

ABSTRACT

This paper investigates whether and how tax incentives of individual investors affect capital structure decisions. Using a large sample of publicly traded European firms from 2002 to 2012 and detailed data on cross-country taxation (including tax treaties), we examine the influence of the largest versus the second-largest investors' tax incentives on the firm's capital structure. We find that the largest investor's (net) tax incentive for debt (relative to equity) positively influences the firm's leverage. We also find that the second-largest investor's tax incentives are incrementally relevant for capital structure decisions. In addition, we show that the tax incentive heterogeneity between the largest and second-largest investor reduces the positive influence of the largest investor's tax incentive on the firm's capital structure. Furthermore, we document that the relevance of the largest investor's tax incentive over and above the second largest investor's tax incentive is increasing in the level of ownership power. We contribute to prior literature by demonstrating that tax incentive effects on corporate leverage are differentially relevant under different ownership-specific circumstances.