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Do personal taxes affect corporate financing decisions?

John R. Graham

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Abstract

The traditional view is that interest deductibility encourages firms to use debt financing; however, some argue that the personal tax disadvantage to interest offsets the corporate tax advantage. This paper investigates the degree to which personal taxes affect corporate financing decisions. In cross-sectional regressions that control for personal taxes, debt usage is positively correlated with tax rates in each year 1980–1994, with significant coefficients in almost every year. A specification that adjusts tax benefits for the personal tax penalty statistically dominates a specification that does not. The positive (negative) effect of corporate (personal) taxes on debt usage is distinctly identified.

Keywords

Debt; Corporate taxes; Personal taxes; Capital structure; Taxes

JEL classification

G32; H20