

Discussion of  
**Optimal Tax-Timing with Transaction Costs**

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# Overview

- This paper presents a model of (Merton-type) dynamic portfolio choice with capital gains taxes (CGT) and transaction costs
- Key findings:
  - With transaction costs, capital losses are not immediately realized
- Policy implications:
  - Imposing financial transactions taxes will reduce trading and CGT revenue
  - Imposing higher CGT taxes can increase tax revenue significantly

# My two cents

- The analysis is very well done
  - Properly modeling all these moving parts is non-trivial
- I have some *quantitative quibbles* about the policy implications
  - How much of actual trading can be captured by the model?
- Caveat: I have never worked in this literature

# 1. The paper's findings

# Model

- Continuous-time dynamic portfolio choice problem a la Merton
  - CRRA infinite-lived investor allocates between stock and bond
- New elements:
  - Capital gains taxes (CGT) + transaction costs
- Why does transaction cost matter?
  - In existing models without transaction costs, all capital losses are realized immediately (“wash sale”)
  - With transaction costs, loss realization can also be delayed

# Policy implications

- 1) Effect of imposing financial transactions tax (transaction costs ↑)
  - Will also reduce trading and thus capital gains taxes
  - May even backfire in terms of tax revenue collection
- 2) Effect of raising CGT tax rate?
  - Can increase tax revenue significantly

## 2. Implications

# What fraction of trading in practice is explained by Merton-type models?

- I don't know the answer, but my impression is a small subset
- Merton model:
  - Allocation between stock and cash
  - No return predictability
- Actual trading:
  - Lots of trading between different stocks
  - Trading driven by heterogeneous views on future returns
- A proper discussion of policy implications require an estimate of what is, and is not, captured by the Merton-type model

# Summary

- Very interesting paper; well executed analysis
- May need more work on quantifying policy implications
- I learned a lot from the paper and appreciate the opportunity to discuss!