



Congress Needs to Stop a Dividend Tax Hike

By Richard McMahon

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Bad news is lurking right around the corner for investors, businesses and the nation's economy. Unless Congress acts before the end of the year, dividend income will be taxed at individual tax rates instead of at the same rate as long-term capital gains.

This will cause the maximum tax rate on dividend income to skyrocket next year from 15% to as high as 43.4%. The top tax rate on capital gains, meanwhile, will rise from 15% percent to a maximum of 23.8%.

The tax rates were temporarily reduced in 2003, when Congress passed the Jobs and Growth Tax Reconciliation Act. The maximum tax rate on dividend income was cut from almost 40% to 15%, and taxpayers in the 10% and 15% tax brackets had their tax rates on dividend income lowered to zero. The 2003 law also cut the maximum tax rate on capital gains from 20% to 15%. Those tax rates were extended in 2006 and again in 2010.

Keeping tax rates on dividends low and on par with those on capital gains helps the tens of millions of Americans who own dividend-paying stocks, either directly or indirectly through mutual funds, to keep more of the dividend income they receive. The lower rates also support the value of dividend-paying stocks held in life insurance policies, pension funds, 401(k) plans, or individual retirement accounts.

The low and parallel tax rate structure also helps companies attract the investment capital they need at a lower cost. Last year, electric utility companies paid out 59.2% of their earnings in the form of dividends. The next highest payout ratios among U.S. business sectors were Consumer Staples at 44.6% and Industrials at 31.3%. And since the dividend tax rate reduction took effect, electric utility capital expenditures have increased 84% – from \$43.0 billion in 2003 to \$79.1 billion in 2011.

These investments include building clean energy facilities that range from large nuclear plants to small renewable-energy projects, as well as state-of-the-art, coal-based generating units and high-efficiency combined-cycle natural gas plants. They are automating distribution networks, and replacing analog electric meters with advanced digital meters. And they are preparing for the advent of mass-produced electric vehicles that are just now entering the U.S. market. Importantly, these capital investment programs create an important source of much-needed, high-quality job creation in many states as well.



Should the dividend tax rate reduction expire, tax policy would revert to favoring debt over equity, as well as investment in those companies that reward investors through capital appreciation, as opposed to those paying dividends to investors. Consequently, higher taxes on dividends will likely tarnish dividend-paying stocks – and because the market is forward-looking, the fear is that their prices will fall sooner rather than later.

Shareholder income is already essentially taxed twice. The company pays a corporate income tax on its earnings, which reduces the amount of net income that can be paid out to shareholders in the form of dividends. The company's shareholders then pay a personal tax on their dividend income.

The top U.S. integrated dividend tax rate is currently 50.8% (when both corporate and individual tax levels, as well as state taxes, are factored in), according to a February 2012 study prepared for the Alliance for Savings and Investment by Ernst & Young. If Congress and the president don't act to stop a dividend tax hike, the top U.S. integrated dividend tax rate will rise to 68.6% – the highest level among developed nations.

Richard McMahon is vice president, finance and energy supply, for the [Edison Electric Institute](#), an association of shareholder-owned electric companies. It is sponsoring a national grassroots advocacy campaign, [Defend My Dividend](#).

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