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The Impact of Taxes on Corporate Defined Benefit Plan Asset Allocation

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Abstract

This paper investigates the extent to which taxes affect a corporation's decision to allocate its defined benefit plan's assets between equity and bonds. Prior theoretical research shows that if a corporation integrates its financial policy and pension investment policy, differences in tax rates create an arbitrage opportunity. The firm's tax benefits from the arbitrage should be positively related to the percentage of its pension assets allocated to bonds. Consistent with this prediction, but contrary to prior empirical work, this paper finds firms' tax benefits are positively and significantly associated with the percentage of their pension assets invested in bonds.