Quiz: 3/19/12 Name & Time Key

Quiz: Assume the corporate tax rate is 30%, the personal tax rate on interest income is 25% and the personal tax rate on equity income is 20%. Determine the optimal capital structure for Android Corporation if the firm has a 45% chance of having an annual EBIT of $1,000,000 and a 55% of having an annual EBIT of $3,000,000. What is Android's optimal level of interest payments?

Note: You will need to do enough <u>calculations</u> to show that your answer is optimal.

Note: Bonus WSJ Questions on back of page

1-3 (-2) not or incorrectly labeled.

+6 ~~8~~

$$T^* = 1 - \frac{(1-(.55)(.3))(1-.2)}{1-.25} = +0.1093 \quad \text{~~24~~} \quad 22$$

+4 +4 +4 +4

3+ (-2) not or incorrectly labeled

+6 ~~8~~

$$T^* = 1 - \frac{(1-0)(1-.2)}{(1-.25)} = -0.067 \quad \text{~~24~~} \quad 22$$

+8 +4 +4

$$= \frac{.2-.25}{1-.25} =$$

+6

$\Rightarrow$ optimal interest = 3 million