

Quiz A: 7/30/14

Name _____

Assume the corporate tax rate is 40%, the individual tax rate on equity income is 10%, and the individual tax rate on interest income is 30%. Assume also that there is a 25% chance that Wind Inc. will realize Earnings Before Interest and Taxes (EBIT) of \$1 million, a 35% chance that Wind will realize an EBIT of \$4 million, a 30% chance that Wind will realize an EBIT of \$7 million, and a 10% chance that Wind will realize an EBIT of \$10 million.

- a. What is the optimal level of interest for Wind? Note: Calculations required. Show your work if you want to receive any partial credit.

- b. Which of the issues we discussed in chapter 16 might cause Wind to optimally have less debt than you answered in part a? Note: a list of the issues without any discussion is fine.