

The Dividend Tax Rate Reduction Works

In 2003, Congress passed an important law—the Jobs and Growth Tax Reconciliation Act of 2003—that *temporarily* reduced to 15 percent the individual tax rate on dividends. (Lower income investors are subject to a dividend tax rate of 5 percent, falling to 0 percent from 2008 to 2010.) Prior to enactment of this law, the maximum tax rate on dividend income was 38.6 percent.¹

Reducing the tax rate on dividends has been an absolute success. More companies are offering dividends—and dividends are larger. As a result, millions of Americans—including millions of senior citizens living on fixed incomes—are receiving more of their investment income. Seventy percent of families receiving dividends had incomes below \$100,000. And, seven million seniors received an average benefit of \$1,231. At the same time, stock market values are increasing. This allows businesses to access lower-cost capital and make critical investments needed for our growing economy.

There's no question that the dividend tax rate reduction is achieving highly favorable results. Take a closer look at how the law promotes economic growth and benefits the millions of Americans who depend on dividend income.

The dividend tax rate reduction encourages more companies to offer dividends—and to increase their dividend payments.

Reducing the tax rate on dividends helped reverse a 25-year decline in the number of companies paying dividends. Today, more companies are viewing dividends as a profitable investment return for themselves and their shareholders.

For example, in the electric utility sector—the largest dividend-paying sector—dividend payments have greatly increased over the past three years. In 2006, 64 percent of shareholder-owned electric companies increased their dividends, the largest percentage increase since 1993.² This momentum continued into 2007, with more than 30 percent of shareholder-owned electric companies either raising or reinstating their dividend during the first quarter—keeping pace with the level of activity during the same period last year.³

This growth follows three straight years of widespread increases. In fact, from 2003 to 2006, S&P 500 annual dividend increases rose 70 percent.⁴ In 2006, S&P 500 shareholders received \$224 billion in regular dividend payments—an increase of 35 percent from 2002. Clearly, the dividend tax rate reduction is having a positive impact in promoting increased dividend payments to shareholders.

¹ Under the original legislation, the reduced dividend tax rate was set to expire in 2008. In May 2006, new legislation passed that extended the reduced dividend tax rate through 2010.

² Edison Electric Institute, “Dividends – Q4 2006 Financial Update,” EEI Finance and Accounting Division, January 2007.

³ Edison Electric Institute, “Dividends – Q1 2007 Financial Update,” EEI Finance and Accounting Division, April 2007.

⁴ American Shareholders Association, “The Economic & Fiscal Impact of the 2003 Tax Cut,” Daniel Clifton, February 2007.

The dividend tax rate reduction gives millions of Americans, including millions of senior citizens, more income.

The dividend tax rate reduction is putting more money in the pockets of 24 million families—including nearly seven million senior citizens on fixed incomes. The amount of dividend income reported by taxpayers increased by more than \$50 million since the dividend tax rate reduction took effect.⁵ Government data show that 70 percent of families receiving dividend income had incomes of less than \$100,000 per year. With the reduced dividend tax rate, their average dividend income was \$1,600—with an average tax cut of \$160.

Senior citizens also greatly benefit from the reduced dividend tax rate. Nearly half (49 percent) of all dividend income reported in 2004—the latest year for which data are available—went to individuals 65 years or older, and 78 percent of total dividend income was paid to individuals 50 years or older.⁶

Importantly, Americans receiving quarterly dividend payments are not the only ones to profit from the reduced dividend tax rate. Individuals with dividend-earning tax-deferred investments—such as 401(k) plans and IRAs—also benefit. As shareholder values increase and companies offer larger dividends, all Americans with these tax-deferred accounts see their investments grow. And, as part of long-term investment accounts, these payments will continue to increase in value for years to come.

The dividend tax rate reduction helps businesses make necessary investments.

With incentives for companies to offer dividends and shareholders to invest, total shareholder value has increased dramatically since 2003. These higher stock prices have generally decreased the cost of capital for companies, making it cheaper for them to borrow money for capital improvements and other business needs.

This development is especially important for capital-intensive industries, such as the electric utility sector, which must make significant investments in transmission, distribution, generation, and environmental compliance to meet demands for electricity. In fact, the electric utility industry's capital expenditures rose 14 percent in 2005 and nearly 25 percent in 2006. This investment in our nation's electric infrastructure is crucial to ensuring that electric companies can continue to provide reliable, affordable electricity in the future.

⁵ Ibid.

⁶ U.S. Internal Revenue Service, Statistics of Income Division, April 2007.

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**EDISON ELECTRIC
INSTITUTE**

701 Pennsylvania Avenue, N.W.
Washington, D.C. 20004-2696
202-508-5000
www.eei.org

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