

PART FIVE: REVENUE RAISERS

1. Reduction in dividends received deduction for portfolio stock

Present Law

Under present law, corporations owning less than the portfolio threshold of 20 percent of the stock of a corporation (by vote and value) are entitled to a deduction equal to 70 percent of the dividends received from a domestic corporation. Corporations owning at least 20 percent are entitled to an 80-percent deduction and corporations owning 80 percent or more may be entitled to a 100 percent deduction.

For purposes of determining whether the 80 percent threshold is met, the ownership of certain corporations under common control may be aggregated.

Description of Proposal

The dividends received deduction for a corporation owning less than the portfolio threshold amount of the stock of a distributing corporation would be reduced from 70 percent to 50 percent. The threshold requirement would be ownership of more than 20 percent of the stock of a corporation (by vote and value).

For purposes of determining whether the more than 20 percent threshold is met, the ownership of corporations could be aggregated to the same extent that it is aggregated under present law for purposes of the 80 percent threshold.

Reasons for Change

The present-law dividends received deduction is too generous for corporations that are not eligible to be treated as the alter ego of the distributing corporation because they do not have a sufficient ownership interest in that corporation. It also permits an investor in a corporation to be treated as a greater than portfolio investor even though the Code may treat the corporation as the alter ego of other corporate investors for other purposes, such as consolidation.

Aggregation should be permitted for purposes of the portfolio stock dividends received deduction threshold to the same extent that it is permitted for purposes of the 80 percent threshold.

Effective Date

The change in the portfolio dividends received deduction would be phased in with a 60-percent deduction for dividends received or accrued after December 31, 1988, a 55-percent deduction for dividends received or accrued after December 31, 1989, and a 50 percent deduction for dividends received or accrued after December 31, 1990. The change in the threshold for the portfolio dividends received deduction would apply to dividends received or accrued after December 31, 1988.

The change in the aggregation rules for purposes of determining whether the portfolio dividends received deduction has been exceeded would apply for dividends received or accrued after December 31, 1987.