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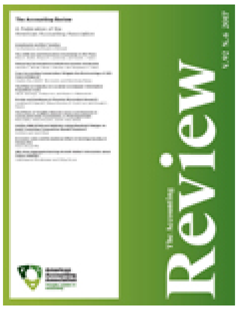

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Taxes and Off-Balance-Sheet Financing: Research and Development Limited Partnerships

Terry Shevlin

ABSTRACT: Research and development limited partnerships are a relatively recent alternative to the more traditional debt and equity funding of research and development costs. This paper provides an economic and empirical analysis of the factors that may motivate firms to select limited partnerships as a source of funding. The analysis uses a framework that relies on extant capital structure models and agency theory to derive empirically testable hypotheses. Results of the empirical tests are consistent with both a tax motivation and, to a lesser extent, an off-balance-sheet motivation for firms to use a limited partnership to fund their research and development costs. More generally, the analysis and results offer support for the clientele tax models of Miller [1977] and DeAngelo and Masulis [1980], and the analysis of taxes by Scholes and Wolfson [1984] and Majd and Myers [1985]. The off-balance-sheet results offer some support for agency model predictions.

RESEARCH and development limited partnerships are a relatively recent phenomenom used by firms to finance research and development (R&D) projects. These partnerships are an alternative source of funding to the more traditional debt and equity funding sources (i.e., in-house). The Department of Commerce estimates that during the period 1981–1984, over $2.3 billion was raised through R&D limited partnerships (see Department of Commerce [1984]). The purpose of this paper is to provide an analysis and empirical tests of the factors suggested (e.g., see Spohr and Wat [1983] and/or Garahan, Fuller, and

Factors favoring use of an *LP* include taxes, off-balance-sheet financing, and risk shifting from the R&D firm onto other parties. An R&D *LP* allows relatively low-tax firms to transfer (sell)

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Terry Shevlin is Assistant Professor of

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Abstract

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