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The Effect of Corporate Taxation on Investment and Financial Policy: Evidence from the DPAD

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Abstract

This study estimates the investment, financing, and payout responses to variation in a firm's effective corporate income tax rate in the United States. I exploit quasi-experimental variation created by the Domestic Production Activities Deduction, a corporate tax expenditure created in 2005. A 1 percentage point reduction in tax rates increases investment by 4.7 percent of installed capital, increases payouts by 0.3 percent of sales, and decreases debt by 5.3 percent of total assets. These estimates

suggest that lower corporate tax rates and faster accelerated depreciation each stimulate a similar increase in investment, per dollar in lost revenue.

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JEL Classification

D22 Firm Behavior: Empirical Analysis

D25 Intertemporal Firm Choice: Investment, Capacity, and Financing

G31 Capital Budgeting; Fixed Investment and Inventory Studies; Capacity

G32 Financing Policy; Financial Risk and Risk Management; Capital and Ownership Structure; Value of Firms; Goodwill

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

H32 Fiscal Policies and Behavior of Economic Agents: Firm

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