



Corporate Cost of Debt: The Issue of Discount or Premium Bonds

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Abstract

The traditional textbook method of calculating a corporation's cost of debt capital tends to minimize the practical process used to arrive at that cost. This is particularly true if the corporation has issued a coupon bond at either premium or discount. The theoretical before-tax cost of debt is easily calculated and does include the amortization of the discount or premium, but the significance of this amortization is not apparent. Further undermining the cost-of-capital process, finance and accounting students are taught that the dollar amount of coupon interest is tax-deductible to the corporation while tending to ignore the tax effect of amortizing the discount or premium or the amortization of other expenses associated with the original issuance of the bond. This paper bridges finance theory with accounting practice to fully include the effect of discount or premium amortization on the cost of debt capital to a corporation and extends material presented in popular finance and accounting textbooks.

Please contact the authors if you have any questions or wish to obtain a copy of the paper.