

Extending Preferences for Dividends and Capital Gains: Who Gains the Most?

Introduction

In 2003, the president proposed legislation to exclude all dividend income from taxation. In an analysis of that proposal using tax year 2002 data (Gist 2003), we showed that a disproportionate share of dividend income (48 percent) was received by taxpayers aged 65 and older, but that only about one-third of *people* aged 65 and older (and a similar percentage of those aged 50–64) would realize any benefit. The reason is that many people aged 65 and older do not file tax returns because their income does not exceed the tax-filing threshold, and many others file returns despite having no tax liability in order to obtain refunds of taxes withheld.

Ultimately, Congress enacted the Job Growth and Tax Reform Reconciliation Act. Rather than repealing the dividend tax, Congress enacted a preferential rate of 15 percent on both dividends and capital gains income, with a special rate of 5 percent on dividends and capital gains for those in the 15 percent tax bracket. Under current law the dividend and capital gains provision expires in 2008, but Congress is considering extending it this year for two more years. This proposal again raises the question of who benefits from the extension of this tax provision. If the dividend and capital gains provisions are extended, all

those with either dividend or capital gains income who filed tax returns and had tax liability would realize a benefit.

This paper takes another look at who would benefit from this proposal using more recent 2002 IRS tax return data. Unlike the earlier study, it examines the distribution of both dividend and capital gains income. After determining who benefits the most from the possible extension of the preferential tax rate on dividends and capital gains, it briefly examines the effect of the tax provisions on the federal budget deficit.

Who Has Dividend and Capital Gains Income?

Table 1 shows the number of tax filers aged 50 and older (divided between those 50 to 64 and those aged 65 and older) and the numbers and percentages of each that had dividend and capital gains income in 2002. Among 50-to-64-year-olds, 9.1 million returns (singles, couples, heads of household) out of nearly 27 million returns in that age group (34 percent) had dividend income; 7.0 million returns filed by that age group (26 percent) had capital gains. Among filers aged 65 and older, 9.0 million had dividend income (53 percent), and 6.9 million had capital gains (41 percent).

Table 1. Population and Tax Filers Aged 50 and Older with Selected Income Sources, Tax Year 2002			
	Aged 50 to 64	Aged 65+	Aged 50+
Number of persons in age group	45,277,350	35,585,425	80,862,775
Tax returns	26,778,762	16,929,528	43,708,290
Taxable returns	23,560,006	12,549,937	36,109,943
No. of tax returns with dividend income (percentage of returns)	9,107,430 (34.0%)	8,964,679 (53.0%)	18,072,109 (41.3%)
No. of persons affected by provision (percentage of people in age group)	13,815,475 (30.5%)	12,585,677 (35.4%)	26,401,152 (32.6%)
No. of tax returns with capital gains (percentage of returns)	7,031,036 (26.3%)	6,949,357 (41.0%)	13,980,393 (32.0%)
Number of persons affected by provision (percentage of all in age group)	10,717,936 (23.7%)	9,779,971 (27.5%)	20,497,907 (25.3%)
Sources: U. S. Census Bureau, Population estimates, National population estimates-characteristics, found at http://www.census.gov/popest/national/asrh/NC-EST2004/NC-EST2004-01.xls ; Internal Revenue Service, 2002 Complete Individual Report File, Statistics of Income Division, September 2005			

Amounts of Dividends and Capital Gains

Table 2 provides additional detail on the amounts of dividend and capital gains income received by tax filers in these two age groups. Although tax filers aged 50 to 64 represented 21 percent of all tax filers, they represented 29 percent of all filers reporting dividend income and a similar percentage of those reporting capital gains. Filers aged 65 and older were only 13 percent of all tax filers, but they too represented almost 29 percent of all filers with dividend income and just under 29 percent of all with capital gains.

Filers aged 50 and older reported 43 percent of all adjusted gross income (AGI) received in 2002 (not shown in Table 2), but they had nearly twice that percentage—80.8 percent—of all dividend income reported in AGI in 2002 (28.0 percent from those 50 to 64 and 52.8 percent from those 65 and older). People aged 50 and older represented 58 percent of all tax returns reporting capital gains, but they reported 69.3 percent of *all* capital gains income collected by the IRS in 2002 (37.5 percent from those 50 to 64, 31.8 percent from those 65+).

Table 2. Number and Percentage of Filers with Dividend and Capital Gains Income, Tax Year 2002, by Age

	Number of filers (millions)	%	Number with dividend income (millions)	%	Amount of dividend income (\$billions)	%	Number with capital gains (millions)	%	Amount of capital gains (\$billions)	%
All filers	130.1	100	31.4	100	103.2	100	24.2	100	238.8	100
50—64	26.8	21	9.1	29.0	28.9	28.0	7.0	29.1	89.5	37.5
65+	16.9	13	9.0	28.5	54.5	52.8	6.9	28.7	75.9	31.8
50+	45.7	34	18.1	57.5	83.4	80.8	13.9	57.8	165.4	69.3

Source: Internal Revenue Service, 2002 Complete Individual Report File, Statistics of Income Division, September 2005

Distribution of Filers with Dividend and Capital Gains Income by Income Class

Table 3 reports the distribution of tax filers by income group. Tax filers with dividend income occurred more frequently among higher income people in both the 50 to 64 and 65+ age groups, but the pattern was more skewed among the former group than the latter. Among the 50 to 64 age group, dividend holders were underrepresented in the under-\$50,000 income groups and overrepresented in the \$50,000 and above income groups. Roughly the same pattern occurred among filers aged 65 and older. With respect to capital gains income, the distribution was somewhat more skewed to the higher income end. Filers aged 50 to 64 who had capital gains were underrepresented relative to total filers in all age groups below \$75,000, whereas a disproportionately higher percentage of filers above \$75,000 had dividend income. Among the aged 65 and older group, the distribution of filers with capital gains was almost identical to the dividend income distribution. Above \$50,000,

filers with capital gains were overrepresented, especially at the highest income levels.

Distribution of Dividend and Capital Gains Income by Income Class

Figure 1 shows the distribution of both dividend and capital gains income among the 50 to 64 age group along with the distribution of tax filers by income group. Total dividend income reported in 2002 was \$103 billion,¹ of which \$29 billion was received by filers aged 50 to 64. More than two-thirds (67.6 percent) of the latter amount went to those with more than \$100,000 in adjusted gross income, and nearly half (48.6 percent) went to those with more than \$200,000 in income.

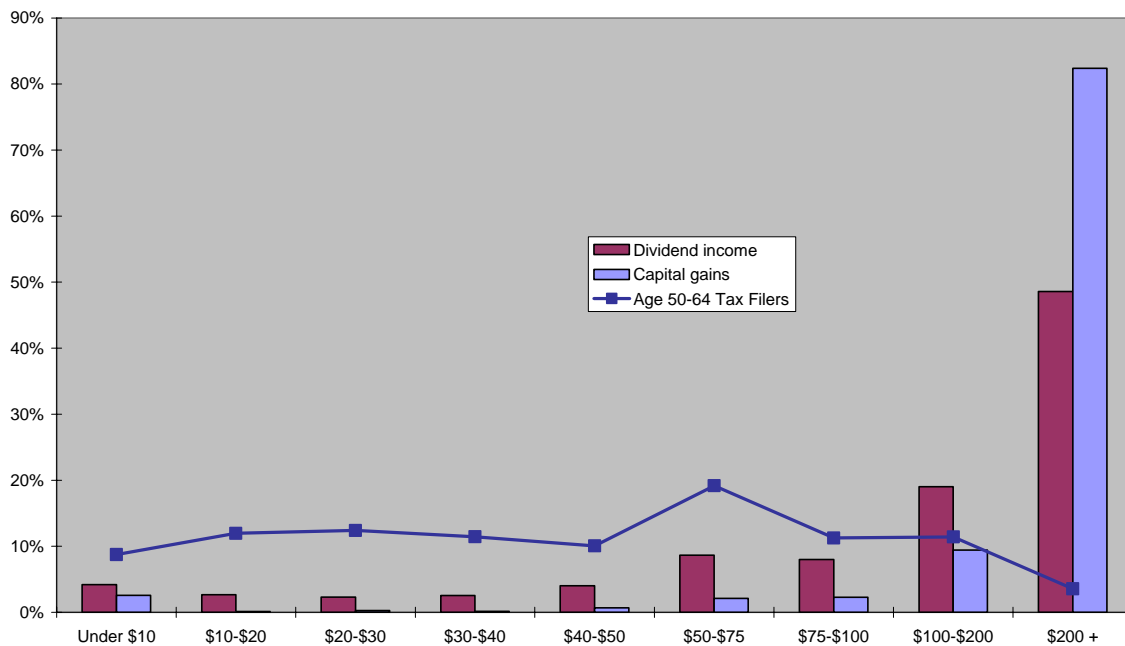
¹ According to the National Income and Product Accounts, personal dividend income in 2002 was actually \$397.2 billion, but well under half of this amount is reported on tax returns, in part because half or more of dividends flow to tax-exempt sources like pension funds and 401(k) plans (Gale 2002; Ledbetter 2005).

Table 3. Distribution of Dividend Income for Taxpayers Aged 50-64 and 65+, Tax Year 2002, by AGI Class

	Filers Aged 50 to 64				Filers Aged 65 and Older			
	Number of All Filers Aged 50-64 (millions)	% Dist. of All Filers Aged 50-64	% Dist. of Filers Aged 50-64 with Dividend Income	% Dist. of Filers Aged 50-64 with Capital Gains Income	Number of All Filers Aged 65+	% Dist. of All Filers Aged 65+	% Dist. of Filers Aged 65+ with Dividend Income	% Dist. of Filers Aged 65+ with Capital Gains Income
Total	26.8	100.0%	100.0%	100.0%	16.9	100.0%	100.0%	100.0%
AGI (000)								
Under \$10	2.3	8.7%	5.03%	6.38%	3.1	18.2%	13.07%	13.85%
\$10-\$20	3.2	12.0%	5.60%	5.58%	4.3	25.6%	20.71%	18.66%
\$20-\$30	3.3	12.4%	7.25%	7.04%	2.4	14.5%	13.32%	12.12%
\$30-\$40	3.1	11.5%	8.20%	7.30%	1.6	9.6%	9.52%	9.48%
\$40-\$50	2.7	10.1%	9.17%	8.57%	1.1	6.7%	7.19%	7.21%
\$50-\$75	5.1	19.2%	20.27%	18.86%	2.0	12.1%	15.08%	15.66%
\$75-\$100	3.0	11.3%	14.92%	14.32%	1.0	6.0%	8.06%	8.75%
\$100-\$200	3.1	11.4%	20.81%	21.42%	0.9	5.4%	8.20%	9.96%
\$200+	1.0	3.6%	8.74%	10.53%	0.3	2.0%	3.30%	4.30%

Source: Internal Revenue Service, 2002 Complete Individual Report File, Statistics of Income Division, September 2005

Figure 1. Percent Distribution of Dividend and Capital Gains Income Among Tax Filers Aged 50-64, with Distribution of Tax Filers in Age Group, Tax Year 2002



Source: Internal Revenue Service, 2002 Complete Individual Report File, Statistics of Income Division, September 2005

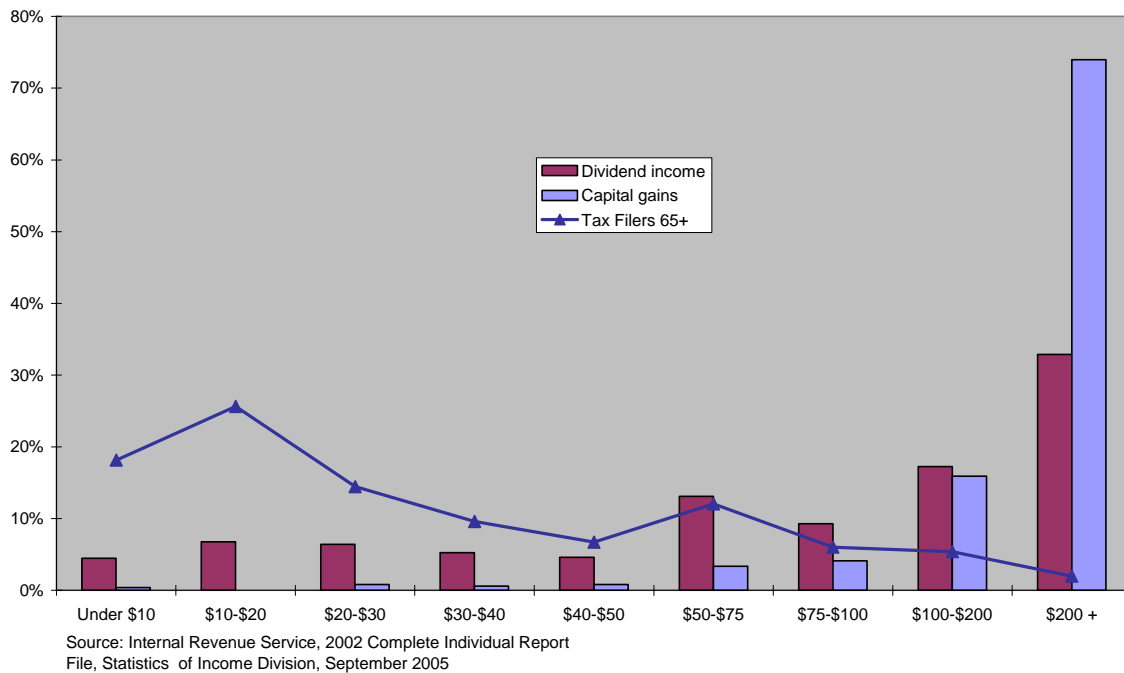
Capital gains included in AGI totaled \$239 billion in 2002, and \$90 billion of that was received by filers aged 50 and older. Tax filers aged 50 to 64 accounted for \$90 billion (38 percent) of all capital gains. Capital gains were skewed even more sharply than dividends toward people with income of \$100,000 or more among both the 50 to 64 population and the 65 and older population. More than 90 percent of all capital gains received by filers aged 50 to 64 went to those with incomes in excess of \$100,000, who represent only 8.4 percent of filers in that age range.

Figure 2 reports the distribution of dividend and capital gains income among filers aged 65 and older by income group, along with the distribution of tax filers in that age group. Filers aged 65+ received \$55 billion in dividend income--more than

half of all dividend income reported--and more than half of that share went to those with income in excess of \$100,000. Of all \$239 billion in capital gains reported in 2002, just under one-third (\$76 billion) went to filers aged 65 and older, and 90 percent of that share went to those in the \$100,000 and above income range.

Of all dividend income reported on all tax returns regardless of age, nearly half (45 percent) was received by the 2.8 percent of filers (3.7 million filers) aged 50 and older with incomes exceeding \$100,000. Capital gains were even more concentrated. Nearly two-thirds (63 percent) of all capital gains for all U.S. filers were received by 3.2 million filers aged 50 or over with at least \$100,000 of income (data not shown).

Figure 2. Percent Distribution of Dividend and Capital Gains Income Among Tax Filers Aged 65+, With Distribution of Tax Filers in Age Group, Tax Year 2002



Although, as we saw in Table 1, tax returns filed by people aged 65 and older

who had dividend income represented a little more than half of all filers in that

age group, only 35 percent of *persons* in that age group would be affected by the provision. The reason is that more than 6 million households aged 65+ did not file returns. Another 4.4 million returns that were filed were not taxable. Although half of all 65+ tax returns that were filed in 2002 reported dividend income, they represented only about 35 percent of all persons in that age group, mainly because of nonfilers or nontaxable returns. Similarly, filers aged 65+ with capital gains income represented 41 percent of all tax returns filed in that age group, but only a little more than one-quarter of all persons aged 65 and older.

Impact of Tax Provisions on Federal Budget Deficit

According to the Congressional Joint Committee on Taxation, the preferential rates of tax for dividends and capital gains would result in a revenue loss of approximately \$20 billion over the period 2006–10. Over the ten-year window from 2006 to 2015, the total revenue loss would exceed \$50 billion. These revenue losses would result in even larger deficits when the costs of added debt service for increased deficits are taken into account. The Congressional Budget Office projects the cumulative federal budget deficit over 2006–15 to be \$1.1 trillion. On a cumulative basis, these tax cuts would add about 5 percent to an already large federal deficit.

Conclusions

Making the 15 percent rate on dividend income permanent would benefit about half of all tax filers aged 65 and older, and about one-third of filers aged 50–64. The lower rate on capital gains would benefit about 4 in 10 filers aged 65 and older and about one-quarter of the 50-to-64-year-old filers. But since many older households do

not file tax returns and/or have no tax liability, only about one-third of *people* aged 50 and older would derive any benefit from the dividend rate, and about one quarter would benefit from the capital gains rate.

These benefits, however, would be rather small for most households, since most have no more than a few thousand dollars in dividends or capital gains, and the benefits would likely be offset by other measures taken as a result of the increased deficit. However, for those with over \$200,000 income, average dividend amounts were \$17,000 for 50-to-64-year-olds and \$60,000 for 65+ filers. Capital gains were even larger--\$100,000 and \$188,000 for the two age groups respectively. Nearly half of the dividend tax benefits and nearly two-thirds of the capital gains benefits would go to less than three percent of filers aged 50 and older—those with incomes exceeding \$100,000.

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March, 2006
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