

# **Heterogeneous Responses to Capital Taxes: Evidence from the Introduction of a Dividend Tax**

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## **Abstract**

We analyze the effects of the introduction of a flat tax on dividends on firm behavior and find that a dividend tax may correct inefficient over-distribution. We use exogenous variation in how the policy affected firms with different legal statuses and financial year-end dates, and distinguish between firms that were caught immediately by the tax and those that could distribute tax-free dividends after the policy announcement. Immediately-affected firms significantly reduce payouts, retain earnings and increase investment, consistent with intertemporal tax arbitrage. In the long run, the allocation of undistributed cash predicts the likelihood of bankruptcy.