A case study on pressco, inc. (1985)

Business

A Case Study on Pressco, Inc. (1985) Submitted by: Cherry Ann Abangtao Maricor Quilnat Hyacinth Mae Yarcia Jan Joseph Tayzon 4BSA Financial Management II History Jane Rogers, a marketing representative of Pressco Inc. , was attempting to sell mechanical drying equipments to Paperco but was unsuccessful in her efforts. However, in November 1985 new tax legislation had been rumored that gained the interest of Paperco to buy new equipments. This gave Jane Rogers the opportunity to persuade again the company to purchase their product.

Point of View Paperco – to avail all the possible tax benefits and cost savings in replacing the drying equipment of the company. Time Context | | | | Year | Significant Events | | | | 1984 | First unsuccessful attempt of Jane Roger to sell mechanical drying equipments to Paperco. | | | | | November 1985 | New tax law was rumoured to be enacted that gained the interest of Paperco to pursue the contract with Pressco Inc. | Statement of the Problem When is the best situation to replace the old drying equipments of Paperco that will enable the company to avail greater tax benefits and cost savings? Statement of Objectives This case study aims to foster discussion and educate students about capital investment. Specifically: 1. To enhance students' skills in decision-making.

2. To have a better understanding on capital budgeting. 3. To know the importance of government regulations regarding depreciation methods and tax implications in capital investment. .

To prepare students in dealing with investment projects of a business. Areas of Consideration • Cost-reduction opportunity of replacing old equipments. •

Elimination of investment tax credit for new equipment due to the new tax legislation. • Extended depreciation lives for new equipment under the new tax regulation. • Reduction of corporate tax rate from 46% to 34% subject to the new tax regulation.

• Economic uncertainty on long-term capital investments. Alternative Courses of Action 1. Buy the new machine yet no new legislation is enacted. Advantages ? The company will continue to use a 5 year ACRS depreciation model with higher depreciation expense. ? Efficiency in operation due to new equipments.

Disadvantage ? The company will retain all tax credits due to using 5 yr. ACRS depreciation model in equipments with 7 yr useful life. 2. Buy the new machine when the new tax proposal is enacted and bind the contract soon enough to be grandfathered or before the enactment of the law. Advantages This will allow the company to receive an investment tax credit that will reduce the company’s taxes. ? The company will continue to use a 5 year ACRS depreciation model with higher depreciation expense.

? Tax rate would reduce to 34%. ? Efficiency in operation due to new equipments. Disadvantage ? Depreciation life of the equipment will not be extended. 3. Buy the new machine when the new tax proposal is enacted but do not bind the contract in time to be grandfathered or after the enactment of the law. Advantages Efficiency in operation due to new equipments.

? Depreciation life of the equipment will be extended by 2 years. ? Tax rate would reduce to 34%. Disadvantages ? MACRS model will be used which generates a lower depreciation expense than the ACRS model. ? The company will not be able to receive the investment tax credit due to binding the contract after the law was enacted. Recommendation Based from the alternative courses of action presented, it is being recommended to do the second option for it provides lower tax implications thus greater cost savings.

Action Plan | | | | | | Action | Description | Persons Involved | Duration | | | | | | | | Binding of contract will be made | | | | 1. Bind the contract with | in a timely manner that will | Top Management | 1 month | | Pressco. | qualify Paperco for | | | | | grandfathering. | | | | | | | | 2. Appropriation of funds for the| The company will set aside funds | Finance Department | | | investment. | to ensure the payment of the new | | 6 months | | | equipments.

| | | | | | | | 3. Invest in New Equipments | The company will buy the new | | | | | Equipments from Pressco. | Top Management | 5 months |