Capital Gains Tax, Supply-driven Trading and Ownership Structure: Direct Evidence of the Lock-In Effect

2009 ATA Mid-year meeting

Discussant comments

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Research Question

Does capital gain taxation affect investors' portfolio decisions (selling decisions) and equity prices?

Do investors sell (appreciated) stocks acquired via an IPO shortly after qualifying for a lower long-term capital gain tax rate?

Does the tax-induced selling pressure affect stock price.

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Incremental Contribution

There is a large body of literature in the U.S. on the effect of capital gain taxes on investor trading activity.

Need to incorporate discussion of inter-temporal tax discontinuity (ITD) research.

Prior research has used stock transaction data to infer direction of trade so need to tone down this contribution.

Contribution to highlight is the environment of the study—large tax incentive for individuals to defer sales until meet 12 month holding period.

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Explanation of Setting

Netting rules for capital gains and losses.

Better explain the composition of investors in the Australian market, in particular for the institutional class.

Study attempts to compare the reaction of individual investors to institutional investors. Conjecture is that the response of the institutional investors will be less severe than individual investors.

- Pensions
- Corporations
- Mutual funds?

Research Design Issues

Focus on ‘abnormal’ metrics.

Should focus be on ‘selling’ decisions instead of buy-sell order imbalance?

Purported contribution is the combination of ownership data with the transaction based trading metric but can use the trade size to isolate individual trades from institutional trades (construct abnormal selling measures for each investor class).

AMS = CG INST DIV POST CGPOST INSTPOST DIVPOST FWJ ESCR

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Research Design Issues

Include loss stocks in the model (expect differential reaction to long-term qualification).

Expand sample to include time period before 1999 Australian Tax Reform. In the pre-period there was no rate incentive to hold 'long-term' so expect differential selling reaction pre and post change.

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Results

Table 5 univariate results – significance in week -4 winners and week -3 losers?

Table 6 regression analysis

Model is marginally significant (F-stat = 2.03).

Support for hypothesis comes from estimate on POST (intercept shift)

Lack of statistical significance of CGPOST is an issue.

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Summary

- Interesting setting to investigate lock-in effect and ITD related tax issues.
- Considerable work done to summarize transaction data, control for escrow periods, and incorporate ownership data.
- Expand citation to relevant literature
- Need to tone down contribution—do not over sell.
- Focus on sales and partition data to proxy for investor types.
- Alter research design.

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