Bush Tax Bill Reduces Tax on Dividends by 61% Creating Opportunity for Private Equity Firms

The Tax Bill just passed by Congress creates an opportunity for private equity firms to increase the IRR from portfolio investments. The Tax Bill:

- Reduces the maximum federal individual income tax rates for 2003 through 2010 from 38.6% to **35%** (a 9.3% reduction)

- Reduces the federal income tax rate on long-term capital gains for sales after May 6, 2003 through Dec. 31, 2008 from 20% to **15%** (a 25% reduction), and

- Reduces the maximum federal income tax rates on most dividends from corporations received after Jan. 1, 2003 through Dec. 31, 2008 from 38.6% to **15%** (a 61% reduction).

This reduction of the tax rate on dividends to the same rate as long-term capital gains creates a unique opportunity for private equity firms to increase the IRR generated from portfolio investments. Generally, because of the time value of money, the sooner money is returned to investors, the greater the IRR on a particular investment. Because the tax rate on dividends is now equal to the tax rate on capital gains, there is no tax reason for portfolio companies to retain excess cash until a realization event so that private equity funds receive the benefits of long-term capital gains rates. Thus, private equity funds should examine each of their portfolio companies to see whether it is advisable to dividend excess cash or to effect a leveraged recapitalization and distribute the excess cash as a dividend to shareholders.

Contact Information

To discuss this opportunity further, please call or email your regular Ropes & Gray attorney.