

# Capital-Based Corporate Tax Benefits: Endogenous Misallocation through Lobbying

VERY PRELIMINARY

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## Abstract

The dominant issue of corporate lobbying in the U.S. is taxation. Firms that lobby are granted tax benefits and enjoy systematically lower effective tax rates than non-politically active firms, even after controlling by firm characteristics. Because most of these tax benefits are tied to capital holding, corporate lobbying could distort the allocation of capital in the economy. A heterogeneous firm model with endogenous lobbying decisions is presented to study the macroeconomic effects of capital-based tax benefits and their interaction with endogenous corporate lobbying behavior. The model is calibrated to U.S. firm-level data. The model suggests that the increase in corporate lobbying and the decrease in effective corporate tax rates between 1998-99 and 2010-11 are mostly due to the increase in the availability of political rents. Moreover, rent-seeking by firms can account for 7.5% of the observed dispersion in the marginal product of capital. The real cost of capital based tax benefits and rent seeking depend on the correlation between firm level productivity and political influence with intermediate levels of this correlation generating larger costs.

Key words: Misallocation, Lobbying, Firm heterogeneity, Firm dynamics, Political economy, Rent seeking.

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