

Marginal Stockholder Tax Effects and Ex-Dividend Day Behavior –  
Thirty-Two Years Later

Edwin J. Elton\*

Martin J. Gruber\*

Christopher R. Blake\*\*

March 12, 2003

\* Nomura Professors of Finance, Stern School of Business, New York University

\*\* Associate Professor of Finance, Fordham University

**Abstract**

Since Elton and Gruber's (E&G) original article on taxes and ex-dividend price behavior was published in 1970, over 100 articles have appeared in the leading journals of financial economics examining whether prices fall by less than the dividends and, if so, whether or not the phenomenon is due to tax effects, market microstructure effects, or some other effect. The microstructure argument is the most serious alternative to the tax argument.

All of the microstructure arguments state that the fall in stock price should be less than the dividend, regardless of whether the dividend is taxable or tax-advantaged. By testing ex-dividend effects on a sample of closed-end funds where dividends are tax-advantaged, we find that taxes should and do cause the fund price to fall by more than the amount of the dividend. This is consistent with a tax argument and inconsistent with a microstructure argument. Examining the sample of tax-free dividends, we find that the E&G and return measures change across two tax regimes exactly as theory suggests they should if taxes mattered.

We then examine non-tax-advantaged closed-end funds. For these funds we should find the traditional ex-dividend tax effects: the fall in price on the ex-dividend date should be less than the dividend during periods when capital gains taxes are less than income taxes. This is what we find. Furthermore, the ex-dividend behavior of these funds generally moves in the direction we would expect across two changes in tax regimes. The taxable sample not only substantiates the tax effect, it also demonstrates that the fall in price greater than the dividend for closed-end municipal bond funds was not due to some peculiar aspect of either our methodology or the closed-end fund industry.

Thirty-two years after E&G's original study, we find new and compelling evidence that taxes play an important part in affecting share price changes.