Taxes and Capital Budgeting

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“The goal of capital budgeting is to make informed decisions that maximize the company’s long-term financial performance and shareholder wealth.” (Taxmann, 2023). "What if we began from a different place? What if we stopped talking about preserving capital markets and turned the question around: What is the purpose of capital in the real world? What if we stood with regular people, the excluded, the dispossessed, and asked what they need and how capital can be of service to them?" (Kelly, 2023, p. 79). “Labor is the superior of capital, and deserves much the higher consideration.” (Lincoln, 1861).

Completing this course will continue to be a difficult challenge for me, not because I struggle with the computations, but because I can not refrain from diverging significantly into ideological discussion. Like an ardent abolitionist living in Virginia in the 1850s, I am compelled to speak out against injustice. Given a choice between passing a course or staying true to deeply held moral beliefs, I will have to choose the later. With that said, I will turn to the topic of describing and explaining capital budgeting items that may or may not be taxed as part of a capital budget project.

“[F]irms that pay income taxes must consider the impact income taxes have on cash flows for long-term investments. When taxes are involved, it is important to understand which cash flows are affected by the tax rate and which are not.” (Managerial Accounting, 2012). The text provides a clear step-by-step example and gives us three key equations:

after-tax inflow = before-tax inflow x (1 - tax rate)

after-tax outflow = before tax outflow x (1 - tax rate)

depreciation tax savings = depreciation expense x tax rate

In the Scientific Products, Inc. example discussed in our assigned chapter, the proposed capital project has a negative NPV of $ (56,135.82), so it does not meet the 10 percent return desired and would not be approved on the basis of this analysis. Even if the tax rate were eliminated, the NPV for the project would still be negative, though at $ (16,432.37) it would be closer to being viable.

Thinking about the implications of tax policy on economic activity naturally led me down another rabbit hole. Supply-side economists since the Reagan era have claimed that reducing taxes spurs economic growth. Evidence from the state of Kansas's experiment with deep tax cutting in 2013 appears to invalidate that claim (Mazerov, 2018).

Even more important from a societal point of view is the impact that tax law has on wealth inequality. In her recent book, *The Second Estate: How the Tax Code Made an American Aristocracy*, prominent law professor and tax expert Ray Madoff details how historical changes in U.S. tax policy have led to with widely reported situation shared by billionaire Warren Buffett where his secretary, Debbie Bosanek, paid taxes at more than double the rate he did. (2025, p. 2). I know we are not supposed to question these things as MBA students. Our job is to just learn the rules and do what our bosses, the lords of capital, tell us to do to help them maximize their profit.

References

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