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Who Really Benefits from Dividend Tax Relief?

Norbert J. Michel

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214 Massachusetts Avenue, NE • Washington, D.C. 20002 • (202) 546-4400 • www.heritage.org

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With major tax reform once again heading the list of legislative priorities, many analysts are hoping that the 108th Congress will make tax law far less a factor in economic decisions than it is today. Making the tax code more economically neutral is particularly desirable when it comes to the tax treatment of dividends paid on investments, since millions of Americans, including many who earn less than $100,000 a year, earn dividend income.

Corporations pay dividends to investors out of after-tax profits, yet these dollars are then subject to another tax: the personal income tax paid by the individuals who receive them. This multiple taxation of dividends discourages investors from finding equity investments that pay a steady stream of income and encourages corporations to retain profits and seek debt financing solely for tax purposes rather than financing their operations with equity.[1] Indeed, these effects may well mean that the tax treatment of dividends is contributing to some of the economy's worst problems, underscoring the hope that Congress will make the tax treatment of dividends more economically neutral.

This economic neutrality could be achieved in a number of ways.[2] For example, corporations could be allowed to deduct dividend payments from their taxes (just as they do with interest payments), or individual investors could be given tax credits on their personal tax returns using the "imputation credit" method. Other countries that have eliminated or reduced the multiple layers of taxation on dividends include Australia, France, Italy, Japan, Germany, Canada, and Great Britain.[3] All of the possible methods have the same goal: reducing the multiple layers of taxation on corporate income.

Consider this example. Assuming a marginal tax rate of 35 percent, for every $100 of pre-tax corporate profits, the federal government initially will take $35. It then will tax the

1. A corporation's after-tax profits can be distributed either as dividends or as capital gains. In either case, these after-tax dollars are taxed again at the personal level. In contrast, when corporations take on debt, they receive a tax deduction for their interest payments. Consequently, interest payments are made out of pre-tax dollars rather than after-tax dollars. These interest payments, therefore, are not subject to the same multiple levels of taxation as dividend payments.
2. While it has been reported that President Bush's economic proposals will include some form of dividend tax relief, the mechanics of the dividend tax cut are not clear as of this writing. See Bob Davis, Greg Hitt, and John McKinnon, "Bush to Propose Broad Tax Cuts in a $600 Billion 'Jobs' Package," *The Wall Street Journal*, January 6, 2003, p. A1, and Mike Allen and Dana Milbank, "President to Seek Dividend Tax Cut," *The Washington Post*, January 3, 2003, p. A1.
3. For a thorough discussion of the methods for eliminating the multiple taxation of dividends, see Deborah Thomas and Keith Sellers, "Eliminate the Double Tax on Dividends," *Journal of Accountancy*, November 1994.

remaining funds again, depending on how much of the $65 the firm decides to pay out as dividends to investors. If the entire $65 were distributed directly to individuals as dividends, the full amount would be taxed as ordinary income to individual investors who receive the dividends.[4] An individual in the 27 percent marginal tax bracket would pay approximately $18 in taxes upon receiving the dividend, leaving only $47 of the original $100 in corporate profits actually paid out to investors. In other words, for every $100 in pre-tax profits, the federal government will take approximately $53—more than half of every dollar earned.

Contrary to common perceptions, such double taxation of dividends affects nearly all Americans, not just a select few. As this report will show, most Americans stand to gain from the elimination of the double tax on dividend dollars. The reasons:

- **Corporations exist in conjunction with people.** The corporation exists only as a legal entity owned and operated by individuals. By definition, all corporate taxes must affect the income available to the owners and workers of the corporation. Since people, not "corporations," pay taxes, taxing income at both the corporate and personal level results in taxing the same income twice.
- **The double taxation of dividend dollars affects all investments.** All investment vehicles compete for investors' dollars; therefore, any noticeable change in one investment's rate of return must affect the others' relative rate of return.[5] Furthermore, all true dividends are subject to this double taxation.
- **Millions of families would benefit from dividend tax relief whether or not they directly receive dividends.** By the end of 2000, about 42 million workers in the United States with a median annual salary of less than $60,000 owned a 401(k) plan. Similarly, at the start of 2002, some 40 percent of U.S. households with a median annual household income of $55,000 owned an individual retirement account (IRA). Since the same investments held in retirement accounts are also held in non-retirement forms, these families with private retirement accounts would also share in the benefits of dividend tax relief.
- **Many moderate-income workers receive dividends.** In 1998, 70 percent of all taxpayers directly receiving dividends earned less than $55,000 in wages and salary. In the same year, 90 percent of all single taxpayers directly receiving dividends earned less than $53,000 in wage and salary income, and 70 percent of all married couples directly receiving dividends earned less than $76,000 in wage and salary income in 1998. Even after considering issues regarding how the Internal Revenue Service (IRS) reports some non-dividend income as "dividends," it is unlikely that only the top one or two income groups would benefit from dividend tax relief.

DISPELLING MYTHS ABOUT DIVIDEND INCOME

A common misconception is that dividend tax relief would benefit only a select few Americans. Part of the reason has to do with how the IRS classifies "dividends."

A recent article by William Gale of the Tax Policy Center, for example, notes that "just under half—46 percent (93/201)—of dividends paid out of the corporate sector were subject to double taxation in 2000."[6] The ratio mentioned in these calculations refers to two measures of dividends: the IRS measure of dividends ($93 billion) and the National Income and Product Accounts (NIPA) definition of dividends ($201 billion). Interest received from mutual funds is reported as dividend income on the IRS 1040 form, and a portion of NIPA dividends includes distributions from S corporations.[7] Neither item is subject to double taxation, but neither item represents dividends.

4. Any amount retained by the firm is liable to be taxed eventually as a capital gain at the personal level.
5. For example, if the return of a dividend-paying equity investment rises while the return of a non–dividend-paying investment remains unchanged, the return of the dividend-paying investment rises relative to the return of the other investment.
6. See William Gale, "About Half of Dividend Payments Do Not Face Double Taxation," *Tax Facts*, November 11, 2002, at *http://www.taxpolicycenter.org/taxfacts*.

Regardless of how various types of earned income are classified by the IRS, all real dividends are subject to double taxation. Even when dividend-paying equities are held in retirement accounts, they are subject eventually to double taxation.

It can also be argued that the harmful effects of the double taxation of dividends are not simply confined to the real dividends declared on individual tax returns.[8] In fact, the effects of the tax structure are not necessarily confined solely to equity markets. Individuals choose from an array of investment choices based on the real after-tax rate of return they expect. Since all the various investment vehicles are competing for investors' dollars, any material change in one investment's return has to affect the relative return of others. Therefore, the double taxation of dividends indirectly affects the returns of all investments—even those in tax-deferred retirement accounts.

In 2001, nearly $2.4 trillion in retirement plan assets were invested in mutual funds, with roughly a 50/50 split between IRAs and employer-sponsored retirement plans such as 401(k) plans.[9] Nearly $1.5 trillion of these assets were held in domestic equities. While these equities were held in tax-deferred retirement accounts through mutual funds, at the same time, they were also being held by non–mutual fund and non–retirement account investors.

Thus, any given equity investment is likely to be held individually, in mutual funds, and in retirement accounts *simultaneously*. Since dividend tax relief means that firms are more likely to increase their dividend payments, the benefit of this type of tax relief will also accrue to individuals holding equities in retirement accounts even though the benefit will not immediately show up on their tax returns.[10]

Exactly on which tax returns these benefits will appear is another interesting question. By the end of 2000, roughly 42 million U.S. workers with a median annual salary of less than $60,000 participated in a 401(k) plan.[11] Similarly, approximately 42 million U.S. households with a median annual household income of $55,000 (40 percent) owned some type of IRA.[12] Data also show that, as of 2002, nearly 53 million U.S. households (just under 50 percent) held some form of equities and about 84 million individuals owned some form of equities.[13] Given that these equities exist in both retirement and non-retirement accounts, and that the double taxation of dividends affects the relative returns of all investments, it should be clear that

7. For differences between IRS and NIPA dividends, see Thae S. Park, "Comparison of BEA Estimates of Personal Income and IRS Estimates of Adjusted Gross Income," *Survey of Current Business*, November 2002, pp. 13–20. For more on NIPA dividends, see Bureau of Economic Analysis, "Annual Revision of the National Income and Product Accounts: Annual Estimates, 1999–2001, and Quarterly Estimates, 1999:I–2002:I," *Survey of Current Business*, August 2002, Table 8.25, at *http://www.bea.doc.gov/bea/ARTICLES/2002/08August/0802AnnualRevision.pdf*.

8. For more on the effects of the double taxation of dividends, see James M. Poterba, "Tax Policy and Corporate Saving," *Brookings Papers on Economic Activity*, Vol. 2 (1987), pp. 455–515.

9. These employer-sponsored plans include 401(k), 403(b), 457, and other defined contribution plans, as well as state and local government employee retirement funds and private defined benefit plans. See Investment Company Institute, *2002 Mutual Fund Fact Book*, at *http://www.ici.org/facts_figures/factbook_toc.html*.

10. There is also reason to believe that dividend tax relief will lead to greater investment and economic growth—outcomes that would benefit all working Americans (even those who do not invest). See Ervin L. Black, Joseph Legoria, and Keith F. Sellers, "Capital Investment Effects of Dividend Imputation," *Journal of the American Taxation Association*, Vol. 22, No. 2 (2000), pp. 40–59; James M. Poterba, "Tax Policy and Corporate Saving," *Brookings Papers on Economic Activity*, No. 2 (1987), pp. 455–515; Peter Birch Sorensen, "Changing Views of the Corporate Income Tax," *National Tax Journal*, Vol. 48, No. 2 (June 1995), pp. 279–294; and James M. Poterba and Lawrence H. Summers, "New Evidence That Taxes Affect the Valuation of Dividends," *Journal of Finance*, Vol. 39, No. 5 (December 1984), pp. 1397–1415.

11. See Investment Company Institute, "401(k) Plan Asset Allocation, Account Balances and Loan Activity in 2000," *Perspective*, Vol. 7, No. 5 (November 2001), at *http://www.ici.org/pdf/per06-01.pdf*.

12. See Investment Company Institute, "Fundamentals," *ICI Research in Brief*, Vol. 11, No. 3 (September 2002), at *http://www.ici.org/pdf/fm-v11n3.pdf*.

13. See Investment Company Institute and Securities Industry Association, *Equity Ownership in America, 2002*, September 2002, at *http://www.ici.org/pdf/rpt_02_equity_owners.pdf*.

eliminating the double taxation of dividends will not benefit only a select few, but rather millions of Americans.

Nonetheless, opponents of dividend tax relief are likely to point to statistics that indicate most taxpayers do not receive dividends and to label dividend tax relief—much like capital gains tax relief—a boon to "the rich."[14] However, the IRS's own data from its 1998 Public Use Tax File from the Statistics of Income Division (SOI) show why this sort of "evidence" is misleading.[15]

Table 1 CDA 03-02

Summary Statistics For All Tax Returns

	After Tax Income	Wage and Salary Income	Dividends	Interest	Capital Gains
Panel A- All Filers					
Number of returns: 124,770,764					
Mean	$39,193	$31,126	$938	$1,412	$3,529
Median	$25,633	$18,930	$0	$15	$0
Std. Deviation	$144,115	$109,414	$28,449	$26,790	$217,665
Panel B- Single Filers					
Number of returns: 55,079,703					
Mean	$20,871	$16,789	$721	$1,074	$1,738
Median	$14,573	$9,980	$0	$0	$0
Std. Deviation	$62,171	$43,474	$17,310	$14,683	$123,454
Panel C- Married Filers					
Number of returns: 52,174,364					
Mean	$63,385	$49,852	$1,429	$2,160	$6,409
Median	$47,993	$38,230	$0	$89	$0
Std. Deviation	$209,432	$160,094	$40,064	$37,929	$310,107

Source: Center For Data Analysis calculations based on the 1998 Public Use Tax File from the Statistics of Income Division of the IRS

A LOOK AT WHO RECEIVES DIVIDENDS

Statistics from the same IRS data set—the SOI 1998 Public Use Tax File—can be presented in several different ways to lead to different observations. Despite a few shortcomings involved in using these data for this purpose,[16] doing so clearly shows that middle-income America would benefit from dividend tax relief.

Tables 1 through 6 show the distribution of dividends for all taxpayers in 1998. Tables 7 through 12 show the distribution of dividends among taxpayers who received dividend income in 1998 and thus would be directly affected by ending the multiple taxation of dividends.

Table 1 summarizes statistics for all individuals in the 1998 SOI file regardless of filing status, age, or whether they received dividends. It shows that many taxpayers do not receive dividends directly. In fact, even when these taxpayers are examined together (Panel A), or as single filers (Panel B), or as married filers (Panel C), the median taxpayer has dividends of $0—meaning that 50 percent of all taxpayers report no dividend income.

The percentiles for these groups of taxpayers, shown in Table 2, show that out of roughly 124 million taxpayers, 70 percent do not receive dividends. Only when examined separately as married filers (Panel C) does the 70th percentile include any dividend income; 70 percent of both combined filers (Panel A) and single filers (Panel B), with an after-tax income of just under $43,000 and $25,000, respectively, report $0 in dividends.[17]

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14. See John McKinnon, "Tax Cut on Dividends Paid to Individuals Gains Support," *The Wall Street Journal*, December 4, 2002, p. A1.

15. Again, it should be noted that the IRS classifies interest income from mutual funds as dividends. This classification discrepancy will be addressed further in a forthcoming CDA report. Nonetheless, the data reported in this paper are representative of the income diversity among investors in the U.S. and how many Americans will be affected in the long run by eliminating the double taxation of dividends.

16. See Appendix, *infra*.

17. For complete details on how after-tax income is defined, see Appendix, *infra*.

Moreover, based on these data, only married filers (Panel C) report much investment income at all. The 50th percentile for single filers includes $0 interest, and the 80th percentile includes $0 capital gains. Similarly, the 40th percentile for combined filers includes $0 interest, and the 80th percentile shows $0 capital gains.

When these groups are partitioned by age, Table 3 shows that the 50th percentile for dividend income remains at $0 for all types of filers in the pre-retirement age group. However, dividend income does register at the 50th percentile for all three groups of filers in the post-retirement age group (see Table 5).

In this post-retirement group for all taxpayers, median dividend income is $111 for the group of combined filers (Panel A), $254 for single filers (Panel B), and $85 for married filers (Panel C). There is a noteworthy difference between the pre- and post-retirement age group at the 80th percentile. For example, for the pre-retirement group, only married filers show any dividend income ($59), as shown in Table 4 (Panel C).

In the post-retirement group, however, the 80th percentile taxpayer reports dividend income in all three filing groups. Table 6 shows that single filers at the 80th percentile, with an after-tax income of $34,740, report dividend income over $6,000; married filers, with after-tax income of about $64,000, have dividend income over $4,000.

Even given this higher proportion of dividend-receiving taxpayers in the post-retirement group, using only the data in Table 1 through Table 6, it is still rather easy to support a claim that only the wealthy will benefit from dividend tax relief. One could argue, for example, that since 80 percent of all taxpayers receive less than $46 in dividends (Table 2, Panel A), dividend tax relief benefits only the upper 20 percent of taxpayers.

A problem with this logic is that the data in these six tables do not distinguish between those taxpayers who receive dividends and those who do not. Therefore, these data do not accurately describe the characteristics of taxpayers who receive dividend income. For this reason, Tables 7 through 12 present summary statistics and percentiles using the same groups of taxpayers but examining the data only for taxpayers with dividend income.

Table 2 CDA 03-02

Percentiles for All Tax Returns

	After Tax Income	Wage and Salary Income	Dividends	Interest	Capital Gains
Panel A- All Filers					
Number of returns: 124,770,764					
10%	$4,039	$0	$0	$0	$0
20	$9,248	$2,390	$0	$0	$0
30	$14,581	$7,056	$0	$0	$0
40	$19,783	$12,800	$0	$0	$0
50	$25,633	$18,930	$0	$15	$0
60	$33,028	$26,130	$0	$53	$0
70	$42,818	$35,450	$0	$156	$0
80	$55,842	$48,320	$46	$508	$0
90	$78,422	$69,820	$827	$2,254	$1,079
Panel B- Single Filers					
Number of returns: 55,079,703					
10%	$1,671	$0	$0	$0	$0
20	$4,249	$741	$0	$0	$0
30	$7,117	$3,230	$0	$0	$0
40	$10,562	$6,008	$0	$0	$0
50	$14,573	$9,980	$0	$0	$0
60	$19,234	$15,090	$0	$18	$0
70	$24,875	$21,060	$0	$71	$0
80	$32,049	$28,510	$9	$292	$0
90	$43,972	$39,810	$598	$1,737	$663
Panel C- Married Filers					
Number of returns: 49,565,262					
10%	$15,185	$0	$0	$0	$0
20	$23,903	$7,590	$0	$0	$0
30	$32,053	$18,960	$0	$11	$0
40	$40,272	$28,820	$0	$38	$0
50	$47,993	$38,230	$0	$89	$0
60	$56,610	$47,840	$0	$193	$0
70	$66,608	$58,390	$20	$446	$0
80	$80,482	$72,000	$260	$1,148	$140
90	$107,513	$96,500	$1,705	$3,767	$2,882

Source: Center For Data Analysis calculations based on the 1998 Public Use Tax File from the Statistics of Income Division of the IRS

Tables 3&4 CDA 03-02

Table 3

Summary Statistics for All Pre-Retirement Tax Returns

	After Tax Income	Wage and Salary Income	Dividends	Interest	Capital Gains
Panel A- All Filers					
Number of returns: 96,325,531					
Mean	$36,975	$32,775	$454	$707	$2,550
Median	$23,458	$20,840	$0	$0	$0
Std. Deviation	$139,901	$106,476	$22,849	$25,039	$204,048
Panel B- Single Filers					
Number of returns: 45,251,528					
Mean	$19,774	$18,199	$285	$426	$1,088
Median	$13,336	$11,980	$0	$0	$0
Std. Deviation	$59,652	$44,475	$10,631	$11,342	$120,917
Panel C- Married Filers					
Number of returns: 35,182,807					
Mean	$65,027	$57,091	$833	$1,313	$5,376
Median	$48,952	$44,640	$0	$43	$0
Std. Deviation	$216,363	$164,456	$35,562	$38,471	$306,169

Source: Center For Data Analysis calculations based on the 1998 Public Use Tax File from the Statistics of Income Division of the IRS

Table 4

Percentiles for All Pre-Retirement Tax Returns

	After Tax Income	Wage and Salary Income	Dividends	Interest	Capital Gains
Panel A- All Filers					
Number of returns: 96,325,531					
10%	$3,269	$1,410	$0	$0	$0
20	$7,849	$5,209	$0	$0	$0
30	$13,084	$10,030	$0	$0	$0
40	$18,063	$15,170	$0	$0	$0
50	$23,458	$20,840	$0	$0	$0
60	$30,115	$27,670	$0	$17	$0
70	$39,757	$36,620	$0	$58	$0
80	$53,022	$49,350	$0	$175	$0
90	$75,560	$70,840	$202	$704	$266
Panel B- Single Filers					
Number of returns: 45,251,528					
10%	$1,378	$418	$0	$0	$0
20	$3,670	$2,618	$0	$0	$0
30	$6,123	$4,854	$0	$0	$0
40	$9,355	$7,965	$0	$0	$0
50	$13,336	$11,980	$0	$0	$0
60	$18,062	$16,800	$0	$0	$0
70	$23,653	$22,490	$0	$23	$0
80	$30,759	$29,550	$0	$89	$0
90	$42,668	$40,980	$132	$436	$107
Panel C- Married Filers					
Number of returns: 35,182,807					
10%	$15,740	$8,213	$0	$0	$0
20	$24,142	$19,020	$0	$0	$0
30	$32,178	$27,820	$0	$0	$0
40	$40,716	$36,390	$0	$16	$0
50	$48,952	$44,640	$0	$43	$0
60	$57,592	$53,370	$0	$93	$0
70	$67,768	$63,170	$0	$197	$0
80	$81,622	$76,880	$59	$473	$0
90	$109,775	$101,500	$609	$1,486	$1,279

Source: Center For Data Analysis calculations based on the 1998 Public Use Tax File from the Statistics of Income Division of the IRS

Tables 5&6 CDA 03-02

Table 5

Summary Statistics for All Post-Retirement Tax Returns

	After Tax Income	Wage and Salary Income	Dividends	Interest	Capital Gains
Panel A- All Filers					
Number of returns: 11,997,542					
Mean	$42,627	$10,269	$4,670	$6,612	$10,436
Median	$33,999	$0	$111	$1,676	$0
Std. Deviation	$113,511	$61,569	$51,204	$39,508	$271,152
Panel B- Single Filers					
Number of returns: 4,399,581					
Mean	$26,630	$3,053	$5,061	$7,093	$8,295
Median	$21,597	$0	$254	$2,272	$0
Std. Deviation	$80,468	$25,083	$47,898	$35,357	$173,999
Panel C- Married Filers					
Number of returns: 7,225,041					
Mean	$52,936	$14,779	$4,579	$6,539	$12,063
Median	$42,626	$90	$85	$1,484	$0
Std. Deviation	$130,866	$76,442	$54,352	$42,710	$321,813

Source: Center For Data Analysis calculations based on the 1998 Public Use Tax File from the Statistics of Income Division of the IRS

Table 6

Percentiles for All Post-Retirement Tax Returns

	After Tax Income	Wage and Salary Income	Dividends	Interest	Capital Gains
Panel A- All Filers					
Number of returns: 11,997,542					
10%	$12,217	$0	$0	$11	$0
20	$18,199	$0	$0	$117	$0
30	$23,643	$0	$0	$354	$0
40	$28,986	$0	$0	$825	$0
50	$33,999	$0	$111	$1,676	$0
60	$39,999	$74	$705	$3,020	$0
70	$45,820	$5,637	$2,044	$5,418	$992
80	$54,666	$15,310	$4,715	$9,066	$4,234
90	$72,566	$33,330	$11,090	$16,910	$14,350
Panel B- Single Filers					
Number of returns: 4,399,581					
10%	$8,565	$0	$0	$10	$0
20	$11,973	$0	$0	$135	$0
30	$15,019	$0	$0	$492	$0
40	$18,307	$0	$0	$1,243	$0
50	$21,597	$0	$254	$2,272	$0
60	$25,160	$0	$1,320	$4,221	$27
70	$29,723	$0	$2,976	$6,669	$1,258
80	$34,740	$403	$6,008	$10,560	$4,575
90	$45,864	$9,012	$13,100	$18,200	$14,090
Panel C- Married Filers					
Number of returns: 7,225,041					
10%	$21,053	$0	$0	$17	$0
20	$27,834	$0	$0	$127	$0
30	$33,045	$0	$0	$333	$0
40	$38,342	$0	$0	$761	$0
50	$42,626	$90	$85	$1,484	$0
60	$47,456	$5,263	$550	$2,720	$0
70	$53,736	$13,510	$1,672	$4,763	$897
80	$63,984	$26,790	$4,033	$8,100	$4,257
90	$84,082	$42,000	$10,100	$16,390	$15,050

Source: Center For Data Analysis calculations based on the 1998 Public Use Tax File from the Statistics of Income Division of the IRS

Tables 7&8 CDA 03-02

Summary Statistics for All Tax Returns With Dividends

	After Tax Income	Wage and Salary Income	Dividends	Interest	Capital Gains
Panel A- All Filers					
Number of returns: 30,484,707					
Mean	$67,450	$49,060	$3,838	$4,130	$13,470
Median	$43,973	$26,040	$478	$435	$220
Std. Deviation	$281,744	$214,129	$57,458	$53,211	$438,954
Panel B- Single Filers					
Number of returns: 11,584,688					
Mean	$29,958	$20,038	$3,426	$3,358	$7,577
Median	$18,718	$2,051	$515	$317	$338
Std. Deviation	$126,914	$87,503	$37,620	$30,920	$267,603
Panel C- Married Filers					
Number of returns: 17,576,934					
Mean	$93,735	$69,249	$4,242	$4,805	$17,846
Median	$64,349	$48,700	$481	$542	$173
Std. Deviation	$351,619	$269,428	$68,940	$64,308	$532,904

Source: Center For Data Analysis calculations based on the 1998 Public Use Tax File from the Statistics of Income Division of the IRS

Percentiles for All Tax Returns With Dividends

	After Tax Income	Wage and Salary Income	Dividends	Interest	Capital Gains
Panel A- All Filers					
Number of returns: 30,484,707					
10%	$2,902	$0	$18	$0	-$205
20	$13,192	$0	$56	$41	$0
30	$23,632	$357	$127	$104	$0
40	$33,529	$10,430	$254	$217	$3
50	$43,973	$26,040	$478	$435	$220
60	$54,884	$40,360	$876	$856	$729
70	$68,482	$55,180	$1,650	$1,720	$1,772
80	$87,987	$74,690	$3,169	$3,621	$4,209
90	$125,147	$107,300	$7,425	$8,632	$11,690
Panel B- Single Filers					
Number of returns: 11,584,688					
10%	-$10	$0	$23	$0	-$98
20	$1,972	$0	$70	$12	$0
30	$6,398	$0	$152	$52	$0
40	$12,168	$0	$286	$136	$44
50	$18,718	$2,051	$515	$317	$338
60	$25,704	$9,779	$932	$712	$838
70	$33,449	$23,110	$1,749	$1,557	$1,704
80	$44,275	$35,500	$3,232	$3,369	$3,574
90	$63,138	$53,350	$7,368	$8,338	$9,151
Panel C- Married Filers					
Number of returns: 17,576,934					
10%	$20,740	$0	$17	$21	-$441
20	$34,046	$96	$52	$74	$0
30	$44,538	$15,590	$122	$155	$0
40	$54,117	$34,290	$248	$289	$0
50	$64,349	$48,700	$481	$542	$173
60	$75,376	$61,540	$887	$1,020	$693
70	$89,339	$76,270	$1,671	$1,941	$1,934
80	$109,879	$95,750	$3,236	$3,918	$4,884
90	$159,242	$132,400	$7,695	$9,230	$14,510

Source: Center For Data Analysis calculations based on the 1998 Public Use Tax File from the Statistics of Income Division of the IRS

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Table 9

Summary Statistics for Pre-Retirement Tax Returns With Dividends

	After Tax Income	Wage and Salary Income	Dividends	Interest	Capital Gains
Panel A- All Filers					
Number of returns: 17,510,397					
Mean	$75,245	$63,668	$2,500	$2,776	$12,975
Median	$48,851	$42,820	$270	$207	$170
Std. Deviation	$316,199	$239,416	$53,542	$57,793	$477,234
Panel B- Single Filers					
Number of returns: 7,038,056					
Mean	$30,948	$26,882	$1,833	$1,649	$6,360
Median	$15,800	$11,540	$280	$112	$311
Std. Deviation	$141,373	$103,691	$26,904	$27,509	$305,817
Panel C- Married Filers					
Number of returns: 9,547,905					
Mean	$110,508	$93,054	$3,069	$3,735	$18,440
Median	$74,377	$66,790	$270	$303	$107
Std. Deviation	$403,647	$306,343	$68,216	$72,858	$586,160

Source: Center For Data Analysis calculations based on the 1998 Public Use Tax File from the Statistics of Income Division of the IRS

Table 10

Percentiles for Pre-Retirement Tax Returns With Dividends

	After Tax Income	Wage and Salary Income	Dividends	Interest	Capital Gains
Panel A- All Filers					
Number of returns: 17,510,397					
10%	$188	$0	$13	$0	-$55
20	$9,792	$2,734	$36	$17	$0
30	$24,668	$17,540	$80	$52	$0
40	$37,208	$30,530	$150	$108	$0
50	$48,851	$42,820	$270	$207	$170
60	$61,549	$54,680	$472	$386	$562
70	$76,426	$69,220	$843	$744	$1,284
80	$98,223	$88,830	$1,643	$1,561	$2,914
90	$140,603	$123,600	$3,843	$4,022	$8,286
Panel B- Single Filers					
Number of returns: 7,038,056					
10%	-$126	$0	$16	$0	$0
20	$9	$0	$47	$0	$0
30	$2,038	$366	$94	$16	$0
40	$6,164	$3,458	$168	$48	$54
50	$15,800	$11,540	$280	$112	$311
60	$26,014	$22,750	$464	$239	$701
70	$35,171	$32,690	$781	$532	$1,334
80	$47,227	$44,600	$1,468	$1,154	$2,615
90	$68,504	$63,330	$3,244	$3,013	$6,273
Panel C- Married Filers					
Number of returns: 9,547,905					
10%	$27,416	$12,310	$13	$13	-$275
20	$43,588	$32,760	$32	$48	$0
30	$54,465	$46,200	$75	$96	$0
40	$64,111	$56,380	$143	$174	$0
50	$74,377	$66,790	$270	$303	$107
60	$86,105	$78,630	$500	$538	$486
70	$101,555	$92,940	$957	$996	$1,320
80	$126,151	$111,900	$1,876	$1,979	$3,598
90	$186,776	$159,100	$4,544	$4,980	$11,640

Source: Center For Data Analysis calculations based on the 1998 Public Use Tax File from the Statistics of Income Division of the IRS

Tables 11&12 CDA 03-02

Table 11

Summary Statistics for Post-Retirement Tax Returns With Dividends

	After Tax Income	Wage and Salary Income	Dividends	Interest	Capital Gains
Panel A- All Filers					
Number of returns: 6,726,259					
Mean	$47,636	$10,088	$8,330	$8,689	$17,441
Median	$35,544	$0	$2,406	$2,978	$877
Std. Deviation	$147,325	$80,484	$68,163	$51,917	$359,876
Panel B- Single Filers					
Number of returns: 2,571,371					
Mean	$28,330	$2,696	$8,659	$8,725	$13,167
Median	$21,844	$0	$3,184	$3,464	$1,107
Std. Deviation	$98,356	$31,774	$62,404	$45,458	$222,552
Panel C- Married Filers					
Number of returns: 4,010,517					
Mean	$60,457	$14,879	$8,249	$8,808	$20,453
Median	$44,921	$0	$1,990	$2,776	$830
Std. Deviation	$172,351	$100,679	$72,744	$56,443	$430,467

Source: Center For Data Analysis calculations based on the 1998 Public Use Tax File from the Statistics of Income Division of the IRS

Table 12

Percentiles for Post-Retirement Tax Returns With Dividends

	After Tax Income	Wage and Salary Income	Dividends	Interest	Capital Gains
Panel A- All Filers					
Number of returns: 6,726,259					
10%	$12,168	$0	$96	$134	-$486
20	$18,652	$0	$354	$415	$0
30	$24,105	$0	$768	$928	$0
40	$29,466	$0	$1,492	$1,708	$121
50	$35,544	$0	$2,406	$2,978	$877
60	$41,977	$0	$3,947	$4,892	$2,393
70	$49,718	$1,078	$6,022	$7,335	$5,143
80	$59,999	$10,080	$10,040	$11,300	$10,610
90	$82,982	$30,000	$17,740	$20,070	$25,730
Panel B- Single Filers					
Number of returns: 2,571,371					
10%	$8,444	$0	$140	$95	-$387
20	$11,966	$0	$515	$441	$0
30	$15,033	$0	$1,166	$1,095	$0
40	$18,612	$0	$2,109	$1,893	$164
50	$21,844	$0	$3,184	$3,464	$1,107
60	$25,348	$0	$4,785	$5,636	$2,404
70	$30,107	$0	$7,381	$8,500	$5,142
80	$36,414	$0	$11,770	$12,360	$10,390
90	$51,504	$5,752	$18,700	$20,470	$24,000
Panel C- Married Filers					
Number of returns: 4,010,517					
10%	$22,388	$0	$89	$156	-$619
20	$28,885	$0	$299	$429	$0
30	$34,878	$0	$621	$922	$0
40	$40,083	$0	$1,147	$1,655	$95
50	$44,921	$0	$1,990	$2,776	$830
60	$51,128	$983	$3,312	$4,541	$2,430
70	$59,099	$8,321	$5,318	$6,894	$5,217
80	$72,667	$21,410	$8,914	$10,800	$10,850
90	$97,639	$41,160	$16,890	$20,120	$27,340

Source: Center For Data Analysis calculations based on the 1998 Public Use Tax File from the Statistics of Income Division of the IRS

The statistics reported in Tables 7 through 12 paint a very different picture. An examination of all dividend-receiving taxpayers (Table 7, Panel A) shows that their median after-tax income is just under $44,000, with dividend income of $478, interest of $435, and capital gains of $220.[18]

As seen on Panel A of Table 8, the 70th percentile taxpayer has an after-tax income of about $68,000 and dividend income of $1,650. These figures show that 70 percent of all taxpayers who received dividends in 1998 earned less than $68,000 in after-tax income.[19] Just as telling is the fact that the median wage and salary income for this 70th percentile taxpayer is just over $55,000 in 1998.

Similarly, single taxpayers receiving dividends have a median after-tax income of $18,718, dividend income of $515, interest of $317, and capital gains of $338 (Table 7, Panel B). Even single taxpayers at the 90th percentile, reporting dividend income of over $7,300 (Table 8, Panel B), have an after-tax income of just over $63,000 and wage and salary income of about $53,000.

Panel C of Table 7 shows that the median reported after-tax income of married taxpayers receiving dividends was about $64,300, with a median dividend income of $481. Married taxpayers at the 70th percentile (Table 8, Panel C) with an after-tax income of $89,339 report dividend income of $1,671 and wage and salary income of just over $76,000.

Further partitioning the data on the dividend-receiving taxpayers into pre- and post-retirement ages produces similar results. As Table 9 shows, the median pre-retirement age single filers (Panel B), married filers (Panel C), and combined single and married filers (Panel A) all report about $300 in dividends. These results are quite different from those on Table 3, where all pre-retirement age taxpayers—even those not receiving dividends—were found to have $0 in dividends at the median.

When only post-retirement age, dividend-receiving taxpayers are considered, the median taxpayers' (single, married, and combined) dividend income is $2,406, with an after-tax income of $35,544 (Table 11, Panel A). The median single taxpayer in this group (Panel B) has a lower after-tax income of $21,844 and a higher dividend income of $3,184. Panel C shows that the median married taxpayer in this group has an after-tax income of $44,921 and a dividend income of just under $2,000.

The three panels in Table 10 and Table 12 list the percentiles for the three categories of filers in the pre-retirement and post-retirement age groups, respectively. The 80th percentile taxpayer in the pre-retirement age group (Table 10, Panel A) has an after-tax income of about $98,000 and dividend income of $1,643. When this is compared with the 80th percentile taxpayer in the post-retirement age group (Table 12, Panel A), who has after-tax income of just under $60,000 and dividend income of about $10,000, it appears that dividends make up a larger percentage of retired people's income. Similar results for both single and married taxpayers in the post-retirement age group (Table 12, Panels B and C) confirm this finding.

Thus, many Americans who invest in the business of America are not "rich," but rather single, married, and retired Americans who make under $100,000 per year. All of these Americans would benefit from dividend tax relief.

CONCLUSION

The double taxation of dividends in the U.S. tax code distorts economic activity because it encourages the retention of corporate profits and debt financing and discourages dividend payments and equity financing, solely for tax purposes.

Eliminating the double taxation of dividends would be a positive step toward tax neutrality. Millions of families would benefit from dividend tax relief, including the many moderate-income workers who receive dividends. As of 2000, more than 42 million American workers owned a 401(k) plan, and nearly 40 percent of all U.S. households owned an IRA. Data show that, as of 2002, nearly

18. Despite the problems with the IRS classification of dividends, the fact that this median taxpayer has capital gain income of $220 increases the likelihood that this dividend income does include real dividends.

19. To reflect "normal" earnings more accurately, the measure used for after-tax income excludes investment income. When income from dividends, capital gains, and interest is added back into the taxpayer's income, the total income is $73,624. For more on using this measure of after-tax income, see Appendix, *infra*.

53 million U.S. households (just under 50 percent) and about 84 million individuals owned some form of equities. Additionally, in 1998, 70 percent of all taxpayers receiving dividends earned less than $55,000 in wages and salary.

All true dividends are subject to double taxation. Since all investments compete for investors' dollars, removing the 35 percent layer of corporate dividend taxes would affect other investments as well. Even the fact that many Americans hold equities in tax-deferred accounts will not, in the long run, diminish the impact of eliminating the double taxation of dividends. Dividend tax relief may be criticized as providing a tax break for "the wealthy," but the IRS's own data clearly suggest otherwise.

—*Norbert J. Michel is a Policy Analyst in the Center for Data Analysis at The Heritage Foundation.*

APPENDIX
METHODOLOGY

One issue surrounding the use of tax return data is the definition of taxpayers' income. For example, individual returns vary from reporting only wage and salary income to reporting up to 15 different types of income.[20] For statistics derived from the Internal Revenue Service's data in its 1998 Public Use Tax File from the Statistics of Income Division (SOI), the author has used a broad definition of income that includes virtually all non-investment income.[21] The measure is calculated for each observation in the SOI 1998 Public Use Tax File and includes the following types of income:

- Wages, salaries, tips, etc., from employees' W-2 forms;
- Alimony received;
- Business income or loss;
- Other gains or losses (sales of business property);
- Total taxable IRA distributions;
- Total taxable pensions and annuities;
- Rental real estate, royalties, partnerships, S corporations, trusts, etc.;
- Farm income;
- Unemployment compensation; and
- Social Security benefits.

Aside from those already mentioned, using the data in the SOI Public Use Tax File for this purpose presents two major shortcomings. It should be noted that the amount reported as "wages, salaries, tips, etc." on the W-2 form does not include payroll taxes or any wages and salary contributed to employer-sponsored tax-advantaged savings plans: cafeteria plans, 401(k) plans, etc. Also, "dividend income" on the IRS form 1040 does include cash distributions that are actually interest payments, not dividends.[22]

Next, the author combined the total tax owed or refunded with the above types of income to create a variable for "after-tax income." The after-tax income variable basically includes all income other than that earned from investments. In other words, it excludes income from dividends, capital gains, and interest. Therefore, the calculated after-tax income serves as a broad measure of taxpayers' "permanent" income.[23]

Summary statistics (mean, median, and standard deviation) and percentiles are calculated for all returns as well as for those returns reporting dividend income. As reported above, when all returns in the 1998 SOI file are considered, more than half of all taxpayers do not report dividend income. Therefore, focusing on all returns alone does not provide a clear picture of the income (and other characteristics) of those individuals reporting dividend income.

Consequently, the author examined filers in every filing status (single, married filing jointly, married filing separately, head of household, or widower) for all ages in two separate categories—those receiving dividends and those not receiving dividends. Additionally, the data in both categories

20. See IRS Form 1040.

21. Results similar to those reported above were found when adjusted gross income (AGI) was used instead of this measure of income. These results are available from the author.

22. In spite of these shortcomings, the statistics presented in this report reflect the income diversity among groups of investors in America today, and therefore how many Americans are affected by the double taxation of dividends. Again, since all investments are competing for investors' dollars, any significant change in one investment choice will have an effect on the others. Both of the major shortcomings will be addressed in a forthcoming CDA Report.

23. The idea is that income earned from working an hourly wage job and/or running a business is representative of normal or "permanent" income, while investment-related income, which can be transitory, depends largely on how much permanent income is earned. The permanent income hypothesis was developed by Milton Friedman in the 1950s. See Milton Friedman, "The Permanent Income Hypothesis: Comment," *American Economic Review*, Vol. 48 (December 1958), pp. 990–991.

are partitioned based on filing status for both pre-retirement age and post—retirement age taxpayers.

In regard to filing status, the author first combined all filers and then examined single and married filers separately (married filing separately and married filing jointly were combined as married filers). Finally, while it is not a perfect classification, all returns including Social Security benefits are categorized as "post-retirement age," and all returns not reporting such benefits are categorized as "pre-retirement age."