

**THE ALLIANCE FOR SAVINGS AND INVESTMENT
STATEMENT**

**TO THE
COMMITTEE ON WAYS AND MEANS
AND THE SENATE COMMITTEE ON FINANCE
FOR THE SEPTEMBER 20, 2012 JOINT HEARING RECORD
REGARDING TAX REFORM AND THE TAX TREATMENT OF
CAPITAL GAINS**

SEPTEMBER 20, 2012

The Alliance for Savings and Investment (ASI) is a diverse coalition of dividend-paying companies, investor organization 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. ASI members include: AGL Resources, Altria, American Forest & Paper Association, American Gas Association (AGA), AT&T, Capital Research & Management Company, CenturyLink, Charles Schwab, Edison Electric Institute (EEI), Frontier Communication, Investment Company Institute (ICI), Laclede Gas Company, MassMutual Life Insurance, National Association of Water Companies, New York Life, NYSE, RAI Service, Securities Industry and Financial Markets Association (SIFMA), Southern Company, Spectra Energy, The Coca-Cola Company, United Parcel Service (UPS), United States Telecom, Vanguard, Verizon, Windstream Corp, Xcel Energy

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We thank Chairman Camp, Chairman Baucus, Ranking Member Levin and Ranking Member Hatch for the opportunity to comment on the impact of increased tax rates on investment income. The ASI's top legislative priority is making permanent today's current tax rates on capital gains and dividends to provide certainty to investors, stability to the economy and a strong foundation for long-term economic growth and job creation.

Background

Historically, the U.S. has provided preferential rates for investment income. Prior to 1986, a portion of long-term capital gains was typically excluded from income. While the Tax Reform Act of 1986 repealed the exclusion, the top income tax rate was also reduced from 50 percent to 28 percent. When top rates began to rise again, Congress decoupled capital gains and income, lowering the capital gains rate to 20 percent in 1997 and 15 percent in 2003.

The 2003 Act took two important steps to boost economic growth. First, it lowered the maximum rate on capital gains to 15 percent. Second, it tied capital gains and dividend income together, lowering the rate on dividends from the top income tax rate to 15 percent. Unfortunately, those rates will sunset – increasing the capital gains tax from 15 percent to 20 percent and more than doubling the dividend rate from 15 percent to 39.6 percent. In addition, beginning in 2013 investment income will be subject to an additional Medicare HI tax of 3.8 percent, raising the top rate on dividend income from 39.6 to 43.4 percent and capital gains to 23.8 percent.

Economic Impact

Allowing the rates to expire could have a significantly negative impact on economic growth. According to the Heritage Foundation, higher investment tax rates would lead to 270,000 fewer jobs in 2018.

In addition to harming the economy, the impact of capital gains tax increases would be borne by millions of Americans, across all income levels. According to IRS data, in 2009, more than 3 million returns with long-term capital gains were filed. Sixty-two 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. Nationwide, 40 percent of all agricultural producers report some capital gains; nearly double the share for all taxpayers. In addition, the average amount of capital gain reported by farmers is about 50 percent higher than 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.

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 toward making U.S. dividend tax laws more competitive with the rest of the world. Taxes on dividends are simply a double tax on corporate income. Indeed, the U.S. fully eliminated the double tax from 1913 until 1953, with the exception of three years in the 1930s. 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. Without Congressional action in 2013, the United States will have the highest integrated dividends tax rate.

Conversely, raising rates would have negative ramifications. Higher tax rates on dividends will encourage companies to use 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 and the value of stock held through 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. For 2009, among taxpayers with qualified dividend income, 63 percent were over the age of 50 and 68 percent were from returns with incomes of less than \$100,000.

Conclusion

If Congress does not act to extend or make permanent capital gains and dividend rates, the maximum tax rate on dividend income will surge by 164 percent, and the capital gains tax rates will increase by as much as 33 percent (and these increases do not include the additional 3.8 percent tax imposed by the Affordable Care Act).

Tax increases on investment income disproportionately affect seniors, farmers and ranchers, and manufacturers and will directly impact middle class tax payers. Undoubtedly, this looming tax increase on investment income will affect asset values. Congress should not assume that market values won't be affected until very near the date of expiration. Instead, the market will begin to price in the expiration months in advance. As the committee considers efforts to improve the tax code and promote economic growth, we urge members to maintain current low rates on both capital gains and dividends and provide certainty to taxpayers and the financial markets well in advance of the expiration dates of the current rates.