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White House Aides Push for 50% Cut in Dividend Taxes

By EDMUND L. ANDREWS

WASHINGTON, Dec. 24 — White House officials are urging President Bush to propose cutting taxes on corporate dividends for shareholders by about half, according to administration officials and Republicans close to the White House.

The proposal, likely to be a crucial part of the tax-cutting plan Mr. Bush will announce in January, is intended to stimulate the economy and reduce what many economists say is an incentive in the current law for companies to avoid paying dividends and to run up debt. While many economists think it would do little to bolster the economy quickly, they say the proposal would give a boost to the stock market.

The 50 percent cut would cost the Treasury more than $100 billion over 10 years, and the tax benefits would overwhelmingly flow to the nation's very wealthiest taxpayers. Mr. Bush is in favor of some kind of reduction in the tax on dividends, a White House official said, but has not settled on an amount.

President Bush's entire tax package is expected to provide as much as $300 billion in reductions over 10 years. It is almost certain to speed up both tax cuts that were supposed to take effect over the next several years and corporate write-offs for investment in new equipment. Officials are also considering measures that benefit middle- or lower-income families, like a more rapid increase in the child-care tax credit.

Administration officials contend that reducing dividend taxes would immediately increase the underlying value of companies and lower their cost of capital. The short-term political appeal is its potential effect on the stock market, because it would instantly make shares of any company that pays dividends more valuable than before.

The long-term benefit of a cut in the dividend tax, the officials say, would be to greatly reduce the market distortions of taxing dividends twice — once as corporate profits and once as dividend income to shareholders — while granting tax deductions on debt interest payments. For shareholders, dividends are now taxed as ordinary income at rates of up to 38.6 percent. By comparison, the maximum tax rate on capital gains — the profit made from the increase in value of shares or other kinds of property — is 20 percent.

Many economists are skeptical that a cut in dividend taxes would provide much immediate stimulus to the economy, which has been Mr. Bush's most important justification for new tax cuts. It would be at least a year before shareholders see any extra money, and the measure would not leave extra money in corporate coffers.

"One wouldn't think of this as the first or second or even third measure to stimulate consumption or investment," said Alan Auerbach, an economist at the University of California at Berkeley who has studied the issue for years.

While the tax on dividends has been a focus of White House discussions, there have been many proposals on how such a reduction could be structured. A White House official cautioned this week that Mr. Bush has not yet decided on exactly how much to reduce the tax on corporate dividends, but the official said advisers agreed in principle on the most logical proposal.

As envisioned, a person would be able to exclude a substantial share of all stock dividends — probably about half — from taxation. There would be no upper limit on the dollar value of dividends that would be tax free, which means that most of the relief would flow to the largest investors.

The Urban-Brooking Tax Policy Center, a research center here, recently calculated that, if the government completely eliminated taxes on corporate dividends, 42 percent of the tax benefits would flow to the wealthiest 1 percent of all taxpayers.

Republicans close to the White House said there were several reasons why officials were attracted to the idea of letting taxpayers exclude about half of all dividend income from taxes.

Eliminating all taxes on corporate dividends would drain so much money from the Treasury — about $300 billion over 10 years, according to some estimates — that President Bush would have no room for other tax cuts.

Reducing dividend taxes by about half, to about 20 percent for people in the top tax bracket, would not only reduce the drain on revenue to the

Treasury but also bring dividend taxes in line with those on capital gains.

Tax analysts said that would eliminate one imbalance in the current tax system that favors fast-growing companies like Microsoft that pay no dividends but attract investors with the prospect of big increases in their stock prices.

Administration officials have looked at ways to reduce dividend taxes that would primarily benefit small investors, but White House advisers say those would do little to correct distortions in the current system.

One option would be to eliminate taxes on the first $1,000 or $3,000 in dividend income. But White House officials think that approach would do little to reduce the distortions in the system because it would not change incentives for the big investors who actually reap most dividends.

Many outside economists agree. "There is a fundamental tension between the distributional effects of these measures and the incentive effect you are trying to achieve," said James Poterba, a professor of economics and public finance at the Massachusetts Institute of Technology.

That the tax cuts themselves would flow overwhelmingly to the nation's wealthiest taxpayers is a fact that Democrats are sure to cite as evidence that the administration wants to cut taxes only for the rich.

Democratic lawmakers are pushing for tax measures that would benefit lower- and middle-income households, like a temporary "holiday" from Social Security taxes or a temporary exemption for the first several thousand dollars in taxable income.

Robert S. McIntyre, director of Citizens for Tax Justice, a research group backed by labor unions, said the entire complaint about "double taxation" was dubious because corporations make such heavy use of legal tax shelters and loopholes.

Although the top corporate tax rate is 35 percent, the average tax rate is only about 15 percent, Mr. McIntyre has estimated on the basis of analyzing corporate tax data.

"Don't worry about the double tax," Mr. McIntyre said. "Worry about the half tax."

But business groups have themselves often been lukewarm about cutting dividend taxes as well, pushing harder for more direct benefits like faster write-offs on new equipment or reductions in overall corporate tax rates.

This year, business lobbyists say they support a cut in the dividend taxes — but not at the expense of other measures that would cut business taxes more directly.

If President Bush has his way, the dividend tax cut will be a permanent change to the tax code. The only reason Mr. Bush may settle for less is that the Senate's complex rules on filibustering make it easier to pass a tax measure that has time limits.