

- October 29, 2009, 5 pm
- HS II (lecture room II)  
Institute for Advanced Studies  
Stumpergasse 56, A – 1060 Wien  
<http://economics.ihs.ac.at/seminars>

## JOINT VIENNA MACROECONOMICS SEMINAR

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### “Profit Taxation and Finance Constraints”

#### Abstract

In the absence of financing frictions, profit taxes reduce investment by their effect on the user cost of capital. With finance constraints due to moral hazard, investment becomes sensitive to cash-flow and own equity of firms. We propose a corporate finance model of investment and derive three central results: (i) Even small taxes impose first order welfare losses on financially constrained firms; (ii) ACE and cashflow tax systems, which are investment neutral in the neoclassical model, are no longer neutral when firms are finance constrained. (iii) When banks are active and provide external finance together with monitoring services, the two systems not only reduce investment, but are also no longer equivalent. With active banks, investment is subject to double moral hazard and the timing of tax payments becomes important. The ACE system gives tax relief at the return stage and provides better incentives than a cash-flow tax which gives tax relief upfront.

with Evelyn Ribi, University of St. Gallen (IFF-HSG).