

Many Taxpayers Will Be Affected if Dividend Tax Rates Rise: Results for the States

A Special Report by the American Council for Capital Formation

As the debate about how to resolve pressing budget and tax issues continues, policymakers must confront a host of decisions. One of the key issues to decide is the fate of the tax rates on income, dividends and capital gains which were enacted during the 2001-2005 period. The ACCF presents this Special Report to help policymakers, the public and the media understand the short and long run consequences of raising tax rates on dividends.

Background:

A series of temporary tax relief measures were enacted by President Bush, including income tax rate cuts in 2001 as well as decreased tax rates for individual capital gains and dividends in 2003. These reductions brought parity between dividend and capital gains tax rates at 15%. Unless Congress acts, and if the nation goes over Fiscal Cliff, the top rate on dividends (now 15%) will expire at the end of 2012, and revert to 43.4% (39.6% plus the healthcare surcharge of 3.8%) raising taxes by almost 190% for millions of Americans. Capital gains tax rate will rise to 23.8% (20% plus the healthcare surcharge).

There are different plans being discussed in Washington, DC as part of the effort to avert the pending tax increases. Possible outcomes are:

1. Revert to pre-Bush levels, as discussed in paragraph above.
2. Keep parity between capital gains and dividends at an increased 20% rate.
3. Keep the Bush tax cuts for capital gains and dividends, parity at 15% rate.

Regardless of the plan chosen, the top dividend and capital gains tax rates will be increased by the 3.8% healthcare surcharge.

The American Council for Capital Formation (ACCF) is a nonprofit, nonpartisan organization advocating tax, energy and regulatory policies that facilitate saving and investment, economic growth and jobs creation. For copies of this special report, please contact the ACCF, 1750 K Street, N.W., Suite 400, Washington D.C. 20006-2302; telephone: 202.293.5811; email: info@accf.org; www.accf.org.

Who Receives Dividends?

According to the latest Internal Revenue Statistics, 24.9 million individual taxpayers had qualified dividends in 2010, totaling \$135.3 billion of qualified dividends, which are ordinary dividends that meet specific criteria to be taxed at the lower tax rate (currently 15%) rather than at higher tax rate for an individual's ordinary income.

The number of tax returns with qualified dividends have the following profile (See **Figure 1**):

- 75% were received by taxpayers age 45 and older,
- 34% were received by taxpayers age 65 and older,
- 66% were received by taxpayers with incomes less than \$100,000, and
- 38% were received by taxpayers with incomes less than \$50,000.

Given the stable performance of dividend paying stocks¹, it is no surprise that the majority of qualified dividend receivers are either retired or preparing for retirement. Raising taxes on dividends would disproportionately hurt many older Americans who are dependent on stable dividend income to supplement their retirement incomes.

Who Receives Dividends at the State Level?

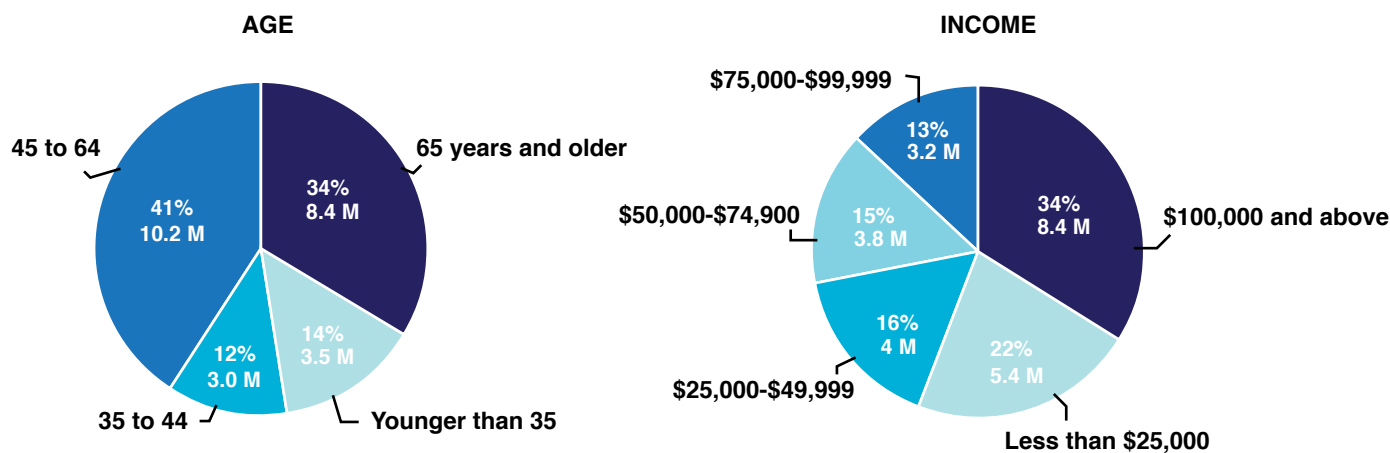
Table 1 shows how qualified dividends are distributed at the state level for the 50 states and District of Columbia. For example, in 2010, 246,000 federal tax returns from Alabama taxpayers had qualified dividends totaling \$1.1 billion and 22% of these were received by taxpayers with incomes less than \$25,000.

In many states, dividend income is subject to state taxation. Dividends will also face higher combined federal and state taxes if the current rates are allowed to expire.

Conclusions

The U.S. economic recovery remains weak and household income is stagnant. Raising tax rates on dividends will make it more difficult for lower and middle income households to maintain living standards. A recent study by Dr. Allen Sinai² analyzed the impact of letting all the Bush tax cuts expire as well as just dividend and capital gains tax rates. The results, in both cases, show that the tax increases would harm the U.S. economy and provide no relief on deficits and debt. In summary, higher tax rates on saving and dividend income will tend to discourage the increase in personal saving that is imperative for the long-run growth of the U.S. economy.

Figure 1. Total U.S. Tax Returns with Qualified Dividends by Age & Income, 2010 (Millions of Returns)



Source: ACCF CPR calculations using Internal Revenue Service, SOI Tax Stats, Individual Income and Tax Data, by State and Size of Adjusted Gross Income, 2010.

1. "A Higher Tax Rate on Dividends: Would it Impact U.S. Economic Recovery and Capital Formation?" American Council for Capital Formation, Center for Policy Research, August 2012, http://accf.org/wp-content/uploads/2012/11/ACCF_Dividends-Special-Report-FINAL.pdf

2. "The Fiscal Cliff: Impact on U.S. Economy and Employment if Bush Tax Cuts Expire," ACCF CPR, June 2012, http://accf.org/wp-content/uploads/2012/06/ACCF_specialReport_2012_Fiscal_FINAL.pdf

Table 1. Tax Returns With Qualified Dividends by Income and by State, 2010
(Number of returns and % of total returns with qualified dividends)

	Total Qualified Dividends Amount (in \$1,000)	Number of Returns With Qualified Dividends	Number of Returns With Qualified Dividends by Adjusted Gross Income				
			Less than \$25,000	\$25,000-\$49,999	\$50,000-\$74,999	\$75,000-\$99,999	\$100,000 and Above
U.S.	\$135,291,843	24,893,546	5,424,453 21.8%	4,013,390 16.1%	3,821,743 15.4%	3,217,885 12.9%	8,416,075 33.8%
Alabama	\$1,104,288	246,455	52,438 21.3%	40,953 16.6%	39,271 15.9%	33,626 13.6%	80,167 32.5%
Alaska	\$290,056	74,848	20,256 27.1%	12,268 16.4%	10,812 14.4%	9,046 12.1%	22,466 30.0%
Arizona	\$2,264,867	426,694	99,640 23.4%	74,345 17.4%	66,940 15.7%	55,928 13.1%	129,841 30.4%
Arkansas	\$2,020,051	159,397	36,760 23.1%	30,270 19.0%	26,498 16.6%	20,983 13.2%	44,886 28.2%
California	\$16,937,328	2,694,487	542,818 20.1%	378,569 14.0%	376,512 14.0%	326,393 12.1%	1,070,195 39.7%
Colorado	\$2,248,360	471,985	99,873 21.2%	73,565 15.6%	71,594 15.2%	62,289 13.2%	164,664 34.9%
Connecticut	\$3,350,665	447,995	90,278 20.2%	60,372 13.5%	62,840 14.0%	55,421 12.4%	179,084 40.0%
Delaware	\$407,425	83,156	16,284 19.6%	14,122 17.0%	13,568 16.3%	11,373 13.7%	27,809 33.4%
DC	\$455,210	62,314	8,741 14.0%	8,427 13.5%	9,133 14.7%	7,384 11.8%	28,629 45.9%
Florida	\$11,045,968	1,425,287	355,736 25.0%	255,019 17.9%	220,900 15.5%	173,707 12.2%	419,925 29.5%
Georgia	\$2,727,706	588,694	119,221 20.3%	89,914 15.3%	88,238 15.0%	77,339 13.1%	213,982 36.3%
Hawaii	\$478,973	122,727	25,307 20.6%	22,575 18.4%	20,959 17.1%	17,583 14.3%	36,303 29.6%
Idaho	\$359,433	101,367	26,842 26.5%	19,639 19.4%	17,257 17.0%	13,435 13.3%	24,194 23.9%
Illinois	\$6,133,224	1,236,746	268,644 21.7%	190,311 15.4%	188,207 15.2%	163,338 13.2%	426,246 34.5%
Indiana	\$1,442,261	472,938	118,261 25.0%	85,022 18.0%	79,433 16.8%	64,302 13.6%	125,920 26.6%
Iowa	\$854,831	293,509	65,060 22.2%	56,889 19.4%	52,788 18.0%	42,755 14.6%	76,017 25.9%
Kansas	\$1,236,532	250,525	57,231 22.8%	43,253 17.3%	40,818 16.3%	34,731 13.9%	74,492 29.7%
Kentucky	\$1,143,005	254,402	58,886 23.1%	46,722 18.4%	42,593 16.7%	34,067 13.4%	72,134 28.4%
Louisiana	\$1,374,059	247,560	53,751 21.7%	41,239 16.7%	37,217 15.0%	31,593 12.8%	83,760 33.8%
Maine	\$478,809	115,072	29,067 25.3%	23,138 20.1%	20,462 17.8%	15,139 13.2%	27,266 23.7%
Maryland	\$2,353,475	538,527	92,392 17.2%	69,236 12.9%	74,094 13.8%	68,992 12.8%	233,813 43.4%
Massachusetts	\$4,549,021	739,848	145,967 19.7%	108,764 14.7%	107,217 14.5%	90,348 12.2%	287,552 38.9%
Michigan	\$3,603,426	812,250	208,339 25.6%	145,064 17.9%	132,258 16.3%	106,565 13.1%	220,024 27.1%
Minnesota	\$2,218,253	545,042	110,409 20.3%	89,639 16.4%	88,374 16.2%	76,816 14.1%	179,804 33.0%

Source: Internal Revenue Service, SOI Tax Stats, Individual Income and Tax Data, by State and Size of Adjusted Gross Income, 2010.
<http://www.irs.gov/uac/SOI-Tax-Stats---Historic-Table-2>

Table 1 continued. Tax Returns With Qualified Dividends by Income and by State, 2010
(Number of returns and % of total returns with qualified dividends)

	Total Qualified Dividends Amount (in \$1,000)	Number of Returns With Qualified Dividends	Number of Returns With Qualified Dividends by Adjusted Gross Income				
			Less than \$25,000	\$25,000-\$49,999	\$50,000-\$74,999	\$75,000-\$99,999	\$100,000 and Above
Mississippi	\$450,244	120,818	27,080 22.4%	21,457 17.8%	19,798 16.4%	16,573 13.7%	35,910 29.7%
Nebraska	\$830,997	170,561	39,298 23.0%	31,405 18.4%	29,177 17.1%	24,489 14.4%	46,192 27.1%
Nevada	\$1,452,998	149,324	32,785 22.0%	25,837 17.3%	24,050 16.1%	19,537 13.1%	47,115 31.6%
New Hampshire	\$630,259	144,012	29,415 20.4%	23,726 16.5%	22,723 15.8%	19,601 13.6%	48,547 33.7%
New Jersey	\$4,554,903	1,026,191	202,800 19.8%	133,867 13.0%	138,092 13.5%	125,096 12.2%	426,336 41.5%
New Mexico	\$530,645	119,809	27,697 23.1%	21,111 17.6%	19,156 16.0%	15,640 13.1%	36,205 30.2%
New York	\$12,241,774	1,848,119	407,483 22.0%	282,005 15.3%	271,428 14.7%	227,319 12.3%	659,884 35.7%
North Carolina	\$2,963,939	688,362	149,764 21.8%	117,149 17.0%	109,132 15.9%	92,082 13.4%	220,235 32.0%
North Dakota	\$201,850	59,099	12,004 20.3%	10,538 17.8%	9,840 16.7%	8,862 15.0%	17,855 30.2%
Ohio	\$3,921,608	990,784	225,634 22.8%	193,877 19.6%	175,970 17.8%	133,793 13.5%	261,510 26.4%
Oklahoma	\$883,735	206,931	45,317 21.9%	37,269 18.0%	33,900 16.4%	27,153 13.1%	63,292 30.6%
Oregon	\$1,401,917	317,814	76,587 24.1%	55,312 17.4%	51,924 16.3%	42,081 13.2%	91,910 28.9%
Pennsylvania	\$6,071,886	1,311,603	324,995 24.8%	226,649 17.3%	207,393 15.8%	168,683 12.9%	383,883 29.3%
Rhode Island	\$535,262	96,766	20,756 21.4%	15,968 16.5%	15,557 16.1%	12,940 13.4%	31,545 32.6%
South Carolina	\$1,279,095	297,517	65,576 22.0%	53,613 18.0%	49,497 16.6%	40,849 13.7%	87,982 29.6%
South Dakota	\$268,371	70,990	16,263 22.9%	14,190 20.0%	12,869 18.1%	10,064 14.2%	17,604 24.8%
Tennessee	\$2,248,576	354,188	80,967 22.9%	61,999 17.5%	56,219 15.9%	45,609 12.9%	109,394 30.9%
Texas	\$10,333,437	1,424,980	268,821 18.9%	201,404 14.1%	199,486 14.0%	178,355 12.5%	576,914 40.5%
Utah	\$580,614	146,460	31,666 21.6%	25,124 17.2%	24,809 16.9%	20,430 13.9%	44,431 30.3%
Vermont	\$353,278	71,599	18,999 26.5%	13,427 18.8%	11,941 16.7%	9,279 13.0%	17,953 25.1%
Virginia	\$3,274,395	758,585	124,883 16.5%	102,392 13.5%	109,363 14.4%	101,686 13.4%	320,261 42.2%
Washington	\$3,493,486	638,482	120,577 18.9%	97,746 15.3%	98,750 15.5%	89,980 14.1%	231,429 36.2%
West Virginia	\$333,618	100,775	25,450 25.3%	19,751 19.6%	17,205 17.1%	13,108 13.0%	25,261 25.1%
Wisconsin	\$1,901,349	587,710	142,719 24.3%	108,712 18.5%	102,029 17.4%	84,274 14.3%	149,976 25.5%
Wyoming	\$837,713	48,777	11,013 22.6%	8,284 17.0%	8,061 16.5%	6,906 14.2%	14,513 29.8%

Source: Internal Revenue Service, SOI Tax Stats, Individual Income and Tax Data, by State and Size of Adjusted Gross Income, 2010.
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