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WHO BELONGS TO THE "INVESTOR CLASS"?

By Joel Friedman

Some supporters of reducing or eliminating individual income taxes on corporate dividends argue that it will benefit a large "investor class" that includes millions of middle-income families. The implication is that a broad cross-section of the American public is now invested in the stock market and that the "investor class" is no longer confined to those with high incomes but has become a more representative group. Although this may be truer than in the past, it misses two fundamental points: First, a significant portion of investments occurs in the context of tax-deferred retirement accounts, particularly for middle-class investors. These investments would be unaffected by proposals that change the tax treatment of stock dividends and capital gains. Second, higher-income taxpayers are not only more likely to have taxable income from dividends and capital gains, but the amount of this income is far higher than for other income groups. In other words, when it comes to stock holdings in taxable accounts, the "investor class" is still dominated by those with high incomes.

These points are demonstrated by data from the Federal Reserve's most recent Survey of Consumer Finances. The SCF data show that in 1998, nearly half of all families had investments in stocks, mutual funds, or retirement accounts.[1] But middle-income families not only had much smaller amounts of assets in these investments than high-income families did, they also had a much larger share of such investments in tax-deferred retirement accounts rather than in taxable accounts.

Using the SCF data, New York University economist Edward Wolff has estimated that in 1998, approximately 85 percent of the value of taxable stocks and mutual funds were held by the top 10 percent of households, when households are ranked according to their net worth. The top one percent of households held 49 percent of the total value of taxable stock and mutual funds. In contrast, the bottom 90 percent of households held only 15 percent of these assets.[2]

Income from Stocks and Mutual Funds

Internal Revenue Service data on income in 2000, the most recent year available, tell a similar story, showing that income derived from taxable stock and mutual fund assets is heavily concentrated at the top of the income spectrum. Only 22 percent of filers with income under

[1] Arthur Kennickell, Martha Starr-McCluer, and Brian Surette, "Recent Changes in U.S. Family Finances: Results from the 1998 Survey of Consumer Finance," Federal Reserve Bulletin, January 2000.

[2] Note that the Federal Reserve recently released SCF data covering through 2001. These data show that in 2001 *more than half* of all families had investments in stocks, mutual funds, or retirement accounts. However, the detailed data needed to update the Edward Wolff calculations shown above of holdings of *taxable* stocks and mutual funds are not yet available.

$100,000 reported any dividend income in 2000, while 72 percent of filers with incomes between $100,000 and $1 million and virtually *all* filers with income over $1 million reported dividends. Further, the amount of dividends reported rises sharply with income. Some 63 percent of all dividend income was reported by the 8.4 percent of tax filers with incomes over $100,000, and more than one-fifth of all dividend income went to the top 0.2 percent of filers with incomes over $1 million. For those with incomes over $1 million who reported corporate dividends, average dividend income totaled more than $75,000 — 65 times more than the average for filers who reported dividends and had income below $100,000.

INCOME FROM CORPORATE DIVIDENDS, 2000

		Dividends*		
Income	**Share of all returns**	**Share of returns with dividends**	**Share of all dividend amounts**	**Average dividend for those with dividends**
Under $100,000	91.6%	22.2%	37.0%	$1,159
$100,000 to $1,000,000	8.2%	71.9%	41.8%	$4,511
Over $1,000,000	0.2%	96.3%	21.2%	$75,463
All returns	100.0%	26.4%	100.0%	$2,411

Source: David Campbell and Michael Parisi, "Individual Income Tax Returns, 2000," *Statistics of Income Bulletin*, Fall 2002.

* Dividend amounts have been adjusted to exclude interest from mutual funds. These interest amounts are classified as dividends for tax purposes, but are assumed not to be part of the Administration's proposal to exempt corporate dividends from individual taxation. The amounts for dividends in the IRS data were reduced across-the-board by 44 percent to adjust for the mutual fund interest, following the methodology used for this adjustment by the Urban Institute-Brookings Institution Tax Policy Center.