

Tax Policy and Firms' Financial Choices: Empirical Evidence from the Dominican Republic

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Abstract. Starting from the seminal writings of Modigliani and Miller (1958, 1963), the literature has developed numerous theoretical and empirical contributions on the relationship between taxation and the financial behaviour of firms. However, although most empirical studies have found a positive association between taxation and financial leverage, the results are often discordant, also due to the different methods used to estimate the tax effect on the capital structure.

The common problem with most of these studies is that the measurement of the tax rate was done on the basis of estimates based on balance sheets and not on the companies' actual tax returns. Consequently, given that very often significant differences are generated between accounting and tax income, it is possible that the results suggest misleading conclusions on the above relationship.

To solve these problems, it would therefore be necessary to use the corporate tax returns. The availability of these data, in fact, would solve the problem of which method to use and, above all, would significantly reduce the risk of error in estimates. However, the tax returns contain confidential information and, therefore, these data are hardly made public or provided to scholars. Consequently, studies that have investigated the tax impact on the capital structure using the tax returns of individual companies are quite rare.

In the context briefly outlined, this study aims to investigate the effects of tax policy on the capital structure of companies in the Dominican Republic, using data from the tax returns of each individual company. The data and analysis cover the period 2006–2015 and were provided by the Ministry of Finance to the World Bank as part of a collaboration on the analysis of the current fiscal policy.

To achieve the objectives of the research, this study develops quantitative analysis models, using the main indicators suggested by the literature to analyse the financial structure of companies and the tax returns of individual companies to measure the actual tax burden and assess whether and in what how the presence of incentives and tax breaks can influence the financial behaviour of companies.

Keywords: Tax policy, Capital structure, Financial Decisions, Dominican Republic