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The United States' High Tax Burden on Personal Dividend Income

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Key Findings

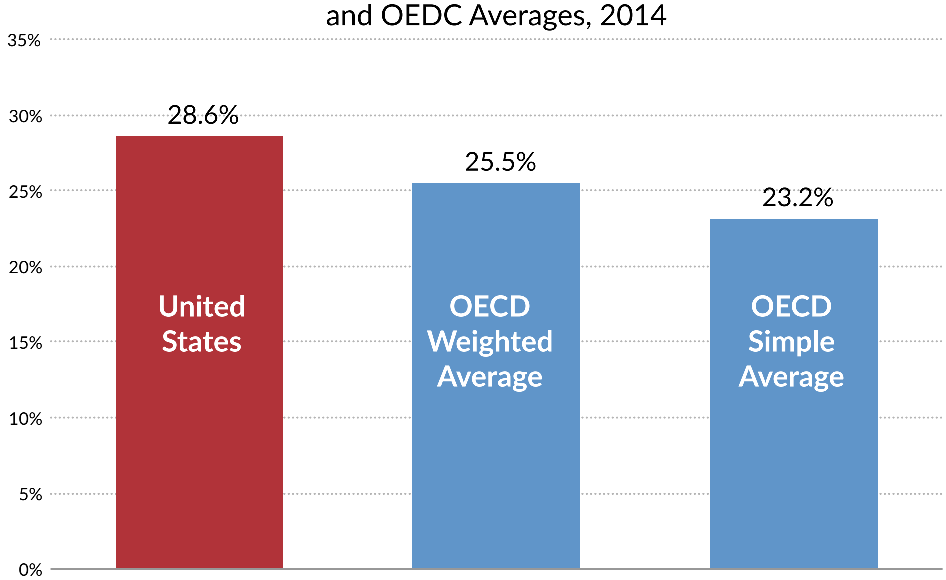
- The combined federal and state top marginal personal dividend tax rate in the United States is 28.6 percent.
- The United States' top marginal tax rate on personal dividend income is 9th highest in the OECD and 5 percentage points higher than average of the 34 member nations.
- Taxpayers in certain states face top marginal rates far higher than the OECD average; Californian taxpayers face the 6th highest top marginal rate in the OECD at 33 percent.
- This double tax on corporate profits biases corporate behavior, leads to lower levels of saving and investment, lower wages, and slower economic growth.

Introduction

Dividends are payments made by a corporation to an individual who owns that corporation's stock. Corporations distribute these dividends to investors from their after-tax profits. Once these shareholders receive this dividend income, they must pay personal income taxes on it. Unfortunately, taxpayers in the United States currently face a high tax burden on personal dividends income.

The United States' top federal marginal tax rate on qualified[1] dividend income is 23.8 percent. U.S. states also tax dividend income at rates ranging from zero to 13.3 percent.[2] Combined, the U.S. average top marginal rate is 28.6 percent. Internationally, U.S. taxpayers face the 9th highest top marginal tax rate on dividend income and a rate about 5 percentage points higher than the average tax rate of 23.2 percent faced by taxpayers across the 34 countries of the Organisation for Economic Co-operation and Development (OECD). Individuals in states such as California, Hawaii, and New York pay some of the highest dividends tax rates in the OECD due to their high marginal tax rates on personal income.

Figure 1. Top Individual Dividend Tax Rates, U.S. and OEDC Averages, 2014



Source: OECD Tax Database and Ernst and Young

The personal dividend tax is a double tax on corporate profit that contributes to a high tax burden on capital. In the past, higher dividend taxes created a distinct tax bias towards corporate retained earnings. Dividend taxes also lead to lower savings and investment, a smaller capital stock, lower wages, and slower economic growth.

1 Qualified dividends are dividends that are paid by a U.S. corporation or qualifying foreign corporation for stocks which have been held more than sixty days. *See* Internal Revenue Service, *Publication 550 (2013), Investment Income and Expenses*, http://www.irs.gov/publications/p550/index.html.
2 Most states tax qualified dividends as ordinary income.

Dividend Taxation in the United States

The current top marginal tax rate on dividend income is 23.8 percent for taxpayers with an adjusted gross income of $200,000 or more ($250,000 or more for married filing jointly). This includes a 20 percent rate on dividend income plus a 3.8 percent tax on unearned income to fund the Affordable Care Act. States also tax personal dividends at top marginal rates that range from zero in states with no personal income tax,[3] such as Alaska, Florida, and Nevada, to 13.3 percent in California (Table 1).[4]

Taking into account federal, state, and local tax rates on dividends, deductibility of state and local taxes, and the phase-out of itemized deductions,[5] combined top marginal tax rates on personal dividend income range from 25 percent in the seven states with no dividend income tax,[6] to 33 percent in California. The average combined top marginal personal dividend income tax rate across the United States is 28.6 percent.[7]

The United States has the 9th Highest Dividend Tax Rate in the OECD

The United States' top marginal tax rate on personal dividend income of 28.6 percent is approximately 5 percentage points higher than the OECD average of 23.2 percent and ranks as the 9th highest of these 34 countries. The highest personal dividend tax rate in the OECD is 48 percent in Ireland. Only two countries (Estonia and the Slovak Republic) do not tax personal dividend income (Table 2).[8]

U.S. States Have Five of the Top Ten Highest Dividend Tax Rates in the OECD

Due to the variation in tax rates across states, taxpayers in some U.S. states face top marginal personal dividend tax rates that are much higher than taxpayers in OECD countries (Table 3). U.S. states have five of the top ten highest marginal personal dividend tax rates in the OECD. California has the 6th highest top marginal tax rate in the OECD with a rate of 33 percent. Even taxpayers in states with no tax on dividend income face a top marginal rate of 25 percent, higher than the OECD average of 23.2 percent.

3 Although New Hampshire and Tennessee have no personal income tax, they both tax interest and dividend income at 5 and 6 percent respectively.

4 Tax Foundation, *Facts &Figures 2014: How Does Your State Compare?* (forthcoming). *See also* Commerce Clearing House *Intelliconnect* database (subscription access).

5 The Pease limitation on itemized deductions reduces many deductions by 3 percent for taxpayers with adjusted gross income exceeding $250,000 ($300,000 married filing jointly).

6 This assumes individuals facing the top marginal rate have itemized deductions against which the Pease limitation is applied.

7 The U.S. average is the combined federal, state, and local rates on dividend income, taking into account the Pease limitation and state/federal deductibility of income taxes weighted by dividend income in each state. For dividend income data, *see* Internal Revenue Service, *Statistics of Income*, *Historic Table 2*, http://www.irs.gov/uac/SOI-Tax-Stats---Historic-Table-2.

8 OECD, *OECD Tax Database*, http://www.oecd.org/tax/tax-policy/tax-database.html. Tax rates are the net top statutory rate paid by a shareholder, taking into account all times of reliefs and gross-up provisions at the shareholder level. *See also* Ernst & Young, *2013-2014 The worldwide personal tax guide*, http://www.ey.com/GL/en/Services/Tax/The-worldwide-personal-tax-guide---Country-list.

Economic Issues with the Personal Dividends Tax

The United States currently places a heavy tax burden on personal dividend income. The U.S. personal dividend tax is a double tax on corporate profits, biases corporate behavior, and leads to lower savings, less investment, lower wages, and lower living standards for all.

A Double Tax on Corporate Profits

The personal dividend income tax is the second tax on corporate profits and contributes to the double taxation of corporate income. Suppose a corporation earns a profit of $100 (Table 4). It then needs to pay the corporate income tax rate of 39.1 percent ($39.10 corporate tax bill).[9] Its after-tax profit is $60.90. The corporation then distributes these after-tax profits as dividends to its stockholders. The stockholders then need to pay the 28.6 percent personal dividends tax rate on the dividends ($17.41 dividend tax bill). In total, the tax burden on the corporate profits is $56.52, for an integrated tax rate of 56.5 percent.[10] The United States' two layers of corporate taxation places a heavy burden on corporate investment, especially considering the United States also has the highest statutory corporate income tax rate in the OECD.[11]

Table 4. Total Tax Burden on Distributed Corporate Profits

Corporate Level			
	Corporate Profit	$100.00	
	Corporate Income Tax Rate		39.10%
	Corporate Income Tax	$39.10	
	After-Tax Profit		$60.90
Individual Level			
	Distributed Profits	$60.90	
	Personal Dividend Tax Rate		28.60%
	Personal Dividend Tax	$17.42	
Total Tax		$56.52	
Total Tax Rate			56.5%

Biases Corporate Behavior

This heavy tax burden on corporate investment can bias corporate behavior. Specifically, it can alter how corporations earn returns for investors. Over the past thirty years, personal dividend income has generally faced higher tax rates than capital gains income.[12] Due to this tax differential, corporations had an incentive to retain their earnings, increasing investors' capital gains rather than

9 The combined federal and state statutory corporate income tax rate.
10 Robert Carroll, *The Economic Effects of the Lower Rate on Dividends*, Tax Foundation Special Report No. 181 (June 2010), http://taxfoundation.org/sites/taxfoundation.org/files/docs/sr181.pdf.
11 OECD, *OECD Tax Database*, http://www.oecd.org/tax/tax-policy/tax-database.html.
12 Capital gains were taxed at the same rate as dividend income for a short period following the Tax Reform Act of 1986. The Omnibus Budget Reconciliation Act of 1990 reintroduced a small differential, and the Omnibus Budget Reconciliation Act of 1993 produced a large differential with dividends taxed at a top rate of 39.6 percent.

distributing profits through dividends. As a result, the number of firms that distributed their profits through dividends consistently declined between 1984 and 2002. However, in 2003, dividend tax rates were lowered to 15 percent and the tax bias between capital gains and dividends was nearly eliminated. Following this change, the number of firms offering dividends drastically increased the next year.[13]

Creates a Bias against Saving and Investment Leading to Lower Living Standards for All

In addition to biasing corporate behavior, high taxation on corporate profits through high dividend taxes creates a bias against saving and investment. Owing to high dividend taxation, people will prefer present consumption over saving, resulting in lower levels of investment and less capital in the future. For investors, this means less available capital for factories and machinery and fewer investment opportunities. For workers, this represents lower levels of productivity and lower wages. In all, there will be slower economic growth and lower living standards for everyone.[14]

Conclusion

Currently, the United States has one of the highest tax burdens on personal dividend income in the OECD. The combined burden of federal, state, and local taxes on dividend income creates marginal rates that exceed the dividend tax rates of most of the United States' major trading partners. Reducing this tax burden on savings and investment will lead to faster economic growth, higher wages, and better living standards for all.

13 Raj Chetty & Emmanuel Saez, *Dividend Taxes and Corporate Behavior: Evidence from the 2003 Dividend Tax Cut*, (Sept. 2004), http://business.illinois.edu/finance/papers/2004/chetty.pdf.
14 *See* Carroll, *supra* note 10.

Table 1. Top Marginal Tax Rate on Personal Dividends Income, by U.S. States, 2014

Rank	State	State Rate	Combined Rate
1	California	13.3%	33.0%
2	Hawaii	11.0%	31.6%
3	New York*	8.8%	31.5%
4	Oregon	9.9%	31.0%
5	Minnesota	9.9%	30.9%
6	New Jersey	9.0%	30.4%
6	Vermont	9.0%	30.4%
8	Maryland*	5.8%	30.3%
9	Maine	8.0%	29.8%
10	Wisconsin*	7.7%	29.6%
10	Iowa*	9.0%	29.6%
12	Idaho	7.4%	29.4%
13	Arkansas*	7.0%	29.2%
13	South Carolina*	7.0%	29.2%
15	Montana*	6.9%	29.1%
15	Nebraska	6.8%	29.1%
17	Connecticut	6.7%	29.0%
17	Delaware	6.6%	29.0%
19	West Virginia	6.5%	28.9%
20	Georgia	6.0%	28.6%
20	Kentucky	6.0%	28.6%
20	Missouri	6.0%	28.6%
20	Tennessee*	6.0%	28.6%
20	Rhode Island	6.0%	28.6%
25	North Carolina	5.8%	28.5%
25	Virginia	5.8%	28.5%
27	Ohio*	5.4%	28.3%
28	Oklahoma	5.3%	28.2%
29	Massachusetts	5.2%	28.1%
30	Illinois	5.0%	28.0%
30	Mississippi	5.0%	28.0%
30	New Hampshire*	5.0%	28.0%
30	Utah	5.0%	28.0%
34	New Mexico*	4.9%	27.9%
34	Louisiana*	6.0%	27.9%
34	Kansas	4.8%	27.9%
37	Indiana*	3.4%	27.8%
37	Michigan*	4.4%	27.8%
37	Colorado	4.6%	27.8%
40	Arizona	4.5%	27.7%
41	Alabama*	5.0%	27.4%
42	Pennsylvania	3.1%	26.8%
43	North Dakota*	3.2%	26.3%
44	Alaska	0.0%	25.0%
44	Florida	0.0%	25.0%
44	Nevada	0.0%	25.0%
44	South Dakota	0.0%	25.0%
44	Texas	0.0%	25.0%
44	Washington	0.0%	25.0%
44	Wyoming	0.0%	25.0%
	D.C.	9.0%	30.4%
	U.S. Average		28.6%

Table 1. Top Marginal Tax Rate on Personal Dividends Income, by U.S. States, 2014

Source: Tax Foundation, Commerce Clearing House, and author's calculations.
*States either allow a taxpayer to deduct their federal taxes from your state taxable income, have local income taxes, or have special tax treatment of dividend income.

Table 2. Top Marginal Tax Rate on Personal Dividends Income, by OECD Nation, 2014

Rank	Country	Rate
1	Ireland	48.0%
2	France	44.0%
3	Denmark	42.0%
4	Korea	35.4%
5	Canada	33.8%
6	United Kingdom	30.6%
7	Israel	30.0%
7	Sweden	30.0%
9	United States	28.6%
10	Norway	28.0%
10	Portugal	28.0%
12	Spain	27.0%
13	Germany	26.4%
14	Austria	25.0%
14	Belgium	25.0%
14	Chile	25.0%
14	Netherlands	25.0%
14	Slovenia	25.0%
19	Australia	23.6%
20	Finland	22.4%
21	Iceland	20.0%
21	Italy	20.0%
21	Luxembourg	20.0%
21	Switzerland	20.0%
25	Poland	19.0%
26	Turkey	17.5%
27	Hungary	16.0%
28	Czech Republic	15.0%
29	Greece	10.0%
29	Japan	10.0%
29	Mexico	10.0%
32	New Zealand	6.9%
33	Estonia	0.0%
33	Slovak Republic	0.0%
	OECD Simple Average	23.2%
	OECD Weighted Average	25.5%

Source: OECD Tax Database and Ernst and Young.

Table 3. Top Marginal Tax Rate on Personal Dividends Income, by OECD Nation and U.S. State, 2014

Rank	State/Country	Rate
1	Ireland	48.0%
2	France	44.0%
3	Denmark	42.0%
4	Korea	35.4%
5	Canada	33.8%
6	California	33.0%
7	Hawaii	31.6%
8	New York	31.5%
9	Oregon	31.0%
10	Minnesota	30.9%
11	United Kingdom	30.6%
12	New Jersey	30.4%
12	Vermont	30.4%
12	D.C.	30.4%
15	Maryland	30.3%
16	Israel	30.0%
16	Sweden	30.0%
18	Maine	29.8%
19	Wisconsin	29.6%
19	Iowa	29.6%
21	Idaho	29.4%
22	Arkansas	29.2%
22	South Carolina	29.2%
24	Montana	29.1%
24	Nebraska	29.1%
26	Connecticut	29.0%
26	Delaware	29.0%
28	West Virginia	28.9%
29	Georgia	28.6%
29	Kentucky	28.6%
29	Missouri	28.6%
29	Tennessee	28.6%
29	United States	28.6%
29	Rhode Island	28.6%
35	North Carolina	28.5%
35	Virginia	28.5%
37	Ohio	28.3%
38	Oklahoma	28.2%
39	Massachusetts	28.1%
40	Norway	28.0%
40	Portugal	28.0%
40	Illinois	28.0%
40	Mississippi	28.0%
40	New Hampshire	28.0%
40	Utah	28.0%
46	New Mexico	27.9%
46	Louisiana	27.9%
46	Kansas	27.9%
49	Indiana	27.8%
49	Michigan	27.8%
49	Colorado	27.8%
52	Arizona	27.7%
53	Alabama	27.4%
54	Spain	27.0%
55	Pennsylvania	26.8%
56	Germany	26.4%
57	North Dakota	26.3%
58	Austria	25.0%
58	Belgium	25.0%
58	Chile	25.0%
58	Netherlands	25.0%
58	Slovenia	25.0%
58	Alaska	25.0%
58	Florida	25.0%
58	Nevada	25.0%
58	South Dakota	25.0%
58	Texas	25.0%
58	Washington	25.0%
58	Wyoming	25.0%
70	Australia	23.6%
71	Finland	22.4%
72	Iceland	20.0%
72	Italy	20.0%
72	Luxembourg	20.0%
72	Switzerland	20.0%
76	Poland	19.0%
77	Turkey	17.5%
78	Hungary	16.0%
79	Czech Republic	15.0%
80	Greece	10.0%
80	Japan	10.0%
80	Mexico	10.0%
83	New Zealand	6.9%
84	Estonia	0.0%
84	Slovak Republic	0.0%
	OECD Simple Average	18.2%

Source: Ernst and Young, Deloitte, Tax Foundation, and author's calculations.

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