

# [Debt and taxes: a new measure for non-debt tax shields](https://assignbuster.com/debt-and-taxes-a-new-measure-for-non-debt-tax-shields/)

Debt and Taxes: A New Measure for Non-debt Tax ShieldsJames SchallheimaandKyle Wellsa, ba. David Eccles School of BusinessUniversity of UtahSalt Lake City, UT 84112-9303b. Anderson Schools of ManagementUniversity of New MexicoAlbuquerque, NM 87131-0001This DraftFebruary 2006“ You can’t underestimate how many of America’s greatest minds are being devoted to whateconomist would all say is totally useless economic activity.”– Peter Cobb, former Deputy Chief of Staff of the Joint Committee on Taxation\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\* Email address for the authors are [email protected]

utah. edu. We thank JohnGraham for providing access to his data and for his helpful comments and Craig Lewis, Mike Lemmon, RyanWhitby and seminar participants at University of New Mexico, Penn State University, University of SouthFlorida, and University of Virginia for helpful suggestions. We are responsible for all remaining errorsDebt and Taxes: A New Measure for Non-debt Tax ShieldsABSTRACTTheory predicts that non-debt tax shields (NDTS) substitute for debt tax shields leading to anegative relation between the two.

Empirical research in this area, however, has failed toprovide robust support for the theory. We propose a new and simple proxy for NDTS calledthe tax spread — the difference between tax expense and taxes paid. We find statisticallysignificant determinants of the tax spread using accounting proxies for tax shielding activities. We then compare the tax spread to Graham (2000) measure of under-leverage — called kink. We find a significant and positive relation between kink and the tax spread, inferring that firmsare finding alternatives to debt to reduce taxable income.

Tax spread is then used as areplacement for previous proxies of non-debt tax shields in extant empirical capital structuremodels and provides results consistent with capital structure theory. Although our…