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The Impact of Investment Incentives: Evidence from UK Corporation Tax Returns

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Abstract

Using UK corporation tax returns, we provide evidence on the effects of accelerated depreciation allowances on investment, exploiting exogenous changes in the qualifying thresholds for first-year depreciation allowances (FYAs) in 2004. The investment rate of qualifying companies increased by 2.1–2.5 percentage points

relative to those that did not qualify. We exploit variation in the timing of tax

payments to show that this effect is primarily due to the change in the cost of capital

rather than the relaxation of financing constraints. This conclusion is not borne out by the cost of

capital estimates that do not control for the effect of our results.

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JEL Classification

D25 Intertemporal Firm Choice: Investment, Capacity, and Financing

G31 Capital Budgeting; Fixed Investment and Inventory Studies; Capacity

H25 Business Taxes and Subsidies including sales and value-added (VAT)

H32 Fiscal Policies and Behavior of Economic Agents: Firm

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