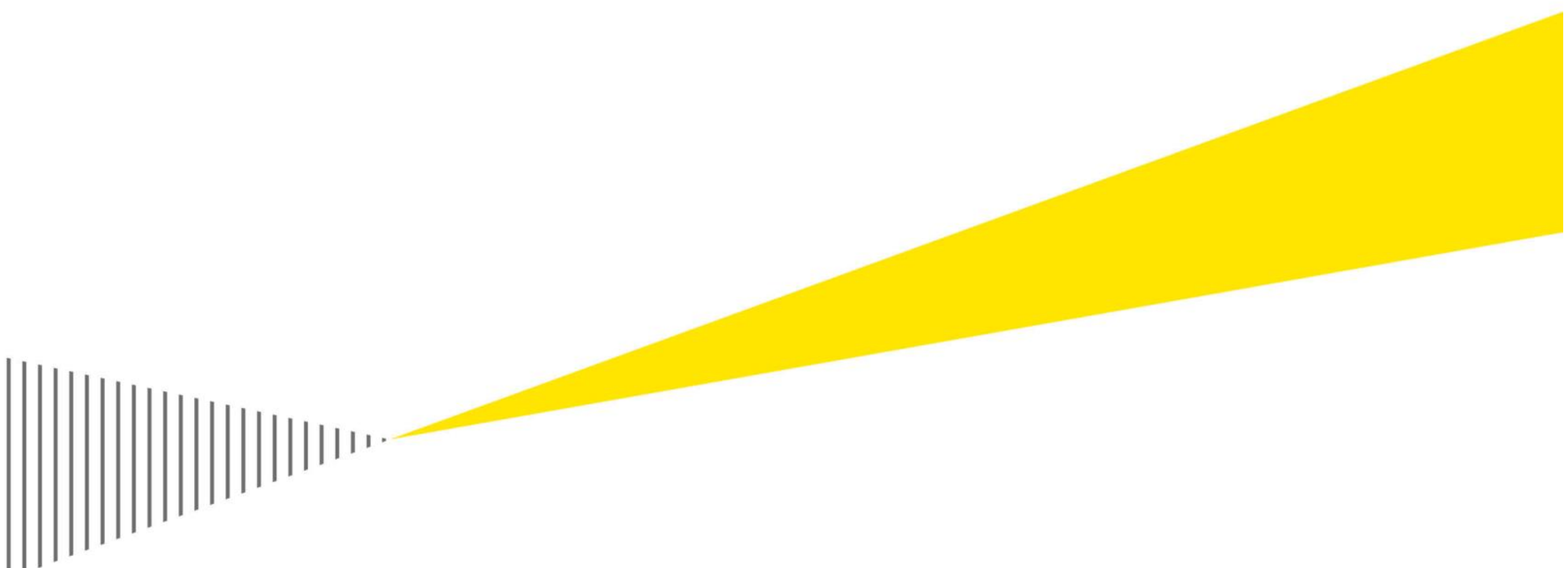
Corporate dividend and capital gains taxation: A comparison of the United States to other developed nations

Prepared for the Alliance for Savings and Investment

April 2015



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Executive summary

This report finds that for 2014, the top US integrated tax rate on corporate profits, which combines corporate-level taxes with investor-level taxes on dividends and capital gains, are among the highest of developed nations. The top US integrated tax rate has increased over the past several years due to the new 3.8% tax on investment income enacted under the 2010 health insurance reform and the increase in the top federal tax rate on dividends and capital gains from 15% to 20% beginning in 2013. The top integrated tax rate has fallen in many other countries since 2000, in large part, due to reductions in statutory corporate income tax rates.

Taking into account both the corporate- and investor-level taxes on corporate profits at the national and subnational level, in 2014 the United States has the second highest top integrated tax rates on both dividends and capital gains among developed countries (OECD and BRIC):

- The top US integrated dividend tax rate is 56.2%, while the average integrated tax rate among OECD and BRIC countries (weighted by GDP and excluding the United States) is 44.5%. In other words, the US rate is nearly 12 percentage points higher than the prevailing average among OECD and BRIC countries.
- The top US integrated long-term capital gains tax rate is 56.3%, while the average integrated tax rate among OECD and BRIC countries (weighted by GDP and excluding the United States) is 40.3%. The US rate is 16 percentage points higher than the prevailing average 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.
- It discourages the payment of dividends and, consequently, can impact corporate governance as investors' decisions about how to allocate capital are disrupted by the absence of signals dividend payments would normally provide.

High tax rates on capital gains also encourage investors to hold assets longer than they would otherwise, a phenomenon referred to as the lock-in effect.

The top integrated tax rates on dividends and capital gains include the following elements of the US income tax system:

- A top federal-state combined statutory corporate income tax rate of 39.0%
- The top federal income tax rate on dividends and capital gains of 20%, which rose from 15% in 2012.
- An average top state income tax rate on dividends (4.4% incl. federal deductibility) and capital gains (4.5% incl. federal deductibility).

- A 3% limitation on itemized deductions for high-income taxpayers (the "Pease" limitation) reinstated in 2012.
- The 3.8% tax on unearned income enacted to help fund the Patient Protection and Affordable Care Act of 2010.

Recent tax plans have varying top dividends and capital gains integrated tax rates, but in most cases leave the United States with top integrated tax rates that remain among the highest of developed nations. Prominent tax plans include:

- Former House Ways and Means Committee Chairman Dave Camp's (R-MI) Tax Reform Act of 2014, which would decrease both the top integrated dividend tax rate (51.2%) and the top integrated long-term capital gains tax rate (51.4%).
- The Administration's Budget for Fiscal Year 2016 in combination with key elements of its Framework for Business Tax Reform would increase both the top integrated dividend tax rate (56.7%) and the top integrated long-term capital gains tax rate (56.8%).
- Senate Finance Committee Ranking Member Ron Wyden's (D-OR) and Senator Dan Coats' (R-IN) Bipartisan Tax Fairness and Simplification Act of 2011, which would decrease both the top integrated dividend tax rate (50.2%) and the top integrated long-term capital gains tax rate (50.3%).

As the tax reform debate progresses, it is important to consider how reform proposals would impact integrated tax rates on dividends and capital gains. High integrated tax rates on dividends and capital gains could increase the tax bias against equity financing and discourage investment in the corporate sector. Increasing the dividend tax rate relative to the capital gains tax rate could discourage companies from distributing corporate earnings to shareholders through dividends.

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I. Introduction

As a result of the American Taxpayer Relief Act of 2012 (ATRA) – a legislative compromise between the full expiration and full extension of the 2001/2003 tax reductions – the United States has the second highest top integrated dividend and long-term capital gains tax rates among developed nations. In particular, the ATRA increased the top federal tax rate on both dividends and long-term capital gains from 15% to 20% and reinstated a 3% limitation on itemized deductions (the "Pease" limitation). Additionally, effective January 2013, high-income taxpayers became subject to a 3.8% Medicare tax on both dividends and capital gains due to changes from the Patient Protection and Affordable Care Act.[1]

The lower tax rates on dividends and capital gains enacted in 2003 were intended to lessen the impact 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 had a long tradition of providing such relief. Recent changes abroad have involved reductions in corporate income tax rates with some scaling back of shareholder relief.

The double tax on corporate profits is of 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 capital 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 to shareholders can affect corporate governance by disrupting important signals dividend payments may provide to investors about the financial health of companies.

With the passage of the ATRA and the expansion of the Medicare tax to dividends and capital gains, the top integrated tax rate on dividends paid to shareholders rose to 56.2% in 2014. Similarly, the top integrated tax rate on corporate income that is retained and realized by shareholders as long-term capital gains rose to 56.3% in 2014.[2] As a result, the United States has the second highest top integrated dividends and long-term capital gains tax rates among developed nations exceeded only by France. Moreover, the top US integrated dividends and capital gains tax rates are significantly higher than the GDP-weighted average rate prevailing in OECD and BRIC countries. These higher tax rates increase the cost of capital and discourage capital investment in the United States.

Several prominent tax reform plans have been proposed in the past several years that would impact the top integrated tax rate on dividends and capital gains. These reform plans have included changes to the corporate income tax rate as well as the taxation of dividends and capital gains. The Administration's Budget for Fiscal Year 2016 and Framework for Business Tax Reform also contemplates changes to the top integrated dividends and capital gains tax rates.

This report compares three tax reform plans to current law:

- Former House Ways and Means Committee Chairman Dave Camp's (R-MI) Tax Reform Act of 2014
- The Administration's Budget for Fiscal Year 2016 combined with its Framework for Business Tax Reform
- Senate Finance Committee Ranking Member Ron Wyden's (D-OR) and Senator Dan Coats' (R-IN) Bipartisan Tax Fairness and Simplification Act of 2011

These tax plans result in varying top integrated tax rates, but would leave the United States with top integrated dividend and long-term capital gains tax rates that remain among the highest among developed nations.

II. 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.[3]

In 1986, dividends became fully taxable, albeit at a top rate of 28% following the Tax Reform Act of 1986.[4] The top federal tax rate on dividends then increased following the tax rate increases enacted in 1990 and 1993.[5] By 1993, dividends earned by high-income taxpayers were subjected to a 39.6% federal income tax rate. In 2003, the federal tax rate on dividends was lowered and synchronized with the new tax rate on long-term capital gains (15%). The 15% dividends tax rate rose to 20% under the ATRA. Dividends of high-income taxpayers are also subject to an additional 3.8% Medicare tax as of 2013.

Capital gains income has always been subject to federal 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% to 28%. 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%, while the top tax rate on ordinary income (including dividends) was increased to 31%. In 1993, the top tax rate on ordinary income was increased to 39.6% and then lowered to 35% under the 2001/2003 tax reductions. The top federal tax rate on long-term capital gains was lowered to 20% in 1997 and to 15% in 2003. Effective as of 2013, the top federal tax rate on long-term capital gains increased to 20% with the passage of the ATRA; as with dividends, capital gains are also subject to the 3.8% Medicare tax for high-income taxpayers.

The ATRA also reinstated the limitation on itemized deductions for high-income taxpayers (i.e., the "Pease limitation") that had been previously phased-out by the 2001/2003 tax reductions. This limitation reduces the allowable itemized deductions for high-income taxpayers. Specifically, the limitation is equal to the lesser of: (1) 3% of the adjusted gross income over the applicable amount, or, (2) 80% of itemized deductions otherwise allowable.

III. The effect of the double tax on economic decision making

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 (see Box 1 below). The double tax is primarily a tax on equity-financed investment because interest is a deductible expense while dividend payments to investors are not.

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. A change in dividend taxes affects not only those who receive company dividend payments, but all those with ownership in company shares; therefore, it is important to know whether dividend taxes are capitalized into share values to understand the distributional effects. 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.

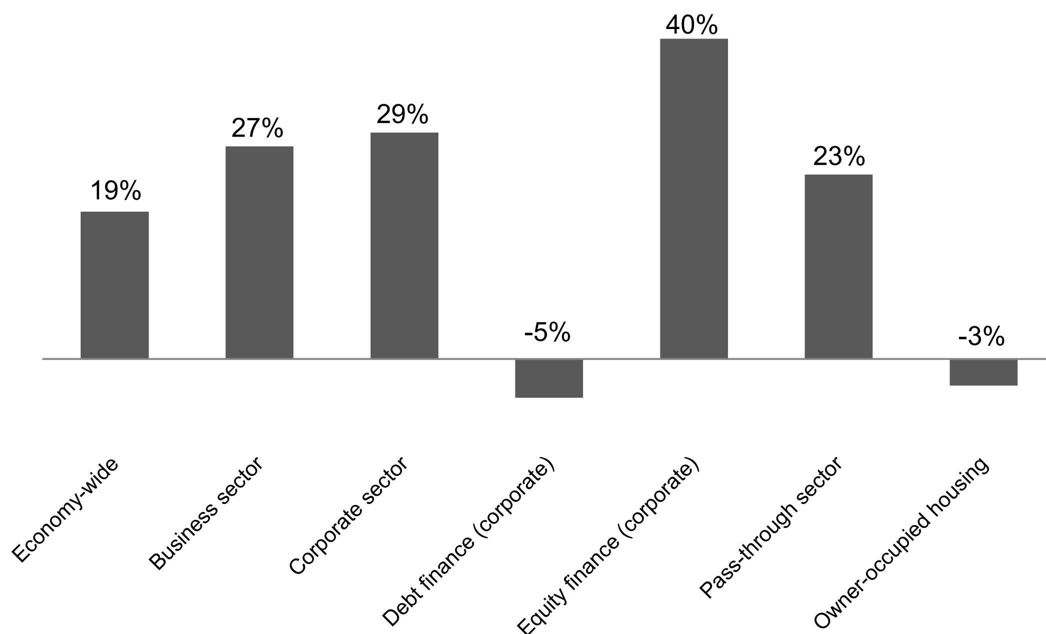
Economic research suggests that a reasonable working assumption is for both views to hold depending on a firm’s source of finance. Newer, immature firms more reliant on newly issued equity are less likely to have dividend taxes capitalized into share values, while older mature firms more reliant on retained earnings are more likely to have dividends taxes capitalized 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. It lowers the after-tax return of 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 (METRs) 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, including the statutory tax rates, depreciation deductions, interest deductions, deferral of tax liability, and 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. These differentials figure prominently in a number of business and investor decisions including the choice between investing in the corporate versus pass-through sectors, the choice between debt versus equity financing, 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, 2014



Note: The business sector includes both the corporate and pass-through sectors. The economy-wide METR is the combination of the business sector and owner-occupied housing.
Source: EY analysis.

Corporate versus pass-through investment

As shown in Figure 1, the METR in the corporate sector (29%) is considerably higher than in the pass-through sector (23%), 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 pass-through capital. 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 (40%) as compared to investment financed with debt (-5%). Other factors contribute to this differential, such as the deductibility of interest and the fact that some debt is held by tax-exempt entities, including pension funds and foreigners.[8] The high tax rate on equity-financed corporate investment compared to debt-financed investment leads to excessive leverage and raises the risk of bankruptcy and 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 lowering the dividend tax rate in 2003. This synchronization was continued with the ATRA, albeit at a higher rate.

Favorable treatment for capital gains over dividends would 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 may be 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.

Box 1: Integrated tax rates on dividends and capital gains

Investor-level taxes 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. Therefore, 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 39.0% corporate level tax rate; this reflects the top 35% federal corporate income tax rate and an average 4.0% state corporate income tax rate (after accounting for deductibility for federal tax purposes). The investor-level taxes are then applied to the remaining $61.00 in income after remittance of the corporate-level tax.

Corporate income distributed to shareholders as dividends is subject to an additional 23.8% federal tax rate (inclusive of the 3.8% Medicare tax) and an average state rate of 4.4% (after accounting for deductibility for federal tax purposes) resulting in an additional $17.23 dividend tax and a top integrated tax rate of 56.2%. The top integrated tax rate on long-term capital gains that are retained is 56.3%, although the effective tax rate might be reduced because capital gains are not taxed until realized and taxpayers may also benefit from step-up of basis at death.

Table 1. Top integrated rates on dividends and capital gains, 2014

	Dividends	**Capital gains**
Pre-tax corporate earnings	$100	$100
Corporate income tax		
Top corporate level tax rate (federal, average state and local)	39.0%	39.0%
Corporate income taxes paid	**$39.00**	**$39.00**
After-tax corporate earnings	$61.00	$61.00
	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	20.0%	20.0%
Medicare tax	3.8%	3.8%
Federal individual taxes paid on dividends/capital gains	$14.52	$14.52
Average top state individual income tax rate (incl. federal deductibility)	4.4%	4.5%
State income tax paid on dividends/capital gains	$2.71	$2.76
Total individual income taxes paid	**$17.23**	**$17.28**
Total taxes paid	**$56.23**	**$56.28**
Top integrated tax rate	**56.2%**	**56.3%**

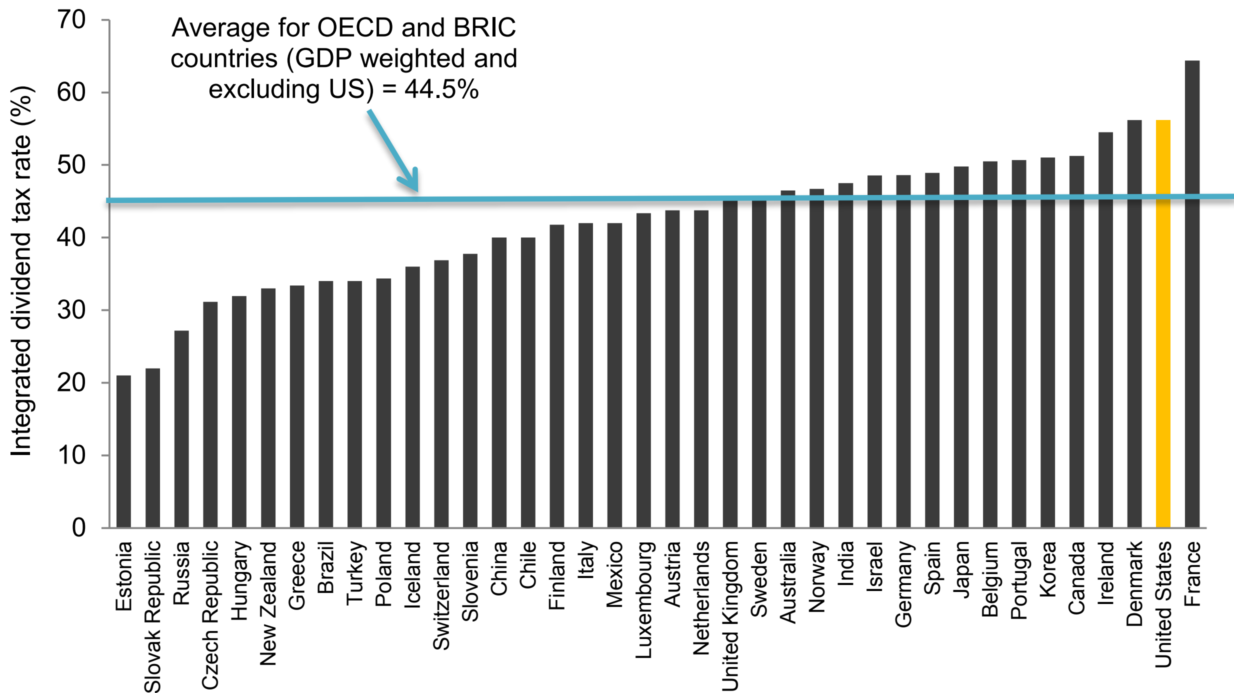
Note: It is common practice to reduce the individual long-term capital gains effective tax rate by 50% to reflect the benefit of deferring capital gains taxes until gains are realized (i.e., asset sold) and another 50% to reflect the benefit of step-up of basis at death. The adjustments would reduce the effective integrated tax rate for income that is retained and ultimately taxed as long-term capital gains to 43.3%. However, in order to provide a neutral basis for international comparison, both the US rate and the foreign rates would need to be adjusted.
Source: EY analysis.

IV. 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. Although the form of relief varies, it is often provided at the shareholder level through three different approaches: a dividend exclusion, lower tax rates, or an imputation credit, whereby shareholders receive a credit for taxes previously paid at the corporate level.[10] In recent years, some countries have reduced shareholder relief as they have reduced statutory corporate income tax rates.

As shown in Figure 2, among the 34 OECD and four BRIC nations in 2014, the United States has the second highest top integrated dividend tax rate (56.2%), exceeded only by France (64.4%).[11]

Figure 2. Top integrated dividend tax rates for OECD and BRIC countries, 2014

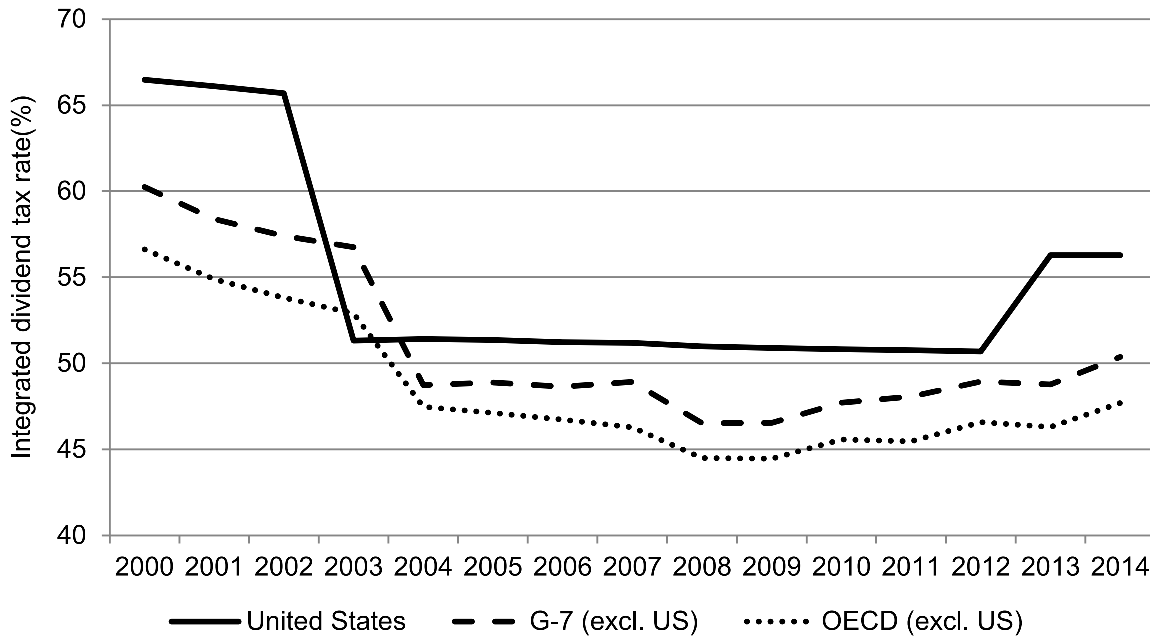


Source: OECD and EY analysis.

Prior to 2003, the United States had a top integrated dividend tax rate that was far above that in most other developed nations. The top US integrated dividend tax rate was 66.5% in 2000, as compared to a GDP-weighted average of 60.2% among the G-7 nations (excl. US) and 56.6% among OECD nations (excl. 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 OECD and G-7 tax rates (excl. US) declined below that of the United States in the following years. By 2012, the top US integrated dividend tax rate of 50.7% was above the GDP-weighted average of 46.6% rate for the OECD (excl. US). This differential increased with the passage of the ATRA and imposition of the 3.8% Medicare tax on dividends and capital gains. The top US integrated dividend tax rate is currently 56.2% relative to the OECD and BRIC GDP-weighted average (excl. US) of 44.5%, an 11.7 percentage point difference.

Figure 3. Trend in top integrated dividend tax rates (GDP-weighted), 2000-2014



Note: Top integrated tax rates for the G-7 and OECD, both excluding the United States, are weighted by each country's GDP.
Source: OECD and EY analysis.

A major factor explaining the decline in the GDP-weighted average top integrated dividend tax rate abroad is the reduction in corporate income tax rates. As shown in Table 2, of the 33 OECD nations (excl. the US), 31 countries have a lower statutory corporate tax rate in 2014 than in 2000. Neighboring Canada reduced its top corporate income tax rate to 26.4% from 43.3% in 2000, while Mexico has reduced its corporate income tax rate to 30% from 35% in 2000. Additionally, Brazil, Russia, India, and China have lower corporate tax rates in 2014 than those in effect in 2000.

Changes in dividend tax rates were more varied across countries (see Table 3). Overall, the "effective" top dividend 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 and BRIC nations (excl. US) from a GDP-weighted average of 29.2% in 2000 to 22.9% in 2014.

Reductions in the effective top dividend tax rate can be attributed to the significant reductions of a few countries between 2000 and 2014. Japan enacted a sharply lower tax rate in 2003, which reduced Japan's effective top dividend tax rate from 43.6% to 10.0%.[12] However, Japan raised its tax rate to 20.3% effective 2014. Between 2000 and 2014, the tax rate in France has fluctuated from 40.8% in 2000 to 29.0% in 2008 before steadily rising to 44.0% by 2014. Germany decreased its effective top dividend tax rate from 31.1% in 2000 to 26.4% by 2014. Notably, the effective personal dividend tax rate of the Netherlands decreased from 60.0% in 2000 to 25.0% by 2014.

Table 2. Top corporate tax rate by country, 2000 and 2014

Country	Top corporate tax rate (2000)	Top corporate tax rate (2014)
GDP-weighted average		
OECD and BRIC (excl. US)	36.7	28.1
OECD (excl. US)	37.0	28.8
Unweighted average		
OECD and BRIC (excl. US)	32.3	25.3
OECD (excl. US)	32.0	24.9
OECD countries		
Australia	34.0	30.0
Austria	34.0	25.0
Belgium	40.2	34.0
Canada	42.4	26.3
Chile	15.0	20.0
Czech Republic	31.0	19.0
Denmark	32.0	24.5
Estonia	26.0	21.0
Finland	29.0	20.0
France	37.8	36.4
Germany	43.3	30.2
Greece	35.0	26.0
Hungary	18.0	19.0
Iceland	30.0	20.0
Ireland	24.0	12.5
Israel	36.0	26.5
Italy	37.0	27.5
Japan	40.9	37.0
Korea	30.8	24.2
Luxembourg	37.5	29.2
Mexico	35.0	30.0
Netherlands	35.0	25.0
New Zealand	33.0	28.0
Norway	28.0	27.0
Poland	30.0	19.0
Portugal	35.2	31.5
Slovak Republic	29.0	22.0
Slovenia	25.0	17.0
Spain	35.0	30.0
Sweden	28.0	22.0
Switzerland	24.9	21.1
Turkey	33.0	20.0
United Kingdom	30.0	21.0
United States	**39.3**	**39.0**
BRIC countries		
Brazil	37.0	34.0
Russia	30.0	20.0
India	38.5	34.0
China	33.0	25.0

Note: Weighted average based on each country's GDP. Rates include taxes imposed by both central and subnational governments.
Source: OECD, *Table II.4 - Overall statutory tax rates on dividend income* and EY analysis and EY analysis (BRIC countries and United States).

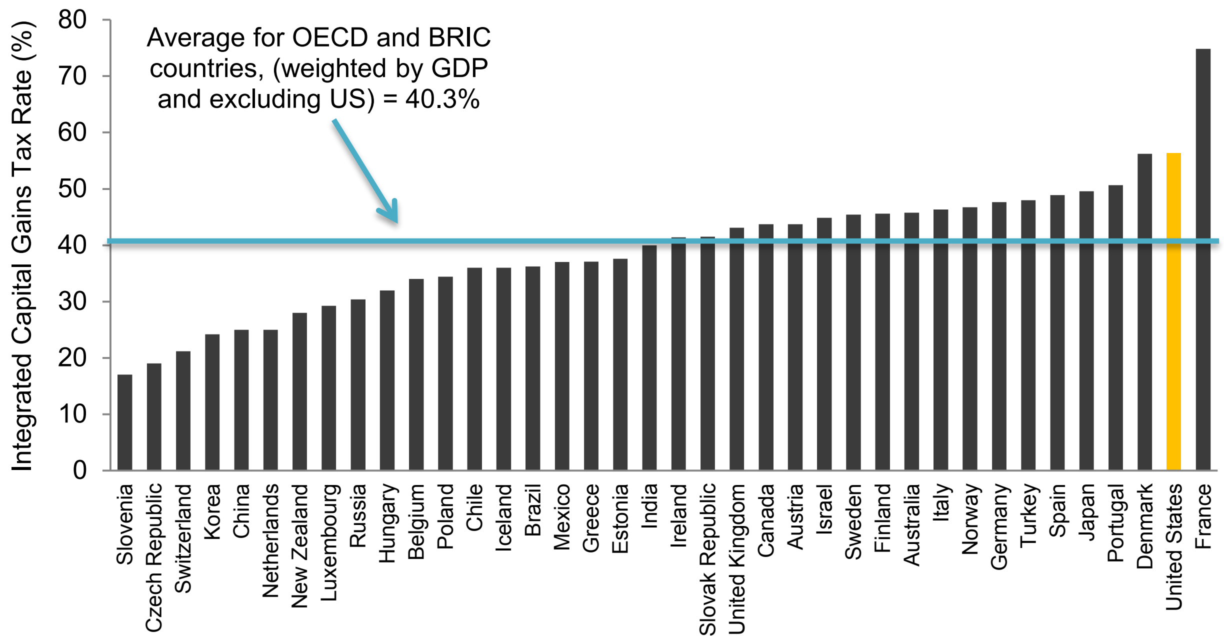
Table 3. Top integrated dividend tax rate by country, 2000 and 2014

Country	Top dividend tax rate (2000)	Integrated dividend tax rate (2000)	Top dividend tax rate (2014)	Integrated dividend tax rate (2014)
GDP-weighted average				
OECD & BRIC (excl. US)	29.2	55.1	22.9	44.5
OECD (excl. US)	31.2	56.6	26.6	47.7
Unweighted average				
OECD & BRIC (excl. US)	22.8	48.1	22.4	42.0
OECD (excl. US)	23.8	48.5	23.6	42.6
OECD countries				
Australia	22.0	48.5	23.5	46.5
Austria	25.0	50.5	25.0	43.8
Belgium	15.0	49.1	25.0	50.5
Canada	32.3	61.0	33.8	51.2
Chile	35.3	45.0	25.0	40.0
Czech Republic	15.0	41.4	15.0	31.2
Denmark	40.0	59.2	42.0	56.2
Estonia	0.0	26.0	0.0	21.0
Finland	0.0	29.0	27.2	41.8
France	40.8	63.2	44.0	64.4
Germany	31.1	60.9	26.4	48.6
Greece	0.0	35.0	10.0	33.4
Hungary	35.0	46.7	16.0	32.0
Iceland	10.0	37.0	20.0	36.0
Ireland	44.0	57.4	48.0	54.5
Israel	25.0	52.0	30.0	48.6
Italy	12.5	44.9	20.0	42.0
Japan	43.6	66.7	20.3	49.8
Korea	20.0	44.6	35.4	51.0
Luxembourg	23.6	52.2	20.0	43.4
Mexico	0.0	35.0	17.1	42.0
Netherlands	60.0	74.0	25.0	43.8
New Zealand	8.9	39.0	6.9	33.0
Norway	0.0	28.0	27.0	46.7
Poland	20.0	44.0	19.0	34.4
Portugal	25.0	51.4	28.0	50.7
Slovak Republic	15.0	39.7	0.0	22.0
Slovenia	30.0	47.5	25.0	37.8
Spain	27.2	52.7	27.0	48.9
Sweden	30.0	49.6	30.0	45.4
Switzerland	42.1	56.5	20.0	36.9
Turkey	31.2	65.0	17.5	34.0
United Kingdom	25.0	47.5	30.6	45.1
United States	**44.8**	**66.5**	**28.2**	**56.2**
BRIC countries				
Brazil	15.0	46.5	0.0	34.0
Russia	15.0	40.5	9.0	27.2
India	10.0	44.7	20.5	47.5
China	20.0	46.4	20.0	40.0

Note: Weighted average based on each country's GDP. Rates include taxes imposed by both central and subnational governments.
Source: OECD, *Table II.4 - Overall statutory tax rates on dividend income* and EY analysis (BRIC countries and United States).

The United States also has one of the highest top integrated long-term capital gains tax rates among developed nations (Figure 4). The top US integrated long-term capital gains tax rate of 56.3% is significantly above the 40.3% GDP-weighted average rate prevailing among OEDC and BRIC countries, a 16 percentage point difference. Among the OECD and BRIC countries, only one country, France (74.9%) has a top integrated long-term capital gains tax rate exceeding that of the United States (56.3%). This is due to the relatively high corporate income tax rate of the United States relative to the OECD and BRIC countries (excl. US) (39.0% relative to 28.1%) and the relatively high long-term capital gains tax rate (28.3% relative to 17.5%).

Figure 4. Top integrated long-term capital gains tax rates for OECD and BRIC countries, 2014



Source: OECD and EY analysis.

Of the 33 non-US OECD countries, six have a long-term capital gains tax rate that exceeds the rate in the United States. None of the BRIC long-term capital gain tax rates exceed that of the United States. Moreover, 10 of the OECD and BRIC countries have no tax on capital gains, 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. Approximately 85% 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. Top integrated long-term capital gains tax rate by country, 2000 and 2014

Country	Top long-term capital gains tax rate (2000)	Integrated capital gains tax rate (2000)	Top long-term capital gains tax rate (2014)	Integrated capital gains tax rate (2014)
GDP-weighted average				
OECD & BRIC (excl. US)	18.8	48.7	17.5	40.3
OECD (excl. US)	19.0	49.0	24.3	45.9
Unweighted average				
OECD & BRIC (excl. US)	19.1	45.4	18.5	39.0
OECD (excl. US)	19.1	45.2	19.9	39.7
OECD countries				
Australia	47.0	65.0	22.5	45.8
Austria	0.0	34.0	25.0	43.8
Belgium	0.0	40.2	0.0	34.0
Canada	36.7	63.5	23.6	43.7
Chile	15.0	27.8	20.0	36.0
Czech Republic	32.0	53.1	0.0	19.0
Denmark	40.0	59.2	42.0	56.2
Estonia	26.0	45.2	21.0	37.6
Finland	28.0	48.9	32.0	45.6
France	26.0	54.0	60.5	74.9
Germany	0.0	43.3	25.0	47.6
Greece	0.0	35.0	15.0	37.1
Hungary	20.0	34.4	16.0	32.0
Iceland	38.3	56.8	20.0	36.0
Ireland	20.0	39.2	33.0	41.4
Israel	50.0	68.0	25.0	44.9
Italy	12.5	44.9	26.0	46.4
Japan	26.0	56.3	20.0	49.6
Korea	20.0	44.6	0.0	24.2
Luxembourg	0.0	37.5	0.0	29.2
Mexico	0.0	35.0	10.0	37.0
Netherlands	0.0	35.0	0.0	25.0
New Zealand	0.0	33.0	0.0	28.0
Norway	28.0	48.2	27.0	46.7
Poland	0.0	30.0	19.0	34.4
Portugal	0.0	35.2	28.0	50.7
Slovak Republic	42.0	58.8	25.0	41.5
Slovenia	50.0	62.5	0.0	17.0
Spain	20.0	48.0	27.0	48.9
Sweden	30.0	49.6	30.0	45.4
Switzerland	0.0	24.9	0.0	21.1
Turkey	0.0	33.0	35.0	48.0
United Kingdom	24.0	46.8	28.0	43.1
United States	**25.0**	**54.5**	**28.3**	**56.3**
BRIC countries				
Brazil	15.0	46.5	15.0	36.3
Russia	30.0	51.0	13.0	30.4
India	10.0	44.7	0.0	40.0
China	20.0	46.4	0.0	25.0

Note: Weighted average based on each country's GDP. Rates include taxes imposed by both central and subnational governments.
Source: EY, *Worldwide Personal Tax Guide,* 2014 and EY analysis.

V. Tax reform and dividend and capital gains taxation

Several US tax reform plans have been proposed that include changes to the corporate income tax rate as well as the taxation of dividends and capital gains. This section examines three tax plans: (1) Former House Ways and Means Committee Chairman Camp's Tax Reform Act of 2014 (the "Camp tax plan"), (2) the Administration's Budget for Fiscal Year 2016 combined with its Framework for Business Tax Reform, and (3) Senator Wyden's and Senator Coats' Bipartisan Tax Fairness and Simplification Act of 2011 (the "Wyden-Coats tax plan").

Table 5 shows the impact each of these tax plans would have on the taxation of corporate profits. The plans would generally involve reductions in the US statutory corporate income tax rate, and modest or no changes to the top federal tax rate on dividends and capital gains.

As shown in Table 5, under the Camp tax plan 40% of dividends and capital gains would be excluded from tax with the remaining amount subject to tax at ordinary income tax rates. With a top federal ordinary income tax rate of 35.0%, this amounts to top federal dividend and capital gains tax rates of 21.0. The 3.8% tax on investment income would remain in place. This tax plan would reduce the combined federal and state corporate income tax rate to 29.7%. In total, the Camp tax plan would reduce both the top integrated dividend tax rate (51.2%) and the top integrated long-term capital gains tax rate (51.4%).

Under The Administration's Budget for Fiscal Year 2016, the top federal tax rates on dividends and long-term capital gains would rise to 30.0% for high-income taxpayers. This is due to the inclusion of the Fair Share Tax that imposes a minimum 30.0% tax rate after (1) regular income tax, (2) the 3.8% Medicare tax on unearned income, (3) the Alternative Minimum Tax, and (4) the employee portion of payroll taxes; this minimum tax is fully phased for taxpayers with adjusted gross income of $2 million ($1 million in the case of a married filing separately). The top tax rates on dividends and capital gains under the Fair Share Tax results in higher top dividends and capital gains tax rates than under the Administration's Fiscal Year 2016 Budget proposal to increase the top statutory tax rate on dividends and capital gains from 23.8% to 28% (including the 3.8% Medicare tax on unearned income). The Administration's Framework for Business Tax Reform would reduce the combined federal-state corporate income tax rate to 32.5%. Combining these various elements from the Budget for Fiscal Year 2016 and the Framework for Business Tax Reform, these changes would increase the top integrated dividend tax rate to 56.7% and top integrated long-term capital gains tax rate to 56.8%.

The Wyden-Coats tax plan would tax dividends and long-term capital gains at a top ordinary tax rate of 35%, but allow a 35%-exclusion for dividends and long-term capital gains. Further, this tax plan would reduce the combined federal-state corporate income tax rate to 28.8%. These changes, combined with the repeal of the Pease limitation, would result in a top integrated dividend tax rate of 50.2% and a top integrated long-term capital gains tax rates of 50.3%.

Table 5. Effect of tax plans on the top integrated dividend and long-term capital gains tax rates

	Current Law (2014)	Camp tax plan	Administration's Budget for Fiscal Year 2016 & Framework for Business Tax Reform	Wyden-Coats tax plan
Federal-state corporate income tax rate	39.0%	29.7%	32.4%	28.8%
Dividends				
Top federal dividend tax rate	20.0%	21.0%	30.0%	22.8%
Medicare tax	3.8%	3.8%	*	3.8%
State dividend tax rate (incl. federal deductibility)	4.4%	5.8%	5.8%	3.5%
Federal-state dividend tax rate	28.2%	30.6%	35.8%	30.1%
Integrated long-term dividend tax rate	**56.2%**	**51.2%**	**56.7%**	**50.2%**
Capital Gains				
Top federal long-term capital gain rate	20.0%	21.0%	30.0%	22.8%
Medicare tax	3.8%	3.8%	*	3.8%
State capital gains tax rate (incl. federal deductibility)	4.5%	6.0%	6.0%	3.6%
Federal-state long-term capital gains tax rate	28.3%	30.8%	36.0%	30.2%
Integrated long-term capital gains tax rate	**56.3%**	**51.4%**	**56.8%**	**50.3%**

Major features of tax plans relating to dividends and capital gains

Provision	Federal corporate income tax rate	Federal dividend tax rate	Federal capital gains tax rate
Tax Reform Act of 2014 ("Camp tax plan")	35%	40%-exclusion applied to 35% top ordinary tax rate	40%-exclusion applied to 35% top ordinary tax rate
The Administration's Budget for Fiscal Year 2016 and Framework for Business Tax Reform	28%	Fair Share Tax results in top 30% rate on dividends	Fair Share Tax results in top 30% rate on capital gains
Bipartisan Tax Fairness and Simplification Act of 2011 ("Wyden-Coats tax plan")	24%	35%-exclusion applied to 35% top ordinary tax rate	35%-exclusion applied to 35% top ordinary tax rate

Note: Estimates include the effects of the limitation on itemized deductions for higher income taxpayers ("Pease" limitation) reinstated in the American Taxpayer Relief Act of 2012 through its effect on the federal deductibility of state and local income taxes. The combination of the Administration's Budget for Fiscal Year 2016 and Framework for Business Tax Reform assumes the individual tax reform of the Budget for Fiscal Year 2016 and the corporate tax reform of the Framework for Business Tax Reform.
Source: EY analysis.

VI. Summary

Even though the 2001/2003 tax reduction on dividends and long-term capital gains put the United States on nearly equal footing with other developed nations, subsequent decreases in the taxation of corporate profits in other developed nations plus increases in the tax rates on dividends and capital gains in the United States have left the United States with the second highest integrated dividend and long-term capital gains tax rates among developed countries. Moreover, each of the corporate, dividend, and long-term capital gains tax rates in the United States is now higher than the average for OECD and BRIC countries.

Several plans to reform the US tax system have included changes to both the corporate income tax rate as well as the investor level taxes on dividends and capital gains. However, among the three reform plans examined in this report, none reduce the top integrated dividend or long-term capital gains tax rates below the average among OECD and BRIC countries where there has been a shift towards providing relief from the double taxation of corporate profits through lower corporate income tax rates rather than at the shareholder level.

Appendix

Country	Top long-term capital gains tax rate	Holding period for long-term capital gain	Other key details
Australia	22.5%	1 year	Only 50% of the capital gains resulting from disposal is subject to tax. Trading stock acquired for the purpose of resale is not subject to capital gains treatment.
Austria	25.0%	1 year	Gains derived from the sale of investments (securities, derivatives, and others) that were purchased on or after April 1, 2012 are subject to tax at a rate of 25%. Gains derived from the sale of shares in a corporation are taxed at a rate of 25% if the sale takes place on or after April 1, 2012.
Belgium	0.0%	N/A	
Brazil	15.0%	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	23.6%	N/A	50% of the year's capital gains are included in taxable income, to the extent that the amount exceeds 50% of capital losses for the year.
Chile	20.0%	N/A	Capital gains derived from sales of shares and other investments are subject to the First Category Tax (20%) as a final tax if the transactions are not habitual and not between related parties.
China	0.0%	N/A	
Czech Republic	0.0%	6 months / 5 years	This rate applies for the securities acquired after 2013. For the securities acquired before 2013, 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 a direct share of less than 5% in the company in the 24-month period preceding the sale. The sale of other securities is generally exempt if the holding period exceeds five years.
Denmark	42.0%	N/A	
Estonia	21.0%	N/A	
Finland	32.0%	N/A	
France	60.5%	N/A	Capital gains realized by a taxable household on the sale of listed or unlisted shares, bonds, or related funds are subject to CSG/CRDS and social tax at a combined rate of 15.5%.
Germany	25.0%	N/A	Gains on the sale of shares are not subject to tax if the shares were acquired before January 1, 2009 and the vendor had a participation of less than 1% in the

			company.
Greece	15.0%	N/A	
Hungary	16.0%	N/A	
Iceland	20.0%	N/A	
India	0.0%	1 year	Long-term capital gains 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 paid on such transaction.
Ireland	33.0%	N/A	
Israel	25.0%	N/A	
Italy	26.0%	N/A	If the transaction involves a qualified percentage of the company's shares, the ordinary rates are applied to 49.72% of the gain. The ordinary rates are applied to 100% of the gain if the shares sold relate to qualified shares of a company residing in a tax haven (as defined by the Italian authorities).
Japan	20.0%	N/A	Capital gains derived from the sale of shares are generally taxed at 20% (15% national tax plus 5% local inhabitant tax).
Korea	0.0%	N/A	Although capital gains derived from the transfer of shares in a company listed on 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 2% (4% for KOSDAQ or KONEX-listed companies and venture companies) of the total outstanding shares or at least KRW 5 billion (KRW 4 billion for KOSDAQ-listed companies and venture companies and KRW 1 billion for KONEX-listed companies) worth of the shares based on the market value at the end of the preceding year ("majority shareholder").
Luxembourg	0.0%	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. Capital gains on non-substantial shareholdings (10% or less) and other securities, such as shares in investment funds, are tax-free only if they are realized more than six months after acquisition.
Mexico	10.0%	N/A	Capital gains are taxed as ordinary income. Gains derived from the sale of shares of Mexican or foreign companies through Mexico's Stock Exchanges are subject to an income tax rate of 10%.
Netherlands	0.0%	N/A	
New Zealand	0.0%	N/A	
Norway	27.0%	N/A	
Poland	19.0%	6 months	

Portugal	28.0%	N/A	Gains derived from the disposal of securities (including autonomous warrants) and derivative financial products are subject to tax at a rate of 28% (a 50% exclusion from tax applies to gains from shares in unlisted micro and small companies) if an exemption does not apply.
Russia	13.0%	N/A	Capital gains are included in regular income. A separate capital gains tax does not apply.
Slovak Republic	25.0%	N/A	Capital gains derived from the sale or exchange of property are taxed as ordinary income at the regular income tax rate. Basic tax rate is 19% and the top tax rate is 25%.
Slovenia	0.0%	5, 10, 15, and 20 years	Capital gains are taxed at a flat rate of 25% 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: 15% after 5 years, 10% after 10 years, 5% after 15 years, and 0% after 20 years.
Spain	27.0%	N/A	Capital gains derived by tax residents are taxed at a rate of 21% on the first €5,999.99, at a rate of 2% on the amount from €6,000 to €23,999.99 and at a rate of 27% on amounts from €24,000 onwards.
Sweden	30.0%	N/A	
Switzerland	0.0%	N/A	
Turkey	35.0%	N/A	
United Kingdom	28.0%	N/A	
United States	28.3%	1 year	Includes weighted-average state capital gains tax rate, after accounting for federal deductibility of state and local taxes. Capital gains are subject to a 3.8% Medicare tax.

Source: EY, Worldwide Personal Tax Guide, 2014

Endnotes

[1] The 3.8% tax on investment earnings applies to taxpayers with modified adjustable gross income over $200,000 who file individually or $250,000 for married couples filing jointly.
[2] The ability of taxpayers to defer long-term capital gains taxes until the disposition of an asset would lower the top effective tax rate on long-term capital gains.
[3] For 1984 the exemption was increased to $200 per filer.
[4] 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% dividends paid deduction for C corporations. The plan would have recommended a full dividends paid deduction except for revenue considerations. See US Department of the Treasury, *Tax Reform for Fairness, Simplicity, and Economic Growth: The Treasury Department Report to the President*, November 10, 1984, p.119.
[5] The top individual income tax rate was increased from 28% to 31% in 1990 under the Omnibus Reconciliation Act of 1990 and from 31% to 39.6% under the Omnibus Reconciliation Act of 1993.
[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 company (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] 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.
[11] The OECD is the Organisation for Economic Co-operation and Development. BRIC countries include Brazil, Russia, India, and China.
[12] The GDP-weighted average OECD effective personal dividend tax rate excluding both the United States and Japan rose from 26.3% in 2000 to 27.8% in 2014. The GDP-weighted personal dividend tax rate for G-7 countries excluding both the United States and Japan was virtually unchanged (28.7% in 2000 to 31.0% in 2014).