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January 30, 2006

CAPITAL GAINS AND DIVIDEND TAX CUTS: DATA MAKE CLEAR THAT HIGH-INCOME HOUSEHOLDS BENEFIT THE MOST

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The tax-cut package enacted in 2003 reduced to 15 percent the top tax rate on long-term capital gains and corporate dividends. Although these tax cuts are slated to expire in 2008, Congress is already debating as part of the current tax reconciliation process whether to extend these tax cuts for another two years, through 2010.[1] In addition, the President and other Administration officials have been calling for these tax cuts to be extended or made permanent. Such a proposal is virtually certain to be in the Administration's 2007 budget.

Supporters of the extension go out of their way to depict the benefits of these tax cuts as being widespread. For instance, in a January 6th speech to the Economic Club of Chicago, the President stated: "American families all across this country have benefited from the tax cuts on dividends and capital gains. Half of American households — that's more than 50 million households — now have some investment in the stock market." This statement and similar claims paint a distorted picture, however, of who is benefiting from these tax cuts; the benefits are overwhelmingly concentrated among those with the highest incomes. This analysis, using available data, attempts to clarify who owns corporate stock, who receives income from this stock, and who will benefit from extension of the capital gains and dividend tax cuts.

Most Stock Is Owned by High-Income Households

In the quote above, the President pointed out that about half of all households own stock. This is consistent with the most recent data from the Federal Reserve Bank's Survey of Consumer Finance. What this statistic ignores, however, is that nearly two-fifths of this stock is held in retirement accounts, such as 401(k)s and IRAs. This distinction is crucial, because capital gains and dividend income accruing inside these retirement accounts is not subject to taxation, and thus would not receive a tax benefit from the reduction in the tax rates on capital gains and dividend income.[2]

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[1] See Joel Friedman, "Senate and House Reconciliation Tax Packages: Nearly $100 Billion in Tax Cuts are on the Table," Center on Budget and Policy Priorities, Revised January 10, 2006.

[2] Income earned in retirement accounts such as 401(k)s and traditional IRAs are taxed only when funds are withdrawn from the accounts, and at that point are subject to regular income tax rates. Withdrawals from Roth IRAs are not subject to income taxes.

Supporters of the tax cuts will likely argue that while those who hold stocks in tax-preferred retirement accounts might not receive a direct tax benefit from the capital gains and dividend tax cuts, they still benefit indirectly to the extent that these tax cuts boost the stock market and push up the value of their portfolios. There is little evidence, however, that these tax cuts have had a positive impact on the stock market. A recent study by three Federal Reserve economists found that these tax cuts did *not* raise the value of U.S. stocks.[3] Similarly, an analysis by the Urban Institute-Brookings Institution Tax Policy Center found that capital gains tax rates and stock market values have been only weakly correlated over time.[4]

Survey of Consumer Finance data for 2001 show that 30 percent of households own some stock in taxable accounts, but that ownership of stock in taxable accounts is much more prevalent among high-income households than among low- and moderate-income households.

- Only 17 percent of households in the bottom 60 percent of the income spectrum own stock in taxable accounts. In contrast, 73 percent of the households in the top 10 percent of the income spectrum own stock in taxable accounts. Among those at the very top of the income spectrum — the top one percent — 84 percent own stock in taxable accounts.

- Further, among those households that own taxable stock, the average holding is much larger for those at the top of the income spectrum than for those with more modest means. For households in the bottom 60 percent of the population that have any taxable stock, the average value of the holding is about $52,000 (in 2001 dollars). The average value is nearly $2 million for those in the top one percent of households.

- Because taxable stock holdings are both smaller and less common for the bottom 60 percent of households, this group owns only 9 percent of all taxable stock. The top 10 percent owns 70 percent of all taxable stock. The top one percent owns 29 percent of all taxable stock.

High-Income Households Receive Most Capital Gains and Dividend Income[5]

Another statistical sleight of hand used to portray the benefits of the capital gains and dividend tax cuts as being widespread is to point to the large numbers of middle-income households that receive this type of investment income. Supporters of the tax cuts will point out, for instance, that the majority of those with capital gains and dividend income have incomes of less than $100,000. This is true, but only because those with incomes below $100,000 comprise the vast majority — 86 percent — of all U.S. households.

The proportion of those with incomes under $100,000 who receive *any* capital gains or dividend income is quite small. According to the Tax Policy Center, in 2005, only 12.5 percent of the

[3] Gene Amromin, Paul Harrison, and Steve Sharpe, "How Did the Dividend Tax Cut Affect Stock Prices?" October 11, 2005. Also see Aviva Aron-Dine, "Study Finds Dividend Tax Cut Failed To Boost Stock Prices," Center on Budget and Policy Priorities, December 12, 2005.

[4] Troy Kravitz and Leonard Burman, "Capital Gains Tax Rate, Stock Markets, and Growth," Tax Notes, November 7, 2005, available online at http://www.urban.org/UploadedPDF/1000851_Tax_Fact_11-7-05.pdf.

[5] This section refers only to capital gains and dividend income subject to tax.

households earning less than $100,000 received dividend income, and only 6.6 percent received any capital gains income.

Further, focusing on the *number* of households claiming capital gains and dividend income does not tell the full story; it is much more important to look at the *amount* of capital gains and dividend income collected by various income groups. Tax Policy Center data for 2005 indicate that the bulk of income from dividends and capital gains flows to high-income households.

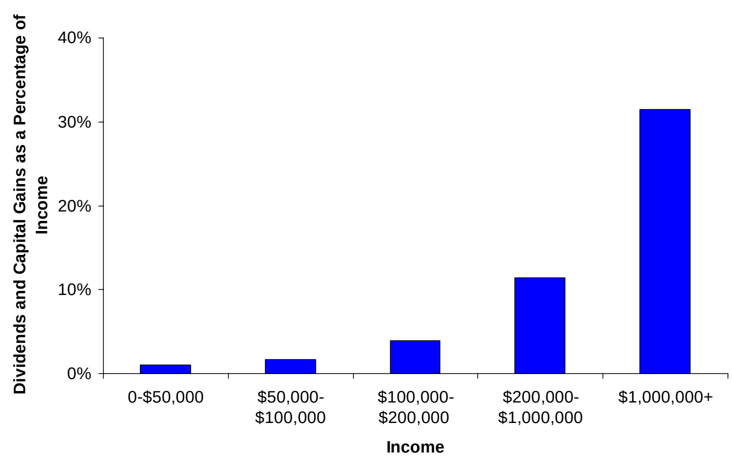
- Over half — 54 percent — of all capital gains and dividend income flows to the 0.2 percent of households with annual incomes over $1 million. More than three-quarters — 78 percent — of this income goes to those households with income over $200,000, which account for about 3 percent of all households.

- In contrast, only 11 percent of capital gains and dividend income goes to the 86 percent of households with incomes of less than $100,000. Only 4 percent of this income flows to the 64 percent of households that have income of less than $50,000.

Not only is income from capital gains and dividends heavily concentrated at the top of the income spectrum, but it also represents a larger portion of income for these very well-off households than it does for those of more modest means. New IRS income tax data for 2003 show that income from capital gains and dividends increases steadily as a percentage of total income as household income rises (see Figure 1). For those making less than $100,000, capital gains and dividend income makes up an average of 1.4 percent of total income. For those making over $100,000, this income accounts for 12.2 percent of total income on average; for those making over $1 million, the share rises to an average of 31.4 percent. Thus, the IRS data show that while capital gains and dividend income accounts for nearly one-third of all income for millionaires, it represents a tiny fraction of income for most families.

FIGURE 1

Capital Gains and Dividend Income Is Larger Share of Total Income of High-Income Households, 2003



Source: Internal Revenue Service, 2003 Statistics of Income

Finally, it is worth noting that data from the Congressional Budget Office indicate that taxable income from stocks and other capital assets have become increasingly more concentrated over time. The data show that in 2003 the top one percent of the income spectrum received 57.5 percent of taxable capital income — which includes income from capital gains, dividends, interest, and rents — the largest share in

Capital Gains and Dividend Income Also Skewed For Elderly Households

Recent analyses by the Tax Foundation have focused on the benefits of the dividends and capital gains tax cuts for the elderly, and have noted that the likelihood of having capital gains and dividend income increases with age.[*] While it is true that the elderly are more likely to have some capital gains or dividend income than younger households, Tax Policy Center data for 2005 shows that among the elderly — as among the population as a whole — capital gains and dividend income is very concentrated among high-income households.

Of the capital gains and dividend income flowing to the elderly in 2005, the Tax Policy Center estimates that more than three-quarters goes to elderly households with incomes over $100,000, which represent 8.5 percent of all elderly households. Moreover, 30 percent of this income goes to the 0.2 percent of elderly households who have incomes over $1 million. In contrast, the 73 percent of seniors with incomes below $50,000 receive only 8 percent of the capital gains and dividend income that goes to the elderly. Thus, any implication that extending the dividends and capital gains tax cuts would offer large benefits to more than a small minority of seniors would be misleading.

[*] Scott Hodge, "Majority of Seniors Benefit from Reduced Capital Gains and Dividend Tax Rates," Tax Foundation, December 6, 2005.

the years examined by CBO, which has data going back to 1979.[6]

Extension of the Dividend and Capital Gains Tax Cuts Would Disproportionately Benefit the Very Wealthy

The House passed a two-year extension of the capital gains and dividend tax cuts as part of its 2006 reconciliation tax-cut package. The Joint Committee on Taxation estimates that this two-year extension would cost $51 billion through 2015 (of this total, only $21 billion shows up in the five-year period 2006-2010, and another $30 billion shows up in the 2011-2015 period). The Administration has called for making these tax cuts permanent, which the Joint Committee on Taxation estimates would cost $148 billion through 2015.

Given that households at the top of the income spectrum own a disproportionate share of stocks held in taxable accounts and receive an outsized share of capital gains and dividend income subject to tax, it is not surprising that this well-off group would benefit the most by far from the extension of these tax cuts. According to the Tax Policy Center:

- In 2009, 72 percent of the benefits of extending the tax cuts would flow to households with incomes above $200,000. Nearly half — 45.3 percent — would go to households with incomes of more than $1 million.

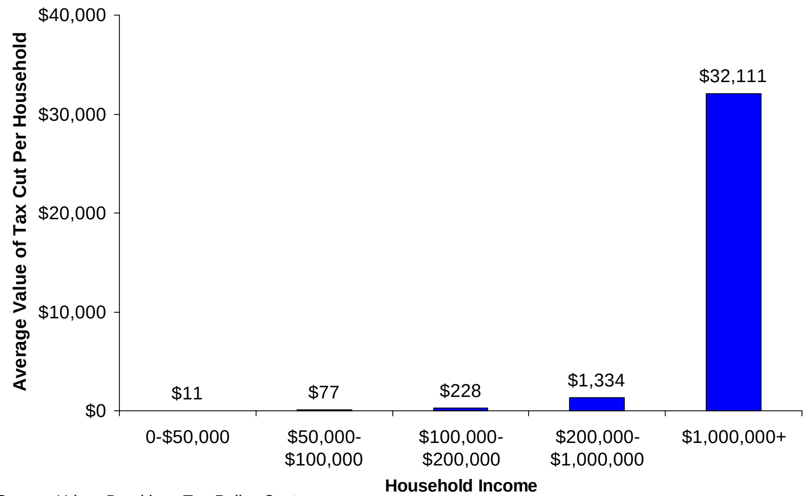
- In contrast, households with incomes below $100,000 would receive only 14 percent of the benefits of this tax cut. Those with income below $50,000 would receive only 4 percent of the benefits.

[6] Isaac Shapiro and Joel Friedman, "New, Unnoticed CBO Data Show That Capital Income Has Become Much More Concentrated At The Top," Center on Budget and Policy Priorities, January 30, 2006.

- Further, the average value of the tax cut that would be received by a household if the tax cuts were extended rises dramatically with income. Households with incomes below $50,000 would see an average tax cut of only $11 in 2009, while those making over $1 million would receive an average tax cut of $32,000 (see Figure 2).

FIGURE 2

Extension of Capital Gains and Dividend Tax Cut Primarily Benefits High-Income Households, 2009



Source: Urban-Brookings Tax Policy Center

Whether measured in absolute terms or as a percentage of income, middle-income households claim little in the way of capital gains and dividend income on their tax returns, and therefore benefit little from reductions in the dividend and capital gains tax rates. These tax cuts represent a significant loss of revenue for the federal government, with most of this money flowing to a modest number of very wealthy households.