Capital Gains Tax and Individual Trading: The Case of Japan

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ABSTRACT

The 2003 tax reform streamlined the complicated institutions of capital gains tax as well as reduced the tax rate to 10%. Was this measure attributed to the recent stock market recovery and the greater participation of individual investors and, if so, to what extent? This study attempts to answer these questions empirically with the individual trading data. Given the limitation with respect to the data, we conduct three analyses to shed light on the issue from different angles. First, we look at the aggregate, market-level data in a standard time-series framework. Second, we conduct the similar, time-series as well as the panel analyses with by-stock data on the securities firms level. Third, with this data, we examine the price change sensitivity of winners' trading volume before and after the reform. The results in all three analyses clearly indicate that the average capital gains tax rate negatively influence individual trading. Therefore, it is concluded that the 2003 tax cut has helped expand the trading by individual investors and, to that extent, the stock market at large since 2003.