Taylor & Francis
Online

Applied Economics ›
Volume 49, 2017 - Issue 8

373 Views | 0 CrossRef citations to date | 0 Altmetric

Original Articles

Dividend taxation and household dividend portfolio decisions: evidence from the U.S. Jobs and Growth Tax Relief Reconciliation Act of 2003

Daeyong Lee

Pages 723-737 | Published online: 11 Jul 2016

Cite this article https://doi.org/10.1080/00036846.2016.1205722

Check for updates

Sample our
Economics, Finance,
Business & Industry Journals
>> Sign in here to start your access
to the latest two volumes for 14 days

Full Article Figures & data References Citations Metrics
Reprints & Permissions Read this article Share

ABSTRACT

This study examines the dividend clientele hypothesis by focusing on the preferential tax treatment of qualified dividends provided by the 2003 Jobs and Growth Tax Relief Reconciliation Act (JGTRRA) in the United States. Using the Public Use Tax File data, the author finds that the ratios of dividends to long-term capital gains before the 2003 tax act significantly declined with household tax rate differentials between dividends and long-term capital gains, but such a negative tax effect on the ratios disappears afterwards. This seemingly tax-inefficient composition of dividends and long-term capital gains after the tax act arises from households' ability to reduce their tax burdens on stocks by exploiting the new preferential tax treatments on qualified

dividends under JGTRRA. That is, households in the upper tax bracket hold significantly greater shares of qualified dividends relative to ordinary dividends after the tax act.

KEYWORDS:

Jobs and Growth Tax Relief Reconciliation Act | qualified dividends | ordinary dividends | dividend clientele | capital gains

JEL CLASSIFICATION:

H24 | G11 | H31

Acknowledgements

The author thanks Neil Bruce, Terry Shevlin, Seik Kim, Daniel Feenberg, Ju-Yeon Lee, Stephen Turnovsky, Eric Zivot, Wen Hai, and participants of the public finance seminar at the University of Washington, University of Oklahoma, and Peking University HSBC Business School for their valuable comments and suggestions. The author also gives special thanks to the anonymous referees for their insightful suggestions. The author is indebted to Anirban Basu for sponsoring the Public Use Tax File data.

Disclosure statement

No potential conflict of interest was reported by the author.

Notes

[1] The exception years were 1913–1936 and 1939–1953 when dividends were tax-exempt and 1988–1990 when long-term capital gains were taxed same as dividends.

[2] Dividends are qualified when they are paid by U.S. corporations or qualified foreign corporations and households hold stocks more than 60 days. If these two conditions are

not satisfied, dividends are considered ordinary ones. For a detailed explanation of qualified dividends versus ordinary dividends, see Section II and Appendix 1.

[3] Capital gains can be either short-term or long-term, and the type of capital gains does not affect the main argument here.

[4] When the subscript i represents stocks paying qualified (ordinary) dividends, the subscript j refers to stocks paying ordinary (qualified) dividends in Equation (3). The derivative of the share of qualified dividends with respect to the tax rate differentials is positive; that is, $\partial IQD*/IQD*+IOY*/\partial \tau OY-\tau QD>0$.

[5] TAXSIM is the NBER's FORTRAN program that calculates tax liabilities and marginal tax rates under U.S. federal and state income tax laws from individual data (http://www.nber.org/~taxsim/). For more details on marginal tax rates, see Appendix 2.

[6] Several cut-off levels (1%, 3% and 5%) are tested in the sensitivity analysis, and the empirical results verify that the main estimates are robust to the different cut-off levels.

[7] All averages are weighted by the Public Use Tax File sampling weights, and all the dollar values for financial income are adjusted to 2006 U.S. dollars.

[8] According to the IRS tax stipulation, if net capital gains are positive, households pay either 5% or 15% long-term capital gains tax depending on their ordinary income tax bracket. If net capital gains are negative (i.e. net capital losses), tax filers' long-term capital gains tax rates are 0%, and they deduct these net capital losses from their other types of taxable income up to $3000 for joint filers and $1500 for singles per year.

[9] Dividends refer to total dividends, including ordinary and qualified for the post-2003 tax act period.

[10] Because JGTRRA reduced capital gains tax rates as well, long-term capital gains realizations may also have changed in addition to the composition of stock portfolio. As a robustness check, I use only dividends as the dependent variable for the analysis; the results were substantively similar to those obtained from the main model.

[11] Although the tax rates on dividends sharply decreased after the tax act, the tax rate differentials still increase with income tax brackets.

[12] Year dummies control for the possibility that households changed their stock portfolios over time after JGTRRA was implemented because of transaction or

information costs (Barber and Odean 2008).

[13] Because wealthier households can handle adverse income shocks relatively easily, they are less likely to depend on periodical income of dividends and more likely to focus on long-term investments (Amromin 2008).

[14] The weak instrumental variable test rejects the null hypothesis (H0:Instrument variable by the first dollar method is weak).

[15] This counter-intuitive result might also be due to the timing of capital gains realization around the 2003 tax reform. Households that waited until the scheduled tax rate reduction on capital gains deferred capital gains realization and did so to a great extent after the 2003 tax act. This timing behaviour increases the values in the denominator of the dependent variable, which rather weakens the significance of the results. As such, the timing of capital gains realization does not drive the result.

[16] The Hausman test for the model specification rejects the null hypothesis at a 1% significance level (F-statistics: 7.93; p-value: 0.005). Thus, the Tobit estimates using the instrumental variable are consistent for true parameters.

[17] This is because the analysis was based on the post-2003 tax data.

[18] All the estimates in section ‘Robustness check’ are available on request.

Related research

People also read | Recommended articles | Cited by

Information for

Authors

R&D professionals

Editors

Librarians

Societies

Open access

Overview

Open journals

Open Select

Dove Medical Press

F1000Research

Opportunities

Reprints and e-prints

Advertising solutions

Accelerated publication

Corporate access solutions

Help and information

Help and contact

Newsroom

All journals

Books

Keep up to date

Register to receive personalised research and resources by email

Sign me up

Copyright © 2026 Informa UK Limited Privacy policy Cookies Terms & conditions Accessibility

Taylor and Francis Group

Registered in England & Wales No. 01072954
5 Howick Place | London | SW1P 1WG