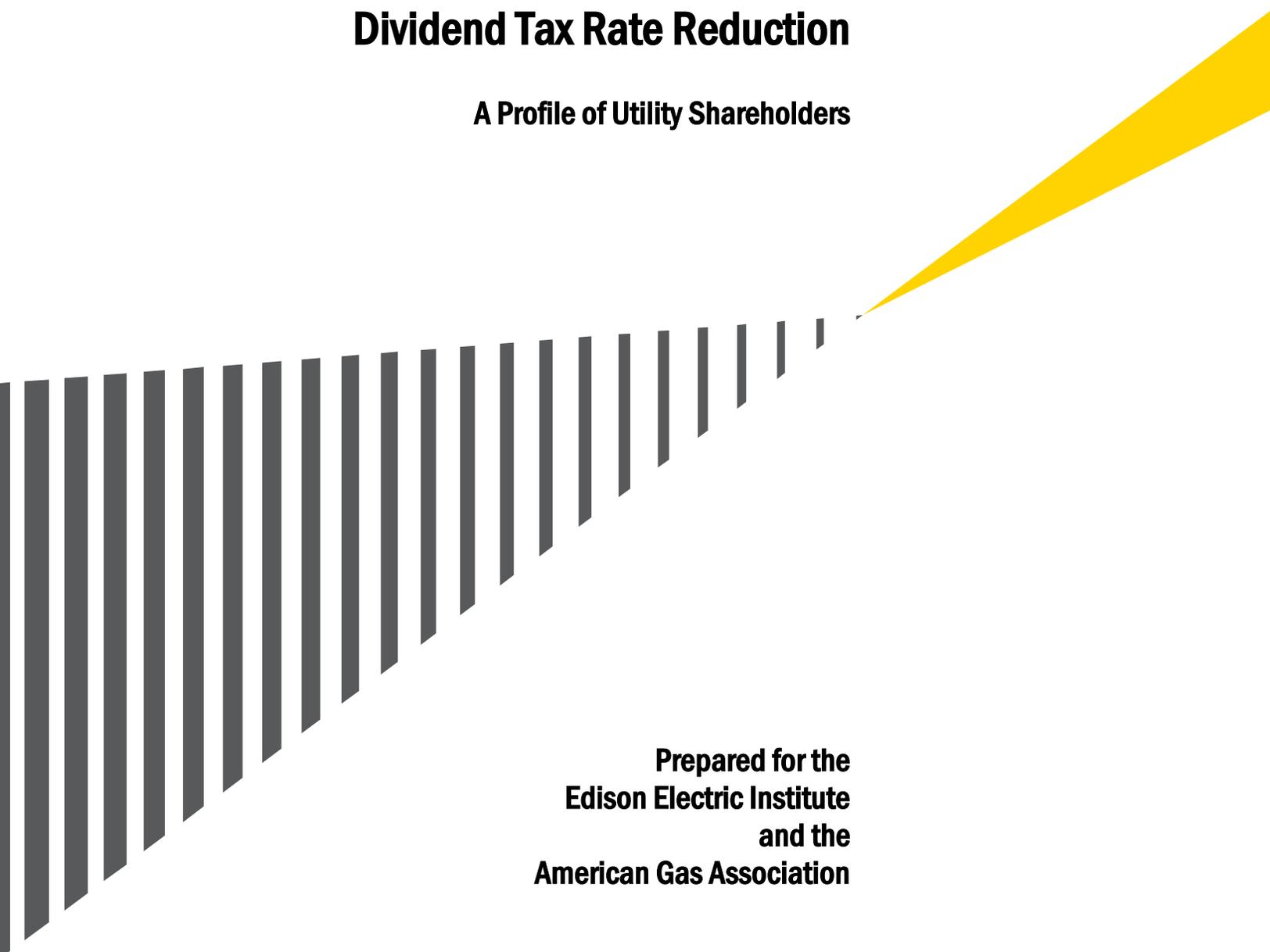


# The Beneficiaries of the Dividend Tax Rate Reduction

A Profile of Utility Shareholders



Prepared for the  
Edison Electric Institute  
and the  
American Gas Association

January 2010



# **The Beneficiaries of the Dividend Tax Rate Reduction: A Profile of Utility Shareholders**

Prepared by the Quantitative Economics and Statistics Practice  
Ernst & Young LLP

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Edison Electric Institute  
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# The Beneficiaries of the Dividend Tax Rate Reduction: A Profile of Utility Shareholders

## Executive Summary

Ernst & Young's Quantitative Economics and Statistics Practice was engaged by the Edison Electric Institute, in cooperation with the American Gas Association, to analyze the age and income characteristics of utility company shareholders who qualify for the lower tax rates on qualified corporate dividends.

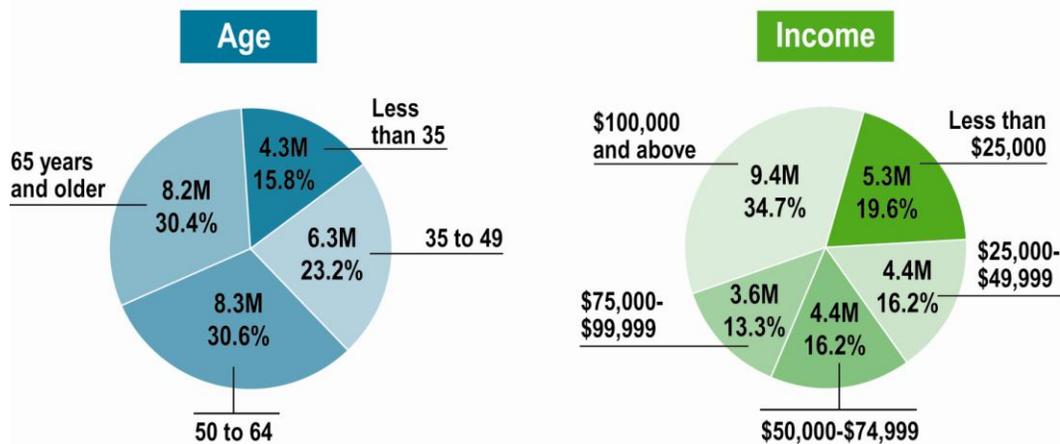
Based on information from the Internal Revenue Service's (IRS's) Statistics of Income on tax returns with qualified dividends and information from a variety of sources on investors' portfolio holdings, we have made estimates of the age and income distribution of tax returns with qualified dividends from utility stocks at the national and state levels.

In 2007, 27.1 million tax returns had dividends qualifying for the lower tax rates from equity investments. Based on our analyses of all shareholders, the percentages of tax returns with qualified dividends have the following profile:

- 61 percent are from taxpayers age 50 and older,
- 30 percent are from taxpayers age 65 and older,
- 65 percent are from returns with incomes less than \$100,000, and
- 36 percent are from returns with incomes less than \$50,000.

## Tax Returns with Qualified Dividends by Age & Income, 2007

(Millions of Returns)



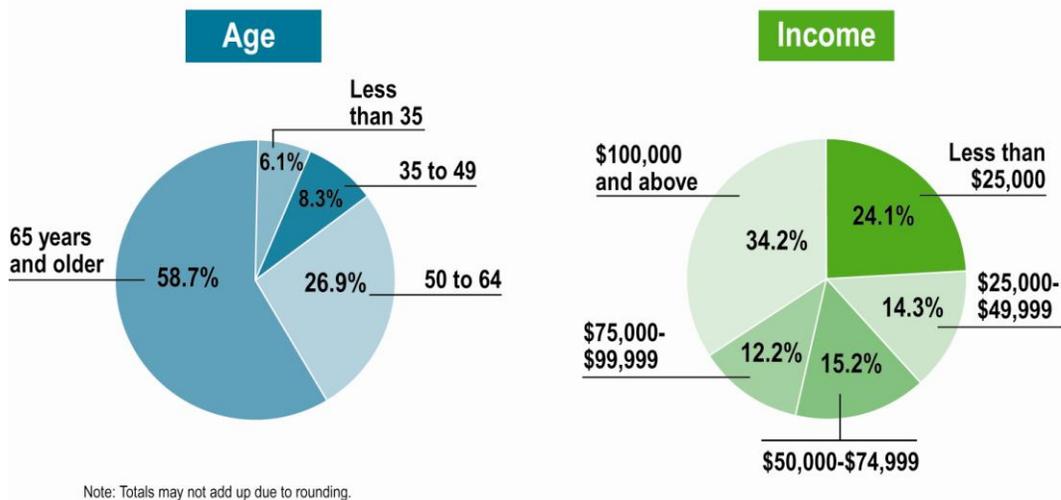
Note: Totals may not add up due to rounding.

According to the Investment Company Institute, more than one-half of older investors cite current income as a principal objective of their investment, compared to 12 percent to 15 percent for younger investors.

Looking specifically at direct shareholders of utility stocks, the percentages of tax returns with qualified dividends have the following profile:

- 86 percent are from taxpayers age 50 and older,
- 59 percent are from taxpayers age 65 and older,
- 66 percent are from returns with incomes less than \$100,000, and
- 38 percent are from returns with incomes less than \$50,000.

### Tax Returns with Qualified Dividends from Direct Utility Stocks, 2007



U.S. electric and natural gas utilities paid \$17.9 billion in dividends in 2008, and increased those dividends to \$18.5 billion in 2009. Lower tax rates on dividends have helped to increase the above-average share appreciation of utility stocks during the past six-and-a-half years, which reduces the cost of capital for the major transmission and distribution system upgrades, environmental and energy-efficiency improvements, and new capacity needs the industry is facing.

# The Beneficiaries of the Dividend Tax Rate Reduction: A Profile of Utility Shareholders

## Introduction

Ernst & Young's Quantitative Economics and Statistics Practice was engaged by the Edison Electric Institute, in cooperation with the American Gas Association, to analyze the age and income characteristics of shareholders—particularly utility company shareholders—who qualify for the lower tax rates on qualified corporate dividends.<sup>1</sup>

Utility stocks, particularly electric and natural gas utility stocks, have above-average dividend yields and below-average relative volatility compared to the overall stock market. These two key characteristics make utility equity investments attractive investments for many investors near or in retirement and investors seeking current income with reduced market volatility.

Investor surveys about the views on the risk tolerance, investment horizons, and financial goals for mutual fund investments find that investors age 65 and older invest in corporate equities, but with shorter time horizons; have an appetite for average or below-average risk (with commensurately lower expected returns); and many seek current income from their investments. Older investors are more likely to own stocks directly and also are more likely to own investments outside of tax-qualified defined contribution plans compared to younger investors.

Based on information from the Internal Revenue Service's (IRS's) Statistics of Income on tax returns with qualified dividends and information from a variety of sources on investors' portfolio holdings, we have made estimates of the age and income distribution of tax returns with qualified dividends from utility stocks at the national and state levels.

## Investor Characteristics, Utility Stock Attributes and Portfolio Considerations

*Holdings of Corporate Equities.* According to the Federal Reserve Board's Flow of Funds, households held \$15.6 trillion of corporate equities at market value at the end of the third quarter of 2009.<sup>2</sup> Households held \$7.4 trillion of corporate equities directly. Another \$8.2 trillion of corporate equities were held indirectly through life insurance companies, private pension plans, government retirement funds, and mutual funds. Equities held in pension and retirement plans and by life insurance companies generally are not subject to current taxation and would not qualify for the lower dividend tax rate. Corporate equities held through mutual funds (outside of defined contribution plans) potentially would qualify for the lower dividend tax rate, and totalled \$2.5 trillion.

Households held roughly \$9.9 trillion of corporate equities directly or through taxable mutual funds. Approximately 19 percent of the total corporate equity holdings by U.S. residents are foreign issues,<sup>3</sup> including American Depositary Receipts, which would not be eligible for the lower tax rate on dividends. Thus, at the end of the third quarter of

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<sup>1</sup> Qualified dividends eligible for the lower tax rate are dividends received by individual shareholders from domestic corporations' or foreign corporations' stocks that are readily tradable on U.S. securities markets or corporations incorporated in a U.S. possession or eligible for benefits under a comprehensive income tax treaty with the United States.

<sup>2</sup> Board of Governors of the Federal Reserve System, Flow of Funds Accounts of the United States, Flows and Outstanding Fourth Quarter 2008, Z1, December 10, 2009, Table B.100.e. Includes households and non-profit organizations.

<sup>3</sup> Federal Reserve, Flow of Funds, Table L. 213.

2009, approximately \$8 trillion of corporate equity of U.S. corporations were held in taxable form by U.S. households. Approximately 75 percent were held directly by households and 25 percent were held indirectly through mutual funds.

The Federal Reserve Board's Survey of Consumer Finances shows the percent of families that hold bonds, stocks, pooled investment funds (mutual and money market funds), and retirement accounts by age and income, as shown in Table 1. Families in which the head of household is age 55 or older are more likely to hold corporate equities directly than younger families, who are somewhat more likely to hold financial investments through mutual funds.

**Table 1. Holdings of Selected Financial Assets by Age and Income, 2007 (Percent of Families)**

	Bonds	Stocks	Pooled Investment Funds	Retirement accounts
<b>All families</b>	<b>1.6</b>	<b>17.9</b>	<b>11.4</b>	<b>52.6</b>
<i>Percentile of income</i>				
Less than 20	*	5.5	3.4	10.7
20-39.9	*	7.8	4.6	35.6
40-59.9	*	14.0	7.1	55.2
60-79.9	1.4	23.2	14.6	73.3
80-89.9	1.8	30.5	18.9	86.7
90-100	8.9	47.5	35.5	89.6
<i>Age of head ( years)</i>				
Younger than 35	*	13.7	5.3	41.6
35-44	0.7	17.0	11.6	57.5
45-54	1.1	18.6	12.6	64.7
55-64	2.1	21.3	14.3	60.9
65-75	4.2	19.1	14.6	51.7
75 or older	3.5	20.2	13.2	30.0

Source: Bucks, Brian K. *Recent Changes in the US Family Finances: Evidence from the 2004 and 2007 Survey of Consumer Finances*, p.A18.

*Investors' Risk Tolerance, Investment Horizons and Financial Goals.* Academic and government studies of households' financial portfolios do not identify different types of assets beyond the general level of equities, bonds, mutual funds, and retirement assets. We were unable to find any prior studies that present or estimate the percent of households investing in utility equities. However, studies on investors' preferences and attributes of utility stocks are available, and can serve as a basis for an estimate of utility stock holdings by age and income.

The Investment Company Institute publishes results on investors' views of mutual funds from a periodic survey of nearly 2,000 mutual fund investors.<sup>4</sup> Table 2 presents the results of a 2009 survey by age. Table 2 shows:

- Mutual fund investors age 65 and older are less likely than younger investors to take above-average or substantial risks, even for above-average or substantial gains.
- Of elderly mutual fund investors, 87 percent are willing to take only average or below-average risks, or no risks at all, in their financial investing compared to 63 percent for investors younger than 40.
- Older investors tend to have shorter planning horizons for household saving and spending, with more than half of investors age 65 and older citing planning horizons of less than five years.
- More than half of older investors cite current income as a principal objective of their mutual fund investment, compared to 12 percent to 15 percent for younger investors.

The data do not suggest that investors age 65 and older shun equities in favor of bonds or fixed-income investments. More than two-thirds of mutual fund investors age 65 and older invest in equity mutual funds and 45 percent invest in individual stocks directly.

Older investors have different objectives and risk tolerances. They are likely to favor individual stocks, higher dividend yields, and lower market volatility. Similarly, older investors are more likely to favor income mutual funds and value funds, which have higher percentages of underlying utility investments.

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<sup>4</sup> Investment Company Institute, Annual Mutual Fund Shareholder Tracking Survey, 2009. The most recent survey was conducted in May 2009 and was based on a sample of 4,201 U.S. households randomly selected, of which 1,805 households, or 43 percent, owned mutual funds.

**Table 2. Mutual Fund Views and Characteristics, by Age, 2009**  
(Percent of mutual fund-owning households by age)

	Younger than 40	40 to 64	65 Years or Older
<b>Level of risk willing to take with financial investments:</b>			
Substantial risk for substantial gain	7%	4%	2%
Above-average risk for above-average gain	30	27	11
Average risk for average gain	49	50	51
Below-average risk for below-average gain	8	10	15
No risk at all	6	9	21
<b>Time horizon when planning household saving and spending:</b>			
The next few months	14%	12%	17%
The next year	8	11	11
The next few years	18	20	25
The next five to 10 years	18	35	31
Longer than 10 years	42	22	16
<b>Financial goals for mutual fund investments:<sup>1</sup></b>			
Retirement	96%	96%	88%
Emergency	42	43	63
Current income	12	15	56
Reduce taxable income	43	53	46
Education	39	25	7
House or other large purchase	19	8	5
<b>Percent of Mutual Fund-Owning Households Own:<sup>1</sup></b>			
Equity Mutual Funds	77%	79%	69%
Bond Mutual Funds	47	49	50
Hybrid Funds	41	43	40
Money Market Funds	58	66	66
Individual stocks	37	44	45
Individual bonds (excluding U.S. savings bonds)	7	14	24
Fixed or variable annuities	17	30	40

<sup>1</sup>Multiple responses are included.

Source: The Investment Company Institute, Washington, DC, *Annual Mutual Fund Shareholder Tracking Survey*, 2009.

This tendency of investors nearing or in retirement (and investors with low- and medium-risk tolerance) to favor investments focused on income or investments balanced toward growth and income is reflected in an Edward Jones portfolio guidance,<sup>5</sup> shown in Table 3. Investors in retirement years and with lower risk tolerances will favor investments focused more on balanced growth and income, and thus favor equity investments that pay higher dividend yields and with lower market volatility.

<sup>5</sup> Edward Jones, Portfolio Objective Guidance Table as determined by the Edward Jones Investment Policy Advisory Committee, posted on firm Web site as of December 2009.

**Table 3. Portfolio Objective Guidance Table by Investor Life Stages and Risk Tolerance**

		INVESTOR LIFE STAGES				
		Early Investing Years	Good Earnings Years	Higher Income & Savings Years	Early Retirement Years	Late Retirement Years
INVESTOR RISK TOLERANCE	High	Growth Focus	Growth Focus	Growth Focus	Growth Focus	Balanced toward Growth
	Medium to High	Growth Focus	Growth Focus	Growth Focus	Balanced toward Growth	Balanced toward Growth
	Medium	Growth Focus	Growth Focus	Balanced toward Growth	Balanced toward Growth	Balanced Growth & Income
	Low to Medium	Balanced toward Growth	Balanced toward Growth	Balanced toward Growth	Balanced Growth & Income	Balanced toward Income
	Low	Balanced toward Growth	Balanced Growth & Income	Balanced Growth & Income	Balanced toward Income	Income Focus

Numerous factors can cause you to adjust your portfolio objective from those suggested in the table, including your:

- Current and future income needs
- Amount of existing savings
- Investing time horizon
- Estate-planning considerations

Please note that if you adjust your Portfolio Objective, it does not mean that your risk tolerance has changed.

The Portfolio Objective Guidance Table as determined by the Edward Jones Investment Policy Advisory Committee.

Source: Edward Jones: The Portfolio Objective Guidance Table as determined by the Edward Jones Investment Policy Advisory Committee.

**Utility Stock Attributes.** Utility stocks, consisting of shares of electric utilities, water utilities, and natural gas utilities, tend to pay relatively high dividend rates and have lower volatility than the overall corporate equity market. Thus, utility stocks generally are perceived as being less risky and more for income-oriented investors. In terms of mutual fund selection, utility stocks are less likely to be included in growth portfolios and are more likely to be included in value portfolios and income portfolios.

U.S. electric and gas utilities paid \$17.9 billion of dividends in 2008, and increased those dividends to \$18.5 billion in 2009.<sup>6</sup> Lower tax rates on dividends have helped increase the above-average share appreciation of utility stocks during the past six-and-a-half years, which reduces the cost of capital for the major transmission and distribution upgrades, environmental and energy-efficiency improvements, and new capacity needs the industry is facing.

Utilities have an above-average dividend payout ratio and a high dividend yield. For the 12 months ended September 30, 2009, U.S. shareholder-owned utilities paid out 56 percent of their net income as dividends, with a dividend yield of 4.2 percent by the end of 2009—both measures significantly higher than most other sectors.<sup>7</sup> Thus, utility stocks are attractive for investors seeking current income. Table 4 compares the dividend payout ratio and yield of the utility sector to a number of other sectors.

<sup>6</sup> Edison Electric Institute, Q4 2009 Financial Update.

<sup>7</sup> Edison Electric Institute, Q4 2009 Financial Update, Dividends.

**Table 4. Dividend Payout Ratio and Yield for Selected Sectors**

Sector	Payout Ratio (%)	Sector	Yield (%)
Financial	57.0	Utilities	4.2%
Utilities	55.9	Consumer Staples	2.8%
Materials	52.3	Industrial	2.5%
Industrial	45.5	Health Care	2.0%
Consumer Staples	41.8	Energy	1.8%
Energy	36.9	Materials	1.7%
Technology	29.9	Financial	1.5%
Consumer Discretionary	28.0	Technology	1.4%
Health Care	25.6	Consumer Discretionary	1.3%

Source: Edison Electric Institute Q4 2009 Financial Update. The dividend payout ratio is for the 12-month period through September 2009. The yield is for the 12-month period through December 31, 2009.

Electric and natural gas utility stocks also have, on average, a low volatility compared to the overall market, and lower than most other industries. A common measure of relative market volatility is the Beta, which is set at one for companies or industries that have the same volatility as the overall stock market. Companies and industries that have a Beta less than one are less volatile than the overall market, while companies and industries with Betas greater than one are more volatile than the overall market. For electric utility companies, the Beta was 0.83 as of January 2009; for natural gas utility companies, the Beta was 0.77. In both cases, this is much lower than the industry average of 2.46. Table 5 shows Betas for a number of industries.

Modern portfolio theory recommends that investors balance the trade-off between risk and return with adjustments in the amount of their portfolio held in fixed-income securities and equities. Modern portfolio theory generally treats equities in terms of general indices without making sector adjustments, thus the percentage of utility equities would be the same regardless of age, income, or risk tolerance, since adjustments would be made in the composition of bonds, equities, and cash. Accordingly, when comparing life-cycle funds, which are designed for investors with a target retirement date, the composition of equities does not change greatly. In the case of Fidelity target retirement funds, utilities represent 2.7 percent of equities in the Fidelity Freedom 2010 Fund (for retired investors), while utilities represent 2.8 percent of equities in the Fidelity Freedom 2040 Funds. The higher utility share for current retirees reflects a smaller share of non-U.S. equities, which are not eligible for the qualified dividend tax rate reduction.

Survey responses from investor relations departments of several large electric utilities indicate that a majority of their direct shareholders are age 65 and older, and are more likely to be middle-income investors. A proprietary age and income distribution of utility shareholders from one brokerage company's customer base shows utility stocks are much more likely to be held by investors age 50 and older and with a proportionately higher share among middle-income investors.

**Table 5. Industry Stock Market Beta for Selected Industries, January 2009**

<b>Industry Name</b>	<b>Beta</b>	<b>Industry Name</b>	<b>Beta</b>
Natural Gas Util	0.77	Telecom. Services	3.20
Electric Utilities	0.83	Retail (Special Lines)	3.50
Water Utility	1.03	Medical Supplies	3.68
Bank	1.10	Drug	3.94
Financial Svcs. (Div.)	1.22	Electronics	3.96
Food Processing	1.84	Computer Software/Svcs	4.31
<b>Total Market</b>	<b>2.46</b>	Biotechnology	4.33
Machinery	2.64	Semiconductor	5.76
Petroleum (Producing)	2.70	Telecom. Equipment	6.15
Medical Services	2.89	Internet	6.33
Industrial Services	3.07		

Source: Damodaran, Aswath. (January 2009). NYU Stern School of Business faculty website:  
[http://pages.stern.nyu.edu/~adamodar/New\\_Home\\_Page/datafile/Betas.html](http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/Betas.html)

Based on these data sources, we have adjusted the national relationship of income and age for all tax returns reporting qualified dividend income in 2007 to estimate the income and age distribution of utility shareholdings. The distribution is of shareholders, rather than the value of the shares or the value of the dividends.

### **The Demographics of Utility Shareholders with Qualified Dividends by Age and Income**

Empirical information about ownership of specific types of equities is limited, compared to the significant literature on portfolio ownership across major types of investments. Information about general equities is generally limited to direct and indirect holdings through mutual funds, and whether the mutual funds are inside or outside of defined contribution plans.

Based on information from a limited number of electric utility investor relations departments from an Edison Electric Institute survey, electric utility investors are heavily weighted toward older investors and middle-income investors. This is consistent with the recommendations for more income-focused stocks and funds suggested by many financial planners, given the risk tolerance of many investors at or near retirement age.

One brokerage company's proprietary account information provided a comparison of the distribution by age and income of ownership of utility stocks with the distribution by age and income of overall stock ownership. This information was used to estimate the percentage of taxpayers with qualified dividends who were likely to own utility stocks.

It is useful to start with the age and income distribution for total households from the U.S. Census Bureau, shown in Table 6. Households in which the head of household is age 65 or older account for 21 percent of all households, and those in which the head of household is between ages 50 to 64 account for 27 percent of all households. Hence, households in which the head of household is age 50 or older account for 48 percent of all households; and those with the head of household younger than 50 account for more than half of all households.

**Table 6. Households, by Age & Income, 2007**

Number of Households (in millions)					
Income	Less than 35 years	35 to 49 years	50 to 64 years	65 years or older	Total
Less than \$25,000	6.5	5.6	6.3	10.6	29.0
\$25,000 - \$49,999	7.6	7.7	6.8	6.9	29.1
\$50,000 - \$74,999	5.2	7.2	6.0	2.9	21.3
\$75,000 - \$99,999	3.0	5.2	4.2	1.5	13.8
\$100,000 and above	3.5	9.3	8.5	2.2	23.6
Total	25.8	35.1	31.8	24.1	116.8
Percent of All Households					
Income	Less than 35 years	35 to 49 years	50 to 64 years	65 years or older	Total
Less than \$25,000	6%	5%	5%	9%	25%
\$25,000 - \$49,999	7%	7%	6%	6%	25%
\$50,000 - \$74,999	4%	6%	5%	2%	18%
\$75,000 - \$99,999	3%	4%	4%	1%	12%
\$100,000 and above	3%	8%	7%	2%	20%
Total	22%	30%	27%	21%	100%

Source: U.S. Census Bureau, Table HINC-02, Current Population Survey, March 2008 Supplement.

Totals may not add due to rounding.

Based on the total number of tax returns, tax returns are more heavily weighted to younger taxpayers who are younger than 35 years of age, due to more single taxpayers and child tax returns. Returns filed by taxpayers age 65 and older accounted for 13 percent of all individual income tax returns in 2007, with almost two-thirds of those returns with adjusted gross income (AGI) of less than \$50,000, as shown in Table 7.

**Table 7. All Tax Returns, by Age & Income, 2007**

Size of adjusted gross income (AGI)	Number of Returns (in millions)				All Returns
	Less than 35 years	35 to 49 years	50 to 64 years	65 years or older	
Less than \$25,000	31.8	11.7	7.8	7.6	58.9
\$25,000 - \$49,999	11.7	11.0	8.0	4.2	34.9
\$50,000 - \$74,999	4.1	6.8	5.8	2.8	19.5
\$75,000 - \$99,999	1.7	4.5	3.8	1.7	11.7
\$100,000 and above	1.6	7.0	6.7	2.7	18.0
Total	50.9	40.9	32.1	19.1	143.0

AGI	Percent of All Returns				All Returns
	Less than 35 years	35 to 49 years	50 to 64 years	65 years or older	
Less than \$25,000	22%	8%	5%	5%	41%
\$25,000 - \$49,999	8%	8%	6%	3%	24%
\$50,000 - \$74,999	3%	5%	4%	2%	14%
\$75,000 - \$99,999	1%	3%	3%	1%	8%
\$100,000 and above	1%	5%	5%	2%	13%
Total	36%	29%	22%	13%	100%

Source: IRS Statistics of Income, special tabulation. Total may not add due to rounding.

The Internal Revenue Service (IRS) Statistics of Income (SOI) reported that 27.1 million tax returns included qualified dividends in 2007, reporting \$155.9 billion of qualified dividends. Based on a special tabulation from the IRS Statistics of Income, Table 8 shows the distribution of returns with qualified dividends by age and income. While roughly one-third of all Form 1040 returns were filed by taxpayers age 50 or older, 61 percent of returns with qualified dividends were filed by the same age group. Taxpayers with less than \$100,000 of AGI accounted for 65 percent of the tax returns with qualified dividends.

To estimate the number of tax returns with qualified dividends from utility stocks, we used information from several sources. Taxpayers could directly hold shares of stock in individual utility corporations or indirectly through mutual funds or financial assets, including life insurance, annuities, and pension funds. Since qualified dividends come from taxable sources, qualified dividends from utilities would come from direct holdings of utility stocks or indirect holdings of taxable mutual funds whose underlying investments include utility stocks.

The Investment Company Institute (ICI) estimates that, on average, between 2005 and 2009, approximately 13.3 million households had stock or hybrid mutual funds in taxable accounts.<sup>8</sup> These mutual funds are held outside of 401k and Individual Retirement Accounts. Hybrid mutual funds comprise balanced funds that include equities, bonds, and other investments. Based on ICI data on the age and income distribution of households with taxable equity and hybrid mutual funds, our estimate assumes most households with taxable equity mutual funds indirectly hold some utility stocks given the diversification of mutual fund holdings.

**Table 8. Tax Returns with Qualified Dividends, by Age & Income, 2007**

Size of adjusted gross income (AGI)	Number of Returns (in millions)					All Returns
	Less than 35 years	35 to 49 years	50 to 64 years	65 years or older		
Less than \$25,000	2.1	0.4	0.8	2.0		5.3
\$25,000 - \$49,999	0.7	0.8	1.3	1.7		4.4
\$50,000 - \$74,999	0.5	1.0	1.4	1.5		4.4
\$75,000 - \$99,999	0.3	1.0	1.3	1.0		3.6
\$100,000 and above	0.6	3.1	3.6	2.1		9.4
Total	4.3	6.3	8.3	8.2		27.1

AGI	Percent of All Returns with Qualified Dividends					All Returns
	Less than 35 years	35 to 49 years	50 to 64 years	65 years or older		
Less than \$25,000	8%	2%	3%	7%		20%
\$25,000 - \$49,999	3%	3%	5%	6%		16%
\$50,000 - \$74,999	2%	4%	5%	5%		16%
\$75,000 - \$99,999	1%	4%	5%	4%		13%
\$100,000 and above	2%	11%	13%	8%		35%
Total	16%	23%	31%	30%		100%

Source: IRS Statistics of Income, special tabulation. Totals may not add due to rounding.

EY estimates that approximately 13.2 million tax returns with qualifying dividends had some utility holdings through taxable mutual funds. The percentage of tax returns with qualifying dividends from taxable mutual funds with utility holdings was 59 percent for taxpayers with an AGI of less than \$100,000, while 54 percent of those tax returns were from taxpayers ages 50 and older, and 21 percent were from taxpayers ages 65 and older.

The remaining 13.9 million tax returns with qualifying dividends are estimated to be receiving dividends from direct holdings of equity shares in individual companies. To determine the percentage of those returns that have some direct utility stock investments, we used information on direct utility stock investments and general stock and mutual fund investments from a major brokerage firm. From this information, we calculated the percentage of investors in a given age and income group that owned stock directly and also owned individual utility stocks.

On average, 23 percent of investors who owned direct equity shares owned some utility company shares. The propensity of investors to own utility stocks directly, conditional on their owning some direct equities, ranged from 8

<sup>8</sup> Special tabulation of data from the Investment Company Institute. See "Ownership of Mutual Funds, Shareholder Sentiment, and Use of the Internet, 2009," *ICI Fundamentals*, Vol. 18, No 7 (December 2009) for the most recent survey information; and "Trends in Ownership of Mutual Funds in the United States, 2007," *ICI Fundamentals*, Vol. 16, No 5 (November 2007) for a description of the weighting methodology.

percent for investors age 35 or younger with incomes of \$50,000 and less up to 36 percent for investors age 65 and older with incomes of \$100,000 and more. This relationship was consistent with the other information on investor risk tolerance, investment horizon, and investment objectives. Older investors were more likely to invest in utility stocks than younger investors, and utility stock ownership increased slightly with income level.

Table 9 shows the estimated 16.3 million tax returns with qualified dividends through ownership in utility stocks either directly through investments in shares of individual companies or indirectly through taxable mutual funds. Many other households own utility stocks through their insurance and retirement accounts, which are not taxed currently. Of tax returns with qualified dividends, 60 percent are estimated to have some utility holdings. This is likely a conservative number since some investors may hold shares in utility companies outside of brokerage firms or have stock holdings in multiple brokerage firms.

*Age and Income Profile of Returns with Direct and Indirect Utility Holdings.* Of tax returns with qualified dividends from direct and indirect utility holdings:

- 60 percent have incomes less than \$100,000,
- 60 percent are taxpayers age 50 and older, and
- 28 percent are taxpayers age 65 and older.

*Age and Income Profile of Returns with Direct Utility Stock Holdings.* The income and age composition of direct utility company stock holdings is more concentrated among lower-income and elderly taxpayers. Of tax returns with qualified dividends from direct utility investments:

- 66 percent have incomes less than \$100,000,
- 38 percent have incomes less than \$50,000,
- 86 percent are from taxpayers age 50 and older, and
- 59 percent are from taxpayers age 65 and older.

Investors in individual utility stocks are much more likely to be seeking above-average dividend yields and lower risk tolerance, and thus are more likely to be held by investors near or in retirement and with low- or middle-class incomes.

**Table 9. Estimate of Tax Returns with Qualified Dividends from Utility Stocks, by Age & Income, 2007**

<b>Number of Returns with Qualified Dividends from Utility Stocks (in millions)</b>					
Size of adjusted gross income (AGI)	Less than 35 years	35 to 49 years	50 to 64 years	65 years or older	All Returns
Less than \$25,000	0.25	0.18	0.31	0.81	1.55
\$25,000 - \$49,999	0.38	0.55	0.67	1.16	2.75
\$50,000 - \$74,999	0.46	0.78	0.88	0.91	3.03
\$75,000 - \$99,999	0.28	0.68	0.88	0.62	2.46
\$100,000 and above	0.60	2.40	2.37	1.13	6.50
Total	1.97	4.59	5.11	4.62	16.30

<b>Percent of Returns with Qualified Dividends from Direct and Indirect Utility Holdings</b>					
Size of AGI	Less than 35 years	35 to 49 years	50 to 64 years	65 years or older	All Returns
Less than \$25,000	2%	1%	2%	5%	10%
\$25,000 - \$49,999	2%	3%	4%	7%	17%
\$50,000 - \$74,999	3%	5%	5%	6%	19%
\$75,000 - \$99,999	2%	4%	5%	4%	15%
\$100,000 and above	4%	15%	15%	7%	40%
Total	12%	28%	31%	28%	100%
Less than \$25,000					

<b>Percent of Returns with Qualified Dividends from Direct Utility Investments</b>					
Size of AGI	Less than 35 years	35 to 49 years	50 to 64 years	65 years or older	All Returns
Less than \$25,000	5%	1%	3%	15%	24%
\$25,000 - \$49,999	1%	1%	4%	8%	14%
\$50,000 - \$74,999	0%	1%	4%	10%	15%
\$75,000 - \$99,999	0%	1%	3%	8%	12%
\$100,000 and above	0%	4%	12%	18%	34%
Total	6%	8%	27%	59%	100%

Source: E&Y Calculations. Totals may not add due to rounding.

## **Estimates of Demographics of Utility Shareholders Qualifying for the Lower Federal Tax Rate on Qualified Dividends by Age and Income, by State**

Based on the national estimate of federal individual income tax returns with qualified dividends from utility stocks, we estimated the age and income distribution of returns with qualified dividends from utility stocks for each of the 50 states.

Information on the age and income distributions within each of the 50 states is available from the U.S. Census Bureau. Based on the estimated propensity of different age and income groups to have taxable mutual equity funds and direct individual stock holdings, we adjusted the national distribution to reflect the relative age and income composition of the households within each state.

Table 10 shows the state-by-state breakdown of percentage of federal individual income tax returns with qualified dividends and also the estimate of those returns with utility holdings. Of the 154.7 million federal tax returns, 27.1 million—or 18 percent—of those returns have qualified dividends benefiting from the lower federal tax rate. An estimated 16.3 million—or 60 percent—of those returns have qualifying dividends from utility holdings. The percentages vary by state.

Table 11 shows the state-by-state breakdown of federal individual income tax returns, by age and income, with qualifying dividends with utility holdings as well as with direct stock investments. As noted above, the majority of tax returns with qualifying dividends from utility holdings is from taxpayers who have incomes less than \$100,000 and are age 50 and older. About two-thirds of tax returns with qualified dividends from direct utility stock holdings are from taxpayers who have incomes less than \$100,000, and 59 percent are age 65 and older. The percent of returns with qualifying dividends that have utility holdings among taxpayers 65 and older ranges from 17 percent in Alaska to 38 percent in Florida.

**Table 10. Returns with Qualified Dividends and Utility Holdings in 2007, by State (Numbers in Millions)**

State	Number of Returns	Returns with Qualified Dividends		Number of Returns with Utility Holdings <sup>1</sup>	Percent of Returns with Qualifying Dividends with Utility Holdings <sup>1</sup>
		Number	Percent		
U.S. National	154.71	27.15	18%	16.30	60%
Alabama	2.35	0.28	12%	0.16	59%
Alaska	0.37	0.08	22%	0.05	59%
Arizona	2.90	0.48	17%	0.29	60%
Arkansas	1.39	0.17	12%	0.10	59%
California	17.60	2.97	17%	1.79	60%
Colorado	2.46	0.51	21%	0.30	60%
Connecticut	1.87	0.48	26%	0.29	61%
Delaware	0.45	0.09	20%	0.05	61%
District of Columbia	0.32	0.06	19%	0.04	60%
Florida	9.69	1.59	16%	0.97	61%
Georgia	4.56	0.65	14%	0.38	59%
Hawaii	0.69	0.14	20%	0.08	62%
Idaho	0.72	0.11	16%	0.07	59%
Illinois	6.56	1.33	20%	0.80	60%
Indiana	3.24	0.52	16%	0.31	60%
Iowa	1.54	0.32	21%	0.19	60%
Kansas	1.40	0.27	19%	0.16	60%
Kentucky	2.14	0.28	13%	0.16	59%
Louisiana	1.58	0.26	16%	0.15	59%
Maine	0.73	0.13	17%	0.08	60%
Maryland	2.94	0.58	20%	0.35	61%
Massachusetts	3.46	0.78	22%	0.47	61%
Michigan	5.02	0.94	19%	0.56	60%
Minnesota	2.73	0.60	22%	0.36	60%
Mississippi	1.44	0.14	9%	0.08	59%
Missouri	3.01	0.54	18%	0.33	60%
Montana	0.51	0.10	20%	0.06	59%
Nebraska	0.92	0.19	20%	0.11	60%
Nevada	1.35	0.17	13%	0.10	60%
New Hampshire	0.72	0.16	22%	0.09	60%
New Jersey	4.58	1.11	24%	0.68	61%
New Mexico	0.98	0.13	14%	0.08	59%
New York	9.92	2.00	20%	1.21	60%
North Carolina	4.60	0.71	15%	0.42	60%
North Dakota	0.34	0.07	19%	0.04	59%
Ohio	6.12	1.10	18%	0.66	60%
Oklahoma	1.77	0.23	13%	0.13	59%
Oregon	1.91	0.35	18%	0.21	60%
Pennsylvania	6.70	1.43	21%	0.86	60%
Rhode Island	0.57	0.11	19%	0.06	60%
South Carolina	2.26	0.31	14%	0.19	60%
South Dakota	0.42	0.08	19%	0.05	60%
Tennessee	3.16	0.39	12%	0.23	59%
Texas	11.28	1.49	13%	0.88	59%
Utah	1.19	0.16	14%	0.10	60%
Vermont	0.34	0.08	22%	0.05	60%
Virginia	4.02	0.79	20%	0.48	60%
Washington	3.37	0.68	20%	0.40	60%
West Virginia	0.93	0.11	12%	0.07	59%
Wisconsin	2.96	0.64	22%	0.38	60%
Wyoming	0.28	0.05	19%	0.03	59%

<sup>1</sup> Utility holdings include direct utility stock investments and indirect holdings through taxable mutual funds  
Source: IRS Statistics of Income; E&Y Calculations

**Table 11. Share of Returns with Qualified Dividends from Utility Stocks for Selected Income and Age Groups in 2007, By State**

State	Percent of Returns with Qualifying Dividends					
	<u>With Utility Holdings<sup>1</sup></u>			<u>With Direct Utility Stock</u>		
	AGI under \$100k	Taxpayer 50 and older	Taxpayer 65 and older	AGI under \$100k	Taxpayer 50 and older	Taxpayer 65 and older
U.S. National	60%	60%	28%	66%	86%	59%
Alabama	69%	63%	30%	74%	86%	61%
Alaska	53%	52%	17%	56%	79%	41%
Arizona	63%	61%	32%	68%	86%	62%
Arkansas	74%	64%	33%	79%	86%	63%
California	51%	57%	27%	57%	85%	57%
Colorado	57%	54%	23%	63%	82%	51%
Connecticut	49%	60%	28%	55%	87%	58%
Delaware	58%	60%	29%	64%	87%	59%
District of Columbia	50%	60%	30%	56%	86%	62%
Florida	64%	67%	38%	67%	90%	69%
Georgia	59%	55%	23%	66%	82%	52%
Hawaii	53%	67%	35%	53%	90%	66%
Idaho	71%	61%	28%	75%	84%	57%
Illinois	57%	58%	27%	63%	85%	57%
Indiana	67%	60%	27%	73%	85%	57%
Iowa	73%	63%	32%	76%	87%	63%
Kansas	67%	61%	30%	71%	85%	60%
Kentucky	71%	60%	29%	76%	85%	59%
Louisiana	69%	61%	29%	75%	84%	59%
Maine	72%	62%	30%	76%	87%	61%
Maryland	51%	59%	26%	56%	86%	56%
Massachusetts	52%	58%	27%	60%	86%	58%
Michigan	60%	59%	27%	66%	85%	56%
Minnesota	61%	56%	25%	68%	84%	55%
Mississippi	74%	63%	31%	78%	85%	61%
Missouri	68%	62%	30%	73%	86%	60%
Montana	76%	65%	32%	80%	86%	60%
Nebraska	70%	61%	31%	74%	86%	61%
Nevada	63%	59%	27%	67%	85%	56%
New Hampshire	59%	57%	25%	64%	85%	54%
New Jersey	48%	59%	27%	54%	87%	58%
New Mexico	69%	63%	31%	73%	85%	60%
New York	54%	60%	29%	61%	87%	60%
North Carolina	66%	59%	28%	71%	85%	58%
North Dakota	76%	63%	33%	80%	85%	63%
Ohio	66%	61%	29%	71%	86%	59%
Oklahoma	72%	63%	32%	76%	85%	61%
Oregon	65%	61%	29%	70%	86%	58%
Pennsylvania	65%	63%	32%	71%	88%	62%
Rhode Island	62%	62%	30%	68%	87%	62%
South Carolina	69%	62%	29%	73%	86%	59%
South Dakota	75%	63%	33%	79%	86%	63%
Tennessee	68%	61%	28%	73%	85%	58%
Texas	60%	56%	25%	67%	82%	55%
Utah	63%	56%	26%	67%	82%	55%
Vermont	68%	62%	28%	71%	86%	58%
Virginia	55%	59%	26%	60%	85%	56%
Washington	60%	58%	26%	66%	84%	55%
West Virginia	77%	67%	35%	81%	87%	64%
Wisconsin	67%	60%	28%	72%	85%	58%
Wyoming	73%	62%	28%	77%	84%	57%

<sup>1</sup> Utility holdings include direct utility stock investments and indirect holdings through taxable mutual funds

Source: E&Y Calculations

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