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MEMORANDUM

A Proposal to Index to the Tax System for Inflation
Combined with Foreign Exchange Gains and Loss Provisions

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I. Introduction

It is recommended that the income tax system in the Dominican Republic be indexed for changes in the domestic price level. Inflation adjustments are necessary for a number of reasons. First, recent inflationary episodes will increase the real tax burden of firms absent private sector adjustments. Second, the increase in the real tax burden due to inflation has not been realized in inflationary economies because the private sector will respond by tax avoidance, evasion and other methods which decrease their real taxes. Such efforts undermine the tax system, and revenues, both real and nominal, fall as a result. Third, a number of Dominican investments have been structured to take advantage the numerous incentives available in the law. It has been recommended that all the tax incentives be eliminated as part of the ongoing reform. This change will significantly increase corporate tax revenues despite lower corporate rates. In this context, indexation is appropriate to instill confidence in the business community and to provide appropriate balance in the allocation of the tax burden. Finally, tax reform efforts might be jeopardized if inflationary pressures continue and no accommodation is made in the tax system.

Inflation indexing systems are claimed to be too difficult to implement in developing economies. An adjustment is necessary but the costs of adopting an appropriate system must be weighed against the gains of increased confidence in the tax system as well as greater compliance and more uniform application of the law. Below a relatively simple indexation system is proposed for the Dominican Republic.[1] The steps necessary to adjust the tax accounts for inflation are <u>purely mechanical</u> and can be performed without much difficulty. The proposed indexation system also includes a method for the treatment of foreign exchange gains and losses. Foreign currency gains and losses are closely related to inflation since nominal exchange rates reflect inflation differentials in part.

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[1] This system is a modified version of the system proposed by Arnold C. Harberger during the Indonesian Tax Reform. See Harberger, "On the Indexing of Business Income Taxation" Indonesian Tax Reform Memorandum, September, 1982.

It is important to emphasize that the relative simplicity of any inflation accounting system is based on the fact that the purpose of the system is to adjust the accounts for the change in the value of the domestic unit of account (the economic unit of account) and to reflect only inflationary changes. An indexing system should not be confused with or designed to accommodate replacement cost accounting, changes in relative prices or to measure true economic business income. The sole purpose of inflationary accounting is to eliminate the biases created by historical cost accounting where accrual methods are used for capital items. All the biases and common difficulties created by historical cost accounting remain, but the real income transfer between the private sector and the government due to inflation is eliminated.

The proposed system is described in the next section. Section 3 contains a number of examples to illustrate the application of the proposed system. An alternative method to accommodate a potential cash flow difficulty due to the use of non indexed debt is discussed in Section 4. Administrative and transition rules are discussed in Section 5.

II. The Proposal

As stated, the purpose of the indexing system proposed here is to adjust the books of account for the depreciation in the purchasing power of the unit of account. Application of this system is based on the following set of rules:

1. The beginning period values of all nonworking capital assets except inventories (that is all assets except cash and accounts receivable) should be increased by the specified rate of inflation on the final statement date. This value is added to taxable income.

2. The beginning period values of equity (initial capital plus retained earnings) should be increased by the specified rate of inflation on the final statement date. The value of this adjustment is subtracted taxable income.

3. All domestic credit instruments (loans to firm and by the firm in terms of receivables and other types of credit) are increased by the specified rate of inflation (if the loan terms specify that the principal balance is adjusted for inflation and the interest rate is quoted in real (or net of inflation terms). These instruments are sometimes called negative amortization loans. The value of this adjustment is subtracted from taxable income.

4. No adjustment is made for other types of domestic credit instruments independent of whether the interest rate charged is fixed or variable.

5. Tax depreciation is to be computed on the adjusted balances of assets.

6. Cost of Goods Sold should be computed using the Last-In-First-Out (LIFO) method with the initial value of inventories being adjusted by the inflation index.

7. The initial value of all instruments (equity and debt) specified in foreign currency should be adjusted by the change in the nominal exchange rate with the resulting difference being added to taxable income as a foreign exchange gain or loss.

These seven adjustments (actually six with no adjustment for non principal indexed debt) are all that is required to fully adjust the tax accounts for inflation and will ensure that the firm's tax liability will remain constant in real terms other things equal.

III. Illustrations

One way to illustrate the procedure is via numerical examples. A number of examples are reported here. The examples were developed to illustrate how the adjustments are made and their effects on an item by item basis. Such an approach should enable the reader to understand the mechanics of each adjustment and hopefully to appreciate the economic underpinnings of the adjustment process. Four tables are presented for each example (labeled A-D). It is assumed that inflation is 50% in each case and that the corporate tax rate is 50%. All nominal flows (wages and output prices) are adjusted for inflation. Table A of each case will contain the inflation adjustment worksheet. This worksheet is the first step of the process. Table B will be the Cost of Goods Sold statement. The table is provided to illustrate the effects of inventory accounting. The income tax computation will be found in Table C. The ending period balance sheet is provided in Table D. This table will be the initial statement in the subsequent period and is provided for completeness as well as to illustrate the fact that the all assets and liabilities balance at the end of the period. Each table contains the results for no inflation and 50% inflation so that comparisons can be made.

A. Case 1: All Equity-Simple Case

The simplest possible case is where the firm holds no initial working capital, all production is sold during the period and financing is 100% equity. The results of this case are illustrated the Tables 1.A- 1.0. The initial value of the machine is increased by 50% and tax depreciation is computed on the adjusted basis (1500 in this case). (See Table 1.A). Equity is also adjusted by the rate of inflation in Table 1.A. The change in assets is added income while the change in liabilities is subtracted from taxable income (See Table 1.C). The net difference (zero in this case) is the measure of the flow value of the change in income due to inflation. That is, the difference, if any, is equal to the accrued real gain or loss resulting from a change in the price level. In this case, the net change is zero, but there may be cases where this will not occur (see below).

Note that real income taxes (Table 1.C) are the same regardless of the level of inflation. That is the 450 paid when there is 50% inflation is equal to exactly 150% of the 300 paid in the no inflation case which implies that real revenues are preserved. Finally, note the balance sheet reflects the change in the price level with both ending assets and liabilities being equal in real (net of inflation) terms.

B. Case 2: All Principal Indexed Local Debt

Principal indexed local debt is an instrument where the basis of the loan is adjusted for changes in the price level. Interest is then charged at a fixed real rate (10% in all examples presented here).[2] That is, the adjustment is made on the basis of the liability and not via the interest rate with the lender maintaining the true value of the loan.

According the indexing rules a loan with the principal amount indexed should have the basis adjusted and interest charged on the adjusted basis. This is shown in Table 2.A. Note that the adjustment is identical to the 100% equity case. In fact, the lender's tax return should reflect the increase in his/her books. That is, the borrower's nominal loan balance is increased (resulting in a decrease in equity) while the lender's principal (equity) is increased. This adjustment will ensure that the tax payments made by parties to both sides of the transaction are adjusted fully for inflation.

Actual interest payments are deducted in the computation of income in addition to depreciation. The net initial balance sheet adjustments are zero in a manner similar to the 100% equity case. The real value of tax revenues and the real ending values of the balance sheet are adjusted fully for inflation.

C. Case 3: Interest Indexed Debt

A second form of inflation adjusted debt instrument is a called a variable rate note. No adjustment is made to basis of this instrument; instead, the interest rate is adjusted to reflect inflation. The real interest rate in these examples is assumed to be 10%. Thus, a variable rate loan would have a nominal interest rate of 65% on an annual basis.[3]

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[2]Periodic payments of principal will reduce the balance due. However these payments will not affect the nature of results and thus such payments are ignored here in order to simplify presentation.

[3]All interest rates are quoted in per annum terms. This implies that the nominal interest rate will be equal to: [(1 +•r)*(1+pdot)- 1], where r is the real rate of interest and pdot is equal to the rate of inflation.

The indexed tax system would not provide any inflation adjustment for the loan basis but would provide for full interest deductibility. This is illustrated in Tables 3.A- 3.0. Note that taxable income and taxes due are exactly equal to their respective values found in Case 2 (the principal indexed case). This results because of the way nominal interest is computed. Note that the interest charge in the current case is equal to 650 (Table 3.C). This value is equal to the 150 interest charge in the principal indexed case (Table 2.C) plus the 500 deduction for the liability adjustment (Tables 2.A and 2.C). Interest rate adjustments require the borrower to pay both real interest and the portion of principal necessary for the lender to be made whole independent of inflation with no adjustments to the nominal value of the debt. In effect, the interest charged consists of both the time value of money and principal repayments. As such, no adjustments to the liabilities are needed in this case (See Table 3.A) and real income is invariant to the method of loan indexation.[4]

Note that cash balances are lower with inflation than without (Table 3.0). This results for two reasons. Interest expense is higher in real terms (650 instead of 150) because the firm must pay the reduced value of the principal (500) due to the manner in which interest rates adjust. Second, the indexation scheme is perfect in the sense that only real interest (the 150 in this case) is deductible from taxes. This is because no adjustment is made on the liability side of the initial balance sheet but the entire value of assets is increased and added to income. While correct this procedure may create cash flow problems for firms. An alternative procedure is proposed in Section 4 to accommodate this difficulty if it is deemed significant.

D. Case 4: 100% with No Indexing

A borrower (lender) who enters a financing arrangement where neither the interest rate nor the principal is adjusted for inflation will experience a transfer of real income. In particular, the borrower (lender) will experience an increase (decrease) in real income. Accordingly these accrued gains (losses) should be subject to tax. This process is illustrated in Tables 4.A- 4.0. In effect, the borrower is paying an interest rate of: 26.67% when the fixed interest rate is 10%, inflation is 50% and no adjustment is made in the basis of the loan. The proposed indexing rules account for this result by providing no adjustment for the initial value of the loan and by allowing the deduction of nominal interest (in this case 100 [See Tables 4.A and 4.C]). Taxable income to the borrower is 550 higher than in either of the two cases where the loans were indexed (Cases 3 and 4). Five hundred represents the gain to borrower from the reduction in the real value of the principal and fifty is equal to the reduced interest on this reduced principal value

[4] Cash flow is different however. The borrower pays the full 650 currently in Case 3 while he/she pays only 150 in Case 2 while increasing the debt by 500. The present value and the real economic value of the balance is the same. This is the result sought in any inflation indexing scheme.

(10% of 500). According taxes (Table 4.C) and equity (Table 4.0) are higher due to the transfer.

It is important to note that domestic lenders who enter such agreements will experience are reduction in taxable income and equity in the amount equal to the increase for the borrower if both parties are in the same tax bracket. One of the concerns about inflation indexing systems is the cash flow consequences of increased taxes from borrowers due to recognition of the accrued real gain due to inflation. It is possible for firms to have negative before tax cash flow and positive taxable income due to such accruals. An alternative is proposed below to address this difficulty should it be judged significant in the Dominican context. This alternative is identical to the one designed to accommodate the cash flow difficulty regarding the inflation adjusted interest rate discussed in Case 3 (See Section 4). It should be kept in mind that these accrued gains to borrowers will be offset by accrued losses to domestic lenders with no change in domestic taxes if both parties are subject to the same rate. Furthermore, the ability of firms to enter long term agreements at fixed rates should be a decreasing function of the inflation rate.[5]

E-G. Cases 5 - 7: Inventories and Cost of Goods Sold

Initial inventories would be adjusted for inflation and cost of Goods Sold would be computed using the LIFO method under the proposed tax accounting rules. The need for LIFO is necessary because cost of sales should reflect the current flows to every extent possible (independent of historical circumstances). The adjustment to initial inventories is necessary to treat inventories (real assets) on par with other assets (buildings, machines and land). In addition, the adjustment for initial inventories would ensure that only real taxable income is subject to tax during periods when sales exceed current production. That is, taxable income in periods when inventories are depleted will be too high in real terms if the inventory basis is not adjusted for inflation.

The principals are illustrated in Tables 5.A- 7.0. Beginning and ending inventories are equal in terms of quantity in Case 5. Initial inventories are adjusted for inflation in Table 5.A and the only consequence is an increase in ending assets (Table 5.0). Stocks are depleted in Case 6. Accordingly taxable income and tax are higher relative to Case 5. However, real income and taxes are the same relative to the no inflation case. This is because of the adjustment made to the initial inventories which, if not performed, would have resulted in a real transfer to the government due to inflation. Case 7 is an example where inventories accumulate during the period. Taxable income and taxes are lower but ending assets are higher (Table 7.0) relative to Case 5 (the constant inventory case), but again the real value of taxes is constant relative to the no inflation

[5] Part of this ability will depend on government lending controls and government borrowing policy.

case. Finally, note that cost of goods sold (Tables 5.B, 6.B, and ?.B) are constant in real terms relative to their respective no inflation counterparts. This is the desired result from any indexation system.

H-K. Cases 8- 11: Working Capital (Other Than Inventories)

Working capital other than inventories represents debt or equity held by the firm. Accounts payable should be treated as any other debt instrument under the indexing system since these liabilities are debt instruments by definition. Accordingly, an adjustment will be made to fixed interest, variable principal payables and no adjustment will be made to other types of domestic payables.

Accounts receivable are the other side of payables and symmetry is maintained by identical treatment. Generally the principal balance of payables is not adjusted for inflation. Rather, either the interest rate is variable or fixed. The variable rate situation is illustrated in Case 8 and the fixed rate assumption is illustrated in Case 9. Note that real taxable income and taxes are constant in Case 8.[6] This is because of the way interest indexing adjusts for both income and principal (See Case 3). The principal component of the interest "income" is offset by the reduction for the adjustment to the liability side of the balance sheet (See Table 8.A and 8.C). Thus, only interest income is subject to tax since the principal component is eliminated by the deduction for the liability adjustment.

Receivables which are fixed based and fixed rate will decline in real value during inflationary periods. In this case, no adjustments to the receivable are required, but the other adjustments ensure that the accrued real loss is realized for tax accounting purposes. This process is shown in Case 9. Interest income from receivables is fixed at 10% and there is no adjustment of the basis. However, the equity basis is adjusted according to the rules which results in a reduction in taxable income (See Tables 9.A and 9.C). This reduction will reduce real taxable income (as it should), taxes and the ending balance sheet values (again as it should). Note should be taken that this adjustment is similar to the situation of a lender who enters a fixed rate, fixed principal lending agreement. This is appropriate since receivables are a loan by definition and inflation adjustment rules need to be consistent in order to preserve the relatively simplicity as well as the correct result.

Cash holdings represent a type of government debt held by the private sector. This debt, the promise to exchange for goods and services, should be treated as any other type of obligation. No adjustment is made to the basis. If interest accrues from cash balances then the nominal value of the interest is included in income. These

[6] Full equity finance is assumed to illustrate the effects of the system on the particular items in question. If debt is present then all the applicable rules would apply.

computations combined with the liability adjustments will provide the appropriate result in each case. This is illustrated in Tables 1O.A- 11.0. Cash balances are invested in short term nominal interest rate (65%) instruments in Case 10. The full value of the interest payment is included in income (Table 1O.C) with the offsetting adjustment of the increase in liabilities (a tax deduction) as shown in Tables 1O.A and 1O.C. The real income and taxes are constant relative to the no inflation case in this situation.

Cash balances which do not accrue interest will have a reduced economic value due to inflation. This is illustrated in Case 11 where it is assumed that no interest accrues on the cash balance. The only adjustment necessary in this case the adjustment to equity. This adjustment reduces taxable income and thus taxes are reduced relative to no inflation case. This is appropriate since the firm has experienced as decrease in accrued real income. The fact that real income is reduced illustrates why firms and individuals flee from holdings of domestic currency during inflationary periods in favor of either tangible assets or foreign exchange. The reduction in taxable income and taxes offsets this incentive to some degree and might be claimed to create a type of moral hazard. However, rational agents will continue to minimize cash balances in inflationary periods even with the tax offset since the tax offset is not equal to 100% of the real value of the currency decline. Therefore, there should be little or no concern about any adverse incentives created by appropriate indexing. The incentives are created by the inflation and not by the tax system with the purpose of indexing to preserve the integrity of the government's revenue system.

L&M. Cases 12 and 13: Foreign Exchange Gains and Losses

In general, the purpose of inflation adjustments is provide accounting appropriate to ensure that only real (as opposed to inflationary) profits are subject to tax. Accordingly, no adjustments should be made for changes in relative prices. For instance, if land prices increase 110% while inflation is 50% then no recognition of the accrued real increase in land values should be made since the purpose of the adjustment is to correct the historical cost for inflation instead of computing the current replacement cost or nominal liquidation value?

Accrued foreign exchange gains and losses should be considered an exception to this rule because of the linkage between domestic inflation and the exchange rate as well as the importance of the exchange rate in open economies such as the Dominican Republic. It is a well established proposition that the exchange rate will adjust to the difference between domestic and international inflation under a flexible rate regime other things equal. Such an intimate linkage combined with the importance of the

[7]A system which provided for replacement cost or nominal liquidation value accounting would attempt to tax true economic income (gross of the return to capital) and thus all accrued real gains would be taxed. Such a system is not practical.

exchange rate in open economies like the Dominican Republic dictates that foreign currency transactions be accounted on an accrual basis to preserve the credit worthiness of firms and to prevent further inflationary transfers to the government. The fact that the Dominican Republic currently attempts to operate with a fixed exchange rate is irrelevant to the need for adjustments. The existence of the parallel market and the pressure on the current exchange rate due to recent inflation is sufficient evidence for the need of adjustments.

Case 12 is a situation where there is a perfect adjustment of the exchange rate to inflation. The firm is assumed to initially have a$ (US) 1,000.00 loan from a foreign bank at an interest rate of 10% fixed in terms of the foreign currency. Initially the exchange rate is assumed to be 1.00. If inflation is 50% then the domestic currency will depreciate to 1.5. In order to pay$ (US) 100.00 in interest to the foreign bank the firm must exchange 150 units of the domestic currency. This is recorded as an interest expense on the domestic tax return (which is the appropriate treatment). However, the value of the debt is still 1,000.00 measured in terms of the local currency but 1,500 local currency units are required to repay the principal. The 500 additional units of local currency represent a foreign exchange loss when measured in terms of the domestic currency. Thus, a foreign exchange loss is appropriate. This adjustment is made in Table 12.A and the tax consequences are found in Table 12.C.

Note that the tax result is <u>identical</u> to the situation where a domestic loan is made and the principal is indexed (the negative amortization case). That is, foreign exchange gains and losses are identical to inflation indexation when the exchange rate fully reflects domestic inflation. It might be argued foreign exchange loans (of either lender or borrower) be treated as principal indexed debt and that no special treatment of foreign exchange gains and losses is necessary. This would be true if the exchange rate is variable and perfectly reflects the change in domestic inflation only. However, the exchange rate reflects other factors (changes in the terms of trade for instance) as well as inflation. In addition, if the exchange rate is fixed by the government then the exchange rate may not adjust to market circumstances. For these reasons it is appropriate to provide for foreign exchange gains and losses as a separate category.

The situation where the exchange rate does not adjust perfectly to changes in domestic inflation is illustrated in Tables 13.A- 13.0. It is assumed that domestic inflation is 50% while the exchange rate depreciates by only 20%. The difference could be attributed to any number of reasons including an increase in the relative price of a domestic export commodity, inflation in the rest of the world or government policy. The reason for the differential between the change in the domestic price level and the change in the in the exchange rate is irrelevant for the purposes of the indexation system. Foreign debt is increased by 20% in terms of the domestic currency in Table 13.A and the loss (on an accrual basis) is recognized as a deduction from income in Table 13.C.

The opposite result will occur when firms hold foreign currency or lend abroad. That is, assets denominated in a foreign currency will experience a foreign exchange gain which will be taxed on an accrual basis.[8] In summary, the exchange gains and loss provisions should be separate and computed based on changes in the exchange rate, not simply indexed for domestic inflation. Such methods are justified given current circumstances and the importance of such adjustments for tax as well as financial policy.

IV. Alternative Treatment of Non-Principal Indexed Debt

Periods of rapid inflation can increase the cash flow burden of firms. This burden is created by the increase in debt service required when debt is denominated in nominal terms but the interest rate is indexed. Indexed interest rates adjust in a manner to preserve the real value of the total payment stream. This implies that "interest" includes both interest income and principal repayments necessary to recover the decline in the value of principal denominated in nominal terms. For instance, if the real interest rate is 10% and inflation is 50% then the nominal interest rate will be 65%. If a loan of 1,000 is made then "interest cost" will be 100 if there is no inflation but 650 with 50% inflation. Inflation adjusted interest is really equal to 150 with the remaining 500 being equal to the decline in the value of the outstanding principal. It should be apparent that even small changes in the rate of inflation could have significant effects on interest cost. A 10% inflation rate increase can more than double the per annum interest cost of a loan with a 10% real interest rate since the nominal rate will increase to 21%.

The proposed indexing system would allow the firm to deduct only real interest cost (See Case 3). Assets are increased by the rate of inflation but only principal indexed debt, foreign debt (via the foreign exchange gains and loss provisions), and equity is indexed with the difference between the increase in assets and liabilities being included in taxable income. Nominal interest is allowed as a deduction but the increase interest cost is offset by the accrued gain in liabilities which effectively reduces the net deduction to the inflation adjusted interest expense which would occur had the principal been indexed and the interest rate fixed (Case 2). This is the correct result but the

[8] There is a source rule issue here. The Dominican Republic is a source country and income accrued from foreign sources is exempt from taxation. It appears that the law is not quite symmetrical. That is, interest on foreign loans may be attributed to domestic sources and thus losses will be recognized as the exchange rate depreciates. However, foreign source interest (or other income) denominated in foreign currency may be defined to foreign source and never subject to tax. In situation where the exchange is expected to depreciate such tax treatment may be perceived as a subsidy for foreign lending and borrowing since interest expense is deductible with foreign exchange losses while foreign interest income and foreign exchange gains are exempt. This issue will require some study and discussion.

increase in taxes combined with the increased financing expense during periods of expected rapid inflation can further reduce the firm's cash flow.

The nature of the problem is illustrated in Case 14 where it is assumed that three assets are employed to produce output and financing is 40% debt. The standard adjustments are made in Table 14.A and income taxes are computed in Table 14.C. Note that taxes have been increased by the amount of inflation, the correct result. However, the firm has experienced a significant decrease in cash flow. This is seen by reference to Table 14.0 where cash balances are reduced by over 50%.

The following alternative is proposed to alleviate this difficulty, in part.[9]

1. All liabilities which are indexed using the standard procedures would continued to be indexed. These items include principal indexed debt, debt in foreign currency and equity.

2. No adjustment is made to non-indexed liabilities. These items include local interest indexed debt and local debt with no type of indexing.

3. Compute the ratio of total liabilities before and after inflation adjustments by dividing the initial value of total liabilities <u>the inflation adjusted value of total liabilities. This number will be greater than or equal to one</u>. Unity less this ratio will be called <u>the asset adjustment proportion.</u>

4. Employ the <u>asset adjustment proportion</u> instead of the inflation index to compute the increase in all assets for which an inflation adjustment is required. These assets include all assets subject to depreciation, depletion and amortization, other physical assets such as land plus initial inventories.

5. Proceed with the other computations of the standard method.

These adjustments effectively eliminate the accrued capital gain on the non-indexed principal balances of loans held by the firm, reducing taxable income and increasing net of tax cash flow. In the simple case where local non-indexed debt and equity are employed for financing the procedure amounts to writing up assets only by the amount of the nominal increase in equity. That is, the procedure is equivalent to multiplying the initial balance of assets by the equity-asset ratio and then by the rate of inflation.

The procedure is illustrated in Case 15. Additional steps are employed to clearly demonstrate the effects. The standard adjustments are made in the column "Inflation

[9]This procedure has been proposed by Glenn Jenkins in Indonesia.

Adjustment Required" in Table 15.A. Note that the difference in the adjustments between total assets and total liabilities is equal to 550. Absent further adjustments this difference is added to income since it is the measure of the accrued gain from non-indexed debt. The alternative procedure would eliminate this accrued gain for tax purposes by reducing the asset adjustment by the amount of the accrued gain. This is shown in the column "Additional Adjustment" in Table 15.A. Thus, the "Value After Adjustment" is lower than the corresponding value in the standard case (Case 14.A) and consequently depreciation is lower. Once this adjustment is made then the computations proceed using the standard procedure. This is shown in Tables 15.8-15.0. Note that taxable income is lower (Table 15.C) and after tax cash flow is higher (Table 15.0) relative to the corresponding values in the standard case (Tables 14.C and 14.0). This is the desired result.

Use of the alternative procedure has a number of consequences. First, it is assumed that no tied debt exists. That is, non-indexed debt adjustments are made independent of whether certain non-principal indexed loans are used to finance certain assets.[10] Second, the amount of the adjustment to the asset side can range from none (when all assets are financed by non-principal indexed debt) to complete (when all assets are financed by liabilities which are indexed). Third, tax depreciation is reduced by the amount of the reduction in the adjustment. Effectively, the alternative provides a method to realize the accrued gain as the assets are depreciated combined with an interest free loan from the government to finance the realization. Finally, firms will be affected differently depending on the composition of both assets and liabilities. Firms which own assets which are depreciated slowly or not at all (land) would enjoy a larger benefit in present value terms other things equal. Firms with higher non-principal indexed debt to asset ratios will have a lower inflation adjustment. These benefits and costs will be offset in part when the assets are deposed and the receipts from disposal reduce the nominal value of the asset pools as proposed as part of the overall reform.

The decision to employ the alternative will depend on a number of factors. Administrative convenience, the extent of the cash flow difficulties actually experienced in the Dominican Republic." Interest rate policy, and political acceptability of the entire system are some factors which should be considered. However, the potential cash flow difficulties are significant enough to warrant serious consideration of the alternative.

V. Administrative and Transition Considerations

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[10]Economically speaking, this assumption is appropriate.

"Significant inflation has already taken place in the Dominican Republic. If fiscal and monetary policy is adjusted to lower the rate of inflation then cash flow concerns are reduced. It should also be kept in mind that taxes will in general be lower and after tax cash flows higher relative to a system which is not indexed at all which is the current practice in the Dominican Republic.

A. Relationship to Depreciation Rules

The proposed indexing system will simplified if the proposed pool depreciation system is employed. Inflation adjustments will be required only for the entire pool and not for the each individual asset. In addition, the proposed declining balance depreciation system will enable accurate and timely adjustments to depreciation accounts.

B. Timing of Adjustments

Inflation adjustments should be and reflect current circumstances. Accuracy is lost if accounts are not adjusted on a periodic basis of about one month. The loss in accuracy is however a increasing function of the rate of inflation. Thus, the time lag between adjustments should be small if inflation is rampant. Current inflationary expectations in the Dominican Republic are not sufficient to require monthly adjustments. Absent indexation of the entire economy, annual adjustments should be sufficient.

It is proposed that annual adjustments be made and that depreciation accounts reflect the half year convention proposed as part of the overall reform. New assets placed in service during the first half of the fiscal year will benefit from an adjustment for an entire year while assets placed in service during the latter half of the fiscal year will not be adjusted. This procedure is consistent with the proposed half year convention where separate accounting of new purchases during the latter half of the year will be required. The new purchases will then be merged into the aggregate pool after the beginning of the next fiscal year following the period the asset is placed in service.

C. Inflation Index

A choice must be made about the appropriate index to employ as the measure of inflation. A review of current Indices available in the Dominican Republic will be necessary. It is important to choose an index which tracks changes in the price level accurately to avoid under or over compensation for inflation.

D. Audit Standards and Forms

Forms should be designed which enable the tax payer to compute the inflationary adjustments in a standard format. This will assist the tax payer in preparing an accurate return and will provide a uniform standard for initial audits.

The major difference between general audit standards and rules under inflation accounting is determining the type of debt held by the firm. It will not be sufficient for audits to confirm the amount of interest. Auditors must be able to identify whether debt is denominated in local or foreign currency in order to compute the foreign exchange gain or loss. In addition, auditors must be able to determine if local debt has the principal indexed (negative amortization). Firms will have an incentive to report debt as principal indexed since such debt reduces the accrued gain necessary for inflation adjustments. Also, principal indexed debt will not reduce the basis for depreciation unlike non-principal indexed instruments. With these exceptions, the audit standards employed under an indexed system are similar to those of more traditional systems.

E. Public Education

It will take at least six months to implement an indexed system after announcement of the formal government policy. Prior to the announcement training materials should be prepared for both auditors and the general public. Audit training should begin as soon as possible and auditors should be given instruction in both mechanics and justifications for the system.

A public awareness campaign should be part of any major tax reform. Indexing for inflation should be part of this campaign. Tax authorities should be prepared to make presentations to all concern parties. Information packages with regulations, examples, sample forms and other pertinent rules should be prepared, distributed and used as part of seminars.

F. Transition Rules

The move to an indexed system cannot be phased. Rather the system must be incorporated at one time. Thus, the major transition rule is whether to allow firms to revalue assets as of the date of implementation. If adjustments are not allowed then future inflation will be taken into account but the firm's books will not accurately reflect the current situation. Alternatively complete revaluation based on historical books will be too complicated and impossible to audit. An acceptable partial solution would be to allow <u>all</u> firms to adjust their books by a constant fraction prior to the date of implementation. Such rough justice might be a necessary compromise with the phase out of tax holidays and other incentives.

The percentage should be chosen with care and might reflect either the rate of domestic inflation for some period of time, say one to three prior years or it could reflect the differential between the official exchange rate at the time of implementation and some time period in the past. The final decision will depend on revenue considerations, ease of transition and other factors.

Table l.A: Inflanon Adjustments
100% Fqmty

Assets	Beginning Balance	Inflation Adjustment Required	Inflation Adjustment Natural	Exchange Gains (wsses)	Value After Adjustment	Depreciation	Interest incane/ Expense
Cash	0.00		0.00		0.00		0.00
Accounts Receivable	0.00		0.00		0.00		0.00
iinventories (LIFO)	0.00		0.00		0.00		
oachinery and Equipnent Less Ac ulated Depreciation	1,000.00	500.00			1,500.00	450.00	
Buildings Less Accumulated Deprecianon	0.00	0.00			0.00	0.00	
Land	0.00	0.00			0.00		
.7otal Assets	**;_,000.00**	**500.00**	**0.00**	**0.00**	**l,SOO.GO**		
IJiabilities							
Local Debt: No 'fype of Indexmg	0.00	0.00			0.00		0.00
Local Vebt: Pnne1pal Indexed	0.00		0.00		0.00		0.00
Local ilebt: Interest Rate Indexed!	0.00	0.00			0.00		0.00
Foreign Debt:	0.00			0.00	0.00		0.00
Eqmty Plus Surplus	:.000.00	500.00			1,500.00		
Total L1ab1lities	**_i,000.00**	500.00	**0.00**	**0.00**	**1,500.00**		

Table 1.B: Cost of Goods Sold
(Last In First OUt)

100% Equity Finance

Item	No Inflation	50% Inflation
Initial Inventories	0.00	0.00
Production Cost	11,100.00	11,650.00
Total Cost of Goods Available for Sale	1,100.00	11,650.00
sales fran CUrrent Production	100.00	100.00
Inventory Remaining From CUrrent Production	0.00	0.00
Inventory Remaining from Initial Inventory	0.00	0.00
Value Of Inventory from CUrrent Production	0.00	0.00
value of Inventory from Initial Production	0.00	0.00
Value of Ending Inventories	0.00	0.00
Cost of Goods Sold	1,100.00	1,650.00

Table 1.C: Canputation of Incane Tax
100% Equity Finance

Item	No Inflation A	No Inflation B	No Inflation Total	50% Inflation A	50% Inflation B	50% Inflation Total
sales	2,000.00			3,000.00		
Cost of Goods Sold	1,100.00			1,650.00		
Operating Income		900.00			1,350.00	
Interest on Cash Balances	0.00			0.00		
Interest on RecelVables	0.00			0.00		
Total other Incane		0.00			0.00	
Total			900.00			1,350.00
costs						
Interest on Non-Indexed Local Debt	0.00			0.00		
1nterest on Principal Indexed Local Debt	0.00			0.00		
Interest on Interest Indexed Local Debt	0.00			0.00		
Interest On Foreign Debt	0.00			0.00		
Depreication on l1achinery and Equipment	300.00			450.00		
Deprec1ation on Buildings	0.00			0.00		
Total Cost			300.00			450.00
Taxable Income Before Inflation Adjustments			600.00			900.00
Inflation Adjustments						
Assets						
:-!achinery and Equi.pment	0.00			500.00		
Buildings	0.00			0.00		
Land	0.00			0.00		
Total Inflatwn Adjustments (+)		0.00			500.00	
Liabilities						
Local Debt Principal Indexed	0.00			0.00		
Equ1ty Plus SUrplus	0.00			500.00		
Total Inflat1on Adjustments (-)		0.00			500.00	
Taxable Income Before Foreign Exchange Gains (Losses)			600.00			900.00
Foragn Exchange Gains and Losses		0.00			0.00	
Taxable Income After All Adjustments			600.00			900.00
corporate Tax			300.00			450.00
Net of Tax Income			300.00			450.00

Table 1.D: Endmg Period Balance Sheet
100% Equity

Assets	Ending Balance No Inflation	Ending Balance 50% Inflation
Cash	600.00	900.00
Accounts Receivable	0.00	0.00
Inventories (LIFO)	0.00	0.00
Hachinery and Equipment Less Acctunulate<i. Depreciation	700.00	1,050.00
Buildings Less Acctunulated Deprec1ation	0.00	0.00
Land	0.00	0.00
Total Assets	1,300.00	1,950.00
Liabilities		
Local Debt: No Type of Indexing	0.00	0.00
Local Debt: Principal Indexed	0.00	0.00
Local Debt: Interest Rate Indexed:	0.00	0.00
Fore1gn Debe:	0.00	0.00
Equity Plus Surplus	1,300.00	1,950.00
Total Liabilities	1,300.00	1,950.00

Table 2.A: Inflation Adjustments
100% Principal Indexed Debt

Assets	Beginning Balance	Inflation Adjustment Required	Inflation Adjustment Natural	Exchange Gains (Losses)	Value After Adjustment	Depreciation	Interest Income/ Expense
Cash	0.00		0.00		0.00		0.00
Accounts Receivable	0.00		0.00		0.00		0.00
Inventories (LIFO)	0.00		0.00		0.00		
Machinery and Equipment Less Accumulated Depreciation	1,000.00	500.00			1,500.00	450.00	
Buildings Less Accumulated Depreciation	0.00	0.00			0.00	0.00	
Land	0.00	0.00			0.00		
Total Assets	1,000.00	500.00	0.00	0.00	1,500.00		
Liabilities							
Local Debt: No Type of Indexing	0.00	0.00			0.00		0.00
Local Debt: Principal Indexed	1,000.00		500.00		1,500.00		150.00
Local Debt: Interest Rate Indexed	0.00	0.00			0.00		0.00
Foreign Debt:	0.00			0.00	0.00		0.00
Equity Plus Surplus	0.00	0.00			0.00		
Total Liabilities	1,000.00	0.00	500.00	0.00	1,500.00		

Table 2.B: Cost of Goods Sold (Last In First <Xlt)

100% Principal Indexed Debt

Item	No "nflation	50% Inflation
Initial Inventories	0.00	0.00
?reduction Cost	11,100.00	11,650.00
Total Cost of Goods Available for Sale	:1,100.00	:1,650.00
Sales fran Current ?reduction	100.00	100.00
Inventory Remaining From CUrrent ?reduction	0.00	0.00
Inventory Remaining from Initial Inventory	0.00	0.00
value Of Inventory from CUrrent ?reduction	0.00	0.00
value of Inventory from Initial Preduction	0.00	0.00
value of Ending Inventories	0.00	0.00
Cost of Goods Sold	:1,100.00	11,650.00

Table 2.C: canputation of Incane Tax
100% Principal Indexed Debt

Item	No Inflation A	No Inflation B	No Inflation Total	50% Inflation A	50% Inflation B	50% Inflation Total
Sales	2,000.00			3,000.00		
Cost of Goods Sold	1,100.00			1,650.00		
Operating Income		900.00			1,350.00	
Interest on cash Balances	0.00			0.00		
Interest on Receivables	0.00			0.00		
Total other Income		0.00			0.00	
Total			900.00			1,350.00
Costs						
Interest on Non-Indexed Local Debt	0.00			0.00		
:nterest on Principal Indexed Local Debt	100.00			150.00		
Interest on Interest Indexed Local Debt	0.00			0.00		
:nterest On Foreign Debt	0.00			0.00		
l!epreication on l1achinery and Eq>.npment	300.00			450.00		
Depreciation on Buildings	0.00			0.00		
Total Cost			400.00			600.00
Taxable Inccrne Before Inflation Adjustments			500.00			750.00
Inflatwn Adjustments						
Assets						
i1achinery and Equi!lll€nt	0.00			500.00		
Buildings	0.00			0.00		
Land	0.00			0.00		
Total Inflation Adjustments (+)		0.00			500.00	
Liabilines						
Local Debt Principal Indexed	0.00			500.00		
Equity Plus Surplus	0.00			0.00		
?otal Inflation Adjustments (-)		0.00			500.00	
Taxable Income Before Foreign Exchange Gains (Losses)			500.00			750.00
Foreign Exchange Gains and Losses		0.00			0.00	
Taxable Income After All Adjustments			500.00			750.00
Corporate Tax			250.00			375.00
Net of Tax Incane			250.00			375.00

Table 2.D: End1ng Perwi Balance Sheet
100% Princ1pal Indexed Debt

Assets	Ending Balance llo /Inflation	Ending Balance 50% Inflation
Cash	550.00	825.00
Accounts Receivable	0.00	0.00
Inventories (LIFO)	0.00	0.00
Hachinery and Equipnent Less Accumulated Deprec1at1on	700.00	1,050.00
Buildings Less Accumulated Depreciation	0.00	0.00
Land	0.00	0.00
Total Assets	1,250.00	1,875.00
Liabilities		
ii.Dcal Debt: No Type of Indexing	0.00	0.00
I.Dcal Debt: Principal Indexed	1,000.00	1,500.00
ii.Dcal Debt: Interest Rate Indexed:	0.00	0.00
Fore1gn Debt:	0.00	0.00
Equity Plus SUrplus	250.00	375.00
Total Liabilities	1,250.00	1,875.00

Table 3.A: Inflation Adjustments
100% Interest Indexed Debt

Assets	Beginning Balance	Inflation Adjustment Required	Inflation Adjustment Natural	Exchange Gains (Losses)	Value After Adjustment	Depreciation	Interest Income/ Expense
Cash	0.00		0.00		0.00		0.00
Accounts Receivable	0.00		0.00		0.00		0.00
Inventories (LIFO)	0.00		0.00		0.00		
Machinery and Equipment Less Accumulated Depreciation	1,000.00	500.00			1,500.00	450.00	
Buildings Less Accumulated Depreciation	0.00	0.00			0.00	0.00	
Land	0.00	0.00			0.00		
Total Assets	1,000.00	500.00	0.00	0.00	1,500.00		
Liabilities							
Local Debt: No Type of Indexing	0.00	0.00			0.00		0.00
Local Debt: Principal Indexed	0.00		0.00		0.00		0.00
Local Debt: Interest Rate Indexed	1,000.00	0.00			1,000.00		650.00
Foreign Debt:	0.00			0.00	0.00		0.00
Equity Plus Surplus	0.00	0.00			0.00		
Total Liabilities	1,000.00	0.00	0.00	0.00	1,000.00		

Table 3.8: Cost of Goods Sold
(Last In First OUt)

100% Interest Indexed Debt

Item	No inflation	50% inflation
Initial Inventories	0.00	0.00
Production Cost	11,100.00	11,650.00
Total Cost of Goods Available for Sale	:1,100.00	11,650.00
Sales fran Current Production	100.00	100.00
Inventory Remaining Fran CUrrent Production	0.00	0.00
Inventory Remaining from Initial Inventory	0.00	0.00
Value Of Inventory fran CUrrent Production	0.00	0.00
Value of Inventory frcm Initial Production	0.00	0.00
Value of &1ding Inventor1es	0.00	0.00
Cost of Goods Sold	11,100.00	11,650.00

Table 3.C: Canputation of Income Tax
100% Interest Indexed Debt

Item	No Inflation A	No Inflation B	No Inflation Total	50% Inflation A	50% Inflation B	50% Inflation Total
Sales	2,000.00			3,000.00		
Cost of Gocxls Sold	1,100.00			1,650.00		
Operating Income		900.00			1,350.00	
Interest on Cash Balances	0.00			0.00		
Interest on Receivables	0.00			0.00		
Total Other Income		0.00			0.00	
Total			900.00			1,350.00
Costs						
Interest on Non-Indexed Local Debt	0.00			0.00		
Interest on Principal Indexed Local Debt	0.00			0.00		
terest on Interest Indexed Local Debt	**100.00**			650.00		
Interest On l'oreign Debt	0.00			0.00		
Depreicat1on on l1achinery and Equipment	300.00			450.00		
Deprecianon on BUlldings	0.00			0.00		
Total Cost			400.00			1,100.00
Taxable Income Before Inflation Adj<llitments			500.00			250.00
Inflatlon Adjustments						
Assets						
:·iachinery and Equipment	0.00			500.00		
BUlldings	0.00			0.00		
Land	0.00			0.00		
Total Inflation Adjustments (+)		0.00			500.00	
L1abihties						
Local Debt Princ1pal Indexed	0.00			0.00		
&p.u ty Plus Surplus	0.00			0.00		
Total Inflation Adjustments (-)		0.00			0.00	
Taxable InaABefore Foreign EXchange Ga1ns (Losses)			500.00			750.00
Foreign EXchange Gains and Losses		0.00			0.00	
Taxable Income After All Adjustments			500.00			750.00
Corporate Tax			250.00			375.00
Net of Tax Income			250.00			375.00

Table 3.D: Ending Period Balance Sheet
100% Interest Indexed Debt

Assets	Ending Balance No Inflation	Ending Balance 50% Inflation
Cash	550.00	325.00
Accounts Receivable	0.00	0.00
Inventories (LIFO)	0.00	0.00
Machinery and Equipment Less Accumulated Depreciation	700.00	1,050.00
Buildings Less Accumulated Depreciation	0.00	0.00
Land	0.00	0.00
Total Assets	1,250.00	1,375.00

Liabilities		
Local Debt: No Type of Indexing	0.00	0.00
Local Debt: Principal Indexed	0.00	0.00
Local Debt: Interest Rate Indexed	1,000.00	1,000.00
Foreign Debt:	0.00	0.00
Equity Plus Surplus	250.00	375.00
Total Liabilities	1,250.00	1,375.00

'!'able 4.A: Inflation Adjustments
100% Debt No Type of Indexing

Assets	Beginning Balance	Inflation Adjustment Required	Inflation Adjustment Natural	Exchange Gains (Losses)	Value After Adjustment	Depreciation	Interest Income/ Expense
cash	0.00		0.00		0.00		0.00
Accounts Rece1vable	0.00		0.00		0.00		0.00
Inventones (LIFO)	0.00		0.00		0.00		
11achinery and Equlpnent Less Accumulated Deprec1at1on	**1,000.00**	500.00			1,500.00	450.00	
Buildings Less Accumulated Deprec1at1on	0.00	0.00			0.00	0.00	
Land	0.00	0.00			0.00		
Total Assets	1,000.00	500.00	0.00	1).00	1,500.00		

Liab1lities	Beginning Balance	Inflation Adjustment Required	Inflation Adjustment Natural	Exchange Gains (Losses)	Value After Adjustment	Depreciation	Interest Income/ Expense
Local Debt: r!o Type of Indexing	1,000.00	0.00			1,000.00		100.00
Local Debt: Principal Indexed	0.00		0.00		0.00		0.00
Local Debt: Interest Rate Indexed!	0.00	0.00			0.00		0.00
Fore1gn Debt:	0.00			0.00	0.00		0.00
Equity Plus Surplus	0.00	0.00			0.00		
Total Liabilities	1,000.00	0.00	0.00	0.00	1,000.00		

Table 4.8: Cost of Goods Sold
(Last In First OUt)

100% Debt No Type of Indexing

Item	No inflation	50% inflation
Initial Inventories	0.00	0.00
Production Cost	11,100.00	11,650.00
Total Cost of Goods Available for Sale	;1,100.00	:1,650.00
Sales fran Current Production	100.00	100.00
Inventory Remaining From Current Production	0.00	0.00
Inventory Remaining from Initial Inventory	0.00	0.00
Value Of Inventory from Current Production	0.00	0.00
value of Inventory from Initial Production	0.00	0.00
value of Ending Inventor1es	0.00	0.00
Cost of Goods Sold	11,100.00	11,650.00

Table 4.C: Canputatlon of Incane Tax
100% Debt No Type of Indexing

Item	No Inflation A	No Inflation B	No Inflation Total	50% Inflation A	50% Inflation B	50% Inflation Total
Sales	2,000.00			3,000.00		
Cost of Goods Sold	1,100.00			1,650.00		
Operating Income		900.00			1,350.00	
Interest on cash Balances	0.00			0.00		
Interest on Receivables	0.00			0.00		
Total other Income		0.00			0.00	
Total			900.00			1,350.00
costs						
Interest on Non-Indexed Local Debt	100.00			100.00		
Interest on Princlpal Indexed Local Debt	0.00			0.00		
illterest on Interest Indexed Local Debt	0.00			0.00		
Interest On Foreign Debt	0.00			0.00		
Deprelcation on Hachinery and Equipment	300.00			450.00		
Depreclatlon on Bulldings	0.00			0.00		
Total Cost			400.00			550.00
Taxable Income Before Inflation Adjustments			**500.00**			800.00
Inflation Adjustrr.ents						
Assets						
Hachinery and Equipment	0.00			500.00		
Buildings	0.00			0.00		
Land	0.00			0.00		
Total Inflation Adjustments (+)		0.00			500.00	
Liabllities						
Local Debt Principal Indexed	0.00			0,00		
Equity Plus Surplus	0.00			0.00		
Total Inflation Adjustments (-)		0.00			0.00	
Taxable Income Before Foreign Exchange Gains (Losses)			500.00			1,300.00
Foreign Exchange Gains and Losses		0.00			0.00	
Taxable Income After All Adjustments			500.00			1,300.00
CorjXlrate Tax			250.00			650.00
Net of Tax Inceme			250.00			650.00

Table 4.D: Ending Period Balance Sheet
100% Debt No Type of Indexing

Assets	Ending Balance No Inflation	Ending Balance 50% Inflation
Cash	550.00	600.00
Accounts Receivable	0.00	0.00
Inventories (LIFO)	0.00	0.00
Hachinery and Equipnent Less Accumulated Depreciation	700.00	1,050.00
Buildings Less Accumulated Deprec1ation	0.00	0.00
Land	0.00	0.00
Total Assets	1,250.00	1,650.00
Liabilities		
Local Debt: No Type of Indexing	1,000.00	1,000.00
Local Debt: Princ1pal Indexed	0.00	0.00
Local Debt: Interest Rate Indexed:	0.00	0.00
Fore1gn Debt:	0.00	0.00
Equity Plus Surplus	250.00	650.00
Total Liabilities	1,250.00	1,650.00

Table 5.A: Inflat1on Adjustments
100% Equity 11ith Equal Beginning and Ending Inventories

Assets	Beginning Balance	Inflation Adjustment Required	Inflation Adjustment Natural	Exchange Gains (Losses)	Value After Adjustment	Deprecntion	Interest Incane/Expense
Cash	0.00		0.00		0.00		0.00
Accounts Receivable	0.00		0.00		0.00		0.00
Inventories (LIFO)	J00.00	200.00			600.00		
Hachlnery and Equipnent less Accumulated Depreciation	1,000.00	500.00			**1,500.00**	450.00	
Buildings Less Accumulated Depreciation	0.00	0.00			0.00	0.00	
Land	0.00	0.00			0.00		
Total Assets	1,400.00	700.00	0.00	0.00	2,100.00		

Local Debt: No Type of Indexing	0.00	0.00			0.00		0.00
Local Debt: Principal Indexed	0.00		0.00		0.00		0.00
Local Debt: Interest Rate Indexed	0.00	0.00			0.00		0.00
Forewn Debt:	0.00			0.00	0.00		0.00
Equity Plus Surplus	1,400.00	'100.00			2,100.00		
Total Liabilities	**1,400.00**	**700.00**	**0.00**	0.GO	**2,100.00**		

Table 5.B: Cost of Goods Sold
(Last In First OUt)
100% Equity mth &jual Begl.llning and Ending Inventories

Item	No Inflation	50% Inflation
Initial Inventories	400.00	600.00
Productlon Cost	1,100.00	1,650.00
Total Cost of Goods Available for oale	·",500.00	12,250.00
Sales fran Current Prcduction	100.00	100.00
Inventory Remallling Fran Current Production	0.00	0.00
Inventory Remaining fran Init1al Inventory	40.00	40.00
Value Of Inventory fran CUrrent Prcduction	0.00	0.00
Value of Inventory fran Initial ?reduction	400.00	600.00
value of Ending Inventories	400.00	600.00
Cost of Goods Sold	11,100.00	11,650.00

able 5.C:Ccrnputat1on of Incane Tax
100% Equity mth Equal Beginning and Ending Inventones

Item	No Inflat1on A	No Inflat1on B	No Inflat1on Total	50% Inflation A	50% Inflation B	50% Inflation Total
:Sales	2,000.00			3,000.00		
;Cost of Goods Sold	1,100.00			1,650.00		
'Operating Income		900.00			1,350.00	
Interest on cash Balances	0.00			0.00 :		
Dlterest on Receivables	0.00			0.00 :		
:Total Other Income		0.00 :			0.00	
;Total			900.00 :			1,350.00
;Costs						
Interest on Non-Indexed Local Debt	0.00			0.00		
Interest on Princ1pal Indexed Local Debt	0.00			0.00		
Interest on Interest Indexed Local Debt	0.00			0.00		
ntecest Cn Foreign Debt	0.00			0.00		
Depreicauon on Hachinery and Equi]Y.llent	300.00			450.00		
Deprec1ation on Buildings	0.00			0.00		
;Total Cost			300.00			450.00
:Taxable Incane Before Inflation Adjustments			600.00			900.00
;Inflation Adjustments						
Assets						
Inventories				200.00		
:1achinery and Equi]Y.llellt	0.00			500.00		
Buildings	0.00			0.00		
	0.00			0.00		
·Total Inflation Adjustments (+)		0.00			700.00	
;Liabilities						
Local Debt Pnncipal Indexed	**0.00**			**0.00**		
Equity Plus SUrplus	0.00 :			700.00 :		
Total Dlflat1on Adjustments (-)		0.00 :			700.00	
:Taxable Dlcome Before Foreign Exchange Gains (!J)sses)			600.00			900.00 :
;Foreign Exchange Gains and !J)sses		0.00			0.00	
:Taxable Incane After All Adjustments			600.00			900.00
;Corporate Tax			300.00			450.00 :
illet of Tax Income			300.00			450.00 :

Table 5.D: Ending Period Balance Sheet
100% Equity with Equal Beginning and Ending Inventories

Assets	Ending Balance No Inflation	Ending Balance 50% Inflation
Cash	600.00	900.00
Accounts Receivable	0.00	0.00
Inventories (LIFO)	400.00	600.00
Machinery and Equipment Less Accumulated Depreciation	700.00	1,050.00
Buildings Less Accumulated Depreciation	0.00	0.00
Land	0.00	0.00
Total Assets	1,700.00	2,550.00
Liabilities		
Local Debt: No Type of Indexing	0.00	0.00
Local Debt: Principal Indexed	0.00	0.00
Local Debt: Interest Rate Indexed	0.00	0.00
Foreign Debt:	0.00	0.00
Equity Plus Surplus	1,700.00	2,550.00
Total Liabilities	1,700.00	2,550.00

Table 6.A: Inflation Adjustments
100% Equity with Depletion of Initial Inventories

Assets	Beginning Balance	Inflation Adjustment Required	Inflation Adjustment Natural	Exchange Gains (Losses)	Value After Adjustment	Depreciation	Interest lincane/ Expense
Cash	0.00		0.00		0.00		0.00
Accounts Receivable	0.00		0.00		0.00		0.00
Inventones (LIFO)	400.00	200.00			600.00		
Hachinery and Equiprent bess Accumulated Depreciation	1,000.00	500.00			1, ,00.00	450.00	
Buildings J.,ess Accumulated Deprec1ation	0.00	0.00			0.00	0.00	
Land	0.00	0.00			0.00		
Total Assets	1,400.00	700.00	0.00	0.00	2,100.00		
Liabilities							
I..ocal Debt: No Type of Indexing	0.00	0.00			0.00		0.00
Local Debt: ?rinc1pal Indexed	0.00		0.00		0.00		0.00
l..ocal Debt: Interest Rate Indexed	0.00	0.00			0.00		0.00
Foreign Debt:	0.00			0.00	0.00		0.00
Equity Plus Surplus	1,400.00	700.00			2,100.00		
Total biabilities	1,400.00	700.00	0.00	0.00	2,100.00		

Table 6.B: Cost of Goods Sold
(Last In First Out)
100% Equity with Depletion of Initial Inventories

Item	No Inflation	50% Inflation
Initial Inventories	400.00	600.00
Production Cost	11,100.00	1,650.00
Total Cost of Goods Available for Sale	1,500.00	2,250.00
Sales from Current Production	100.00	100.00
Inventory Remaining From Current Production	0.00	0.00
Inventory Remaining from Initial Inventory	25.00	25.00
Value Of Inventory from Current Production	0.00	0.00
Value of Inventory from Initial Production	250.00	375.00
Value of Ending Inventories	250.00	375.00
Cost of Goods Sold	1,250.00	1,875.00

Table 6.C: canputation of Incane Tax
100% Equity \lith Depletion of Initial Inventories

Item	No Inflation A	No Inflation B	No Inflation Total	50% Inflation A	50% Inflation B	50% Inflation Total
Sales	2,300.00			3,450.00		
:Cost of Gocds Sold	1,250.00			1,875.00		
:Operatmg Incane		1,050.00			1,575.00	
Interest on cash Balances	0.00			0.00 :		
b1terest on Receivables	0.00			0.00 :		
;Total Other Income		0.00			0.00	
:Total			1,050.00			1,575.00
;Costs						
Interest on Non-Indexed Local Debt	0.00			0.00		
Interest on Principal Indexed Local Debt	0.00			0.00		
Interest on Interest Indexed Local Debt	0.00			0.00		
Interest On Foreign Debt	0.00			0.00		
Depreicat1on on l!achinery and EqUlpment	300.00			450.00		
Depreciation on Buildings	0.00			0.00		
;Total Cost			*300.00* :			450.00
;Taxable Income Before Inflation Adjustments			750.00 :			1,125.00 :
:Inflation Adjustrr.ents						
Assets						
Inventones				200.00		
:·Iachinery and Equipment	0.00			500.00		
Buildings	0.00			0.00		
Land	0.00			0.00		
Total fuflation Adjustments (+)		0.00			700.00 :	
;Liabilities						
Local Debt Principal Indexed	0.00			0.00		
:<:quity Plus SUrplus	0.00			700.00		
Total Inflation Adjustments H		0.00 :			700.00 :	
:Taxable Income Before Foreign Exchange Gains (Losses)			750.00 :			1,125.00
;Foreign Exchange Gains and Losses		0.00			0.00	
;Taxable Inccme After All Adjustrrents			750.00 :			; 1,125.00 :
;Corporate Tax			375.00 ;			562.50
:Net of Tax b1come			375.00 :			562.50

Table 6.D: Ending Peri<Xi Balance Sheet
100% Equity Hith Depletion of Initial Inventones

Assets	Ending Balance No Inflat1on	Ending Balance 50% Inflation
Cash	825.00	,237.50
Accounts Receivable	0.00	0.00
Inventories (LIFO)	250.00	375.00
Hachinery and Equ1pment Less Accumulated Depreciation	700.00	1,050.00
Buildings Less Accumulated Deprec1ation	0.00	0.00
Land	0.00	0.00
Total Assets	1,775.00	2,662.50
Liabilihes		
Local Debt: llo Type of Index:mg	0.00	0.00
Local Debt: Principel Indexed	0.00	0.00
Local Debt: Interest Rate Indexed	0.00	0.00
Foreign :Ot:	0.00	0.00
Equ1ty Plus Surplus	1,775.00	2,662.50
Total Liab1lities	1,775.00	2,662.50

Table 7.A: Inflation Adjustments
100% Equity uith Inventory Accumulation

Assets	Beginning Balance	Inflation Adjustment Required	Inflation Adjustment Hatural	Exchange Gains (Losses)	Value After Adjustment	Depreciation	Interest lncane/ Expense
cash	0.00		0.00		0.00		0.00
Accounts Rece1vable	0.00		0.00		0.00		0.00
rnventor1es (LIFO)	400.00	200.00			600.00		
Xacbinery and Equipment Less Accumulated Deprec1ation	1,000.00	500.00			1,500.00	450.00	
Buildings Less Accumulated Deprec1at1on	0.00	0.00			0.00	0.00	
Land	0.00	0.00			0.00		
Total Assets	1,400.00	700.00	0.00	0.00	2,100.00		
Liabilitles							
Local Debt: No Type of Indexing	0.00	0.00			0.00		0.00
Local Debt: Princ1pal Indexed	0.00		0.00		0.00		0.00
Local Debt: Interest Rate Indexe<i.	0.00	0.00			0.00		0.00
Foragn Debt:	0.00			0.00	0.00		0.00
Equity Plus Surplus	1,400.00	700.00			2,100.00		
Total Liabilities	1,400.00	700.00	0.00	0.00	2,100.00		

Table 7.B: Cost of G<xxls Sold
(Last In First OUt)
100% Equity with Inventory Accumulation

Item	No inflation	50% inflation
Initial Inventones	400.00	600.00
Prcxluction Cost	1,100.00	1,650.00
Total Cost of G<xxls Available for Sale	1,500.00	12,250.00
Sales fran CUrrent Prcxluctlon	75.00	75.00
Inventory Remalliing From CUrrent Prcxluct1on	25.00	25.00
Inventory Remalliing from Initial Inventory	40.00	40.00
Value Of Inventory fran Current Prcxluction	275.00	412.50
Value of Inventory from Initial Prcxluction	**00.00**	600.00
Value of EndJ.ng Inventones	675.00	11,012.50
Cost of G<xxls Sold	825.00	11,237.50

Table 7.C: Computation of Income Tax
100% Equity Inventory Accumulation

Item	No Inflation A	No Inflation B	No Inflation Total	50% Inflation A	50% Inflation B	50% Inflation Total
Sales	1,500.00			2,250.00		
Cost of Goods Sold	825.00			1,237.50		
Operating Income		675.00			1,012.50	
Interest on Cash Balances	0.00			0.00		
Interest on Receivables	0.00			0.00		
Total Other Income		0.00			0.00	
Total			675.00			1,012.50
Costs						
Interest on Non-Indexed Local Debt	0.00			0.00		
Interest on Principal Indexed Local Debt	0.00			0.00		
Interest on Interest Indexed Local Debt	0.00			0.00		
Interest On Foreign Debt	0.00			0.00		
Depreciation on Machinery and Equipment	300.00			450.00		
Depreciation on Buildings	0.00			0.00		
Total Cost			300.00			450.00
Taxable Income Before Inflation Adjustments			375.00			562.50
Inflation Adjustments						
Assets						
Inventories				200.00		
Machinery and Equipment	0.00			500.00		
Buildings	0.00			0.00		
Land	0.00			0.00		
Total Inflation Adjustments (+)		0.00			700.00	
Liabilities						
Local Debt Principal Indexed	0.00			0.00		
Equity Plus Surplus	0.00			700.00		
Total Inflation Adjustments (-)		0.00			700.00	
Taxable Income Before Foreign Exchange Gains (Losses)			375.00			562.50
Foreign Exchange Gains and Losses		0.00			0.00	
Taxable Income After All Adjustments			375.00			562.50
Corporate Tax			187.50			281.25
Net of Tax Income			187.50			281.25

Table 7.D: Ending Period Balance Sheet
100% El:juity HJ.th Inventory Accumulation

Assets	Ending Balance No iinflat1on	Ending Balance 50% iinflation
cash	212.50	318.75
Accounts Receivable	0.00	0.00
Inventories (LIFO)	675.00	1,012.50
l1achinery and Eq\npment Less Accumulated Depreciation	700.00	1,050.00
Buildings Less Accumulated Depreciatwn	0.00	0.00
Land	0.00	0.00
Total Assets	1,587.50	2,381.25
Liabilitles		
Local Debt: No Type of Indexing	0.00	0.00
Local Debt: Principal Indexed	0.00	0.00
Local Debt: Interest Rate Indexed:	0.00	0.00
Fore1gn Debt:	0.00	0.00
El:!Uity Plus surplus	1,587.50	2,381.25
Total L1abilities	1,587.50	2,381.25

Table 8.A: Inflation Adjustments

100% Equity With Inflation Adjusted Interest Charged on Receivables

Assets	Beginning Balance	Inflation Adjustment Required	Inflation Adjustment Natural	Exchange Gains (Losses)	Value After Adjustment	Depreciation	Interest Income/ Expense
Cash	0.00		0.00		0.00		0.00
Accounts Receivable	875.00		0.00		875.00		568.75
Inventories (LIFO)	0.00	0.00			0.00		
Machinery and Equipment Less Accumulated Depreciation	1,000.00	500.00					
Buildings Less Accumulated Depreciation	0.00	0.00					
Land	0.00	0.00					
Total Assets	1,875.00	500.00					

Liabilities	Beginning Balance	Inflation Adjustment Required
Local Debt: No Type of Indexing	0.00	0.00
Local Debt: Principal Indexed	0.00	
Local Debt: Interest Rate Indexed:	0.00	0.00
Foreign Debt:	0.00	
Equity Plus Surplus	1,875.00	937.50
Total Liabilities	1,875.00	937.50

Table 8.B: Cost of Goods Sold
(Last In First OUt)
100% Equity with Naninal Interest Charged on Receivables

Item	No inflation	50% inflatlon
Initial Inventories	0.00	0.00
Production Cost	1,100.00	11,650.00
Total Cost of Goods Available for Sale	1,100.00	11,650.00
Sales fran current Production	100.00	100.00
Inventory Remaining Fran Current Production	0.00	0.00
Inventory Remaining from Initial Inventory	0.00	0.00
Value Of Inventory fran Current Production	0.00	0.00
Value of Inventory from Initial Production	0.00	0.00
Value of Endlllg Inventories	0.00	0.00
Cost of Goods Sold	1,100.00	11,650.00

Table 8.C: canputanon of Incane Tax
100% Equity with Nominal Interest Charged on Receivables

Item	No Inflation A	No Inflation 8	No Inflation Total	50% Inflation A	50% Inflation B	50% Inflation Total
:sales	2,000.00			3,000.00		
:Cost of Goods Sold	1,100.00			1,650.00		
:Operating Income		900.00			1,350.00	
Interest on Cash Balances	0.00			0.00		
Interest on Receivables	87.50			568.75		
:Total Other Income		87.50			568.75	
!Total			987.50			1,918.75
ICosts						
Interest on Non-Indexed Local Debt	0.00			0.00		
Interest on Principal Indexed Local Debt	0.00			0.00		
iterest on Interest Indexed Local Debt	0.00			0.00		
Interest On Fore1gn Debt	0.00			0.00		
Depre1cat1on on l1achinery and Equipnent	300.00			450.00		
Deprec1ation on Buildings	0.00			0.00		
:Total Cost			300.00			450.00
:Taxable Incane Before Inflation Adjustments			687.50			1,468.75
IInflatlon Adjustments						
Assets						
Inventones	0.00			0.00		
:·fachinery and Equipnent	0.00			500.00		
Buildmgs	0.00			0.00		
Land	0.00			0.00		
Total Inflat1On Adjustments (+)		0.00			500.00	
;Llabilities						
Local Debt Principal Indexed	0.00			0.00		
Equity Plus SUrplus	0.00			937.50		
Total Inflation Adjustments (-)		0.00			937.50 :	
iTaxable Income Before Fore1gn Exchange Gains (Losses)			687.50 :			: 1,031.25
IForeign Exchange Gains and Losses		0.00			0.00	
:Taxable Incoo:e After All Adjustments			687.50 :			1,031.25
Corporate Tax			343.75 :			515.63
:Net of Tax Incane			343.75 :			515.63

Table 8.D: Ending Period Balance Sheet
100% Equity Hith Nani.nal Interest Charged on Receivables

Assets	Ending Balance No Inflation	Ending Balance 50% Inflation
Cash	1,518.75	2,715.63
Accounts Receivable	0.00	0.00
rnventor1es (LIFO)	0.00	0.00
Hachmery and Equipnent Less Accumulated Depreciat1on	700.00	1,050.00
Buildings Less Accumulated Deprec1ahon	0.00	0.00
Land	0.00	0.00
Total Assets	2,218.75	3,765.63
L1abillties		
Local Debt: No Type of Indexing	0.00	0.00
Local Debt: Principal Indexed	0.00	0.00
Local Debt: Interest Rate Indexed:	0.00	0.00
Fore1gn Debt:	0.00	0.00
Fquity Plus Surplus	2,218.75	3,328.13
Total Liabilit1es	2,218.75	3,328.13

Table 9.A: Inflation Adjustments
100% Eq\llty Wlth Interest Charged on Receivables not Inflation Adjusted

Assets	Beginning Balance	Inflation Adjustment Required	Inflation Adjustment Natural	Exchange Gains (Losses)	Value After Adjustment	Depreciation	Interest Income/ Expense
cash	0.00		0.00		0.00		0.00
ACCO\llltS Rece1vable	875.00		0.00		875.00		87.50
Inventor1es (LIFO)	0.00	0.00			0.00		
lHachinery and Eqmpnent Less Accumulated Depreciation	1,000.00	500.00					
Buildings Less Accumulated Depreciat10n	0.00	0.00					
Land	0.00	0.00					
Total Assets	1,875.00	500.00	0.00				
Liabilities							
Local Debt: No Type of Indexing	0.00	0.00					
Local Debt: Princ1pal Indexed	0.00		0.00				
Local Debt: Interest Rate Indexed:	0.00	0.00					
Foreign Debt:	0.00						
Equ1ty Plus Surplus	1,875.00	937.50					
Total Llabil1t1es	1,875.00	937.50	0.00				

Table 9.B: Cost of Gocxls Sold
(Last In First Cl.lt)
100% Equity with Receivables Interest Not Indexed

Item	0 inflation	50% inflation
initial Inventories	0.00	0.00
Production Cost	11,100.00	11,650.00
Total Cost of Gocxls Available for Sale	:1,100.00	11,650.00
Sales fran CUrrent Production	100.00	100.00
Inventory Remaining From CUrrent Productwn	0.00	0.00
Inventory Remaining fran Init1al Inventory	0.00	0.00
Value Of Inventory from CUrrent Production	0.00	0.00
Value of Inventory from Initial Production	0.00	0.00
Value of Ending Inventorles	0.00	0.00
Cost of Gocxls Sold	11,100.00	11,650.00

Table 9.C: Canputation of Incane Tax
100% Equity with Interest on Receivables not Indexed

Item	No Inflation A	No Inflation B	No Inflation Total	50% Inflation A	50% Inflation B	50% Inflation Total
sales	2,000.00			3,000.00		
Cost of Gco:ls Sold	1,100.00			1,650.00		
Operating Income		900.00			1,350.00	
Interest on cash Balances	0.00			0.00		
Interest on Receivables	87.50			87.50		
Total Other Inccme		87.50			87.50	
Total			987.50			1,437.50
Costs						
Interest on Non-Indexed Local Debt	0.00			0.00		
Interest on Principal Indexed Local Debt	0.00			0.00		
Interest on Interest Indexed Local Debt	0.00			0.00		
Interest On Foreign Debt	0.00			0.00		
Deprelcation on Hachinery and Equipment	300.00			450.00		
Depreclat1on on Buildings	0.00			0.00		
Total Cost			300.00			450.00
Taxable Income Before Inflation Adjustments			687.50			987.50
Inflation Adjustments						
Assets						
Invenrories	0.00			0.00		
i·!achinery and El:juipment	0.00			500.00		
Buildlllgs	0.00			0.00		
Land	0.00			0.00		
Total Inflat1on Adjustments (+)		0.00			500.00	
Liabilities						
Local Debt Principal Indexed	0.00			0.00		
El:juity Plus SUrplus	0.00			937.50		
Total Inflation Adjustments (-)		0.00			937.50	
Taxable Incane Before Foreign Exchange Gains (Losses)			687.50			550.00
Foreign Exchange Gains and Losses		0.00			0.00	
Taxable Incane After All Adjustments			687.50			550.00
Corporate Tax			343.75			275.00
!let of Tax Incame			343.75			275.00

Table 9.D: Ending Peno:i Balance Sheet
100% Equity 1<ith Rece1vables Interest Rate not Indexed

Assets	Ending Balance No Inflation	Ending Balance 50% Inflation
Cash	1,518.75	2,475.00
Accounts Rece1vable	0.00	0.00
Inventories (LIFO)	0.00	0.00
Hachinery and Equipnent Less Accumulated Deprec1at1on	700.00	1,050.00
Buildings Less Accumulated Depreciation	0.00	0.00
a..and	0.00	0.00
Total Assets	2,218.75	3,525.00
Liabilitles		
Local Debt: No Type of Indexing	0.00	0.00
Local Debt: Principal Indexed	0.00	0.00
Local Debt: Interest Rate Indexe0.i	0.00	0.00
Foreign Debt:	0.00	0.00
Equity Plus Surplus	2,218.75	3,087.50
Total Liabilities	2,218.75	3,087.50

Table 10.A: Inflation Adjustments

100% Equity With Nominal Interest on Cash

Assets	Beginning Balance	Inflation Adjustment Required	Inflation Adjustment Natural	Exchange Gains (Losses)	Value After Adjustment	Depreciation	Interest Income/ Expense
Cash	345.00		0.00		345.00		224.25
Accounts Receivable	0.00		0.00		0.00		0.00
Inventories (LIFO)	0.00	0.00			0.00		
Machinery and Equipment Less Accumulated Depreciation	1,000.00	500.00			1,500.00	450.00	
Buildings less Accumulated Depreciation	0.00	0.00			0.00	0.00	
Land	0.00	0.00			0.00		
Total Assets	1,345.00	500.00	0.00	0.00	1,845.00		
Liabilities							
Local Debt: No Type of Indexing	0.00	0.00			0.00		0.00
Local Debt: Principal Indexed	0.00		0.00		0.00		0.00
Local Debt: Interest Rate Indexed:	0.00	0.00			0.00		0.00
Foreign Debt:	0.00			0.00	0.00		0.00
Equity Plus Surplus	1,345.00	672.50			2,017.50		
Total Liabilities	1,345.00	672.50	0.00	0.00	2,017.50		

Table lO.B: Cost of Goods Sold
(Last In first Cl.lt)
100% Eqw.ty ln.th Naninal Interest on Cash

Item	llo inflation	50% inflation
Initial Inventories	0.00	0.00
Prcxluction Cost	11,100.00	11,650.00
Total Cost of Goods Available for Sale	;1,100.00	11,650.00
Sales fran Current Prcxluction	100.00	100.00
Inventory Remaining from Current Prcxluction	0.00	0.00
Inventory Remaining fran Initial Inventory	0.00	0.00
Value Of Inventory fran Current Prcxluction	0.00	0.00
Value of Inventory fran Initial Product1on	0.00	0.00
Value of Ending Inventories	0.00	0.00
Cost of Goods Sold	;1,100.00	**11,650.00**

Table lO.c: Computation of Incane Tax
100% Equity with Nalllnal Interest on cash

Item	No Inflation A	No Inflation B	No Inflation Total	50% Inflation A	50% Inflation B	50% Inflation Total
sales	2,000.00			3,000.00		
Cost of Goods Sold	1,100.00			1,650.00		
Operating Incane		900.00			1,350.00	
Interest on cash Balances	34.50			224.25		
Interest on Receivables	0.00			0.00		
Total Other Incane		34.50			224.25	
Total			934.50			1,574.25
costs						
Interest on Non-Indexed Local Debt	0.00			0.00		
Interest on Principal Indexed Local Debt	0.00			0.00		
nterest on Interest Indexed Local Debt	0.00			0.00		
Interest On Fore1gn Debt	0.00			0.00		
Jepre1eat1on on Hachinery and Equi]Xf,ent	300.00			450.00		
Deprec1at1on on BUlldings	0.00			0.00		
;Total Cost			300.00			450.00
Taxable Income Before Inflation Adjustments			634.50			1,124.25
Inflation Adjustments						
Assets						
Inventories	0.00			0.00		
:-!achinery and Equipnent	0.00			500.00		
Buildings	0.00			0.00		
Land	0.00			0.00		
Total Inflatlon Adjustments (+)		0.00			500.00	
'Liabilities						
Local Debt Princ1pal Indexed	0.00			0.00		
Zquity Plus SUrplus	0.00			672.50		
Total Inflation Adjustments (-)		0.00			672.50	
Taxable Incane Before Foreign Exchange Gains (Losses)			634.50			951.75
Foreign Exchange Gains and Losses		0.00			0.00	
Taxable Incane After All Adjustments			634.50			951.75
Corporate Tax			317.25			475.88
Uet of Tax Income			317.25			475.88

Table 10.D: Ending Period Balance Sheet
100% Equity With Nominal Interest on Cash

Assets	Ending Balance No Inflation	Ending Balance 50% Inflation
Cash	962.25	1,443.38
Accounts Receivable	0.00	0.00
Inventories (LIFO)	0.00	0.00
Machinery and Equipment Less Accumulated Depreciation	700.00	1,050.00
Buildings Less Accumulated Depreciation	0.00	0.00
Land	0.00	0.00
Total Assets	1,662.25	2,493.38
Liabilities		
Local Debt: No Type of Indexing	0.00	0.00
Local Debt: Principal Indexed	0.00	0.00
Local Debt: Interest Rate Indexed:	0.00	0.00
Foreign Debt:	0.00	0.00
Equity Plus Surplus	1,662.25	2,493.38
Total Liabilities	1,662.25	2,493.38

Table 11.A: Inflation Adjustments
100% Equity uith No Interest on cash

Assets	Beginning Balance	Inflation Adjustment Required	Inflation Adjustment Natural	Exchange Gains (Losses)	Value After Adjustment	Depreciation	Interest incane/ Expense
Cash	345.00		0.00		345.00		0.00
Accounts Rece1vable	0.00		0.00		0.00		0.00
Inventones (LIFO)	0.00	0.00			0.00		
Hachinery and Equiprent Less Accumulated Deprec1ation	1,000.00	500.00			1,500.00	450.00	
Buildings Less Accumulated Depreciat1on	0.00	0.00			0.00	0.00	
Land	0.00	0.00			0.00		
Total Assets	1,345.00	500.00	0.00	0.00	1,845.00		
Llabllities							
!neal Debt: No Type of Indexing	0.00	0.00			0.00		0.00
!neal Debt: Princ1pal Indexed	0.00		0.00		0.00		0.00
!neal Debt: Interest Rate Indexed	0.00	0.00			0.00		0.00
Foreign Debt:	0.00			0.00	0.00		0.00
l&ruity Pl\Surplus	1,345.00	672.50			2,017.50		
Total!,iabllities	1,345.00	672.50	0.00	0.00	2,017.50		

Table 11.B: Cost of Goods Sold
(Last In First OUt)
100% Equity with No Interest on Cash

Item	No rnflation	50% inflation
Initial Inventories	0.00	0.00
Production Cost	1,100.00	1,650.00
Total Cost of Goods Available for Sale	1,100.00	1,650.00
Sales fran Current Production	100.00	100.00
Inventory Remaining Fran current Product1on	0.00	0.00
Inventory Remaining fran Initial Inventory	0.00	0.00
Value Of Inventory fran current Production	0.00	0.00
value of Inventory fran Initial Production	0.00	0.00
value of 1ding rnventorles	0.00	0.00
Cost of Goods Sold	1,100.00	1,650.00

Table Il.C: Ccrnputation of Incane Tax
100% Equity with No Interest on Cash

Item	A	B	Total			
	No Inflation					
]Sales	2,000.00					
:cost of Goods Sold	1,100.00					
:Operating Income		900.00				
: Interest on Cash Balances	0.00					
: Dlterest on Receivables	0.00					
:Total other Incane		0.00				
:Total			900.00			
!Costs						
Interest on Non-Indexed Local Debt	0.00					
Interest on Princ1pal Indexed Local Debt	0.00					
Interest on Interest Indexed Local Debt	0.00					
Interest On Foreign Debt	0.00					
Depre1cation on rlachinery and El:!Uipnent	300.00					
Depreciation on Buildings	0.00					
:Total Cost			300.00 :			450.00 :
:Taxable Incane Before Inflation AdjustJoonts			600.00 :			900.00 :
/Inflation Adjustments						
Assets						
nwentories	0.00			0.00		
:·!achinery and Equipnent	0.00			500.00		
Buildlngs	0.00			0.00		
Land	0.00			0.00		
Total Inflat1on Adjustments (+)		0.00. :			500.00 :	
:Liabilities						
Local Debt Pnncipal Dldexed	0.00			0.00		
El:juity Plus Surplus	0.00			672.50		
Total Inflation Adjustloonts (-)		0.00 :			672.50 :	
:Taxable Incane Before Fore1gn Exchange Gains (Losses)			600.00 :			727.50 :
:Foreign Exchange Gains and Losses		0.00			0.00	
;Taxable Income After All AdjustJoonts			600.00 :			727.50 :
:Corporate Tax			300.00 :			363.75
/Net of Tax Incane			300.00 :			363.75

Table 11.D: Ending Period Balance Sheet
100% Equity With No Interest on cash

Assets	Ending Balance No Inflation	Ending Balance 50% Inflation
Cash	945.00	1,331.25
Accounts Receivable	0.00	0.00
Inventories (LIFO)	0.00	0.00
Machinery and Equipment Less Accumulated Depreciation	700.00	1,050.00
Buildings Less Accumulated Depreciation	0.00	0.00
Land	0.00	0.00
Total Assets	1,645.00	2,381.25
Liabilities		
Local Debt: No Type of Indexing	0.00	0.00
Local Debt: Principal Indexed	0.00	0.00
Local Debt: Interest Rate Indexed:	0.00	0.00
Foreign Debt:	0.00	0.00
Equity Plus Surplus	1,645.00	2,381.25
Total Liabilities	1,645.00	2,381.25

Table 12.A: Inflation Adjustments
l00% Fore1gn Debt·,11th Exchange Rate Change Equal to Rate of Inflation

Assets	lBeglnn1ng ;Balance	:Inflation lAdjustment :Required	;Inflat1on lAdjustrr ntl :rlatural	:Exchange: Gains ;(Losses)	Value After Adjustment:	;Deprec1ation	:Interest: lincome/ /Expense
,Cash	0.00		0.00		0.00		0.00
:Accouncs Rece1vable	0.00		0.00		0.00		0.00
Inventor1es LITO)	0.00	'.l.GO			0.00		
;I·lachinery and F.qulpment Less AcCl.unulated Deprec1at1on	**1,000.00**	500.00			1,500.00	450.00	
:Buildings Less Accumulated Deprec1anon	0.00	0.00			0.00	0.00	
1Lana.	0.00	0.00			0.00		
;Total Assets	1,000.00	500.00 :	0.00	0.00	1,500.00 :		
Liablllties							
:Local Debt: l!o Type of Indexing	0.00	0.00			0.00		0.00
;Local Debt: ?nncipal Indexed	0.00		0.00		0.00		0.00
iLocal Jebt: Interest Rate Indexe<i.	0.00	0.00			0.00		0.00
ıFore1qt1 D2bt:	**1,000.00**			500.00	.500.00		150.00
:Ei:!\llty :0:us Surplus	0.00	0.00			0.00		
;Total Luw'JJ.:;.itles	**1,000.00** ;	0.00	0.00	*i* 500.00	i 1,S00.00 ,		

Table 12.8: Cost of Goods Sold
(Last In First OUt)
100% Foreign Debt <J.th Exchange Rate Change Fqual to Rate o

Item	He Inflation	50% inflation
iinJ.tial DlventorJ.es	0.00	0.00
Productwn Cost	1,100.00	11,650.00
Total Cost of Goods Available for Sale	::,:00.00	[1,650.00
Sales frcm CUrrent Producnon	100.00	00.00
Inventory Remaining Frm, CUrrent Production	0.00	0.00
Inventory Remalning fran Initial Inventory	0.00	0.00
value Of Inventory fran CUrrent Production	0.00	0.00
Value of Inventory from Initial Production	0.00	0.00
Value of Emling Inventones	0.00	0.00
Cost of Goods Sold	.i,:00.00	i1,630.00

Table 12.C: canputation of Income Tax
100% Fore1gn Debt with Exchange Rate Change Equal to Rate of Inflat1on

Item	No Inflation A	No Inflation B	No Inflation Total	50% Inflation A	50% Inflation B	50% Inflation Total
:sales	2,000.00			3,000.00		
Cost of Gco:Js Sold	1,100.00			1,650.00		
:Operating Income		900.00			1,350.00	
Interest on Cash Balances	0.00			0.00		
:nterest on Receivables	0.00			0.00		
:Total Other Income		0.00			0.00	
:·rotal			900.00			1,350.00
:costs						
Interest on Non-Indexed Local Debt	0.00			0.00		
:nterest on Pr1nc1pal Indexed Local Debt	0.00			0.00		
Interest on Interest Indexed Local Debt	0.00			0.00		
D1t2r2st On foreign Debt	100.00			150.00		
Depreicanon on Hachlliely and EqUlpment	300.00			.J50.00		
Jepreciat1on on BUlldings	0.00			0.00		
:Total Cost			400.00			600.00
Taxable Income Before b1flahon Adjusuoonts			500.00			750.00
:Inflat1on Adjustments						
Assets						
Inventones	0.00			0.00		
:·iachinery and &!U1pment	0.00			S00.00		
Bmldlngs	0.00			0.00		
kmd	0.00			0.00		
Total Inflatwn Adjusuoonts (+)		0.00			500.00	
:Liabllities						
Local Debt Pr1ncipal Indexed	0.00			0.00		
;;:quity Plus SUrplus	0.00			0.00		
Total Inflation Adjustments (-)		0.00			0.00	
Taxable Income Before Foreign Exchange Gains (Losses)			500.00			1 250.00
Foreign Exchange Gains and Losses		0.00			(500.00)	
Taxanle Income After All Adjustments			**500.00**			750.00
;Corporate Tax			250.00			375.00
:Net of Tax Income			250.00			375.00

Table 12.D: iliding Period Balance Sheet
100% Foreign Debt with Exchange Rate Change Equal to Rate of Inflati

Assets	Ending Balance io :Inflation	Ending Balance 50% :Inflation
:cash	550.00	825.00
:Accounts Rece1vable	0.00	0.00
Inventones (LIFO)	0.00	0.00
:Nachinery and Equipment Less Accl.llnulated Deprec1atwn	700.00	i.,050.00
:Buildlngs Less Accl.llnulated Deprecia-c1on	0.00	0.00
;Land	0.00	0.00
:Total Assets	1,250.00	1,875.00
l;iabilities		
;Local Debt: Ho Type of IndexJ.ng	0.00	0.00
;Local Debt: Pnncipal Indexed	0.00	0.00
:Local Debt: Interest Rate Indexed:	0.00	0.00
:Foreign De:Ot:	1,000.00	1,500.00
:Equlty Plus Surplus	250.00	375.00
:Total Liab1lities	1,250.00	1,875.00

Table 13.A: Inflation Adjustments
100% Foreign Debt with Exchange Rate Change Less than the Rate of Inflation

Assets	Beginning Balance	Inflation Adjustment Required	Inflation Adjustment Natural	Exchange Gains (Losses)	Value After Adjustment	Depreciation	Interest Income/ Expense
Cash	0.00		0.00		0.00		0.00
Accounts Receivable	0.00		0.00		0.00		0.00
Inventories (LIIO)	0.00	0.00			0.00		
Machinery and Equipment Less Accumulated Depreciation	1,000.00	500.00			**1,500.00**	450.00	
Buildings Less Accumulated Depreciation	0.00	0.00			0.00	0.00	
Land	0.00	0.00			0.00		
Total Assets	1,000.00	500.00	0.00	0.00	1,500.00		
Liabilities							
Local Debt: No Type of Indexing	0.00	0.00			0.00		0.00
Local Debt: Principal Indexed	Q.00		0.00		0.00		0.00
Local Debt: Interest Rate Indexed	0.00	0.00			0.00		0.00
Foreign Debt:	'-,000.00			200.00	1,200.00		120.00
Equity Plus Surplus	0.00	0.00			0.00		
Total Liabilities	.000.00	0.00	0.00	200.00	1,200.00		

Table 13.B: Cost of Goods Sold
(Last In First <Alt)
l00% Fore1gn Debt mth Exchange Rate Change L€ss Than the R

Item	No inflation	50% Inflation
Initial Inventories	0.00	0.00
Production Cost	i1,100.00	1,650.00
Total Cost of Goods Available for Sale	1,100.00	1,650.00
Sales fran Current Production	100.00	00.00
Inventory Remaining From Current Product1on	0.00	0.00
Inventory Remaining fran Init1al Inventory	0.00	0.00
Value Of Inventory from Current Production	0.00	0.00
Value of Inventory from Dlitial Production	0.00	0.00
Value of Endlllg Inventories	0.00	0.00
cost of Goods Sold	i1,100.00	1,650.00

Table 13.C: Canputat10n of Incane Tax
100% Foreign Debt with Exchange Rate Change Less Than the Rate of Inflation

Item	No Inflation A	No Inflation B	No Inflation Total	50% Inflation A	50% Inflation B	50% Inflation Total
;Sales	2,000.00			: 3,000.00		
;cost of Goods Sold	1,100.00			i 1,650.00		
;Operat1ng Income						
Interest on cash Balances						
Interest on Rece1vables						
:Total other Income						
;Total						1,350.00 :
;Costs						
Interest on Non-Indexed Local Debt	0.00			0.00		
Interest on Principal Indexed Local Debt	0.00			0.00		
terest on Interest Indexed Local Debt	0.00			0.00		
=nterest On Fore1g11 Debt	100.00			:20.00		
Depre1canon on Hachinery and Equirment	300.00			450.00		
Deprec1ation on BUlldings	0.00			0.00		
:Total Cost			400.00			570.00
:Taxable Income Before Inflat10n Adjustments			500.00			780.00 :
:Inflation Adjustments						
Assets						
Inventories	0.00			0.00		
;·lachinery and Eq\llrtnent	0.00			500.00		
Buildings	0.00			0.00		
Lan<i	0.00			0.00		
Total Inflation Adjustments (+)		0.00			500.00	
;LJ.abillties						
iDeal Debt Pr1nc1pal Indexed	0.00			0.00		
ity Plus Surplus	0.00			0.00		
Total Inflation Adjustments (-)		0.00			0.00	
:Taxable Income Before Foreign Exchange Gains (Losses)			500.00			, 1,280.00 :
Foreign Exchange Gains and Losses		0.00			(200.00)	
:Taxable Income After All Adjustments			500.00 :			1,080.00 :
;Corporate Tax			250.00 :			540.00
:Net of Tax Incane			250.00 :			540.00

Table 13.D: Ending Period Balance Sheet
J.00% Foreign Debt Hith Exchange Rate Change Less Than the Rate of In

Assets	Ending Balance No Inflation	Ending Balance 50% Inflation
Cash	550.00	690.00
Accounts Receivable	0.00	0.00
Inventories (LIFO)	0.00	0.00
l!achinery anci li:p.nrment Less Accumulated Depreciation	700.00	1,050.00
Buildings Less Accumulated Depreciatwn	0.00	0.00
Land	0.00	0.00
Total Assets	1,250.00	1,740.00
Liabilitles		
Local Debt: llo Type of Indexmg	0.00	0.00
Local Debt: Pnncipal Indexed	0.00	0.00
Local Debt: Interest Rate Indexed:	0.00	0.00
Foreign Debt:	1,000.00	1,200.00
Eqmty Plus Surplus	250.00	540.00
Total L1ab1lities	1,250.00	1,740.00

Table 14.A: Inflation Adjustments
Mutiple Assets with 40% Interest Rate Indexed Debt: Standard System

Assets	Beginning Balance	Inflation Adjustment Required	Inflation Adjustment Natural	Exchange Gains (Losses)	Value After Adjustment	Depreciation	Interest Incane/ Expense
cash	0.00		0.00		0.00		0.00
Accounts Receivable	0.00		0.00		0.00		0.00
Inventories (LIFO)	0.00	0.00			0.00		
l!achinery and Equipoont Less Accumulated Depreciation	800.00	400.00			1,200.00	360.00	
Buildings Less Accumulated Depreciation	1,200.00	600.00			1,800.00	90.00	
Total Assets	2,750.00	1,375.00	0.00	0.00	4,125.00		
Liabilities							
Local Debt: No Type of Indexing	0.00	0.00			0.00		0.00
Local Debt: Principal Indexed	0.00		0.00		0.00		0.00
Local Debt: Interest Rate Indexed	1,100.00	0.00			1,100.00		715.00
Foreign Debt:	0.00			0.00	0.00		0.00
Equity Plus Surplus	1,650.00	825.00			2,475.00		
Total Liabilities	2,750.00	825.00	0.00	0.00	3,575.00		

Table 14.B: Cost of Goods Sold
(Last In First OUt)
l!utiple Assets with 40% Interest Rate Indexed Debt: Standa

Item	No inflation	150% inflation
Initial Inventories	0.00	0.00
Production Cost	11,100.00	11,650.00
Total Cost of Goods Available for Sale	11,100.00	11,650.00
Sales fran CUrrent Production	100.00	100.00
Inventory Remaining Fran CUrrent Production	0.00	0.00
Inventory Remaining fran Initial Inventory	0.00	0.00
Value Of Inventory fran CUrrent Production	0.00	0.00
Value of Inventory fran Initial Production	0.00	0.00
Value of Ending Inventories	0.00	0.00
Cost of Goods Sold	11,100.00	11,650.00

Table 14.C: Conputation of Incane Tax
llutiple Assets with 40% Interest Rate Indexed Debt: Standard System

	No Inflation			50% Inflation		
Item	A	B	Total	A	B	Total
Sales	2,000.00			3,000.00		
Cost of Goods Sold	1,100.00			1,650.00		
Operating Incane		900.00			1,350.00	
Interest on cash Balances	0.00			0.00		
Interest on Receivables	0.00			0.00		
Total other Incane		0.00			0.00	
Total			900.00			1,350.00
Costs						
Interest on Non-Indexed Local Debt	0.00			0.00		
Interest on Principal Indexed Local Debt	0.00			0.00		
Interest on Interest Indexed Local Debt	110.00			715.00		
Interest On Foreign Debt	0.00			0.00		
Depreication on Machinery and Equipment	240.00			360.00		
Depreciation on Buildings	60.00			90.00		
Total Cost			410.00			1,165.00
Taxable Income Before Inflation Adjustments			490.00			185.00
Inflation Adjustments						
Assets						
Inventories	0.00			0.00		
llachinery and Equipment	0.00			400.00		
Buildings	0.00			600.00		
Land	0.00			375.00		
Total Inflation Adjustments (+)		0.00			1,375.00	
Liabilities						
Local Debt Principal Indexed	0.00			0.00		
Equity Plus SUrplus	0.00			825.00		
Total Inflation Adjustments (-)		0.00			825.00	
Taxable Incane Before Foreign Exchange Gains (Losses)			490.00			735.00
Foreign Exchange Gains and Losses		0.00			0.00	
Taxable Incane After All Adjustments			490.00			735.00
Corporate Tax			245.00			367.50
Net of Tax Incane			245.00			367.50

Table 14.D: Ending Period Balance Sheet
Mutiple Assets with 40% Interest Rate Indexed Debt: Standard System

Assets	Ending Balance No Inflation	Ending Balance 50% Inflation
Cash	545.00	267.50
Accounts Receivable	0.00	0.00
Inventories (LIFO)	0.00	0.00
Machinery and f4uipnent Less AcCUIIrul.ated Depreciation	560.00	840.00
Buildings L€ss Accumulated Depreciation	1,140.00	1,710.00
Land	750.00	1,125.00
Total Assets	2,995.00	3,942.50
Liabilities		
I..ocal Debt: No Type of Indexing	0.00	0.00
I..ocal Debt: Principal Indexed	0.00	0.00
I..ocal Debt: Interest Rate Indexed	1,100.00	1,100.00
Foreign Debt:	0.00	0.00
lf4uity Plus SUrplus	1,895.00	2,842.50
Total Liabilities	2,995.00	3,942.50

Table 15.A: Inflation Adjustments
Mutiple Assets with 40% Interest Rate Indexed Debt: Alternative System

Assets	Beginning Balance	Inflation Adjustment Required	Inflation Adjustment Natural	[illegible]	Value After Adjustment	Depreciation	Interest Income/ Expense
Cash	0.00		0.00		0.00		0.00
Accounts Receivable	0.00		0.00		0.00		0.00
Inventories (LIFO)	0.00	0.00			0.00		
Machinery and Equipment Less Accumulated Depreciation	800.00	400.00		(160.00)	1,040.00	312.00	
Buildings Less Accumulated Depreciation	1,200.00	600.00		(240.00)	1,560.00	78.00	
Land	750.00	375.00		(150.00)	975.00		
Total Assets	2,750.00	1,375.00	0.00	(550.00)	3,575.00		
Liabilities							
Local Debt: No Type of Indexing	0.00	0.00			0.00		0.00
Local Debt: Principal Indexed	0.00		0.00		0.00		0.00
Local Debt: Interest Rate Indexed	1,100.00	0.00			1,100.00		715.00
Foreign Debt:	0.00			0.00	0.00		0.00
Equity Plus Surplus	1,650.00	825.00			2,475.00		
Total Liabilities	2,750.00	825.00	0.00		3,575.00		

Table 15.B: Cost of Goods Sold
(Last In First OUt)
tiple Assets with 40% Interest Rate Indexed
Alternative System

Item	No Inflation	50% Inflation
Initial Inventories	0.00	0.00
Production Cost	11,100.00	11,650.00
Total Cost of Goods Availahle for Sale	11,100.00	11,650.00
Sales fran CUrrent Production	100.00	100.00
Inventory Remaining Fran CUrrent Production	0.00	0.00
Inventory Remaining fran Initial Inventory	0.00	0.00
Value Of Lnventory fran CUrrent Production	0.00	0.00
Value of Inventory fran Initial Production	0.00	0.00
Value of Ending Inventories	0.00	0.00
Cost of Goods Sold	11,100.00	11,650.00

Table 15.C: Ccrnputation of Incane Tax
l!utiple Assets with 40% Interest Rate Indexed Debt: Alternative System

Item	No Inflation A	No Inflation B	No Inflation Total	50% Inflation A	50% Inflation B	50% Inflation Total
Sales	2,000.00			**3,000.00**		
Cost of Goods Sold	1,100.00			1,650.00		
Operating Incane		**900.00**			1,350.00	
Interest on cash Balances	0.00			0.00		
Interest on Receivables	0.00			0.00		
Total other Incane		0.00			0.00	
Total			900.00			1,350.00
costs						
Interest on Non-Indexed local Debt	0.00			0.00		
Interest on Principal Indexed local Debt	0.00			0.00		
Interest on Interest Indexed local Debt	110.00			715.00		
Interest On Foreign Debt	0.00			0.00		
Depreication on Machinery and Equipoont	240.00			312.00		
Depreciation on Buildings	60.00			78.00		
Total Cost			410.00			1.105.00
Taxable Incane Before Inflation Adjustments			490.00			245.00
Inflation Adjustments						
Assets						
Inventories	0.00			0.00		
l!achinery and Equipoont	0.00			240.00		
Buildings	0.00			360.00		
Land	0.00			225.00		
Total Inflation Adjustments (+)		0.00			825.00	
Liabilities						
Lccal Debt Principal Indexed	0.00			0.00		
Equity Plus SUrplus	0.00			825.00		
Total Inflation Adjustments (-)		0.00			825.00	
Taxable Incane Before Foreign EKchange Gains (Losses)			490.00			245.00
Foreign EKchange Gains and Losses		0.00			0.00	
Taxable Incane After All Adjustments			490.00			245.00
Corporate Tax			245.00			122.50
Net of Tax Incane			245.00			122.50

Table 15.D: Ending Period Balance Sheet
Mutiple Assets with 40% Interest Rate Indexed Debt:
Alternative System

Assets	Ending Balance No Inflation	Ending Balance 50% Inflation
Cash	545.00	512.50
Accounts Receivable	0.00	0.00
Inventories (LIFO)	0.00	0.00
Machinery and EquiJIlleilt		
Less Accumulated Depreciation	560.00	728.00
Buildings Less Accumulated		
Depreciation	1,140.00	1,482.00
Land	750.00	975.00
Total Assets	2,995.00	3,697.50
Liabilities		
Local Debt: No Type of Indexing	0.00	0.00
Lxal Debt: Principal Indexed	0.00	0.00
Lxal Debt: Interest Rate Indexed	1,100.00	1,100.00
Foreign Debt:	0.00	0.00
Equity Plus SUrplus	1,895.00	2,597.50
Total Liabilities	2,995.00	3,697.50