Follow the money! Why dividends overreact to flat-tax reforms

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Abstract

We estimate behavioral responses to dividend taxation using recent French reforms: a rate hike and, five years later, a cut. Exploiting tax data at household and firm-level as well as data linking firms and shareholders, we find very large dividend tax elasticities to both reforms. Individuals who control firms adjust dividend receipts instantaneously, accounting for most of the aggregate dividend reaction. Investment is insensitive to dividend taxation.

Dividend adjustments are instead driven by corporate saving, as owner-managers treat firms as low-tax saving vehicles. Corporate profits decline following dividend tax increases, suggesting firms also serve as tax-free consumption vehicles. Our results fit the 'new view' of dividend taxation, provided an additional low-tax yet costly payout option is available that offers a tax arbitrage opportunity to entrepreneurs in control of their firms.