

Quiz: 3/7/12

Name & Time _____

Quiz: Assume the corporate tax rate equals 30%, that the personal tax rate on equity income equals 25%, and that the personal tax rate on interest income equals 20%. Assume also that Boeing Corp expects to earn an EBIT of \$3,000,000 per year for the foreseeable future. Boeing currently has no debt but is considering whether or not to issue \$1,000,000 of debt at a 5% interest rate.

- a. How would issuing the debt affect the value of Boeing?
- b. What annual tax savings would the debt generate for Boeing?
- c. What changes in tax rates would give firms a greater incentive to issue debt?

Note: Bonus WSJ Questions on back of page