

ESSAYS ON CAPITAL GAINS, HOUSEHOLD CONSUMPTION, AND THE CORPORATE PAYOUT PUZZLE

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CAPITAL-GAINS TAXATION, THE LOCK-IN EFFECT AND THE CORPORATE PAYOUT PUZZLE (Job Market Paper)

Out of their after-tax profits, corporations pay dividends and often repurchase shares to generate capital gains for their shareholders. Capital gains typically attract lower effective rates of tax than dividends, which leads to the payout puzzle: Why do corporations continue to pay dividends in spite of their relative tax disadvantage? This essay develops a model of corporate payout policy to explain some aspects of the puzzle. The key element of the model is the lock-in effect caused by the fact that capital gains are taxed only upon realization, which implies that taxpayers can reduce the effective rate of tax by postponing realizations, i.e., by locking in accrued capital gains. Shareholders with an accrued capital gain, thus, would require a lock-in premium to compensate them for their higher tax liability resulting from the sale. This premium is an increasing function of accrued capital gains and the desired holding period for equity. In this setting firms pay dividends in equilibrium whenever the lock-in premium is high relative to the tax disadvantage of dividend payments. It follows that firms with a relatively high proportion of shareholders with sizable capital gains and/or long holding periods face higher repurchasing costs and are thus more likely to pay dividends. The model shows that total payout increases as the capital gains tax and the profits tax increase, whereas the dividend tax has no effect. These results provide insight into empirical relationships between corporate payout policy and taxes at the personal and corporate level. These insights are explored further with data from a panel of Canadian corporations listed on the TSX over the period 1987-2008. The empirical results are largely consistent with those of the model.

REAL ESTATE CAPITAL GAINS AND CONSUMER SPENDING: SOME RESULTS FROM CANADIAN SURVEY DATA

This paper presents estimates of the marginal propensity to consume out of accrued capital gains on owner-occupied housing in Canada. It is the first Canadian study to use micro-data, and its main methodological contribution lies in using a hedonic regression approach to estimate capital gains. Earlier studies, mostly in the USA and UK, have relied on regional house-price indices and other proxies, whereas the hedonic approach estimates accrued gains based on actual housing transactions. The analysis is based on data from the Survey of Household Spending (SHS) over the years 2000-2006. The SHS is a Canada-wide cross-sectional survey containing comprehensive information on household consumption expenditures and dwelling characteristics. The latter information is used to estimate a set of hedonic equations relating the market price of a home to its characteristics, and changes in regression coefficients over time are used to compute capital gains. The results suggest that household consumption expenditures increase in the level of accrued capital gains on housing, and that the sustainability of these gains is important for the magnitude of the increase. When the level of accrued capital gains is persistent over time total household consumption increases approximately eight and a half cents for every dollar of capital gains income. Spending on non-durable consumption increases by approximately six cents. When accrued capital gains are transitory, i.e., not persistent over time, total consumption increases by one and a half cents for every dollar of capital gains income. These results are consistent with the permanent income hypothesis, a concept explored in the paper.