

Debt and taxes: a new measure for non- debt tax shields



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Debt and Taxes: A New Measure for Non-debt Tax Shields James

Schallheim and Kyle Wells, ba. David Eccles School of Business University of Utah Salt Lake City, UT 84112-9303b. Anderson Schools of

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Draft February 2006 “ You can’t underestimate how many of America’s

greatest minds are being devoted to what economist 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

utah. edu. We thank John Graham for providing access to his data and for his

helpful comments and Craig Lewis, Mike Lemmon, Ryan Whitby and seminar

participants at University of New Mexico, Penn State University, University of

South Florida, and University of Virginia for helpful suggestions. We are

responsible for all remaining errors Debt and Taxes: A New Measure for Non-

debt Tax Shields ABSTRACT Theory predicts that non-debt tax shields (NDTS)

substitute for debt tax shields leading to a negative relation between the two.

Empirical research in this area, however, has failed to provide robust support

for the theory. We propose a new and simple proxy for NDTS called the tax

spread — the difference between tax expense and taxes paid. We find

statistically significant 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 firms are finding alternatives to debt to reduce taxable income.

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