

The Taxation on Capital Gains and the Stock Price Volatility



Abstract

This study establishes a model of the stock market involving the rational speculators to investigate whether the imposition of tax on capital gains can reduce the market volatility. The finding is that the effect of tax on the stock price volatility varies according to the types of shocks hitting the market. In the cases of the issuing shock and the dividend shock, raising the tax rate could be a way to stabilize the stock market. On the contrary, when the margin-rate shock occurs, it tends to magnify the effect of the shock and therefore increases the market volatility. Thus, it could be concluded that an increase in the tax rate may increase or decrease the stock price volatility depending on the type of unexpected shocks.