

Solution:

The table is filled with values to answer (1) and (2).

TABLE FOR PROBLEM 8-63 (Amount in € in millions)				
Particulars	1. Zero Income Tax		2. 40% Income Tax	
	Straight Line	Accelerated	Straight Line	Accelerated
Revenues (all cash)	89,325	89,325	89,325	89,325
Cash operating expense	(85,856)	(85,856)	(85,856)	(85,856)
Cash provided by operation before tax	3,469	3,469	3,469	3,469
Depreciation Expense	(1,633)	(2,363)	(1,633)	(2,363)
Pre-tax Income	1,836	1,106	1,836.0	1,106.0
Income Tax	0	0	(1,101.6)	(663.6)
Net Income	25,542	23,542	734.4	442.4
Supplementary Analysis:				
Cash provided by operation before tax	3,469	3,469	3,469	3,469
Income Tax	0	0	(1,101.6)	(663.6)
Cash provided by operations	3,469	3,469	2,367.4	2,805.4

(3) No, depreciation does not provide cash, as with zero tax, any of the two-depreciation method used results in the same cash flow. The difference occurs due to income tax, which shows that the depreciation helps to reduce income tax, and this accounts for its apparent way of “earning cash”.

(4) All increased by €438.

(5) There will be no effect of this on the cash flow, because depreciation does not affect cash flow at all. It is a non-cash expense, so it has no effect.