average tax savings for households with adjusted gross incomes below $50,000 would be less than $40. To stimulate consumer spending effectively, a tax break or rebate must be aimed at the households who would spend it most quickly, the working people who live from paycheck to paycheck.

Tax Payers and Tax Break from Eliminating Income Tax on Dividends



Eliminating dividends from taxable household income would deliver another big tax break to the richest families in America; it would greatly reduce revenue without providing much stimulus to the economy. This proposal is yet another tax break for the rich being sold as tax reform and a stimulus measure.

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Notes

[1] Data for the table and the chart come from the Urban Institute-Brookings Tax Policy Center, Table 2.

[2] See *U.S. Internal Revenue Statistics of Income*, 1999; Table 1.4: Individual Income Tax, All Returns, 1999: Sources of Income, Adjustments, and Tax Items, by Size of Adjusted Gross Income. http://www.irs.gov/taxstats/article/0,,id=96586,00.html

[3] This estimate of the foregone taxes treats all income reported as "dividends" by the IRS as potentially tax exempt. It is possible that the law would leave some of this income – notably interest from mutual funds – taxable.

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