

Quiz A for 1:00 Class: 3/6/13

Name _____

Assume the corporate tax rate equals 40%, that the personal tax rate on equity income equals 20%, and that the personal tax rate on interest income equals 35%. Assume also that TaxFlow Inc. has a 10% chance of earning \$1 million per year, a 30% chance of earning \$5 million per year, a 25% chance of earning \$15 million per year, and a 35% chance of earning \$20 million per year. What is TaxFlow's optimal level of interest payments?

Note: You will need to perform calculations to justify your answer. Show your work in case you need partial credit.

Wall Street Journal Questions are on the back of this page.