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**Read My Lips: More New Tax Cuts – The
Distributional Impacts of Repealing Dividend Taxation**

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Abstract

The Bush administration advocates its January 2003 proposal to repeal personal dividend taxation on the basis that the cut would stimulate the economy, primarily benefit American seniors, and eliminate an unfair case of "double taxation." This paper primarily analyzes the proposal using a different criterion – its distributional impacts. Contrary to the administration's claim that seniors receive over half of all dividend income, U.S. Census Bureau data indicate that seniors receive only about one-quarter of dividend income. Dividend income is more concentrated towards high-income tax filers than the distribution of U.S. income as a whole. About two-thirds of dividend income accrues to the top 10% of tax filers. Less than one-fifth of tax filers with adjusted gross incomes of less than \$75,000 have any dividend income at all. Also, dividend income is highly skewed by race – only 8% of blacks and 6% of Hispanics receive dividend income.

An analysis of the distribution of the benefits of repealing dividend taxes is conducted using IRS summary data of the 2000 tax returns. Most taxpayers (about three-quarters) receive no dividend income and would receive no direct benefits from the proposal to repeal dividend taxes. On the other hand, filers with an adjusted gross income of at least \$100,000 would receive average annual benefits of over \$3,000. Over 75% of the total benefits would accrue to the top 8% of taxpayers. About 40% of the benefits would accrue to the top ½% of taxpayers, who would receive average annual tax savings of about \$26,000.

The distribution of benefits is more skewed than the distribution of dividend income. From this fact we can conclude that the proposal to repeal dividend taxation would, *ceteris paribus*, increase after-tax income inequality in the U.S. Given that U.S. inequality is higher than in any other developed country and at an historic high, policies that reduce inequality seem more desirable than those that have the opposite effect. Given the significant cost of the overall tax cut, one likely long-term effect is the reduction of federal services including, perhaps, Social Security benefits. Thus, the ironic conclusion is that the President's proposal, rather than helping low-income seniors, appears more likely to hurt them because of the potential for shortfalls in Social Security funding in the long term.

Read My Lips: More New Tax Cuts – The Distributional Impacts of Repealing Dividend Taxation

I. Introduction

In January of 2003 President Bush outlined a proposal for a new round of tax cuts intended to boost the American economy. A key component of this proposal is the repeal of dividend taxation for individual taxpayers. In his January 28, 2003 State of the Union speech, Bush stated that:

“We should also strengthen the economy by treating investors equally in our tax laws. It's fair to tax a company's profits. It is not fair to again tax the shareholder on the same profits. To boost investor confidence, and to help the nearly 10 million seniors who receive dividend income, I ask you to end the unfair double taxation of dividends.”¹

The implication that dividend taxation particularly harms low-income seniors is repeated in further official presentation of the President's plan:

“Roughly 35 million American households receive dividend income that is taxable and will directly benefit under the President's plan. More than half of these dividends go to America's seniors, many of whom rely on these checks for a steady source of income in their retirement.”

“Almost half of all savings from the dividend exclusion under the President's plan would go to taxpayers 65 and older. The average tax savings for the 9.8 million seniors receiving dividends would be \$936.”²

From these statements, we see that the President offers three points in promoting his proposal. First, repealing shareholder dividend taxation will boost investor confidence and provide a stimulus to the economy. Second, the current scheme of taxing dividends at both the corporate and shareholder level is unfair. Third, the tax cut will particularly benefit seniors.

This paper will primarily analyze the distributional implications of the President's proposal to repeal dividend taxes, including the impact on seniors. However, before proceeding to the analysis some brief comments are offered on the first two supporting reasons presented by the Bush administration for the tax plan.

The stimulus effect of the President's proposal has its supporters and detractors, among both politicians and economists. A group of over 450 economists, including 10 Nobel

¹ Excerpt taken from <http://www.whitehouse.gov/news/releases/2003/01/20030128-17.html>. Accessed Feb. 20, 2003.

² Excerpts taken from <http://www.whitehouse.gov/infocus/economy/>. Accessed Feb. 5, 2003.

laureates, recently signed a statement in opposition to the overall tax plan. Regarding the proposal to repeal dividend taxation, the statement reads:

“The permanent dividend tax cut, in particular, is not credible as a short-term stimulus. As tax reform, the dividend tax cut is misdirected in that it targets individuals rather than corporations, is overly complex, and could be, but is not, part of a revenue-neutral tax reform effort.”³

In opposition, a statement signed by over 100 economists, including three Nobel laureates, expressed support for the Bush administration’s overall proposal, including repealing dividend taxation.⁴ On February 11, 2003, Federal Reserve chairman Alan Greenspan questioned the need for the fiscal stimulus embodied in the tax cut proposal. While Greenspan expressed support for the basic concept of eliminating dividend taxation, he stressed that such a tax cut should be offset by tax increases or spending cuts.⁵

The President’s second point, that dividend taxation is unfair, must be evaluated in the context of the broader tax code. “Double taxation” is not unique to the situation of dividends. In fact, double taxation is both widespread and commonly accepted. For example, state sales taxes represent a form of double taxation – income is taxed by states both when it is received and when it is spent. Excise taxes on goods such as gasoline, cigarettes, and alcohol can also be viewed as a double taxation. Other factors are more important than how often a transaction or income is taxed, including the overall tax rate, the distribution of taxes, and the effect of taxation on market outcomes. So the President’s inference that double taxation is, in principle, unfair does not appear justified.

The economists publicly opposing the Bush tax cuts have criticized the President’s proposal in that it will “generate further inequalities in after-tax income.”⁶ Franco Modigliani, who received the 1985 Nobel in economics, called the proposal to repeal dividend taxes “a preposterous program. It has only one effect: to make the very rich” richer. While the 2000 Nobel winner Daniel McFadden called it a “weapon of mass destruction aimed at the middle class.”⁷ This paper specifically analyzes the distributional implications of the proposal to repeal dividend taxation. Three important conclusions are reached:

1. The President’s claim that more than half of dividends go to seniors is not supported by the data. Instead, the majority of dividends go to high-income households, particularly those that are middle-aged and white.

³ The full statement is available at http://www.epinet.org/stmt/2003/statement_signed.pdf (Accessed Feb. 20, 2003). The statement also appeared in a full-page ad in the New York Times on Feb. 11, 2003.

⁴ The full statement, as sent the U.S. Congress by the National Taxpayers Union, is available at http://www.ntu.org/features/ntu_on_capitolhill/L0301taxpayeragenda.php3 (Accessed Feb. 20, 2003).

⁵ “Greenspan Throws Cold Water On Bush Arguments for Tax Cut,” *New York Times*, Feb. 12, 2003, Sec. A, Page 1.

⁶ From the Economists’ Statement Opposing the Bush Tax Cuts, available at http://www.epinet.org/stmt/2003/statement_signed.pdf (Accessed Feb. 20, 2003).

⁷ “Nobel Laureates Attack Tax Plan,” *Boston Globe*, Feb. 11, 2003, Page D1.

2. Repeal of dividend taxation would be a highly-skewed benefit in favor of high-income households. Based on an analysis of IRS tax returns, about 75% of the tax savings would accrue to those with an adjusted gross income of \$100,000 or more – less than 10% of all tax filers. Most tax filers receive no dividend income and would, consequently, receive no direct benefits from the elimination of dividend taxes.
3. The proposal to repeal dividend taxation will, ceteris paribus, exacerbate income inequality in the U.S. Given that current levels of income inequality in the U.S. are at historic high levels, and higher than in any other developed country, one must question the pursuit of policies that further increase inequality.

II. Dividend Income and Seniors

First, we explore the validity of the President’s claim that more than half of dividends go to seniors. The U.S. Census Bureau publishes data annually on the distribution and composition of money income in the United States. For this analysis, the most recent complete data on dividend income is used, based on 1999 data.⁸ The Census Bureau data indicate that in 1999 about 40 million people received dividend income. Among these individuals, the average dividend income was \$3,112. The Census Bureau divides its income data into four age categories. Table 1 presents the 1999 distribution of dividend income by these four categories. In sharp contrast to the President’s claim, only about 26% of all dividend income is received by those age 65 or over. In fact, people aged 25-44 received more dividend income in 1999 than people age 65 or over. The age group with the largest proportion of dividend income includes those aged 45 to 64 years. No evidence could be located in support of the assertion that seniors receive more than half of all dividend income.

Table 1. Distribution of Dividend Income by Age Category, 1999

Age Category	Number of People with Dividend Income (thousands)	Mean Dividend Income	Total Dividend Income (\$ billions)	Share of Dividend Income (percent)
15-24 Years	1,841	\$1,501	\$2.763	2.2%
25-44 Years	15,669	\$2,331	\$36.524	28.9%
45-64 Years	16,039	\$3,397	\$54.484	43.2%
65 or Over	7,014	\$4,627	\$32.454	25.7%
TOTAL	40,564	\$3,112	\$126.225 ⁹	100.0%

⁸ *Money Income in the United States, 1999*, U.S. Census Bureau report P60-209, September 2000.

⁹ Note that the total dividend income obtained from summing the dividend income for each age category differs slightly from the total obtained by multiplying 40,564,000 people by the \$3,112 average dividend income. The difference is likely due to rounding errors or minor discrepancies in the data.

III. The Distribution of Dividend Income

The most relevant issue in studying the distributional impacts of repealing dividend taxation is the distribution by income. To explore how dividends are spread across the income spectrum, we use summary data from the 2000 individual income tax returns filed with the Internal Revenue Service.¹⁰ The IRS data indicate the total number of returns with dividend income (about 34 million) and the total amount of dividend income claimed by taxpayers (about \$147 billion). These data are given for each of 19 adjusted gross income (AGI) categories. AGI includes income from wages, interest, dividends, capital gains, business profits, rents, alimony, and several other sources, less allowable deductions from IRA contributions, moving expenses, self-employed health insurance, and other deductions.

The detailed AGI categories given by the IRS allow a comprehensive analysis of the distribution of dividend income, particularly among those with very high incomes. Table 2 presents the distribution of dividend income by AGI. About 85% of all tax filers have an AGI of under \$75,000, but fewer than one-fifth of these filers have any dividend income at all. Tax filers with an AGI of \$75,000 or less received an average dividend income in 2000 of about \$380. Contrast this with the claim that seniors will receive an average tax *savings* of \$936. In reality, the majority of Americans will receive no benefit from the proposal to repeal dividend taxes simply because they have no dividend income.

Unlike the typical American, we can see in Table 2 that those in the upper income brackets receive a significant amount of dividend income. Tax filers with an AGI of \$100,000 or more, about 8% of all filers, received 63% of all dividend income in 2000, with average dividends of about \$8,500. For those tax filers with an AGI of \$500,000 or more, nearly all received at least some dividend income. Those with an AGI of more than \$10 million received average dividends of nearly \$1 million in 2000. Clearly, these are the taxpayers who stand to benefit substantially from a repeal of dividend taxation.

Box 1: The Racial Distribution of Dividend Income

The distribution of dividend income is skewed on the basis of race. According to the U.S. Census Bureau, whites received 93% of all dividend income in 1999 while only 75% of the U.S. population is white. About 23% of all whites with any income had some dividend income in 1999. Non-whites are much less likely to have dividend income. Only 8% of blacks and 6% of Hispanics with income in 1999 had dividend income. Whites with dividend income also tend to receive more dividend income than non-whites with dividend income. While whites with dividend income received an average of \$3,161 in dividends in 1999, blacks received \$2,377 and Hispanics received \$2,695.

¹⁰ "Individual Income Tax Returns, 2000" by David Campbell and Michael Parisi, *IRS Statistics of Income Bulletin*, Fall 2002.

Table 2. Distribution of Dividend Income by AGI Category, 2000 Tax Returns

AGI Category	Number of Returns (thousands)	Number of Returns with Dividends (thousands)	Amount of Dividends (\$ millions)	Average Dividend Income per Return
No AGI ¹¹	1,146	382	\$1,576	\$1,375
\$1 under \$5,000	12,803	2,024	1,126	88
\$5,000 under \$10,000	12,802	1,605	1,904	149
\$10,000 under \$15,000	12,111	1,623	2,667	220
\$15,000 under \$20,000	11,662	1,588	3,193	274
\$20,000 under \$25,000	9,993	1,417	2,492	249
\$25,000 under \$30,000	8,369	1,355	2,618	313
\$30,000 under \$40,000	13,547	2,927	5,391	398
\$40,000 under \$50,000	10,412	2,712	6,288	604
\$50,000 under \$75,000	17,076	6,303	14,572	853
\$75,000 under \$100,000	8,597	4,340	12,569	1,462
\$100,000 under \$200,000	8,083	5,430	26,866	3,324
\$200,000 under \$500,000	2,136	1,836	23,168	10,848
\$500,000 under \$1,000,000	396	368	11,465	28,943
\$1,000,000 under \$1,500,000	100	95	5,163	51,882
\$1,500,000 under \$2,000,000	45	43	3,489	78,266
\$2,000,000 under \$5,000,000	67	65	8,072	120,901
\$5,000,000 under \$10,000,000	18	17	4,694	266,578
\$10,000,000 or more	11	11	9,673	862,542
TOTAL	129,374	34,141	\$146,986	\$1,136

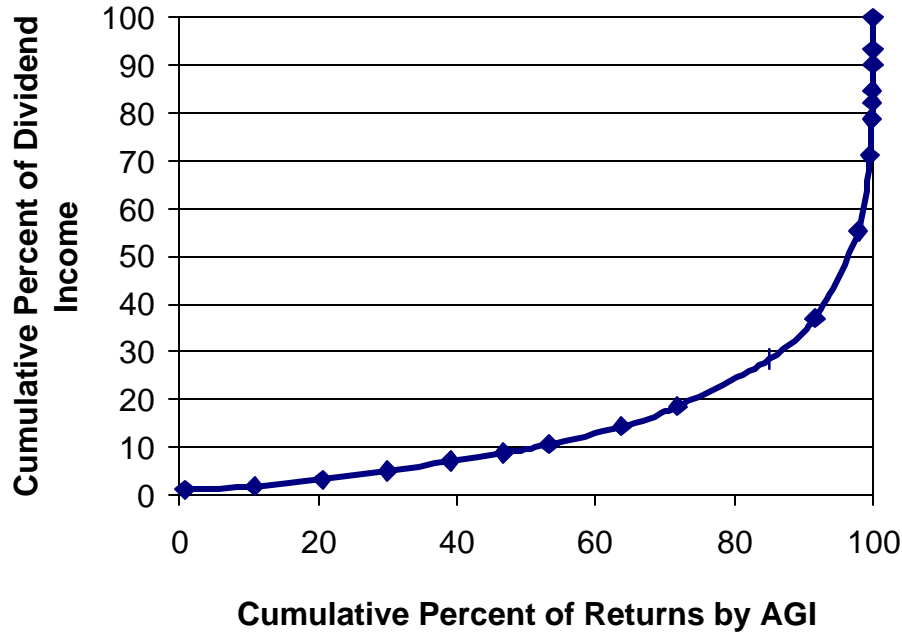
To further explore the distribution of dividend income, we can plot the cumulative proportion of tax returns, arranged from lowest to highest, against the cumulative proportion of dividend income. This plot is similar to a Lorenz curve, commonly used to illustrate inequality in the income distribution.¹² As seen in Figure 1, the plot displays a high degree of curvature, indicating a significant level of inequality. The bottom half of taxpayers received only about 10% of all dividend income. About 65% of all dividend income accrued to the highest 10% of taxpayers while the top ½% of taxpayers received about 30% of dividend income.

Similar to analyses of income distribution, one can calculate a Gini coefficient based on the distribution of dividend income (see Appendix 1 for the details of calculating a Gini coefficient). Approximate calculations indicate that the Gini coefficient for dividend

¹¹ Includes individuals with zero or negative AGI. For example, a sole proprietor claiming a net loss could have a negative AGI yet still claim positive dividend income.

¹² Note that this plot is not exactly analogous to a Lorenz curve. A Lorenz curve plots the distribution of income ordered by income. Figure 1 plots dividend income ordered by AGI, not ordered by dividend income.

Figure 1. Distribution of 2000 Dividend Income, by AGI



income, based on the distribution by AGI, is about 0.70.¹³ This is much more unequal than the distribution of U.S. income as a whole, which is currently about 0.47.

IV. Benefits to Seniors from Repeal of Dividend Taxation

The President claims that seniors, nearly 10 million strong, would receive a disproportionate share of the benefits from eliminating dividend taxes – an average savings of nearly \$1,000 each. We now examine these assertions. First, do 9.8 million seniors currently receive dividend income? The Census Bureau data presented in Table 1 indicate that the number of people aged 65 and over who received dividend income in 1999 was only about seven million – 17% lower than the administration’s figure. A couple of explanations could be suggested to explain the discrepancy. The administration could be using more recent data showing that more seniors receive dividend income. Also, the administration could be using a different definition of “seniors,” such as those aged 60 or over.

Next, consider the administration’s claim that seniors with dividend income will receive an average benefit of \$936. An important point is the difference between the *average* benefit and the benefits to the *typical* senior with dividend income. Given an unequal

¹³ Gini coefficient calculation made by assuming linearity between each data point. This creates a minor downward bias in the calculation; the actual Gini coefficient based on dividend income would be slightly higher.

distribution of dividend income among seniors, most seniors with dividend income would realize benefits less than \$936 while a relatively small number would obtain benefits much larger than \$936. The administration also fails to mention that only about 22% of all seniors have any dividend income at all. So over three-quarters of seniors would receive *no benefit whatsoever* from the elimination of dividend taxation.

Is the President's average tax savings estimate of \$936 valid? The detailed data necessary to explore the validity of this claim are not readily available.¹⁴ However, a speculative analysis can be conducted which, incidentally, sheds some additional light on what type of seniors receive dividend income. We know from Table 1 that the average dividend income for a senior who received dividend income in 1999 was \$4,627. A tax savings of \$936 would imply that the average marginal tax rate for dividend income received by seniors would have to be 20.2%. In order for a senior to reach a tax bracket above 15% (the next highest rate is 27%), he or she would have to have taxable income¹⁵ in 2002 of \$27,950 if filing as single, and \$46,700 if filing a joint return. However, most seniors do not have sufficient income to enter the 27% tax bracket. According to the U.S. Census Bureau, mean total income for seniors in 1999 was only \$21,417.¹⁶ With deductions and exemptions, average taxable income for seniors would be in the range of \$12,000 assuming a single filer with the standard deduction and exemption (less for a tax status of married filing jointly). So, most seniors would be taxed at a maximum marginal rate of 10% or 15%, inconsistent with the implied tax rate based on the administration's average benefits of \$936.

We cannot conclude that the administration's estimate of average tax savings is inflated. The likely explanation is that seniors who receive dividend income have higher incomes than most seniors and are taxed at a higher marginal rate. Of course, the problem with this explanation is that it undermines the administration's implication that needy seniors rely on dividend income to get by. The analysis above suggests that most of these are not low-income seniors struggling to make ends meet but reasonably secure seniors who are not in desperate need of tax relief.

V. Who Really Benefits from Repealing Dividend Taxation

As one might expect from the data presented earlier, the major beneficiaries of the dividend tax repeal would be the very wealthy, not seniors. An important point to consider is that lower-income Americans who receive dividend income are taxed at lower marginal rates. Many Americans are taxed at a maximum marginal rate of only 10% or 15%, and few are taxed at a rate above 27% (a married couple would need taxable income of about \$113,000 to exceed the 27% tax bracket). However, high-income taxpayers are taxed at a higher marginal rate, up to 38.6% in 2002. So, typical taxpayers receive little, if any, dividend income and would receive savings of 10%, 15%, or at most

¹⁴ Specifically, one would need to know the distribution of seniors' income, including dividends, by AGI.

¹⁵ Note that taxable income differs from AGI. Basically, taxable income is AGI less deductions (itemized or standard) and exemptions.

¹⁶ Money Income in the United States, 1999, Table 12.

27% of their dividend income. A typical high-income taxpayer, on the other hand, receives a significant amount of dividend income and is taxed on this income at a marginal rate of up to 38.6%.

One can use the data from Table 2 to estimate the average tax savings for those in each AGI category. Tax savings for each AGI category are estimated using the 2002 tax tables from the IRS. As tax brackets differ by filing status, the analysis is not straightforward. Also, the appropriate marginal tax rate must be determined based on taxable income rather than AGI. See Appendix 2 for the detailed assumptions made to derive the tax savings estimates. The results, by AGI category, are presented in Table 3.¹⁷

Recall that 85% of all taxpayers had an AGI of less than \$75,000 in 2000. The benefits of the Bush proposal to repeal dividend taxation for these taxpayers average less than \$100. Of course, for a taxpayer who receives no dividend income (the majority of taxpayers), he or she receives no direct benefit from repealing dividend taxes. For a typical taxpayer with an AGI of around \$20,000 or \$30,000, the average benefits of repealing dividend taxes amount to only about \$40.

Table 3. Benefits of Repealing Dividend Taxation

AGI Category	Avg. Dividend Income per Return (\$)	Avg. Tax Savings (\$)	Share of Savings (%)	Avg. Increase in AGI (%)
No AGI	\$1,375	\$0	0.0%	0.0%
\$1 under \$5,000	88	9	0.3	0.3
\$5,000 under \$10,000	149	15	0.5	0.2
\$10,000 under \$15,000	220	22	0.6	0.2
\$15,000 under \$20,000	274	38	1.1	0.2
\$20,000 under \$25,000	249	34	0.8	0.2
\$25,000 under \$30,000	313	47	0.9	0.2
\$30,000 under \$40,000	398	60	1.9	0.2
\$40,000 under \$50,000	604	124	3.1	0.3
\$50,000 under \$75,000	853	157	6.4	0.3
\$75,000 under \$100,000	1,462	396	8.1	0.5
\$100,000 under \$200,000	3,324	911	17.6	0.7
\$200,000 under \$500,000	10,848	3,797	19.4	1.3
\$500,000 under \$1,000,000	28,943	11,172	10.6	1.6
\$1,000,000 under \$1,500,000	51,882	20,026	4.8	1.7
\$1,500,000 under \$2,000,000	78,266	30,211	3.2	1.8
\$2,000,000 under \$5,000,000	120,901	46,668	7.4	1.6
\$5,000,000 under \$10,000,000	266,578	102,899	4.3	1.5
\$10,000,000 or more	862,542	332,941	8.9	1.2
TOTAL	\$1,136	\$323	100%	+0.7%

¹⁷ The benefit estimates in Table 3 are based on the quantity and distribution of dividend income in 2000. Of course, the quantity and distribution of dividend income could differ in the future. Thus, the estimates should not be interpreted as projections of tax savings should dividend taxes be eliminated.

In contrast, at the upper end of the income distribution significant savings are evident (see Table 3). Taxpayers with an AGI of over \$100,000 receive an average benefit of over \$3,000. Those with an AGI of \$10 million or more receive an average benefit of over \$300,000. So, a typical taxpayer receives a very small benefit, if any, from the President's proposal while very high-income payers receive huge benefits.

The second-to-last column in Table 3 indicates the distribution of the tax savings from repealing the dividend tax. Those taxpayers with an AGI of less than \$50,000 (about 72% of all taxpayers) would receive an aggregate share of only 9% of the benefits. On the other hand, those with an AGI over \$100,000 (just 8% of taxpayers) would receive slightly over 75% of the savings. Even further, most of those benefits (nearly 40% of all benefits) would accrue to the highest ½% of taxpayers, those with an AGI of \$500,000 or more.

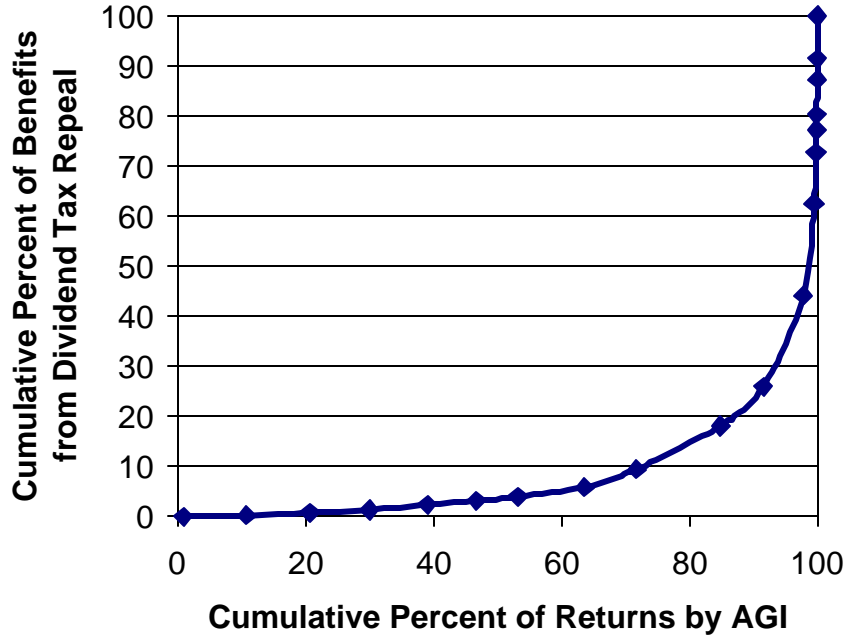
VI. Impact on Economic Inequality

Given that the wealthy receive the majority of dividend income, it is not surprising that they would receive most of the benefits. This will be true with any across-the-board tax cut. High-income filers pay most of the taxes in the U.S. and would receive most of the benefits of any general tax cut. So, the fact that the benefits of repealing dividend taxation accrue predominately to the wealthy does not necessarily imply that repealing dividend taxation exacerbates economic inequality in the U.S. To explore this issue, one needs to determine how the proposal affects the overall distribution of after-tax income.

One way to conduct this analysis is to estimate the percentage change in income for different AGI levels. For a policy to be neutral with respect to inequality levels, those in all income categories would see their income increase (or decrease) by the same proportion. As seen in the last column of Table 3, that is not the case with the proposal to repeal dividend taxes. Those with a low AGI see a minor increase in their average income – less than 0.5% (using a base of average AGI). However, those with more than \$200,000 in AGI see an income increase over 1.0%. From these data, we can conclude that repealing dividend taxation will, *ceteris paribus*, increase income inequality in the U.S.

Similar to Figure 1, we can plot the distribution of the benefits of repealing the dividend tax against the distribution of returns ordered by AGI. Figure 2 shows the results, which again are highly-skewed towards those with high AGI's. The distribution of tax savings can again be calculated using a coefficient similar to a Gini ratio. The results based on the data shown in Figure 2 produce a coefficient of 0.83. So, the distribution of the benefits of repealing the dividend tax is more unevenly distributed than dividend income itself (coefficient of 0.70), and much more unevenly distributed than overall income in the United States (coefficient of 0.47). Again, this demonstrates that repealing dividend taxes will further increase income inequality in the U.S.

Figure 2. Estimated Distribution of Tax Savings from Repeal of Dividend Taxation, by AGI



VII. Conclusions

This paper has examined the distributional benefits of the Bush administration’s proposal to permanently eliminate dividend taxation received by individuals. The administration’s claim that seniors receive the majority of dividend income is not supported by the available data. It appears that the administration overstates the proportion of dividend income that accrues to seniors by a factor of two. Additionally, the implication that the primary beneficiaries of repealing dividend taxation are seniors who rely on dividend income to get by is misleading. Most taxpayers receive no dividend income, particularly those who are non-white, and would not benefit from a repeal of dividend taxation. High-income taxpayers receive the majority of dividend income and would be the primary beneficiaries of dividend tax repeal.

The distribution of the benefits of repealing dividend taxation is disproportional to the distribution of dividend income. Thus, repealing dividend taxation would, *ceteris paribus*, increase income inequality in the U.S. Currently, income inequality in the U.S. is at a historic high.¹⁸ Also, the level of economic inequality in the U.S. exceeds that

¹⁸ The Changing Shape of the Nation’s Income Distribution, 1947-1998, U.S. Census Bureau report P60-204, June 2000.

found in any other developed country.¹⁹ In light of this reality, policies that decrease economic inequality appear much more necessary than policies that further increase inequality. Further, any federal tax cut will necessitate a reduction in spending unless it is offset with tax increases in other areas.²⁰ The Bush tax cut proposal is not revenue neutral, as noted in the economists' statement opposing the tax cut. This leads to an important question that has not been addressed by the Bush administration – how will federal spending be reduced to compensate for the tax cut?

While revenue reductions could be offset with increased borrowing in the short term, permanent tax cuts will eventually impose fiscal constraints on the federal government. Spending cuts could, of course, be prioritized in numerous ways. However, a particular concern voiced by the Bush administration's critics is that permanent tax cuts will threaten the long-term solvency of the Social Security program. Currently, the largest share of federal outlays (about 36%) is allocated towards Social Security, Medicare, and other federal retirement programs. While the Social Security trust fund is currently running a surplus, the aging of the U.S. population implies that the trust fund, without revision, is not a permanent solution to the problem of funding Social Security. Large permanent tax cuts only increase the likelihood that, eventually, Social Security benefits will have to be cut as the trust fund is drawn down.

Unlike the case with dividend income, Social Security is an important source of income to American seniors, particularly low-income seniors. Nearly 40% of all income received by seniors comes from Social Security while less than 5% comes from dividends.²¹ Any reduction in Social Security benefits, including increasing the eligibility age, is likely to have a disproportionate impact on low-income seniors.

This leads to an ironic implication of the Bush tax cut. The tax cut, because it is revenue reducing, poses an increased risk that Social Security and other federal retirement benefits will have to be scaled back in the future. The President states that his tax cut provides needed tax relief to America's seniors. In the long run, it may be that low-income seniors will suffer the most should dividend taxes be eliminated.

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¹⁹ World Development Indicators 2002, World Bank, Table 2.8, Available at http://www.worldbank.org/poverty/data/2_8wdi2002.pdf.

²⁰ A tax cut could, in theory, stimulate economic growth sufficiently such that federal revenues increase as incomes and profits rise. This is the standard supply-side argument for tax cuts, used to support the Reagan cuts in the 1980s. The historical result, however, was not rising revenues and surpluses, but rising deficits.

²¹ Money Income in the United States, 1999, Table 12.

Appendix 1. Gini Coefficients

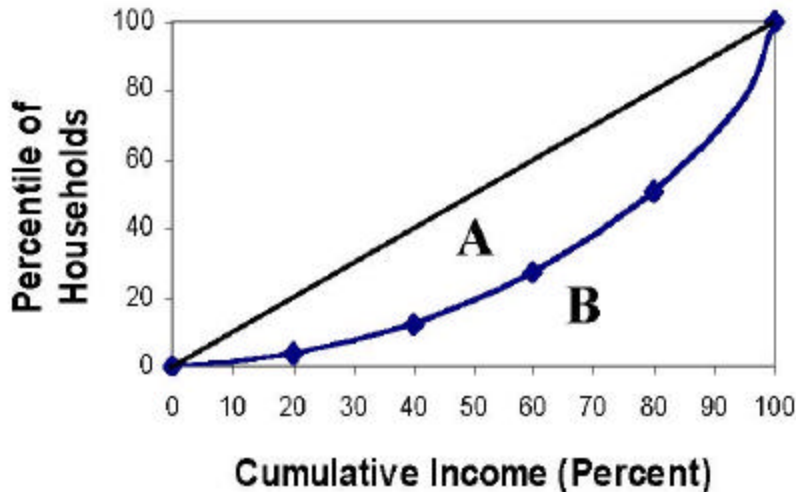
The Gini coefficient is a common metric used by economists to measure the degree of inequality in the distribution of income or wealth. To illustrate the steps necessary to calculate a Gini coefficient, consider its application to the distribution of income across households. First, arrange all households from lowest income to highest. Then add up the total income of all households. Next, calculate the cumulative percentage of income belonging to each group of ordered households. For example, in the U.S. the bottom 20% of households received 3.5% of income in 2001.²² The second quintile received 8.8% of income, so the cumulative share of income to the bottom 40 percentiles of households is 12.3%. Plot this relationship as shown in Figure A1. The curve shown in Figure 1 is referred to as a Lorenz curve.

If income were equally distributed, the Lorenz curve would be the 45-degree line shown in Figure 1. As income becomes more unevenly distributed, the Lorenz curve bows away from the straight line. Thus, the larger area A in Figure 1, the greater the degree of inequality. A Gini coefficient is calculated as:

$$\text{Gini coefficient} = \text{Area A} / (\text{Area A} + \text{Area B})$$

Note that a Gini coefficient must range between zero (perfect equality) and one (one individual or household receives everything). While other measures are used to measure economic inequality, the Gini coefficient is the most widely used metric and has been estimated for most countries in the world.

Figure A1. Lorenz Curve for the U.S. Distribution of Income



²² Money Income in the United States: 2001, U.S. Census Bureau report P60-218, September 2002.

Appendix 2. Details of Calculations to Estimate Tax Savings by AGI Category

For each AGI category shown in Table 3, the IRS presents data on average taxable income in 2000. These data are presented in Table A1 below. Given taxable income, one can compare this to an IRS tax rate table and determine the appropriate marginal tax rate. Assuming this tax rate represents the rate of dividend taxation, it can simply be multiplied by average dividend income to estimate the savings of repealing dividend taxes. However, the applicable marginal tax rate is contingent upon filing status. Table A1 indicates the 2002 marginal tax rates for each taxable income amount for the statuses of single, married filing jointly, and married filing separately.

The most recent data on the distribution of tax filing status by AGI is from the 1999 tax returns.²³ These data are presented in Table A1. The maximum AGI category in 1999 was \$1 million or more. The filing status distribution of \$1 million or more from 1999 is assumed to apply to all 2000 AGI categories above \$1 million. Note that most filers with a low AGI are single while the vast majority of very high-income filers are married.

To estimate the marginal rate applied to dividends for each AGI category, the 2002 marginal tax rate is weighed by the distribution by filing status. In cases where the marginal rate for an AGI category is constant across filing statuses, weighing is not necessary. However, for AGI categories such as \$40,000-to-\$50,000, an estimated applicable rate is dependent upon the distribution of filers. The estimated applicable rate, presented in the last column, is the tax rate assumed to apply to dividend income for each AGI category. Multiplying this rate by the average amount of dividend income in each AGI category produces an estimate of the tax savings should dividend taxes on individuals be repealed.

²³ "Individual Income Tax, All Returns, 1999: Adjusted Gross Income, Exemptions, Deductions, and Tax Items, by Size of Adjusted Gross Income and Marital Status," Statistics of Income, 1999, Individual Income Tax Returns, October 2001, November 2001. Downloadable Excel spreadsheet available at <http://www.irs.gov/taxstats/article/0,,id=96978,00.html> (Accessed Feb. 20, 2003).

Table A1. Taxable Income and Filing Status, by AGI Category

AGI Category	Avg. Taxable Income per Return ²⁴	2002 Maximum Marginal Tax Rates			1999 Distribution by Filing Status			Estimated Applicable Marginal Rate
		Single	Married, Joint Return	Married, Separate Return	Single	Married, Joint Return	Married, Separate Return	
No AGI	\$0	0%	0%	0%	49.0%	39.8%	11.2%	0.0%
\$1 under \$5,000	\$995	10%	10%	10%	85.4%	5.0%	9.6%	10.0%
\$5k under \$10k	\$2,181	10%	10%	10%	68.6%	10.4%	21.0%	10.0%
\$10k under \$15k	\$4,680	10%	10%	10%	56.4%	16.6%	27.0%	10.0%
\$15k under \$20k	\$7,154	15%	10%	15%	49.9%	23.5%	26.6%	13.8%
\$20k under \$25k	\$11,271	15%	10%	15%	48.3%	27.1%	24.7%	13.6%
\$25k under \$30k	\$15,499	15%	15%	15%	48.8%	30.1%	21.1%	15.0%
\$30k under \$40k	\$21,586	15%	15%	15%	42.1%	40.2%	17.7%	15.0%
\$40k under \$50k	\$29,412	27%	15%	27%	32.1%	54.6%	13.3%	20.4%
\$50k under \$75k	\$42,569	27%	15%	27%	21.0%	71.9%	7.1%	18.4%
\$75k under \$100k	\$62,626	27%	27%	30%	13.1%	83.0%	3.9%	27.1%
\$100k under \$200k	\$101,734	30%	27%	30%	11.2%	86.0%	2.8%	27.4%
\$200k under \$500k	\$244,699	35%	35%	35%	11.4%	85.6%	2.9%	35.0%
\$500k under \$1m	\$605,947	38.6%	38.6%	38.6%	12.4%	84.4%	3.2%	38.6%
\$1m under \$1.5m	\$1,092,724	38.6%	38.6%	38.6%	13.1%	83.0%	3.8%	38.6%
\$1.5m under \$2m	\$1,563,955	38.6%	38.6%	38.6%	13.1%	83.0%	3.8%	38.6%
\$2m under \$5m	\$2,720,958	38.6%	38.6%	38.6%	13.1%	83.0%	3.8%	38.6%
\$5m under \$10m	\$6,244,602	38.6%	38.6%	38.6%	13.1%	83.0%	3.8%	38.6%
\$10m or more	\$24,010,714	38.6%	38.6%	38.6%	13.1%	83.0%	3.8%	38.6%

²⁴ Data from "Individual Income Tax Returns, 2000" by David Campbell and Michael Parisi, *IRS Statistics of Income Bulletin*, Fall 2002.

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