Dividend Reinvestment Plans: Legislative History of the Economic Recovery Tax Act of 1981 (H.R. 4242, 97th Congress; Public Law 97-34)

The Economic Recovery Act of 1981 (ERTA) included a provision allowing corporations to create tax favored public utility dividend reinvestment plans. Under the provision, a public utility could establish a plan under which individuals holding stock could elect to receive their dividends in the form of shares instead of cash and up to $750 per year ($1,500 for joint filers) worth of such stock would be excluded from income. Stock issued under this provision had a zero basis and was taxed as capital gains if held longer than a year. The provision was effective for 4 years from December 31, 1981 to January 1, 1986.

The legislative record for this provision demonstrates that its enactment was supported by a strong coalition of companies and a significant bipartisan and bicameral group of elected officials. In the year of its enactment, Congressman J.J. Pickle (D-TX) introduced H.R. 654 with 145 cosponsors, 17 from the Committee on Ways and Means. Senator Bentsen (D-TX) introduced a companion bill in the Senate, S. 141. Both bills differed from the provision subsequently enacted in three significant ways: first, the Pickle/Bentsen legislation would have been applicable to all corporations, not just public utilities; second, the legislation had a higher cap on distributions eligible for the tax exclusion to $1,500 and $3,000; and finally, the Pickle/Bentsen legislation provided the benefit to all taxpayers (including corporations, trusts, estates, non-residential aliens, and individuals holding more than 5 percent of the voting stock) not just individual investors.

On April 2, 1981, the Committee on Ways and Means held one in a series of hearings on the "Tax Aspects of the President's Economic Program." An entire panel was devoted to the issue of dividend reinvestment plans: Herbert B. Cohn (Chm, Committee for Capital Formation Through Dividend Reinvestment); James J. O'Connor (Chm and Pres, Commonwealth Edison Co, representing Edison Electric Institute); John Flynn (representing the International Union of Operating Engineers and four other labor unions); Samuel Goldberg (VP, Inco US); and Brent Wilson (Assoc. Assistant Professor, U of VA). Additionally, the panel highlighted support from 12 different associations and advocacy groups, such as AARP, ABA, AGA, Business Roundtable and others. Mr. Cohen's committee represented as many as 60 corporations. In short, support was broad based, including companies, investors, and trade unions.

In addition to a strong coalition, supporters of the legislation had by the time of the hearing developed powerful economic arguments for its passage, including job creation, efficient capitalization, and progressivity.

For example, the coalition hired a well known economist to develop estimates of increased economic activity and job creation.

The legislation would:

1. Increase business fixed investment by about $1 billion annually;

2. Increase gross national product by approximately $2.7 billion annually; and

3. (Create s)ome 50,000 jobs per year.

As a consequence, they were able pick up the unqualified endorsement of five unions, "This is not a labor issue or a management issue. It is a national issue that unites both of us in a common effort."

They made a strong case that the legislation would not only provide in excess of $4 billion in new common stock capital annually, but would do so in a extremely cost efficient manner.

> We believe the dividend reinvestment proposal is one of the most direct, most closely targeted and most cost-effective proposals for encouraging new external capital formation where it is most urgently needed. It is most direct because the reinvestment in new issue stock represents instantaneous formation of new capital… It is most cost-effective since it will provide a substantial increase in new capital formation and new capital investment, while involving a modest or non-existent revenue loss.

Additionally, the coalition was able to demonstrate that provision would primarily appeal to small investors by showing figures from non-tax favored reinvestment plan which showed that the vast majority of the participants owned fewer than 200 shares. Once the Pickle/Bentsen bill was amended for ERTA to limit participation to only individual investors and the cap was lowered substantially, the argument that the provision primarily benefited middle class investors was only strengthened.

Specific ERTA legislative history on dividend reinvestment plans as represented by committee reports is sparse; however, the general policy intent behind the Act is made clear. Congress and the Reagan Administration were attempting to stimulate the economy by incentivizing business investment in plant and equipment.

The Ways and Means Committee Report (H. Rpt. 97-201, July 24, 1981, pp. 152-3; CIS-NO: 81-H783-5) discussion regarding Dividend Reinvestment Plans stated in general that "(i)n providing for expensing of depreciable property and corporate tax rate reductions, the committee acted to stimulate capital formation through internal generation of funds. These funds fundamentally will be used to replace obsolescent capital equipment."

Further, the committee wrote, "In the case of public utilities, …, the committee wishes to encourage the generation of funds to provide capital for the purchase of new equipment through reinvestment of dividends by shareholders." (ibid.)

The Senate bill did not include a provision on utility reinvestment.

The Conference Report generally followed the House bill with two changes: it cut the exclusion amount in half from $1,500 for individuals $3,000 for joint filers to $750 for individuals and $1,500 for joint filers; and it sunset the exclusion after 3 years. Both of these changes were likely made to mitigate the revenue lost caused by the inclusion of the provision. (H. Rep. No. 97-215 Aug. 1, 1981)

Statutory construction of the amendment also indicates Congressional intent. A prominent feature of the change was a disallowance of the exclusion if the utility had repurchased any of its stock within one year before or after the distribution date. By implication, increasing capital formation directly from shareholders was the primary motivation for including the amendment in the Act.

One core element for its successful inclusion in ERTA was the mitigation of revenue loss brought about by the amendments list above. As originally drafted the revenue effect was a significant $4 billion dollars over 5 years. With the changes outlined above, its cost shrunk to approximately $1.6 billion over 5 years.

	Year 1	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**5 yrTotal**
Original bill	-640	-849	-1,050	-1,034	-1,038	-4,031
ERTA	-130	-365	-416	-449	-278	-1,638
% Difference	20.3%	42.9%	39.6%	43.4%	26.7%	40.6%

Taking into account economic growth since 1981, it is clear that the cost of enactment of similar legislation would be significantly higher. As in other pieces of legislation sought by the water and wastewater industry, it may be necessary for the industry to seek a "water-only" solution in order to make the cost acceptable. Of course, this would further erode political support for such legislation.

In conclusion, the coalition seeking passage of the dividend reinvestment legislation was broad, well-organized and had done significant economic analysis. It was, of course, helped ultimately by the election of President Reagan. It is equally clear, however, that they were able to receive comparable consideration with the President's core agenda by building support from both labor and business and bolster their arguments with sound economic analysis.