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Headline: Taxes Depress Corporate Borrowing: Evidence from Private Firms

Article Link: https://www.nber.org/papers/w32398

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Tweet: .@toniwhited and @ivan_t_ivanov find that state tax cuts “make capital more productive and spur borrowing” by small private firms, as investment opportunities and lower credit spreads outweigh the reduced tax subsidy to borrowing.

Summary: [Miller-Modigliani theory says] the benefit from the interest tax deduction is larger than countervailing costs of debt related to financial distress, and prior empirical work finds a positive relation between debt and taxes. Using comprehensive samples of both private and public companies, we study the evolution of corporate borrowing around changes in 6 state corporate income taxes since the 1990s. For small private firms corporate taxes, on average, depress leverage. The leverage of large private firms does not change in response to tax legislation. Small firms' leverage first responds to the tax cuts in the enactment year with no significant reaction before enactment. The event study coefficients on or after the enactment dates [Figure a, panels A and B] are precisely estimated, ranging from approximately 4% in the enactment year to about 2% four years later. We find that bank assessments of loan default rates fall by 20-30bps after tax cuts. This last result supports the notion that default risk [is] also tax-sensitive.

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Primary Topic: Taxation

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