The Alliance for Savings and Investment (ASI) is a diverse coalition of dividend-paying companies, investor organizations and trade associations, formed in support of a common goal: to promote economic recovery, growth and job creation through policies that foster private savings and capital investment. We believe lower tax rates on investment income encourage people in our society to take the risk of investing their money in productive endeavors which produce jobs and build wealth.

In 2003, in an effort to boost economic growth, Congress lowered the maximum rate on capital gains and dividends to 15 percent. In 2012, those rates were raised to 20 percent for those earning more than $400,000. The compromise that was enacted took two very important steps--ensuring that the rates for capital gains and dividends remained equal and making the rates permanent.

As Congress now considers the important topic of comprehensive tax reform, we appreciate the opportunity to comment on the significance of how investment income is taxed.

Capital Gains

According to IRS data, in 2008, more than 8 million tax returns reported $528 billion of long-term capital gains. Sixty-one percent of those returns were from taxpayers with adjusted gross income of less than $100,000.

Farm and ranch owners are disproportionately impacted by capital gains tax increases. According to the IRS, in 2010 about 38 percent of all farmers reported some capital gains—more than three times the share for all other taxpayers. The average amount of capital gain reported by farmers was also more double the average capital gain reported by other taxpayers. The impact of capital gains taxes on farming and ranching is also significant because production agriculture requires large investments in land and buildings that are held for long periods of time.

Higher capital gains taxes also make the U.S. less competitive. According to a report by Ernst & Young LLP, the U.S. capital gains tax rate compares unfavorably with that of many other major economies. Even with current rates, more than half of the countries surveyed have individual capital gains tax rates lower than that of the U.S. Allowing rates to increase would undermine efforts to keep the U.S competitive with our trading partners. Chairman Camp recently has released a discussion draft that would accelerate the taxation of capital gains and change their character from capital to ordinary in some cases. In addition to preserving the preferential rate for capital gains, Congress should be careful not to allow substantial erosion of the tax preference through re-characterization.

Dividends

By synchronizing the tax rates of capital gains and dividends, Congress eliminated the tax bias toward investing in high growth-low dividend companies. Maintaining parity between the two rates is important to ensure that investors' decisions remain "tax neutral" A higher tax rate on dividends could lead investors to favor higher risk capital gains over lower risk dividend paying stocks.

Keeping tax rates low will encourage more companies to pay dividends. The Cato Institute found that 19 companies in the S&P 500 began paying dividends for the first time in the immediate aftermath of the tax reform enacted in 2003. The study also found that dividend payments by S&P 500 companies rose from $146 billion to $172 billion in the first year following the 2003 tax cut. The overall pay-out of dividends in 2005 was more than 36.5 percent higher than the payout before the 2003 tax cut, and dividend income reported by taxpayers increased by a similar margin.

In addition to promoting growth, lower dividend tax rates promote market stability. Keeping rates low helps to attract and keep shareholders who are interested in a more long-term buy and hold strategy, which benefits shareholders, companies and ultimately the economy.

When Congress reduced the rates on dividends in 2003, it took an appropriate step in the right direction to make U.S. tax laws with respect to dividends more competitive with the rest of the world. Taxes on dividends is plain and simple a double tax on corporate income. Most other developed countries provide some relief from the double tax, and the lower rates help bring the United States into a comparable position with our major trading partners. Indeed, the U.S. fully eliminated the double tax from 1913 until 1953, with the exception of three years in the 1930s.

Conversely, raising rates would have negative ramifications. Higher tax rates on dividends will encourage the use of debt financing versus equity financing. As dividend-paying stocks become less valuable, publicly traded companies will find it more difficult to finance investments through stock offerings. Deductions for debt related interest will make debt financing more advantageous.

According to the bipartisan Tax Foundation, raising dividend tax rates will disadvantage the largest dividend-paying companies and could reduce the level of dividends paid to shareholders. If this happens, all taxpayers who receive dividend income would be affected, regardless of their income level, by discouraging investment in dividend-paying companies and potentially lowering dividend payouts.

Adverse Impact on Retirees

Lower investment tax rates don't just benefit direct shareholders; they benefit the tens of millions of Americans who own stock indirectly through mutual funds, life insurance policies, pension funds, or 401(k) plans.

According to a January 2010 study by Ernst & Young, of the 27.1 million Americans who received dividend payments from utility companies in 2007, 61 percent were taxpayers age 50 and older and 30 percent were taxpayers 65 and older.

Further, according to IRS data older Americans and those saving for retirement would be disproportionately hurt by a tax increase on capital gains income. Older Americans rely on income from capital gains. For 2008, among taxpayers with capital gains income, 32 percent were over age 65. Further, 41 percent of taxpayers reporting capital gains income were between ages 45 and 65, saving for retirement. They earned nearly 50 percent of all capital gains income.

Raising taxes on investment income could depress the value of stocks held in various retirement savings plans, doubling the damage done to seniors.

Conclusion

Tax increases on investment income hinder economic growth and disproportionately affect seniors, farmers and ranchers. As the committee considers efforts to improve the tax code and promote economic growth, we urge members to maintain low rates on both capital gains and dividends.