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Tax act spurs some to boost payouts

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After falling out of favor during the 1990s, corporate dividends have come roaring back.

So far this year, more than a half-dozen public companies doing business in Hampton Roads have boosted their quarterly dividends by at least 10 percent.

The reason is lower tax rates on dividend income, a key part of the tax package that President Bush signed into law in May.

Dividends had been taxed as ordinary income at rates as high as 38.6 percent for some taxpayers. The new tax law reduced the top rate to 15 percent and put it on par with the tax rate for capital gains.

"The reduced tax rate on dividends makes it as efficient for us to return capital to shareholders directly through dividends as through stock buybacks," Bank of America Chairman Ken Lewis said in June when announcing a 25 percent increase in the bank's quarterly dividend.

Public companies like Bank of America use their accumulated earnings in several ways, including buying other companies, stepping up their capital spending and paying down debt. Often, they return some earnings to stockholders by boosting their dividends or buying back shares.

Like many companies, Charlotte, N.C.-based Bank of America routinely repurchased its shares during the 1990s, effectively leaving less shares in the marketplace. As intended, this boosted the value of shares that remained in investors' hands.

Over time, lower tax rates on dividend income will likely generate significant amounts of cash for investors. But will investors respond to one of the Bush administration's goals by plowing that money back into the stock market?

Some shareholders have remained on the sidelines since the tax-law change because they've found dividend tax issues complicated, said Maria Crawford Scott, editor of the American Association of Individual Investors' monthly journal in Chicago.

The lower rate for taxation of dividends lasts only five years, so "tax laws aren't going to remain the same, and it's hard to make plans when things are in a state of flux," Scott said.

David West, research director at the brokerage firm Davenport & Co. in Richmond, said the reduced tax rate "certainly has added a positive tone to the market."

However, it's tough to give the tax changes full credit for the surge in stock prices since last March, West and other investment professionals said. In fact, the share prices of many companies boosting their dividends this year haven't fared as well as many speculative stocks that pay no dividends, said George F. Shipp, a Virginia Beach investment strategist with the Richmond-based brokerage firm Scott & Stringfellow Inc.

With the sharp drop in interest rates, some investors seeking higher yields than those available from bonds and bank CDs have poured money into stocks, especially blue chips that offered safe dividends.

The news regarding corporate dividends isn't entirely positive. The number of companies cutting or omitting their dividends climbed sharply in June, according to Standard & Poor's, the credit-rating and investment research firm.

"Given the change in tax treatment of dividends, companies that have the ability to increase appear to be doing so,"

Standard & Poor's said in a July 1 report on dividend activity. "But the large number of cuts and omissions suggests that some corporations are still struggling."

Even those companies that have raised their dividends will continue to use their earnings to buy back shares on occasion instead of steadily boosting dividends, said Vijay Singal, a finance professor at Virginia Tech and head of the finance department. Share repurchases, he said, are a much more flexible way to reward shareholders.

When a company raises its dividend, shareholders assume that the higher payments can be sustained. A dividend increase, said Singal, "is a long-term commitment."

"If companies reduce their dividend, that's taken as a strongly negative signal that their earnings are weak or more volatile," he said.

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