Understanding the Nature of Capital Gains Responses to Taxes using Transaction-Level Data

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Abstract

We study how trading responds to tax incentives using transaction-level data on all capital gains resulting from sales of financial assets between 2011 and 2019 in the U.S. The detailed nature of the data provides two key advantages. First, it allows us to study how the short- vs long-term capital gains tax rate differentiation shapes individuals' trading behaviors. Second, it allows us to observe the timing and frequency of realizations, and therefore evaluate to what extent capital gain responses are driven by avoidance versus real changes of economic behavior. Finally, we use our empirical results to provide guidance on the optimal setting of short/long-term threshold.