Focusing on reduction of the capital gains tax rate in Japan, this paper examines whether tax-loss selling by individual investors affects turn-of-the-year returns. The capital gains tax reduction law decays benefits to realize capital losses and results in lower relationships between tax-loss selling and turn-of-the-year returns. Empirical findings in this study lend support for the prediction. Considering that stocks with larger capital losses (gains) are more (less) likely to be subject to tax-loss selling, I find that the long-short portfolio which longs in stocks with larger capital losses and shorts in stocks with larger capital gains yields higher turn-of-the-year returns in the pre-tax-reduction period than in the post-tax-reduction period.

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