Bush's Stimulus Plan Would Eliminate Tax on Dividends

By EDMUND L. ANDREWS

WASHINGTON, Jan. 5 — President Bush will propose eliminating taxes on corporate dividends paid to shareholders, a measure that could cost the government $300 billion over 10 years and would be far bolder than some of his advisers had been suggesting, administration officials said today.

Until a few days ago, administration officials had suggested cutting dividend taxes in half. By Friday, they said the reduction would be bigger. Today they confirmed that Mr. Bush would propose eliminating the dividend tax entirely. Rather than phase in the change, a White House official said, Mr. Bush will propose making it effective immediately.

The move will be the centerpiece of what is now a $600 billion package that is aimed at spurring economic growth, but it would also create much bigger budget deficits for the future.

Supporters of the idea say it will correct a major distortion in the tax system, which is that dividends are taxed twice — once at the corporate level as profits and a second time as dividend income to shareholders.

But even before Mr. Bush describes his proposal in a speech in Chicago on Tuesday, Democrats stepped up their accusations today that his plan would benefit the very wealthiest and ignore the needs of middle-income families.

"When they direct their tax programs to benefit the very, very, very few and eliminate the majority from any benefit of these tax cuts, it is class war," said Senator Harry Reid of Nevada, the Senate's assistant Democratic leader, on the NBC News program "Meet the Press."

Eliminating dividend taxes, administration officials contend, would greatly increase the value of corporate profits and should lead to an increase in stock market valuations.

Many economists predict that the plan will help stock prices, but say they are skeptical that it will do much to increase business investment or consumer spending in the short term.

In addition to excluding dividend taxes, the proposal seeks to speed up rate reductions scheduled to take hold in 2004 and 2006 and is likely to include added tax breaks to stimulate investment by corporations, White House officials said.
White House officials said today that much of Mr. Bush's plan would be "front-loaded," with a disproportionate share of the tax cuts and new spending coming in the first year.

The package is likely to include an extension of federal unemployment benefits; an immediate increase in the child care tax credit; a more rapid reduction in the so-called marriage penalty for two-income households; and new money for state governments.

Administration officials are hoping that a full elimination of taxes on the dividends that shareholders are paid by corporations will give the stock market a powerful lift and shore up confidence. The decision was first reported by Time magazine's online edition.

R. Glenn Hubbard, chairman of the White House Council of Economic Advisers, has suggested that the move could lift stock prices by 20 percent.

Even enthusiastic supporters were surprised by Mr. Bush's plan. "I am surprised and happy," said Kevin Hassett, an economist at the American Enterprise Institute, a conservative research group here. "This will provide a lot of juice to the market."

But many economists said they were dubious about the impact on either business investment or consumer spending. The proposal would give shareholders more money, but probably not until they submitted their taxes in 2004. And corporations would not save any tax money.

Partly for those reasons, business groups have not pushed for lower taxes on dividends. But now, faced with Mr. Bush's determination, business lobbyists say they are behind him.

"The animal spirits of business have been depressed," said Jerry Jasinowski, president of the National Association of Manufacturers. "There is no question but that the impact of this on confidence will be immediate. The first thing that chief executives do when they get up in the morning is check the price of their stock."

Though many details of the plan remained unclear tonight, tax analysts said several kinds of tax reductions would inherently hit sooner rather than later.

An increase in the child care tax credit, to $1,000 from $600, would be one quick option. Another would be to expand last year's big "bonus depreciation" for corporations, a temporary tax break that allows companies to write off 30 percent of their investment in certain kinds of equipment in their first year.

Regardless of the fine print, the tax plan would lead to higher budget deficits at a time when the possibility of a war against Iraq could add tens of billions in extra costs.

Even without new tax cuts, the nonpartisan Congressional Budget Office has estimated that the government's shortfall this year will be $145 billion. The new tax cuts could easily push the deficit to more than $200 billion, and a war in Iraq could send it higher.
still. White House officials say the deficit would still be modest in relation to the overall economy, and pose much less danger than the prospect of slower growth.

Mr. Bush is apt to face little difficulty with his plan in the House of Representatives, where Republicans are in the majority and have a strong grip on the legislative process.

He faces more difficulty in the Senate, where Republicans have a tiny majority but not enough votes to override a Democratic filibuster.

"It doesn't matter how good the policy is if you can't get it through," said Senator Charles Grassley, Republican of Iowa, who is chairman of the Senate Finance Committee.

Mr. Grassley, a moderate Republican who prides himself on winning support from Democrats, said a dividend tax cut would have to be accompanied by measures like a bigger child care tax credit that affect middle-income taxpayers.

Mr. Grassley said the most important question for him was not any particular proposal by Mr. Bush, but rather his willingness to be flexible in the forthcoming political battles.

Politically, the biggest issue is almost certain to be the question of fairness. Analysts have estimated that more than half the tax benefit of eliminating dividend taxes would flow to the wealthiest 5 percent of taxpayers.

Democratic lawmakers are already accusing Mr. Bush of looking out only for the rich, but even a few Republicans are nervous.

"I think it's very important that we give low-income Americans a break," said Senator John McCain, Republican of Arizona, on the CBS News program "Face the Nation."

Mr. McCain noted that he had voted against Mr. Bush's $1.35 trillion tax cut in 2001 because it was "too tilted" to the rich. "If that's continued, obviously then I wouldn't support that," he said.

Some of the more combative Republicans in Congress said the analysts' statistics were a red herring, because many middle-income and lower-income people do not pay any federal income taxes.

"You've got to start out with the fact that about 37 percent of the people in this country don't pay federal income taxes," said Senator Rick Santorum of Pennsylvania, the third-ranked Republican in the Senate. "When you start out that the top two-thirds of the people in this country are the folks who pay taxes," Mr. Santorum said on "Fox News Sunday," "those are the folks you're going to have to give tax cuts to."