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Question 1

Question Type: MultipleChoice

A firm is exploring the possibility of engaging in a new capital project. A salvage company is offering the him more for its old equipment than the equipment's book value. If the firm accepts the salvage company's offer, the reduction to the net initial investment in the project will be?

Options:

A- Less than if the salvage company's offer had resulted in a loss.

B- Greater than if the salvage company's offer had resulted in a loss

C- The same as if the salvage company's offer had reused in a loss.

D- Not determinable from the information given.

Answer:

A

Explanation:

Since the salvage company's offer is for more than the book value of the equipment, an accrual- basis gain would result A loss on disposal of old equipment results in a tax benefit, since the loss reduces accrual basis income. Therefore, a gain. which increases accrual-basis income, results in a tax detriment, and the reduction to the net initial investment will be less than if the salvage company's offer had resulted in a loss.

Question 2

Question Type: MultipleChoice

A firm is considering a capital project for which the following information is available: An existing piece of equipment that would be disposed of to make room for new equipment has a historical cost of $370,000. It has a salvage value of $10000 and has been depreciated on a straight-line basis for 16 of the estimated 18 years of its useful life. The new equipment has a cost of $500,000 and the firm expects it will have to devote $20,000 in cash and $24,000 in accounts receivable to the new project. The firm's effective tax rate is 40%. The required net initial irwestrnent in the new project is?

Options:

A- $544,000

B- $534,000

C- $518,000

D- $498,000

Answer:

C

Explanation:

The net initial investment consists of the initial outlay for new equipment ($500,000) plus the increase to working capital ($44,000) minus the net after-tax cash flow from the disposal of the old equipment ($26,000). The cash inflow from the disposal of the old equipment is calculated as follows:

Question 3

Question Type: MultipleChoice

Calamity Cauliflower Corporation is considering undertaking a capital project. The company would have to commit $24000 of working capital in addition to an immediate outlay of $160 .000 for new equipment. The project is expected to generate $100 .000 of annual income for 10 years. At the end of that time, the new equipment, witch will be depreciated on a straight-line basis, is expected to have a salvage value of $ 10.000. The existing equipment that would be sold to make room for the project has a historical cost of $220,000 and accumulated depreciation of $208,000. It has an estimated remaining useful life of 2 years and the remaining book value is being depreciated on a straight-line basis. A scrap dealer has agreed to buy it for $8,000. The company's effective tax rate is 40%. Calamity Cauliflower's relevant after-tax annual cash inflow from the ongoing operations of the project is

Options:

A- $100,000

B- $60,000

C- $40,000

D- $0

Answer:

B

Explanation:

The relevant after-tax annual cash inflow for the project consists of the gross cash inflow

,($10O.000) minus income tax expense ($100,000 x AO). or $60,000.

Question 4

Question Type: **MultipleChoice**

Calamity Cauliflower Corporation is conceding undertaking a capital project. The company would have to commit $24,000 of working capital in addition to an immediate outlay of $160,000 for new equipment. The project is expected to generate $100,000 of annual income for 10 years At the end of that time, the new equipment, witch will be depreciated on a straight-line basis, is expected to have a sage value of $10,000. The exiting equipment that would be sold to make room for the project has a historical cost of $220,000 and accumulated depreciation of $208,000. It has an estimated remaining useful life of 2 years and the remaining book value is being depreciated on a straight-line basis A scrap dealer has agreed to buy it for $8,000. The company's effective tax rate is 40%. The net initial investment required for Calamity Cauliflower to undertake this capital project is

Options:

A- $184,000

B- $176,000

C- $174,400

D- $160,000

Answer:

C

Explanation:

The net initial investment consists of the initial outlay for new equipment ($160,000) plus the increase to working capital ($24,000) minus the net after-tax cash flow from the disposal of the old equipment ($9,600).

Question 5

Question Type: MultipleChoice

Calamity Cauliflower Corporation is considering undertaking a capital project. The company would have to commit $24,000 of working capital in addition to an immediate outlay of $160,000 for new equipment. The project is expected to generate $100,000 of annual income for 10 years. At the end of that time, the new equipment, which will be depreciated on a straight-line basis, is expected to have a salvage value of $10,000. The existing equipment that would be sold to make room for the project has a histoncal cost of $220,000 and accumulated depreciation of $208,000. It has an estimated remaining useful life of 2 years and the remaining book value is being depreciated on a straight-line basis. A scrap dealer has agreed to buy it for $8,000. The company's effective tax rate is 40%. The total after-tax cash inflow relevant to Calamity Cauliflower's disposal of the old equipment is

Options:

A- $9,600

B- $8,000

C- $6,400

D- $1,600

Answer:

A

Explanation:

The relevant after-tax cash inflow consists of the proceeds on the disposal ($8.000) plus the tax benefit ($1,600).

Question 6

Question Type: **MultipleChoice**

Calamity Cauliflower Corporation is considering undertaking a capital project. The company would have to commit $24,000 of working capital in addition to an immediate outlay of $160,000 for new equipment. The project is expected to generate $100,000 of annual income for 10 years. At the end of that time, the new equipment, witch will be depreciated on a straight-line basis, is expected to have a salvage value of $10,000. The existing equipment that would be sold to make room for the project has a histoncal cost of $220,000 and accumulated depreciation of $208,000. It has an estimated remaining useful life of 2 years and the remaining book value is being depreciated on a straight-line basis. A scrap dealer has agreed to buy it for $8,000. The company's effective tax rate is 40%. Calamity Cauliflower's tax benefit arising from the disposal of the old equipment is

Options:

A- $8,000

B- $4,800

C- $3,200

D- $1,600

Answer:

D

Explanation:

A firm enjoys a tax benefit upon recognizing a loss on disposal because the loss reduces book income. The old equipments book value is historical cost ($220,000) minus accumulated depreciation ($208,000).

The tax benefit is the accrual-basis loss on the disposal times the effective tax rate.