# Corporate Dividend and Capital Gains Taxation: A comparison of the United States to other developed nations

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## Executive Summary

Without action by Congress, the tax rates on dividends and capital gains are set to increase significantly on January 1, 2013. Even with the expiring tax rate reductions enacted in 2003, the United States currently imposes among the highest integrated tax rates on dividends and capital gains on corporate profits among developed nations. This study compares the tax rates on dividends and capital gains in the United States to those imposed by other developed countries and discusses the policy concerns that have caused other countries to impose lower tax rates on capital gains and dividends.

In 2003, the United States followed the standard practice of most other developed nations by providing some relief from the double tax on corporate profits (which arises from subjecting corporate income to tax at both the corporate and shareholder levels) by lowering the tax rates on dividends and capital gains. With the sunset of the 2001/2003 tax cuts at the end of 2012 these tax rates will rise significantly:

- The top federal income tax rate on dividends will increase from its current level of 15 percent to 39.6 percent in 2013.
- The top federal income tax rate on long-term capital gains will rise from its current level of 15 percent to 20 percent in 2013 (and from zero percent to 10 percent for lower income taxpayers).
- For many taxpayers, both dividends and capital gains will also become subject to the additional 3.8 percent Medicare tax in 2013 due to changes under the Affordable Care Act of 2010.

Taking into account both the corporate and investor level taxes on corporate profits and state level taxes, the United States has among the highest integrated tax rates among developed countries and these integrated tax rates will rise sharply in 2013:

- The current top US integrated dividend tax rate of 50.8 percent will rise to 68.6 percent in 2013, significantly higher than in all other OECD and BRIC countries.
- The current top US integrated capital gains tax rate of 50.8 percent will rise to 56.7 percent in 2013, the second highest among OECD and BRIC countries.

Most developed countries provide relief from the double tax on corporate profits because it distorts important economic decisions that waste economic resources and adversely affect economic performance:

- It discourages capital investment, particularly in the corporate sector, reducing capital formation and, ultimately, living standards.
- It favors debt over equity financing, which may result in greater reliance on debt financing and leave certain sectors and companies more at risk during periods of economic weakness.
- A tax policy that discourages the payment of dividends can impact corporate governance as investors' decisions about how to allocate capital are disrupted by the absence of signals dividend payments would normally provide.

With the current policy debate on tax reform intensifying and the sunset of the 2001/2003 tax cuts at the end of 2012, Congress and the Administration will need to consider whether the tax rates on dividends and long-term capital gains should remain at their current levels or rise.

Recent tax and entitlement reform plans would also change the taxation of dividends and capital gains, as well as the corporate level tax, and in most cases leave the United States with integrated dividend and capital gains tax rates that are among the highest among developed nations. As the tax reform debate progresses, it is important to consider carefully the adverse economic consequences of high tax rates on dividends and capital gains.

# Dividend and Capital Gains Taxation: A comparison of the United States to other developed nations

## Introduction

With the sunset of the 2001/2003 tax cuts at the end of 2012, the Congress and Administration will need to consider whether the tax rates on dividends and long-term capital gains should remain at their current levels or rise. Without action, the top tax rate on dividends will rise from its current level of 15 percent to 39.6 percent in 2013. The top tax rate on long-term capital gains will rise from its current level of 15 percent to 20 percent in 2013 (and from zero percent to 10 percent for lower income taxpayers). For many taxpayers, both dividends and capital gains will also become subject to the 3.8 percent Medicare tax in 2013 due to changes under the Affordable Care Act of 2010.

The investor level taxes on dividends and capital gains figure prominently in the structure of the US income tax system. These tax rates were lowered in 2003 to reduce the effects of the double tax on corporate profits, which arises from subjecting corporate income to tax at both the corporate and shareholder levels.

Most developed nations provide relief from the double tax. While the mechanism for providing relief varies across countries, sometimes taking the form of an imputation credit and sometimes a shareholder exclusion, most developed nations have a long tradition for providing such relief. Recent reductions in the corporate income tax rate by various countries have also reduced the double tax abroad.

It is only with the lower rates on dividends and long-term capital gains enacted in 2003 that the United States recently began to provide meaningful relief from the double tax on corporate earnings.[1] Even with these lower rates, the United States has one of the highest integrated tax rates imposed on new corporate equity-financed investment among developed nations. Moreover, the integrated tax rate will rise significantly with the sunset of the 2001/2003 tax cuts at the end of 2012 and the application of the Medicare tax to unearned income beginning in 2013.

The double tax on corporate profits is of significant concern because it distorts a number of economic decisions. First, it discourages capital investment, particularly in the corporate sector. This both reduces capital formation generally and leads to the misallocation of investment within the economy. Second, the double tax favors debt over equity financing. Greater reliance on debt financing may leave certain sectors and companies more at risk during periods of economic weakness. Finally, a tax policy that discourages the payment of dividends can affect corporate governance by disrupting important signals dividend payments provide to investors about the financial health of companies.

With the sunset of the 2001/2003 tax cuts and the expansion of the Medicare tax to unearned income, the top integrated tax rate on company dividends paid to shareholders will rise from 50.8 percent in 2011 (and 2012) to 68.6 percent in 2013. Similarly, the top integrated tax rate on corporate income that is retained and realized by shareholders as capital gains will rise from

50.8 percent to 56.7 percent in 2013. With these increases, in 2013 the United States will have the highest integrated dividends tax rate and the second highest integrated long-term capital gains tax rate among developed nations.

Not only do these increases reflect a significant increase as compared to the integrated tax rates that have prevailed in the United States over the past decade, but they also represent a large increase as compared to the effective rates in other developed nations.

Recent tax and entitlement reform plans discussed below have included changes to the taxation of dividends and capital gains. These proposals have two features in common. First, the proposals would continue to synchronize the tax rates on dividends and capital gains. Second, they would keep the integrated dividends and long-term capital gains tax rates well below those scheduled to become effective in 2013.

## The double tax on corporate profits

The earnings from new equity-financed corporate investments are subject to two layers of tax, first when income is earned at the corporate level, and again when corporate earnings are distributed to shareholders as dividends or retained and later realized by shareholders as capital gains. These two layers of tax are often referred to as the "double tax" on corporate profits. The double tax is primarily a tax on equity-financed investment because interest is a deductible expense while dividend payments to investors are not.

### *History of taxing dividends and capital gains*

While the United States has had both an individual and corporate income tax since 1913, explicit double taxation has not always been the case. From 1913 through 1953, the United States generally exempted a portion of dividend income from the individual income tax (with the exception of 1936-1939). Then between 1954 and 1986, dividends were subject to taxation, but with an exemption generally limited to the first $50 or $100 of dividend income per filer.[2]

In 1986, dividends became fully taxable, albeit at a top rate of 28 percent following the Tax Reform Act of 1986.[3] The top tax rate on dividends then increased following the tax rate increases enacted in 1990 and 1993.[4] By 1993, dividends earned by high-income taxpayers were subjected to a 39.6 percent federal income tax rate. In 2003, the tax rate on dividends was lowered and synchronized with the new tax rate on long-term capital gains (15 percent). The 15 percent dividends tax rate is now scheduled to sunset at the end of 2012. Dividends will also be subject to the additional 3.8% Medicare tax beginning in 2013 for individuals with annual wages over $200,000 ($250,000 for married couples).

Capital gains income has always been subject to tax, although it has often received preferential treatment relative to ordinary income. Prior to the Tax Reform Act of 1986, a portion of long-term capital gains was typically excluded from income. The 1986 Act repealed the exclusion and taxed long-term capital gains as ordinary income, albeit after reducing the top tax rate on ordinary income from 50 percent to 28 percent. In 1990, the tax rates on long-term capital gains and ordinary income were decoupled, with long-term capital gains taxed at a top rate of 28 percent, while the top tax rate on ordinary income (including dividends) was increased to 31 percent. In 1993, the top tax rate on ordinary income was increased to 39.6 percent and then lowered to 35 percent under the 2001/2003 tax cuts. The top tax rate on long-term capital gains was lowered to 20 percent in 1997 and to 15 percent in 2003. Beginning in 2013, the top tax rate on long-term capital gains is scheduled to rise to 20 percent. As with dividends, capital gains will also be subject to the 3.8 percent Medicare tax for higher-wage taxpayers.

### *Integrated tax rates on dividends and capital gains*

As discussed above, the investor-level tax on dividends and capital gains are a second layer of tax that are in addition to the corporate income tax, thus giving rise to the double tax on corporate profits. Thus, it is important to consider the combination of the corporate and investor level taxes on dividends and capital gains.

Table 1 illustrates the calculation of the top integrated tax rates on dividends and long-term capital gains for a corporate investment that produces $100 in pre-tax income. First, this income is subject to a top marginal 39.2 percent corporate level tax reflecting the top 35 percent federal corporate income tax rate and an average 4.2 percent state corporate income tax rate (after accounting for deductibility for federal tax purposes). The investor level taxes are then applied to the remaining $60.80 in income after remittance of the corporate level tax.

Corporate income distributed to shareholders as dividends is subject to an additional 15 percent federal tax rate and a 4.0 percent average state rate (after accounting for deductibility for federal tax purposes) resulting in an additional $11.57 dividend tax and an integrated tax rate of 50.8 percent. The integrated tax rate on corporate income that is retained is also 50.8 percent, although the effective tax rate might be further reduced because capital gains are not taxed until realized and taxpayers may also benefit from step-up of basis at death.[5]

**Table 1. Top integrated tax rates on dividends and capital gains, 2011**

| | Dividends | Capital Gains |
|---|---|---|
| Pre-tax corporate earnings | $100 | $100 |
| | Corporate income tax | |
| Top corporate level tax rate (federal, average state and local) | 39.2% | 39.2% |
| **Corporate income taxes paid** | **$39.20** | **$39.20** |
| | Distribution to shareholders | |
| After-tax corporate earnings | $60.80 | $60.80 |
| | Dividend payment to shareholders | Retained earnings or stock buyback leading to capital gains for shareholders |
| | Individual income tax | |
| Top federal dividend/capital gains tax rate | 15.0% | 15.0% |
| Individual taxes paid on dividends/capital gains | $9.12 | $9.12 |
| Average top state individual income tax rate | 4.0% | 4.0% |
| State income tax paid on dividends/capital gains | $2.45 | $2.45 |
| **Total individual income taxes paid** | **$11.57** | **$11.57** |
| **Total taxes paid** | **$50.77** | **$50.77** |
| **Top integrated tax rate** | **50.8%** | **50.8%** |

Source: Ernst & Young LLP.

## The effect of the double tax on economic decision making

A key issue concerning the effect of dividend taxes on business and investor decisions is the extent to which they are capitalized into share values or affect a firm's dividend or investment decisions. Whether dividend taxes are capitalized into share values is important for understanding the distributional effects of dividend taxes because a change in dividend taxes affects not only those who receive company dividend payments, but all those with ownership in company shares. Alternatively to the extent dividend taxes are not capitalized into share values, they will affect investment decisions and company dividend policy by creating a wedge between before and after-tax returns.

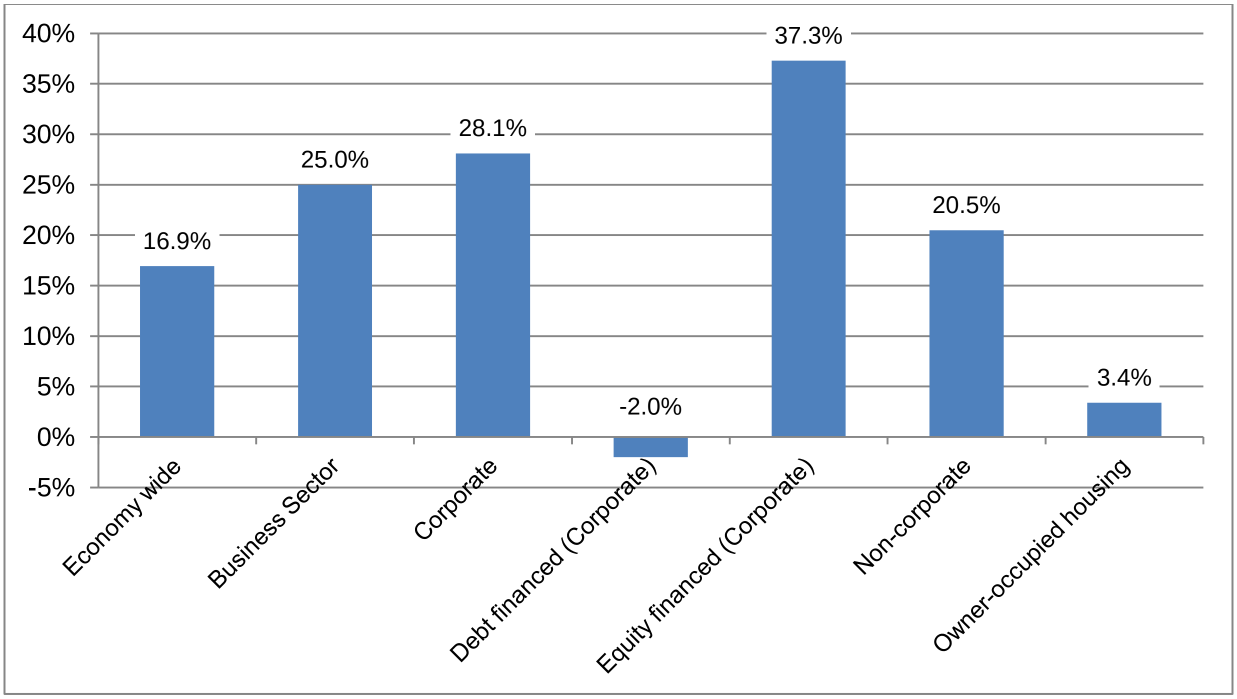
Recent research suggests that a reasonable working assumption is for both views to hold depending on a firm's source of finance. Newer, immature firms more reliant on newly issued equity are less likely to capitalize dividend taxes into share values, while older mature firms more reliant on retained earnings are more likely to capitalize dividends taxes into share values.[6] Under either view, dividend taxes adversely affect the decision to make new equity-financed investment.

The double tax affects a number of economic decisions. One effect is to lower the after-tax return to equity-financed corporate investment, which discourages capital investment and results in less capital formation. With less capital available for each worker to work with, labor productivity is lowered, which reduces the wages of workers, and ultimately, Americans' standard of living. In addition to discouraging capital formation generally, the double tax also distorts a number of other economic decisions.

Economists often use marginal effective tax rates (METR) to measure the impact of taxes on investment and examine differential effects across the economy. METRs capture how various provisions in the Internal Revenue Code (the "Code"), including the statutory tax rates, depreciation deductions, interest deductions, deferral of tax liability, and both the individual and corporate levels of tax, affect the after-tax rate of return to a new investment. The METR shows how much larger an investment's economic income needs to be to cover taxes over its lifetime.

As shown in Figure 1, the METR varies considerably by sector and source of finance and the role the double tax plays. These differentials figure prominently in a number of business and investor decisions including the choice between investing in the corporate versus non-corporate sectors, the choice between debt versus equity finance, and a corporation's dividend policy. The double tax also affects the overall level of investment and capital formation in the economy.

**Figure 1. Marginal effective tax rates on new investment, by sector and method of financing, 2011**




Source: Ernst & Young LLP.

### *Corporate vs. non-corporate investment*

As shown in Figure 1, the METR in the corporate sector (28.1 percent) is considerably higher than in the noncorporate sector (20.5 percent) and this differential can be attributed entirely to the double tax. The double tax increases the required pre-tax rate of return for corporate capital as compared to non-corporate capital. While under a neutral tax system investment would flow to its best and highest use, without regard to its tax treatment, the higher required return that results from the double tax discourages investment in the corporate sector. In addition to the economic harm associated with this misallocation of capital, the double tax also leads to too few companies, particularly those that are publicly-held, receiving the benefits that accompany the corporate form (e.g., centralized management, access to capital markets, limited liability).[7]

### *Debt versus equity finance*

The double tax also contributes to the high METR on equity financed corporate investment (37.3 percent) as compared to investment financed with debt (-2.0 percent). Other factors, such as the deductibility of interest and the fact that some debt is held by tax-exempt entities, such as pension funds and foreigners,[8] contribute to this differential. The high tax rate on equity financed corporate investment as compared to debt financed investment leads to excessive leverage and raises the risk of bankruptcy or other forms of financial distress, particularly during periods of economic weakness. Overreliance on debt also reflects a misallocation of resources in the economy whereby more neutral treatment could raise economic performance.

### *Firm dividend policy*

As a company chooses how to distribute profits to shareholders, the investor level taxes on dividends and capital gains can affect that decision. If dividends are more highly taxed than capital gains, a company will be more likely to use stock repurchases or otherwise retain earnings as a way to return corporate earnings to the shareholder. The shareholder would then pay capital gains tax on the appreciation in share value. Synchronization of dividend and capital gains rates helps reduce the tax bias against dividend payments and was one rationale behind the lower dividend tax rate enacted in 2003.

Favorable treatment for capital gains over dividends will lead to an over-investment of firms financing new investment through retained earnings. This may be more heavily concentrated in certain sectors of the economy, thereby distorting the allocation of resources. Dividends can also have the added benefit of improving corporate governance as they are a simple and important signal to investors of a company's financial viability.[9] Finally, dividends can also help address the principal-agent problem by serving as a restraint on corporate managers deviating too far from the interest of investors.

Evidence from the lower dividend tax rate enacted in 2003 found that dividend payments by publicly traded corporations increased by approximately 20 percent within a year after the enactment of the tax cut.[10] An earlier study suggested that dividends would increase by approximately 30 percent as a result of reducing tax rates on dividends and capital gains.[11] Were dividend taxes to increase in 2013 as scheduled, it is reasonable to expect that businesses would reduce dividend payments.

### *Overall investment*

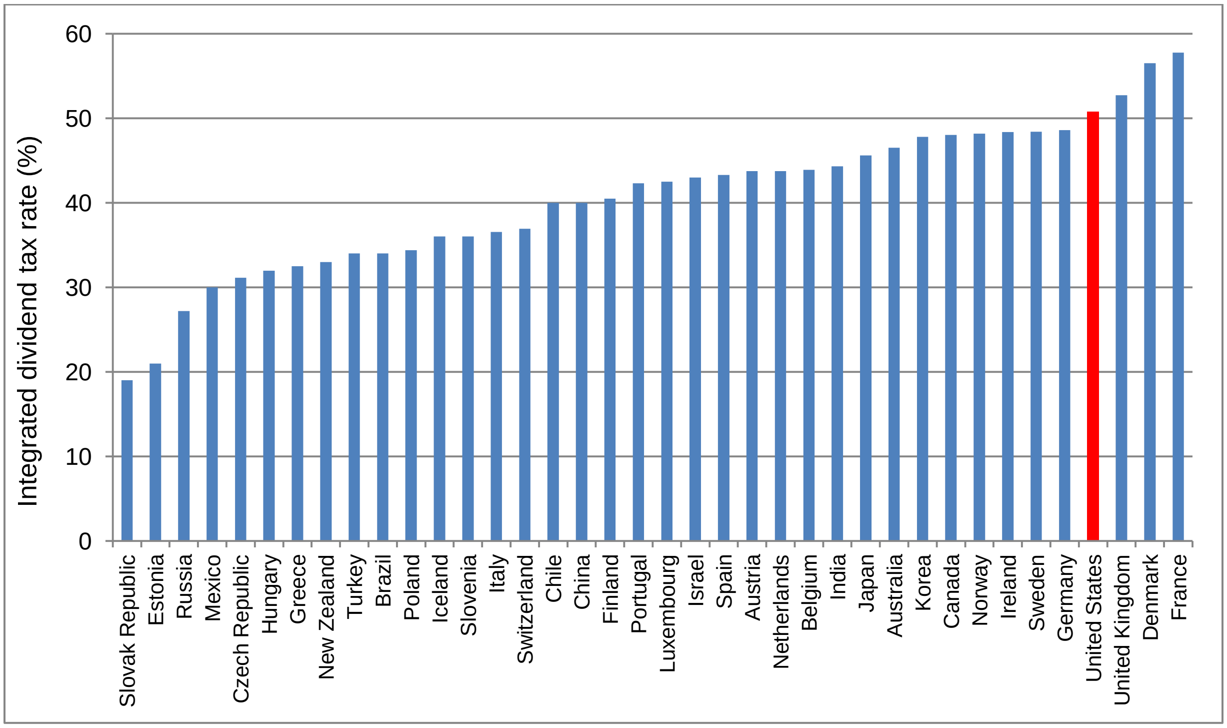
Without the lower investor level taxes on dividends and capital gains enacted in 2003, the overall METR on new investment would be 12 percent higher (a METR of 19.0 percent) than shown in Figure 1 (16.9 percent).[12] Also accounting for the increase in the top ordinary income tax rate to 39.6 percent and the application of the 3.8 percent Medicare tax  to unearned income, the overall METR on new investment would rise by nearly 20 percent (to 20.4 percent). The increase in the METR for new investment would increase the most in the corporate sector due to the role the tax on dividends and capital gains plays through the double tax on corporate profits. This higher level of tax on investment, particularly investment in the business and corporate sectors, would discourage investment and would reduce labor productivity, and, ultimately, reduce living standards.

## International comparison of dividend and capital gains taxes

Most other developed nations provide at least some relief from the double tax and many have done so for decades. Countries vary in the form of relief, but it is often provided at the shareholder level through three different approaches: a dividend exclusion, lower rates, or an imputation credit, whereby shareholders receive a credit for taxes previously paid at the corporate level.[13]

As shown in Figure 2, among the 34 OECD and four BRIC nations in 2011, the United States (50.8 percent) has the fourth highest integrated dividend tax rate, exceeded only by France (57.8 percent), Denmark (56.5 percent) and the United Kingdom (52.7 percent).

**Figure 2. Integrated dividend tax rates for OECD and BRIC countries, 2011**

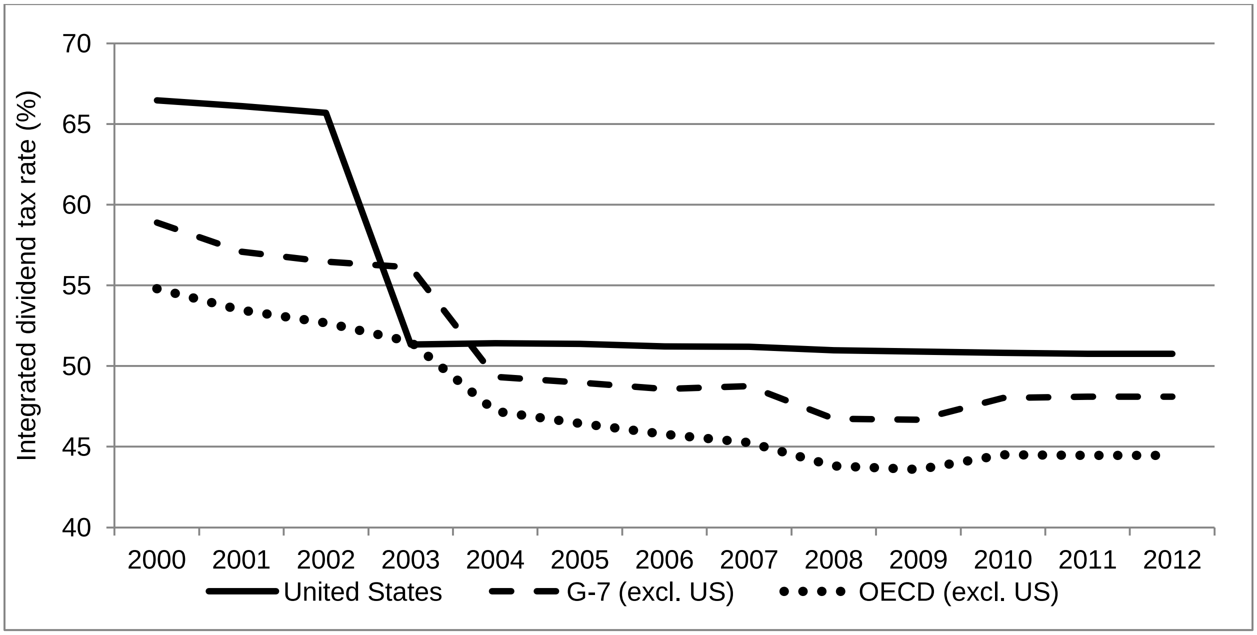



Source: OECD and computations by Ernst & Young LLP.

Prior to 2003, the United States had an integrated dividend tax rate that was far above that in most other developed nations. The integrated US dividend tax rate was 66.5 percent in 2000, as compared to a GDP-weighted average of 58.9 percent among the G-7 nations (non-US) and 54.8 percent among OECD nations (non-US).

An important aspect of the recent experience abroad is the significant reduction in the tax rate on corporate earnings paid out as dividends. As shown in Figure 3, while the United States had achieved near parity when the US dividend tax rate was reduced in 2003, the United States now has an integrated dividend tax rate of 50.8 percent, above the GDP-weighted average of 48.1 percent rate for the G-7 (non-US) and the GDP-weighted average of 44.5 percent rate for the OECD (non-US).

**Figure 3. Trend in integrated dividend tax rates (GDP-weighted), 2000-2012**




Note: Integrated tax rates for the G-7 and the OECD, both excluding the United States, are weighted by each country's gross domestic product.
Source: OECD and computations by Ernst & Young LLP.

A major factor explaining the decline in the GDP-weighted average integrated dividend tax rates abroad is the reduction in corporate income tax rates. As shown in Table 2, of the 34 OECD nations, 30 have lowered their statutory corporate tax rates since 2000. The four BRIC countries – Brazil, the Russian Federation, India and China – have also all lowered their corporate tax rates.

Moreover, scheduled reductions in corporate income tax rates abroad will continue to further drive down the integrated dividend tax rates. The United Kingdom is scheduled to lower its corporate tax rate to 23 percent by 2014. Canada lowered its federal corporate tax rate to 16.5 percent in 2011, with a further reduction to 15 percent in 2012.[14] The Japanese government recently enacted a reduction in its federal corporate income tax rate by 5 percentage points and the enactment of a temporary 3-year 10 percent surtax applied to the federal tax rate, both effective April 1, 2012.

Changes in personal dividend tax rates were more varied across countries (see Table 3). Overall, the "effective" personal dividends tax rate, which takes into account all the varied features of a country's tax treatment of dividends under its individual income tax, fell among OECD nations (non-US) from a GDP-weighted average of 28.9 percent in 2000 to 21.4 percent in 2011. Among G-7 countries (non-US) the GDP-weighted average personal dividend tax rate fell from 33.0 percent to 22.9 percent.

These reductions in the average personal dividend tax rate, however, were primarily due to the sharply lower personal dividend tax rate enacted in Japan in 2003, which reduced Japan's personal dividend tax rate from 50 percent to 10 percent.[15] Canada moved from a partial imputation credit to a full imputation credit, but also lowered its corporate tax rate leaving its personal dividend tax rate only somewhat lower (28.7 percent in 2011 as compared to 32.3 percent in 2000). France and Germany both experienced modest declines in their personal dividend tax rates. In the United Kingdom, which retained its partial imputation system, the personal dividend tax rate rose from 25 percent to 36.1 percent.

**Table 2. Top corporate tax rates by country, 2000 and 2011**

| Country | Top corporate tax rate (2000) | Top corporate tax rate (2011) |
|---|---|---|
| | *OECD Countries* | |
| Australia | 34.0 | 30.0 |
| Austria | 34.0 | 25.0 |
| Belgium | 40.2 | 34.0 |
| Canada | 42.4 | 27.6 |
| Chile | 15.0 | 17.0 |
| Czech Republic | 31.0 | 19.0 |
| Denmark | 32.0 | 25.0 |
| Estonia | 26.0 | 21.0 |
| Finland | 29.0 | 26.0 |
| France | 37.8 | 34.4 |
| Germany | 43.3 | 30.2 |
| Greece | 35.0 | 20.0 |
| Hungary | 18.0 | 19.0 |
| Iceland | 30.0 | 20.0 |
| Ireland | 24.0 | 12.5 |
| Israel | 36.0 | 24.0 |
| Italy | 37.0 | 27.5 |
| Japan | 40.9 | 39.5 |
| Korea | 30.8 | 24.2 |
| Luxembourg | 37.5 | 28.6 |
| Mexico | 35.0 | 30.0 |
| Netherlands | 35.0 | 25.0 |
| New Zealand | 33.0 | 28.0 |
| Norway | 28.0 | 28.0 |
| Poland | 30.0 | 19.0 |
| Portugal | 35.2 | 26.5 |
| Slovak Republic | 29.0 | 19.0 |
| Slovenia | 25.0 | 20.0 |
| Spain | 35.0 | 30.0 |
| Sweden | 28.0 | 26.3 |
| Switzerland | 24.9 | 21.2 |
| Turkey | 33.0 | 20.0 |
| United Kingdom | 30.0 | 26.0 |
| **United States** | **39.3** | **39.2** |
| OECD Avg (non-US) | 36.3 | 29.1 |
| | *BRIC Countries* | |
| Brazil (non-OECD) | 37.0 | 34.0 |
| Russia (non-OECD) | 30.0 | 20.0 |
| India (non-OECD) | 38.5 | 33.2 |
| China (non-OECD) | 33.0 | 25.0 |

Note: Weighted average based on each country's GDP. Include both central government and subnational tax rates.
Source: OECD, *Table II.4. Overall statutory tax rates on dividend income* and computations by Ernst & Young LLP (BRIC countries and United States).

**Table 3. Tax rates on dividends for the OECD and BRIC countries, 2000 and 2011**

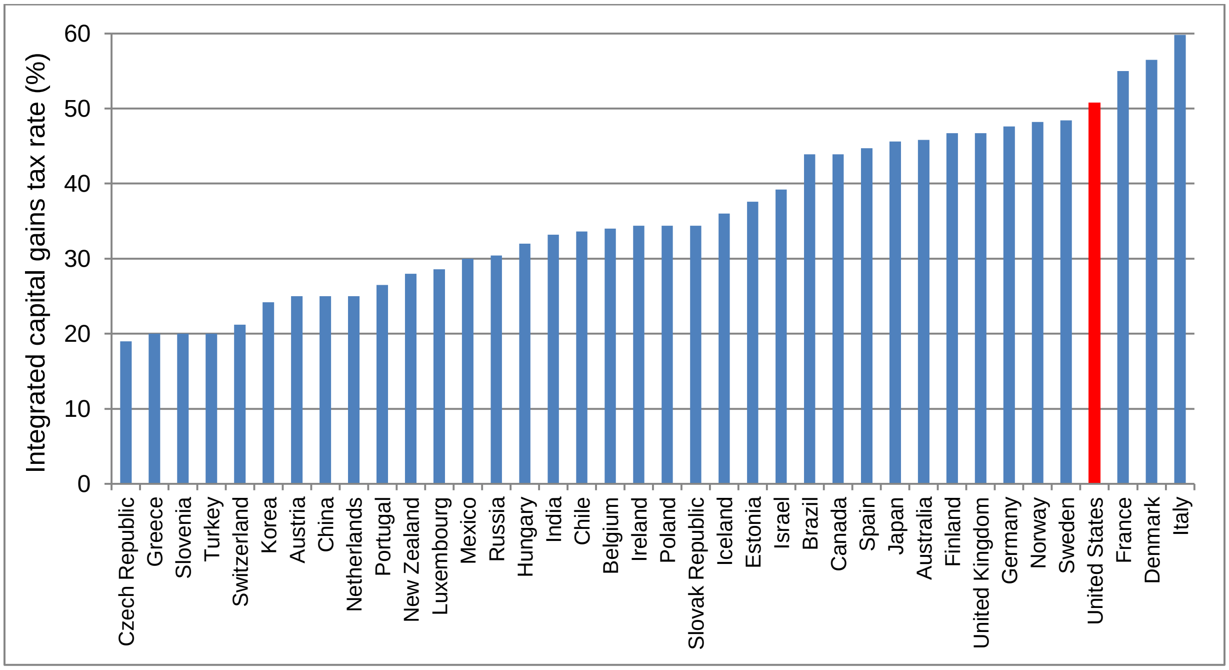
| **Country** | **Top personal dividend tax rate (2000)** | **Integrated dividend tax rate (2000)** | **Top personal dividend Tax rate (2011)** | **Integrated dividend tax rate (2011)** |
|---|---|---|---|---|
| *OECD Countries* | | | | |
| Australia | 22.0* | 48.5 | 23.6* | 46.5 |
| Austria | 25.0 | 50.5 | 25.0 | 43.8 |
| Belgium | 15.0 | 49.1 | 15.0 | 43.9 |
| Canada | 32.3* | 61.0 | 28.2* | 48.0 |
| Chile | 35.3* | 45.0 | 27.7* | 40.0 |
| Czech Republic | 15.0 | 41.4 | 15.0 | 31.2 |
| Denmark | 40.0 | 59.2 | 42.0 | 56.5 |
| Estonia | 0 | 26.0 | 0.0 | 21.0 |
| Finland | 0* | 29.0 | 19.6 | 40.5 |
| France | 40.8* | 63.2 | 35.6 | 57.8 |
| Germany | 31.1* | 60.9 | 26.4 | 48.6 |
| Greece | 0 | 35.0 | 21.0 | 32.5 |
| Hungary | 46.0 | 55.7 | 16.0 | 32.0 |
| Iceland | 10.0 | 37.0 | 20.0 | 36.0 |
| Ireland | 44.0 | 57.4 | 41.0 | 48.4 |
| Israel | 25.0 | 52.0 | 25.0 | 43.0 |
| Italy | 12.5 | 44.9 | 12.5 | 36.6 |
| Japan | 43.6* | 66.7 | 10.0 | 45.6 |
| Korea | 20.0 | 44.6 | 31.1* | 47.8 |
| Luxembourg | 23.6 | 52.2 | 19.5 | 42.5 |
| Mexico | 0* | 35.0 | 0* | 30.0 |
| Netherlands | 60.0 | 74.0 | 25.0 | 43.8 |
| New Zealand | 8.9* | 39.0 | 6.9* | 33.0 |
| Norway | 0* | 28.0 | 28.0 | 48.2 |
| Poland | 20.0 | 44.0 | 19.0 | 34.4 |
| Portugal | 25.0 | 51.4 | 21.5 | 42.3 |
| Slovak Republic | 15.0 | 39.7 | 0 | 19.0 |
| Slovenia | 30.0 | 47.5 | 20.0 | 36.0 |
| Spain | 27.2* | 52.7 | 19.0 | 43.3 |
| Sweden | 30.0 | 49.6 | 30.0 | 48.4 |
| Switzerland | 42.1 | 56.5 | 20.0 | 36.9 |
| Turkey | 31.2* | 65.0 | 17.5 | 34.0 |
| United Kingdom | 25.0* | 47.5 | 36.1* | 52.7 |
| **United States** | **44.8** | **66.5** | **19.1** | **50.8** |
| OECD Avg (non-US)* | 28.9 | 54.8 | 21.4 | 44.5 |
| *BRIC Countries* | | | | |
| Brazil (non-OECD) | 15.0 | 46.5 | 0 | 34.0 |
| Russia (non-OECD) | 15.0 | 40.5 | 9.0 | 27.2 |
| India (non-OECD) | 10.0 | 44.7 | 16.6 | 44.3 |
| China (non-OECD) | 20.0 | 46.4 | 20.0 | 40.0 |

*Dividend imputation system used.
Note: Weighted average based on each country's GDP. Include both central government and subnational tax rates.
Source: OECD, *Table II.4. Overall statutory tax rates on dividend income* and computations by Ernst & Young LLP (BRIC countries and United States).

***Integrated statutory tax rate on long-term capital gains also among highest in the world***

The United States also had one of the highest integrated long-term capital gains tax rates among developed nations in 2011 (Figure 4). Among the OECD and BRIC countries, only three countries, Italy (59.8 percent), Denmark (56.5 percent) and France (55.0 percent) have integrated long-term capital gains tax rates exceeding the US integrated long-term capital gains tax rate of 50.8 percent (Table 4). Even though the US integrated long-term capital gains tax rate ranks amongst the highest, the 19.1 percent US long-term capital gains rate is only somewhat higher than the GDP weighted average of 17.8 percent for OECD nations (non-US).

**Figure 4. Integrated long-term capital gains tax rates for OECD and BRIC countries, 2011**




Source: Ernst & Young LLP, The 2011 Global Executive, 2011 and computations by Ernst & Young LLP.

Eighteen of the 34 OECD and four BRIC countries have a long-term capital gains tax rate that exceeds the rate in the United States. Eleven of the OECD and BRIC countries have a zero capital gains tax rate, although many of these countries tend to be among the smaller economies.

Another aspect to capital gains taxation is whether countries typically tax capital gains at tax rates that are lower than those applied to ordinary income. In addition to the issues related to the double tax described above, a lower tax rate on capital gains can be justified on policy grounds because high capital gains tax rates lengthen investors' holding period and the capital gains tax is a tax on both real and inflationary gains. About four-fifths of the OECD and BRIC countries tax capital gains at rates below the rates applied to ordinary income.

The rules governing capital gains, such as holding periods, special rates, and other special rules for particular assets, vary widely among countries. A summary of these rules is provided in the Appendix.

**Table 4. Integrated long-term capital gains tax rates on corporate equities by country, 2000 and 2011**

| Country | Top long-term capital gains tax rate (2000) | Integrated capital gains tax rate (2000) | Top long-term capital gains tax rate (2011) | Integrated capital gains tax rate (2011) |
|---|---|---|---|---|
| *OECD Countries* | | | | |
| Australia | 47.0 | 65.0 | 22.5 | 45.8 |
| Austria | 0 | 34.0 | 0 | 25.0 |
| Belgium | 0 | 40.2 | 0 | 34.0 |
| Canada | 36.65 | 63.5 | 22.54 | 43.9 |
| Chile | 15.0 | 27.8 | 20.0 | 33.6 |
| Czech Republic | 32.0 | 53.1 | 0 | 19.0 |
| Denmark | 40.0 | 59.2 | 42.0 | 56.5 |
| Estonia | 26.0 | 45.2 | 21.0 | 37.6 |
| Finland | 28.0 | 48.9 | 28.0 | 46.7 |
| France | 26.0 | 54.0 | 31.3 | 54.9 |
| Germany | 0 | 43.3 | 25.0 | 47.7 |
| Greece | 0 | 35.0 | 0 | 20.0 |
| Hungary | 20.0 | 34.4 | 16.0 | 32.0 |
| Iceland | 38.34 | 56.8 | 20.0 | 36.0 |
| Ireland | 20.0 | 39.2 | 25.0 | 34.4 |
| Israel | 50.0 | 68.0 | 20.0 | 39.2 |
| Italy | 12.5 | 44.9 | 44.5 | 59.8 |
| Japan | 26.0 | 56.3 | 10.0 | 45.6 |
| Korea | 20.0 | 44.6 | 0 | 24.2 |
| Luxembourg | 0 | 37.5 | 0 | 28.6 |
| Mexico | 0 | 35.0 | 0 | 30.0 |
| Netherlands | 0 | 35.0 | 0 | 25.0 |
| New Zealand | 0 | 33.0 | 0 | 28.0 |
| Norway | 28.0 | 48.2 | 28.0 | 48.2 |
| Poland | 0 | 30.0 | 19.0 | 34.4 |
| Portugal | 0 | 35.2 | 0 | 26.5 |
| Slovak Republic | 42.0 | 58.8 | 19.0 | 34.4 |
| Slovenia | 50.0 | 62.5 | 0 | 20.0 |
| Spain | 20.0 | 48.0 | 21.0 | 44.7 |
| Sweden | 30.0 | 49.6 | 30.0 | 48.4 |
| Switzerland | 0 | 24.9 | 0 | 21.2 |
| Turkey | 0 | 33.0 | 0 | 20.0 |
| United Kingdom | 24.0 | 46.8 | 28.0 | 46.7 |
| **United States** | **25.0** | **54.5** | **19.1** | **50.8** |
| OECD Avg (non-US)* | 17.4 | 47.4 | 17.8 | 41.7 |
| *BRIC Countries* | | | | |
| Brazil (non-OECD) | 15.0 | 46.5 | 15.0 | 43.9 |
| Russia (non-OECD) | 30.0 | 51.0 | 13.0 | 30.4 |
| India (non-OECD) | 10.0 | 44.7 | 0 | 33.2 |
| China (non-OECD) | 20.0 | 46.4 | 0 | 25.0 |

Note: Weighted average based on each country's GDP. Includes both central government and subnational tax rates.
Source: Ernst & Young LLP, *The 2011 Global Executive*, 2011 and computations by Ernst & Young LLP.

## Dividend and capital gains tax rates in 2013

Several changes scheduled to occur in 2013 will significantly increase the double tax on corporate profits. First, the lower tax rates on ordinary income, dividends and long-term capital gains enacted in 2001 and 2003 are scheduled to sunset. Consequently, in 2013 the top federal rate on long-term capital gains will rise to 20 percent and the top tax rate on dividends will rise to 39.6 percent. Second, under the Affordable Care Act of 2010 (ACA), beginning in 2013 a 3.8 percent Medicare tax will apply to unearned income for individuals with annual incomes over $200,000 ($250,000 for married couples).

As shown in Table 5, these changes will have a significant effect on the dividends and long-term capital gains tax rates. The top federal statutory tax rate on dividends will rise from 15 percent in 2011 to 43.4 percent in 2013, reflecting both the top 39.6 percent ordinary tax rate and the 3.8 percent Medicare tax. The top integrated dividend tax rate will rise from 50.8 percent to 68.6 percent, the highest among OECD and BRIC countries.

The tax rates on long-term capital gains will also rise. The top federal statutory long-term capital gains rate will increase from 15 percent to 23.8 percent, including the 3.8 percent Medicare tax. The top integrated long-term capital gains tax rate will rise from 50.8 percent to 56.7 percent, the second highest among OECD and BRIC countries.

Under President Obama's fiscal year 2012 Budget, the top tax rates on dividends and long-term capital gains would increase to 23.8 percent for high-income taxpayers (i.e., married couples with incomes greater than $250,000 and single persons with incomes greater than $200,000). Importantly, the Obama Administration would keep the statutory dividends and long-term capital gains tax rates synchronized. With these changes the top integrated dividends and long-term capital gains tax rates would increase to 56.7 percent.

The President's Fiscal Responsibility Commission proposed to tax both dividends and long-term capital gains as ordinary income at a top tax rate of 28 percent. Again, there was recognition of the importance for synchronizing the statutory tax rates for dividends and long-term capital gains. With these changes the top integrated dividends and long-term capital gains tax rates would increase to 57.1 percent.

The Bi-partisan Tax Fairness and Simplification Act proposed by Senators Ron Wyden (D-OR) and Dan Coats (R-IN) would tax dividends and long-term capital gains at a top ordinary tax rate of 35 percent, but allow an exclusion of 35 percent of dividends and long-term capital gains. This results in a top effective individual tax rate on dividends and long-term capital gains of 22.75 percent. This plan also lowers the corporate tax rate to 24 percent. The top integrated dividends and long-term capital gains tax rates would be close to current law at 50.7 percent.

Also shown on Table 5 are the effects of an "illustrative tax plan" that lowers the top individual and corporate tax rates to 25 percent, taxes dividends at ordinary tax rates and taxes long-term capital gains at a top rate of 20 percent. With these changes, the integrated dividends tax rate would be 53.2 percent and the integrated capital gains tax rate would by 49.7 percent, above the integrated rates in most OECD and BRIC countries.

**Table 5. Effect of proposals on the top integrated dividend and capital gains tax rates**

| | 2011 Law | 2013 Law | Proposals Affecting Dividends and Capital Gains: Obama FY 2012 Budget Proposal | President's Fiscal Responsibility and Reform Commission | Wyden-Coats Bi-Partisan Tax Fairness and Simplification Act | Illustrative Tax Plan: Top 25% Federal Corporate tax rate |
|---|---|---|---|---|---|---|
| Federal-state corporate income tax rate | 39.2% | 39.2% | 39.2% | 32.7% | 28.9% | 29.9% |
| Dividends | | | | | | |
| Top federal dividend tax rate | 15.0% | 39.6% | 20.0% | 28.0% | 22.75% | 25.0% |
| Medicare tax | 0.0% | 3.8% | 3.8% | 3.8% | 3.8% | 3.8% |
| State dividend tax rate (includes fed. deductibility) | 4.0% | 4.9% | 4.9% | 4.5% | 4.0% | 4.9% |
| Federal-state dividend tax rate | 19.0% | 48.3% | 28.7% | 36.3% | 30.6% | 33.7% |
| **Integrated dividend tax rate** | **50.8%** | **68.6%** | **56.7%** | **57.1%** | **50.7%** | **53.2%** |
| Capital gains | | | | | | |
| Top federal long-term capital gains tax rate | 15.0% | 20.0% | 20.0% | 28.0% | 22.75% | 20.0% |
| Medicare tax | 0.0% | 3.8% | 3.8% | 3.8% | 3.8% | 3.8% |
| State cap. gains tax rate (includes fed. deductibility) | 4.0% | 4.9% | 4.9% | 4.5% | 4.0% | 4.9% |
| Federal-state long-term capital gains tax rate | 19.0% | 28.7% | 28.7% | 36.3% | 30.6% | 28.7% |
| **Integrated long-term capital gains tax rate** | **50.8%** | **56.7%** | **56.7%** | **57.1%** | **50.7%** | **49.7%** |

*Addendum: Major features of tax plans relating to dividends and capital gains*

| | Federal corporate income tax rate | Federal dividend tax rate | Federal capital gains tax rate |
|---|---|---|---|
| Obama FY 2012 Budget Proposal | 35% | Top 20% tax rate | Top 20% tax rate |
| President's National Commission on Fiscal Responsibility and Reform Report | 28% | Subject to 28% tax rate on ordinary income | Subject to 28% tax rate on ordinary income |
| Wyden-Coats Bi-Partisan Tax Fairness and Simplification Act | 24% | 35%-exclusion applied to 35% top ordinary tax rate | 35%-exclusion applied to 35% top ordinary tax rate |
| Illustrative tax plan | 25% | Subject to 25% tax rate on ordinary income | Top 20% tax rate |

Note: Estimates of 2013 law and the Obama FY 2012 Budget proposal include the effects of the limitation on itemized deductions for higher income taxpayers ("Pease" provision) scheduled to return in 2013 through their effect on the federal deductibility of state and local income taxes.
Source: Computations by Ernst & Young LLP.

## Summary

Even though lower tax rates on dividends and long-term capital gains enacted in the United States in 2003 put the United States on nearly equal footing with other developed nations at that time, subsequent changes in other countries' tax systems have left the United States with high integrated dividend and long-term capital gains tax rates. Much of the recent decline in those integrated rates abroad has been the result of continued reductions in lower corporate income tax rates.

Personal dividend tax rates abroad have remained on average, largely unchanged. Some nations have reduced personal dividend tax rates, while other countries have increased their personal dividends tax rates. Nevertheless, developed countries continue to provide significant relief from the double tax on corporate profits.

The Administration's fiscal year 2012 Budget, as well as the major tax and entitlement reform proposals, have included provisions to address the double tax on corporate profits. These proposals have emphasized both the synchronization of the dividends and long-term capital gains tax rates and have proposed changes to both the corporate and individual level tax that would generally keep the integrated dividends and long-term capital gains tax rates well below the levels scheduled to take effect in 2013.

## Appendix

### Tax treatment of long-term capital gains on corporate equities for OECD and BRIC countries, 2011

| Country | Top Long-Term Individual Capital Gains Tax Rates on Corporate Equities | Holding Period for Long-Term Capital Gains | Other Key Details |
|---|---|---|---|
| Australia | 22.5% | 1 year | Only 50% of the capital gain resulting from the disposal is subject to tax. |
| Austria | 0% | 1 year | Gains derived from the sale of shares in a corporation before 1 October 2011 are taxed at half the normal rate (highest normal rate is 50%) if the shareholder has owned 1% or more of the company at any time during the five years before the sale and if the period between acquisition and sale is more than one year. |
| Belgium | 0% | N/A | |
| Brazil | 15% | N/A | Capital gains on one transaction each month are exempt from tax if the sale price is less than R$35,000. Capital gains derived from the sale of shares listed on Brazilian stock exchanges are exempt from tax if the sale price is less than R$20,000 (approximately US$12,500). If the sale price exceeds R$20,000, the entire gain is taxed at a rate of 15%. |
| Canada | 22.54 | N/A | Capital gains tax equal to half of ordinary income rate. |
| Chile | 20% | N/A | Capital gains derived from sales of shares and other investments are subject to the First Category Tax as a final tax if the transactions are not habitual and not between related parties. The rates of this First Category Tax are 20% for 2011, 18.5% for 2012 and 17% for 2013 and future years. |
| China | 0% | N/A | |

| Country | Top Long-Term Individual Capital Gains Tax Rates on Corporate Equities | Holding Period for Long-Term Capital Gains | Other Key Details |
|---|---|---|---|
| Czech Republic | 0% | 6 months | The sale of securities is exempt from tax if the securities have been held for a period of more than 6 months and if the individual had less than a direct share of 5% in the company in the 24-month period preceding the sale. |
| Denmark | 42% | N/A | |
| Estonia | 21% | N/A | |
| Finland | 28% | N/A | |
| France | 31.3% | N/A | |
| Germany | 25% | N/A | Gains on the sale of shares are not subject to tax if all of the following conditions are satisfied:<br>• The shares were acquired before 1 January 2009.<br>• The vendor had a participation of less than 1% in the company.<br>• The shares were held by the vendor for more than one year. |
| Greece | 0% | N/A | Capital gains derived from the sale of listed shares acquired on or after 1 January 2012 will be subject to tax according to the general |

| Country | Top Long-Term Individual Capital Gains Tax Rates on Corporate Equities | Holding Period for Long-Term Capital Gains | Other Key Details |
|---|---|---|---|
| | | | income tax provisions. |
| Hungary | 16% | N/A | If transaction applies to a qualified percentage of company's shares, the ordinary rate applies to 49.72% of the gain.(40% for earnings yielded before 1 January 2008.) |
| Iceland | 0% | N/A | In general, a capital gains withholding tax at a rate of 20% is levied on all capital gains realized by nonresidents. |
| India | 0% | 1 year | Long-term capital gains (gains derived from listed securities held longer than one year) derived from the transfer of equity shares or units of an equity-oriented fund listed on a recognized stock exchange in India are exempt from tax if Securities Transaction Tax (STT) is payable on such transaction. |
| Ireland | 25% | N/A | Exemptions are available on capital gains for the first €1,270 of taxable gains derived during the 2011 tax year. |
| Israel | 20% | N/A | Israeli residents are taxed at a rate of 20% on the real (inflation adjusted) gains derived from sales of traded securities in Israel and abroad. |
| Italy | 44.5% | N/A | Capital gains derived by residents from the sale of securities (including shares representing capital and other similar interests, convertible obligations, stock options and similar rights) not related to business activities are subject to a flat tax. The income tax rates are: 23%, 27%, 38%, 41%, & 43%. If transaction applies to a qualified percentage of company's shares, the ordinary rate applies to 49.72% of the gain.(40% for earnings yielded before 1 January 2008.) |

| Country | Top Long-Term Individual Capital Gains Tax Rates on Corporate Equities | Holding Period for Long-Term Capital Gains | Other Key Details |
|---|---|---|---|
| Japan | 10% | N/A | Capital gains derived from the sale of shares are generally taxed at 20% (15% national tax plus 5% local inhabitant tax). If a taxpayer sells certain listed shares through a securities company or bank in Japan, a reduced tax rate of 10% (7% national tax plus 3% local inhabitant tax) applies until 31 December 2011. |
| Korea | 0% | N/A | Although capital gains derived from the transfer of shares in a company listed in the Korean stock market are not taxable, the shareholder of such a listed company is subject to capital gains tax on gains derived from the transfer of shares if the shareholder, together with related parties, owned at least 3% of the total outstanding shares or at least W 10 billion worth of the shares based on the market value at the end of the preceding year ("majority shareholder"). In general, gains derived from taxable transfers of shares are subject to tax at a rate of 20% (22% including resident surtax). |
| Luxembourg | 0% | 6 months | Substantial shareholdings (more than 10%) in resident or nonresident corporations are fully subject to tax on capital gains in the hands of resident taxpayers. The maximum rates are 40.56% or 41.34% for 2011. |
| Mexico | 0% | N/A | Gains derived from shares sold on the Mexican stock exchange are exempt from tax if the taxpayer does not trade more than 10% of the paid-in stock of the listed company within a period of 24 months. Otherwise it is taxed as normal income, the highest rate it 30%. |
| Netherlands | 0% | N/A | Capital gains derived from the sale of a substantial interest in a company (that is, 5% of the issued share capital) is taxed at a rate of 25%. |

| Country | Top Long-Term Individual Capital Gains Tax Rates on Corporate Equities | Holding Period for Long-Term Capital Gains | Other Key Details |
|---|---|---|---|
| New Zealand | 0% | N/A | |
| Norway | 28% | N/A | |
| Poland | 19% | 6 months | |
| Portugal | 46.5% | 1 year | Capital gains derived from sales of shares of stock companies, bonds and debentures, up to an annual positive balance (between gains and losses) of €500 are exempt from tax. After that, they are taxed at normal income rates. |
| Russia | 13% | N/A | Taxed at normal income tax rate. |
| Slovak Republic | 19% | N/A | Taxed at normal income tax rate. |
| Slovenia | 0% | N/A | Capital gains are taxed at a flat tax rate of 20% with a reduction of the tax rate for every completed five-year period of ownership of the capital. As a result, the following are the tax rates:<br>• 15% after 5 years<br>• 10% after 10 years<br>• 5% after 15 years<br>• 0% after 20 years |
| Spain | 21% | N/A | Capital gains derived by tax residents are taxed at a rate of 19% on the first €6,000 and at a rate of 21% on the amount exceeding €6,000. |
| Sweden | 30% | N/A | |
| Switzerland | 0% | N/A | |
| Turkey | 0% | N/A | |

| Country | Top Long-Term Individual Capital Gains Tax Rates on Corporate Equities | Holding Period for Long-Term Capital Gains | Other Key Details |
|---|---|---|---|
| United Kingdom | 28% | N/A | Effective from 23 June 2010, the 18% rate applies to basic rate taxpayers only. Higher rate taxpayers (individuals with taxable income exceeding £35,000) pay capital gains tax at a rate 28%. Gains derived from the disposal of a business are taxed at a rate of 10%. A lifetime allowance known as "entrepreneurs' relief," is granted. This lifetime allowance is increased to £10 million, effective from 6 April 2011. |
| United States | 19.1% | 1 year | The federal tax rate is 0% for individuals in the 10% or 15% bracket for ordinary income. Includes average state capital gains tax rate, after accounting for federal deductibility of state and local taxes. |

Source: Ernst & Young LLP, *The 2011 Global Executive*, 2011.

[1] The ability of businesses to organize as pass-through entities, such as S corporations, partnerships and sole proprietorships, that are subject to only one level of tax on income allocated to owners can be viewed as one form of “self-help” integration, although generally limited to smaller and/or closely-held businesses. A limited dividend exclusion was included in the Internal Revenue Code from 1954 through 1986, but repealed by the Tax Reform Act of 1986 in favor of lower tax rates generally. This exclusion, however, only applied to a small portion of company dividends because it was limited to $100 per filer in most years. Prior to 1954, an exclusion for dividends was generally provided for a portion of the double tax.

[2] For 1984 the exemption was increased to $200 per filer.

[3] The tax reform plan put forward in 1984 by the US Treasury Department (Treasury I) that eventually led to the Tax Reform Act of 1986 had recommended a 50-percent dividends paid deduction for C corporations. The plan would have recommended a full dividends paid deduction except for revenue considerations. See U.S. Department of the Treasury, *Tax Reform for Fairness, Simplicity, and Economic Growth: The Treasury Department Report to the President*, November 10, 1984, p.119.

[4] The top individual income tax rate was increased from 28 percent to 31 percent in 1990 under the Omnibus Reconciliation Act of 1990 and from 31 percent to 39.6 percent under the Omnibus Reconciliation Act of 1993.

[5] It is common practice to reduce the individual long-term capital gains effective tax rate by 50 percent to reflect the benefit of deferring capital taxes until gains are realized (i.e., asset sold) and another 50 percent to reflect the benefit of step-up of basis at death. The adjustments would reduce the integrated tax rate for income that is retained and ultimately taxed as long-term capital gains to 43.1 percent.

[6] See Alan J. Auerbach and Kevin A. Hassett, (2003), “On the Marginal Source of Investment Funds,” *Journal of Public Economics,* 87 (1), January, pp. 205-232.

[7] Limited liability is also available to many pass-through businesses that organize as limited liability corporations (LLCs) or partnerships (LLPs).

[8] The low METR for debt-financed investment reflects the deductibility of interest by businesses and that roughly one-half of debt is held by tax-exempt taxpayers, such as pension funds and foreigners.

[9] For example, see Randall Morck and Bernard Yeung, (2005), “Dividend Taxation and Corporate Governance,” *Journal of Economic Perspectives,* Vol. 19(3), pp. 163-180.

[10] See Raj Chetty and Emmanuel Saez, (2005), “The Effects of the 2003 Dividend Tax Cut on Corporate Behavior: Interpreting the Evidence,” *American Economic Review*, Vol. 96(2), pp. 124-129.

[11] See James Poterba, (2004), “Taxation and Corporate Payout Policy,” *American Economic Review,* Vol. 94(2), pp. 171-175.

[12] Estimates are based on the Ernst & Young LLP QUEST Cost of Capital Model assuming the top federal dividend tax rate rises to 39.6 percent and the top federal capital gains tax rate rises to 20 percent. The estimates also assume that 50 percent of the higher dividend tax rates are capitalized into share values and the remaining 50 percent influences investment incentives.

[13] Under an imputation credit, shareholders gross up their dividend by the corporate tax rate (i.e., the dividend divided by one minus the corporate tax rate) to compute the gross dividend. The taxpayer then claims the allowed credit. A full imputation system would completely eliminate the corporate level tax, while a partial credit would eliminate just part of the corporate level tax.

[14] Canada’s combined national-subnational corporate income tax rate was lowered from 29.4 percent in 2010 to 27.6 percent in 2011. Further rate reductions will lower the combined corporate tax rate to 25.75 percent by 2014.

[15] The average OECD personal dividend tax rate excluding both the United States and Japan fell from 25.6 percent in 2000 to 23.6 percent in 2001. The personal dividend tax rate for G-7 countries excluding both the United States and Japan was virtually unchanged (28.4 percent in 2000 and 28.1 percent in 2011).