

## **Reappearing Dividends:**

### **A Tax-Based Test of the Information Content of Dividends**

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#### **Abstract**

This paper implements a tax-based test to distinguish between the alternative hypotheses of firms' dividend policy. The study is motivated by the shift in dividend policy in the late 1990s away from cash dividends and a sharp reversal starting in 2000, coupled with the recent changes in the dividend tax code. Preliminary results indicate that prior to 1990s the share price response per dollar of dividends to an increase in taxation is considerably greater compared to the later periods. Furthermore, in spite of the decrease in dividend taxes in 2003, the change in stock price per dollar dividend seems improve in this later part of the sample. The results suggest that prior to 1990s firms tend to pay dividends to signal their future profitability to the market. The greater stock price response to dividend announcements and the increase in the propensity to pay dividends in later part of the sample is consistent with the view that firms have chosen to use dividends as a signal of confidence to mitigate the concerns over corporate governance. The evidence does not seem to support for the view that firms pay dividends to simply cater their investor clientele.