Report on: Italy's ACE Tax and Its Effect on a Firm's Leverage

This paper claims to investigate the effect of the new ACE-type corporation tax in Italy on the capital structure of Italian companies. The ACE has been advocated by many economists, most recently by the Mirrlees review, so an analysis of its effects in practice would be very useful.

However, given the reform has only just been undertaken, it is not possible yet to evaluate its effects. The authors instead use company level data between 2006 and 2010. It might in principle be possible to identify the effects of the ACE by first estimating the effect on capital structure of the tax advantage to debt in this period, and then simulating the effects of its removal under the ACE. However, this is not the approach taken in the paper.

Instead the paper shows the results of regressing the leverage ratio on some controls and a variable that appears to be intended to reflect the benefit of the ACE. I cannot understand what is intended to be the strategy here. The ACE did not exist prior to 2012, so it seems bizarre to include it in regressions to investigate its effect on leverage using data that end in 2010. The authors perhaps intend to model the effect of the earlier DIT, which is also discussed in the paper. But if so, they do not say so.

So what is this variable actually capturing? The authors do not specify their measure in any detail (they only refer to De Mooij, 2011). But the base for the ACE presumably includes new equity, and at least new retained earnings. But this is naturally correlated with the leverage ratio: if a company chooses to issue new equity instead of debt, then its ACE base will rise and its leverage ratio will fall. Surely that effect has nothing to do with the behavioral response to introducing additional tax relief?

More specific points are as follows.

- More care should be taken to describe the data, and especially the construction of the key ACE variable, and the other controls used in the estimation.
- Although fixed effects are used, there is almost no attempt to control for endogeneity. The last set of results use GMM, but allow only sales to be endogenous: surely the ACE variable is endogenous? There are no tests for endogeneity, or the validity of instruments. Indeed, no regression results are actually presented.