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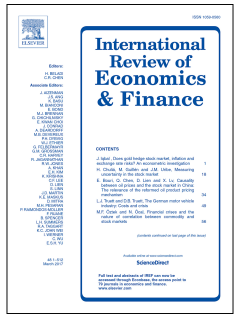

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Does The Debt Tax Shield Distort Ownership Efficiency?*

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Abstract

The tax laws of most developed countries are debt biased since firms can deduct interest on debt but not on equity. This bias is known to distort investment decisions. However, less is known about how the debt tax shield affects the ownership of assets when bidders differ financial expertise and thus in optimal use of leverage. We show that the debt tax shield need not always distort ownership efficiency. Assets end up with the socially preferred owner when differences in financial and productive expertise between bidders is small and better financial expertise reduces expected bankruptcy costs.

Keywords: Acquisitions, Capital Gains Tax, Corporate Tax, LBOs, M&As, Ownership, Private Equity, Tax Shields.

JEL classification: D20, G32, G33, G34, H25, H32, L19, L22.

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