TAX FOUNDATION

FISCAL FACT

June 2015
No. 472

The Tax Burden on Personal Dividend Income across the OECD, 2015

By Kyle Pomerleau
Economist

Key Findings:

- The average combined federal, state, and local top marginal tax rate on dividends in the United States is 28.6 percent – 9th highest in the OECD.
- Taxpayers in California face the highest dividend income tax rate in the United States at 33 percent.
- The U.S. average top marginal tax rate on dividend income of 28.6 percent is 4.5 percentage points higher than the simple average across industrialized nations of 24 percent and 1.5 percentage points higher than the weighted average.
- The average tax rate on personal dividend income has increased across the OECD in the past decade.
- The taxation of dividend income can create a double-tax on corporate income, increases the cost of capital, and reduces investment in the economy.

The Tax Foundation is a 501(c)(3) non-partisan, non-profit research institution founded in 1937 to educate the public on tax policy. Based in Washington, D.C., our economic and policy analysis is guided by the principles of sound tax policy: simplicity, neutrality, transparency, and stability.

©2015 Tax Foundation
Distributed under
Creative Commons CC-BY-NC 4.0

Editor, Melodie Bowler
Designer, Dan Carvajal

Tax Foundation
1325 G Street, NW, Suite 950
Washington, DC 20005

202.464.6200

taxfoundation.org

Introduction

Dividends are payments made by a corporation to an individual who owns stock in that corporation. 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 dividend income.

The United States' top federal marginal tax rate on qualified[1] dividend income is 23.8 percent. Individual states also tax dividend income at rates ranging from zero to 13.3 percent.[2] Combined, the U.S. average top marginal tax rate is 28.6 percent. Internationally, U.S. taxpayers face the 9th highest top marginal tax rate on dividend income, which is about 4.5 percentage points higher than the average tax rate of 24 percent across the 34 countries of the Organisation for Economic Co-operation and Development (OECD).

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

Dividend Taxation in the United States

The current federal 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 taxpayers 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]

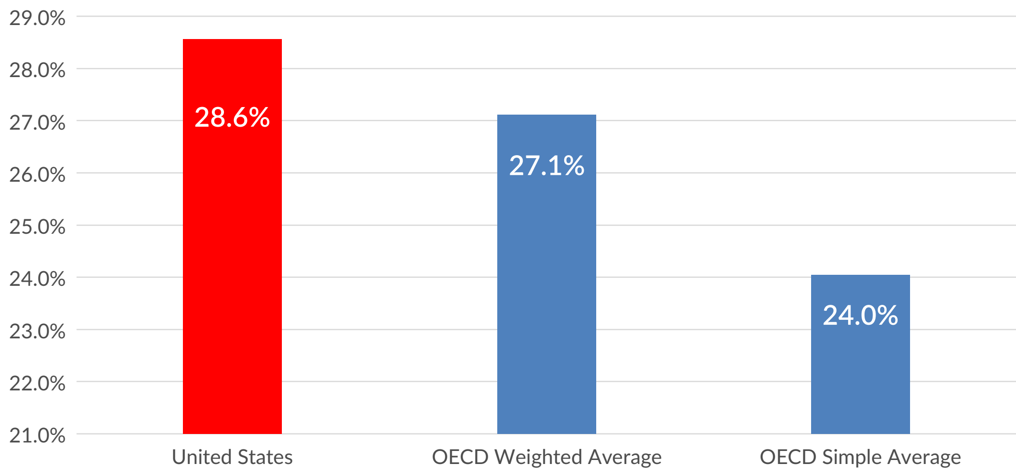
Taking into account federal, state, and local tax rates on dividends, deductibility of state and local taxes, and the phase-out of itemized deductions,[5] combined top marginal tax rates on personal dividend income range from 25 percent in the seven states with no personal income tax[6] to 33 percent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

1 Qualified dividends are dividends that are paid by a U.S. corporation or qualifying foreign corporation for stocks which have been held for 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.
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 2015: How Does Your State Compare? 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 for married taxpayers 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.

Chart 1.

The United States Has an above-Average Top Marginal Tax Rate on Dividend Income

Top Marginal Personal Dividend Tax Rates, U.S. and OECD Averages, 2015



Source: OECD Tax Database, Ernst and Young, Commerce Clearing House, and Author's calculations.

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 4.5 percentage points higher than the OECD average of 24 percent, about 1.5 percentage points higher than the OECD weighted average (weighted by GDP), and ranks as the 9th highest of these 34 countries. The highest personal dividend tax rate in the OECD is 51 percent in Ireland. Only two countries (Estonia and the Slovak Republic) do not tax personal dividend income (Table 2).[8]

Personal Taxes on Dividend Income Have Increased across the OECD over the Past Decade

In 2000, the average top marginal tax rate on personal dividend income was 24.4 percent (34.9 percent weighted by GDP) in the OECD (Chart 2). The higher weighted average was driven by the fact that the United States had a top marginal dividend income tax rate of 46 percent. Between 2000 and 2004, many OECD countries cut their top marginal dividend income tax rates, some countries cut them dramatically. For example, the Netherlands reduced its top rate by 35 percentage points from 60 percent to 25 percent, and Japan reduced its rate by 33.6 percentage points from 43.6 percent to 10 percent. The United States reduced its tax rate by 25.5 percentage points from 46 percent to 20.5 percent. The average rate across the OECD declined from 24 percent (34.9 weighted) in 2000 to 20 percent (20 percent weighted) in 2004.

8 OECD, *OECD Tax Database*, http://www.oecd.org/tax/tax-policy/tax-database.htm. 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.

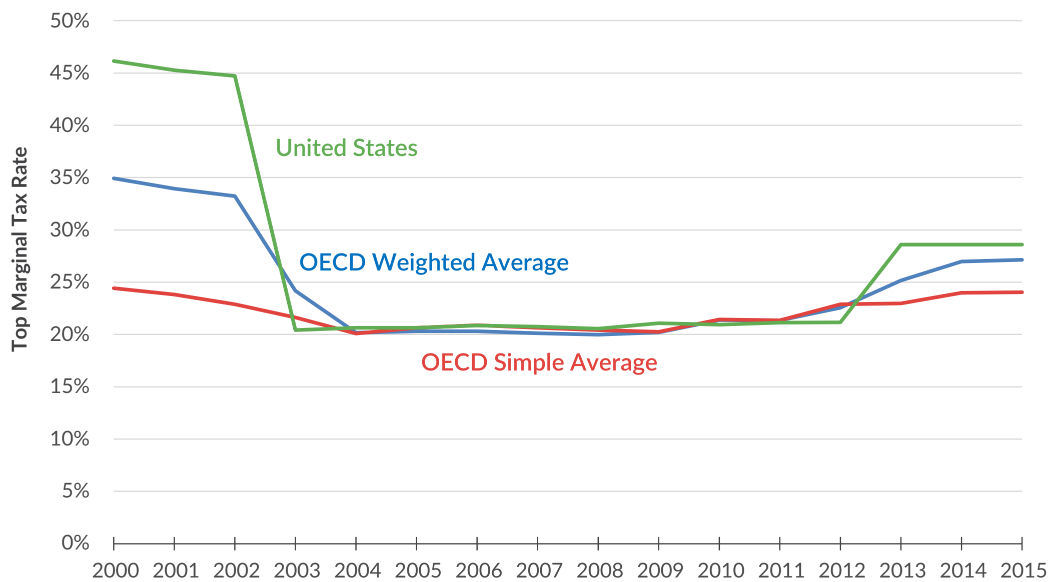
From 2004 to 2009, top marginal tax rates on personal dividend income remained steady throughout the OECD. The OECD average was about 20 percent (both the simple and weighted averages).

After the global recession, several countries began raising their dividend tax rates.[9] Between 2009 and 2015, the average OECD tax rate increased from 20 percent to 24 percent (27.1 percent weighted by GDP). Eighteen of the 34 OECD countries increased their top marginal dividend tax rates during these 6 years. The United States was one of the countries to increase its top marginal dividend tax rate. At the end of the year in 2012, the top marginal dividend tax rate in the United States increased from 20 percent to 28.6 percent as part of the "Fiscal Cliff" deal and the Affordable Care Act.

Chart 2.

The Personal Tax on Dividend Income has Increased Slightly in the Last Decade in the OECD

Top Marginal Personal Dividend Income Tax Rate (U.S. and OECD Average, 2000-2015



Source: OECD Tax Database, Ernst and Young, Commerce Clearing House, and Author's calculations.

Economic Issues with the Personal Dividend 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.

9 Over the same time period, countries have lowered their corporate tax rates.

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 3). It then needs to pay the combined federal and state corporate income tax rate of 39.1 percent ($39.10 corporate tax bill).[10] 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 combined federal and state personal dividend tax rate on the dividends ($17.41 dividend tax bill). In total, the tax burden on the corporation's profit is $56.52, for an integrated tax rate of 56.5 percent, which is the second highest in the OECD.[11] 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.[12]

Table 3. 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.[13] Due to this tax differential, corporations had an incentive to retain their earnings, increasing investors' capital gains rather than 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, the dividend tax rate was 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.[14]

10 The combined federal and state statutory corporate income tax rate.

11 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.

12 OECD, *OECD Tax Database*, http://www.oecd.org/tax/tax-policy/tax-database.htm.

13 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.

14 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.

6

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. Due 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.[15]

Conclusion

Currently, the United States has the ninth highest top marginal tax rate 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.

15 *See* Carroll, *supra* note 10.

Table 1. Top Marginal Tax Rate on Personal Dividend Income, by U.S. States, 2015

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%
7	Vermont	9.0%	30.4%
8	Maryland*	5.8%	30.3%
9	Maine	8.0%	29.8%
10	Wisconsin*	7.7%	29.6%
11	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%
16	Nebraska	6.8%	29.1%
17	Connecticut	6.7%	29.0%
18	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%
24	Rhode Island	6.0%	28.6%
25	North Carolina	5.8%	28.5%
25	Virginia	5.8%	28.5%
27	Ohio*	5.3%	28.3%
28	Oklahoma	5.3%	28.2%
29	Massachusetts	5.2%	28.1%
30	Mississippi	5.0%	28.0%
30	New Hampshire	5.0%	28.0%
30	Utah	5.0%	28.0%
33	New Mexico*	4.9%	27.9%
34	Louisiana*	6.0%	27.9%
35	Colorado	4.6%	27.8%
36	Indiana*	3.3%	27.8%
36	Kansas	4.6%	27.8%
38	Michigan*	4.3%	27.7%
39	Arizona	4.5%	27.7%
40	Alabama*	5.0%	27.4%
41	Illinois	3.8%	27.2%
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%

Source: Tax Foundation, Commerce Clearing House, and Author's Calculations.

* States either allow taxpayers to deduct their federal taxes from their state taxable incomes, have local income taxes, or have special tax treatment of personal dividend income.

Table 2. Top Marginal Tax Rate on Personal Dividend Income, by OECD Nation, 2015

Rank	Country	Rate
1	Ireland	51.0%
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	Finland	28.1%
11	Portugal	28.0%
12	Australia	27.1%
13	Norway	27.0%
14	Germany	26.4%
15	Italy	26.0%
16	Austria	25.0%
16	Belgium	25.0%
16	Netherlands	25.0%
16	Slovenia	25.0%
20	Spain	24.0%
21	Chile	22.6%
22	Switzerland	21.1%
23	Japan	20.3%
24	Iceland	20.0%
24	Luxembourg	20.0%
26	Poland	19.0%
27	Turkey	17.5%
28	Mexico	17.1%
29	Hungary	16.0%
30	Czech Republic	15.0%
31	Greece	10.0%
32	New Zealand	6.9%
33	Estonia	0.0%
33	Slovak Republic	0.0%
	OECD Simple Average	24.0%
	OECD Weighted Average	27.1%

Source: OECD Tax Database and Ernst and Young.