

COMMENTS - JANUARY, 2004

ACCOUNTING AND AUDITING

- The Financial Accounting Standards Board says the August electricity failure which resulted in a blackout in the Northeast and Midwest, while not an ordinary event, was not of a nature to satisfy the requirement for being an "extraordinary item" either. To qualify as an "extraordinary item," the event must be both unusual in nature and infrequent in occurrence. Blackouts, regardless of size, happen all the time, according to the FASB, making them an ordinary cost of doing business. As such, they can't be segregated on the income statement and reflected as "extraordinary items."
- Have you ever stopped to think about the breadth and scope of the finance functions of your business? You'll probably be surprised at the many activities they encompass, and how vital they are to the success of your firm. Essentially, the finance function can be broken up into three main activities, each with a series of sub-functions. They are:

Transaction processing - accounts receivable, customer billing, credit and collections, accounts payable, general accounting, payroll, tax accounting, cost accounting, fixed asset accounting, benefits administration and internal and external reporting.

Control and risk management - budgeting, cash flow management, insurance risk management, forecasting, tax planning, performance reporting, treasury management and internal and external audit.

Decision support - Business performance analysis (ratio analysis), cost analysis, pricing analysis, business planning support and finance function management.

You'll find, regardless of whether your business is a small organization at a single location or a global concern, the finance function will still comprise all of the elements and activities we have described. The essential difference is in a large enterprise all of the activities are performed in-house by a variety of departments, and the firm's independent CPAs are mainly relied on for external audit requirements. Conversely, in smaller organizations there is much greater reliance on the independent CPA to perform many of the functions and there may also be outsourcing of some finance activities to the CPA firm, the bank or specialized outsourcing firms. Overall, it is fair to say that the smaller the business, the greater the reliance on the CPA for all phases of financial management support.

- Although audits are not designed to uncover fraud, auditors are guided by professional standards to be alert to the possibility fraud may exist. That is why the Auditing Standards Board recently issued Statement on Auditing Standards No. 99, *Consideration of Fraud in a Financial Statement Audit*. It became effective for audits

of financial statements began on or after December 15, 2002, and although it does not change the auditor's responsibility to detect fraud, it does provide more specific guidance for independent auditors on how to assess the risk of fraud and implement additional fraud detection procedures. Furthermore, in light of the public mistrust created by highly publicized accounting scandals, auditors will undoubtedly dig deeper and show less flexibility when questionable accounting treatments are uncovered. Besides such obvious factors as unethical or illegal client behavior, matters such as delay in the payment of the audit fee or uncooperativeness of the client in rendering needed information, are other signs that may make the auditor wary. Other factors which may arouse the auditor's concerns include:

- < Poor record-keeping by the client
- < High-risk nature of the client's business and potential exposure to litigation
- < Deterioration in the overall auditor-client relationship
- < Deterioration in the client's business which is sapping the company's financial strength
- < Internal conflicts within the client organization
- < Excessive tie-in between management compensation and company valuation or performance
- < Management disregard for regulations and for internal controls
- < Management restrictions on the auditor's activities and access to information
- < Past history of illegal management activity
- < Concentration of management in a few individuals without adequate oversight
- < Limited size of the organization which makes it impossible to have an adequate segregation of duties among company personnel

It's important to understand CPAs are governed by stringent professional standards, and the relationship can be impaired both by overt actions by the client as well as by circumstances which are beyond anyone's control. Clearly, trust is an overriding element in the auditor-client relationship and the auditor's perception of the client's integrity plays an important role in the audit decisions made throughout the engagement.

ADMINISTRATION, SYSTEMS AND EDP

- The FBI and the Computer Security Institute claim last year 90% of corporations were subject to computer security breaches and 80% suffered financial losses in connection therewith. They suggest overall systems security is enhanced by the following:
 - < Establishment of an information security policy which outline's the firm's objectives, standards and compliance requirements for information security
 - < Maintenance of an inventory of information assets including software, computer equipment, databases and files and their location
 - < Screening key personnel through background checks and restricting access to sensitive files
 - < Physically protecting information assets to prevent access by random employees or janitorial workers

- < Documenting the proper procedures for operating the computer system
 - < Establishment of strict access control rules which restrict access to data to authorized personnel
 - < Providing fire walls and other security measures for all new hardware and software being installed in the system
 - < Development of a business continuity plan which enables a firm to recover quickly from a natural disaster or a systems failure
 - < Utilization of sufficient documentation and controls to immediately identify any deviations from normal operating procedures
- How long does it take to restore an information technology system after a disaster or a virus attack? According to a Harris Poll the time-frame in hours is as follows:

E-mail	9.1
Order Entry	9.2
Customer Relations Management	10.8
Financial Management	10.8
Supply Chain	10.9

The time frames were based on a survey of large companies and the time it usually takes to get systems up and operating again. Small firms may have a significantly different recovery time.

- In companies which use a cycle counting approach rather than taking an annual physical inventory, responsible managers are often concerned they may accidentally skip items which should be counted, or conversely, they may be counting more than is required. To avoid these problems, there are two systematic approaches can help. One is to use the "geographic" method of counting whereby the count starts at one end of the warehouse and a certain number of items are counted daily, until the personnel performing the counts reach the other end of the warehouse. Alternatively, the "ranking" method may be used, whereby frequency of counts is based on sales activity of the inventory items. The greater the sales activity, the more frequently items are counted throughout the year. Factors which will determine which method is more appropriate include the condition of the warehouse, likelihood items have been misplaced, cost of the items and degree of accuracy desired by management.
- About 50% of large companies and 30% of small companies are monitoring employees to prevent inappropriate use of technology by the workers. Also, about 20% of small companies and 25% of large companies track workers' use of technology for obtaining cost accounting data and a small percentage of companies (under 10%) do monitoring to measure productivity. Meanwhile, about 45% of small firms and 15% of large firms report they do no tracking of employee use of technology at all. How do these policies compare with your practices?

- Farmers and other agricultural producers can now obtain cash incentives under a variety of incentive programs. For example, farmers can now get cash incentives for fighting global warming via the Agriculture Department's Environmental Quality Incentive Program, the Conservation Reserve Program and the Forest Land Enhancement Program. The Agency says it will consider conservation practices to reduce greenhouse gases when it evaluates applications for these programs. Planting trees and other vegetative cover and developing renewable energy systems are just two illustrations of activities which may qualify for incentives. Similarly, producers can also receive Agriculture Department funds for preserving grassland under the new Grassland Reserve Program. Here the Agency will pay up to 90% of the cost of preserving grassland was never cultivated and 75% for land which had been cultivated. Finally, more livestock producers are eligible for drought aid from the Agriculture Department. It has extended distribution of nonfat dry milk to livestock producers at nominal cost to producers in a number of counties in Utah and Idaho.

FEDERAL REGULATIONS

- The U.S. Office of Management and Budget has revised Circular A-133, *Audits of States, Local Governments, and Non-profit Organizations*. The regulation establishes guidelines and policies related to audits of Federal awards which are also known as single audits. Among the revisions is an increase to \$500,000, from \$300,000, in the minimum amount of an award which requires an audit. The revisions are effective for fiscal years ending after December 31, 2003.
- After years of delays, beginning November 24th, 2003, wireless telephone customers were able to keep their phone numbers when they switch carriers. The carriers will charge fees for transferring phone numbers. However, some carriers are already charging their customers fees for implementing portability. For example, Sprint PCS includes a 63 cent per month surcharge for this service.

INSURANCE

- If you want to keep your homeowner's insurance costs to a minimum and also minimize the chances of having a policy canceled, here are some common sense suggestions:
 - < Raise deductibles.
 - < Avoid add-on coverage which induces you to make small claims for items such as jewelry.
 - < If you are switching voluntarily do not cancel the old policy, but let it overlap for the 60 to 90-day period until the old insurer can drop your coverage.
 - < Avoid switching carriers to save just a few dollars since a claim during the first 6 months of new coverage can lead to a rise in premiums or policy cancellation.
 - < Avoid submitting small claims since this can result in cancellation of discounts.
 - < Compare repair cost to deductibles, and, if it is only a few hundred dollars greater, avoid making a claim.

These are just a few ideas for minimizing insurance costs. A review of existing

insurance in conjunction with your personal financial planning may bring other economies to light.

- Small firms which merge should not overlook their exposure to the continued health coverage rules. Federal regulations provide that companies with at least 20 employees must offer their departing workers the option of purchasing continuing medical coverage for at least 18 months at the group insurance rates. However, if a firm has fewer than 20 workers and buys the stock of another company and the two firms combined had more than 20 employees in the prior year, the continuation health care coverage requirement takes effect immediately. Conversely, if the merger is in the form of an asset purchase, the rules apply for the following year.
- Veterinary bills for a dog or a cat can easily run into the thousands of dollars. Thus, pet owners should be pleased an increasing number of employers are now including "veterinary pet insurance" among the eligible voluntary benefits of their cafeteria plan. Typically, reimbursement ranges from 70% to 100% of covered expenses after a deductible is satisfied and premiums may range upward of \$200 per year. As a pet owner you should also be aware some insurance companies refuse to provide homeowner's insurance if the insured keeps breeds of dogs which are considered dangerous in the home. The breeds are Doberman pinschers, Pit bulls, Presa Canarios and Rottweilers. Before purchasing a homeowner's insurance policy, make sure the policy has no exclusion if you keep one of these dogs as a pet.

LABOR RELATIONS

- How frequently does your firm provide performance reviews for your workers? Although these type of reviews were conducted twice a year or more frequently prior to the bursting of the Internet bubble, most companies have gone back to annual performance reviews. A recent survey of 427 companies indicated that 70% of the firms conduct these reviews only once a year while 18% perform them more frequently. Surprisingly, 5% of the respondents indicated they don't engage in performance reviews at all. Some firms, in order to take the formality out of the process, do small reviews on a monthly basis. An advantage of this approach is to help employees modify unsatisfactory performance quickly, and also to provide rapid feedback to the employee.
- In June, 2003, the National Federation of Independent Business conducted a survey of small business to determine what kinds of benefits were most frequently provided and what percentage of firms were offering them to their workers. Here are the results:

Paid vacations	75%
Health insurance plans	61%
Paid sick leave	59%
Disability insurance	41%
Job related education	39%
Pension plan	30%
Life insurance	29%
Dental insurance	24%

The employers also stated if they could add \$1 per hour to the employee's compensation, they would add the sum to the pay rather than provide increased benefits, because they believe the take home pay is the overriding concern of their workers.

- The IRS has issued new golden parachute regulations as well as a revenue procedure for valuing stock options which are treated as golden parachute payments. They revise an earlier valuation method for stock options. Under the Internal Revenue Code a company cannot deduct "excess" golden parachute payments and an executive must pay a 20% excise tax on them. While the new regulation continues to allow the use of certain option valuation methods, it also provides new flexibility to make certain adjustments for early termination of employment or changes in the value of the stock price. The regulations become effective for payments made after January 1, 2004.

MARKETING

- Retail chains opening new stores or upgrading existing ones are questioning whether to make new investments in their computer networks to add service, enhance connectivity and increase productivity. Among the features being considered are:

Store connectivity - using the network to link store areas with one another, stores with one another and stores with corporate headquarters to enhance operating efficiency.

Store mobility - which utilizes wireless technologies such as handheld computers for in-store inventory management and wireless cash registers as added checkouts when lines are long, to lower cost.

In-store broadcasting - which allows messages to be customized for specific departments and tailored to a particular time of day.

Networked in-store kiosks - such as music sampling stations and gift registries which have generated significant sales and happy customers.

Video intelligence - which permits the same network that handles video surveillance for loss prevention to be used for observing customer shopping patterns.

Unless retailers stay abreast of technology developments at the store level, they are likely to be left behind in the battle for customers.

- Convenience and good customer service are high on the agenda of Internet shoppers. Surveys show 45% of consumers view service as more important than price in dealing with an Internet vendor. Thus, it is vital e-mail responses are made within the same business day on which they are received. Also, if shoppers have a problem, you can expect them to become impatient if they are kept waiting for a considerable time before being connected with a real person who can assist them. According to one survey, 91% of respondents indicated they would stop dealing with a vendor if it consistently took over 10 minutes to be connected with a live service representative.

These attitudes are particularly prevalent among high-end customers with household incomes of \$100,000 or more. Companies which operate both a web site and real stores are particularly vulnerable because customers who have a bad online experience say they would reduce their spending at brick and mortar stores of the same company as well as end shopping at the web site.

MONEY, BANKING AND CREDIT

- Investors should be aware a number of insurers are threatening to discontinue writing excess SIPC coverage which protects investors against their brokerage firm's failure. The insurers claim they are abandoning this lucrative line of business because the underlying policies, as currently written, force them to assume potentially unlimited liability because they place no limit on the number of accounts covered or the financial risk attached to each account. No one is sure whether the withdrawal by the insurers is merely a ploy to squeeze greater premiums from the brokerage firms, or whether the threat is real. In the latter case, it is questionable whether the brokerage firms would be able to obtain protection for investor accounts in excess of basic SIPC coverage which is limited to \$500,000 in stocks and bonds, and up to \$100,000 in cash held in a brokerage account. In light of the uncertainty, investors should be alert to any changes in excess SIPC coverage announced by their brokerage firms, and determine whether the modifications might expose them to the risk of loss.
- More and more businesses are looking into electronic payments as a means of lowering their payment costs. According to the National Automated Clearing House Network, payments last year by e-check grew 213%, EDI payments increased 14%, and direct deposit of paychecks and expense account reimbursement rose by 4.8%. An increasing number of companies are also looking into e-invoicing. While only 10% use e-invoicing today, another 40% are considering it as a means of lowering their administrative costs.
- Although the politicians and many economists claim we are in a recovery, bankruptcy filings were up again for the third straight year. The over 1.5 million personal bankruptcy filings in 2002 represented a 6% increase over 2001. Federal Reserve data also shows consumer debt reached an all-time high of \$1.7 trillion, with revolving debt accounting for \$711 billion because consumers have loaded up on credit card debt. For a creditor, it's a perilous environment. Therefore, for your self-preservation, if you extend credit, secure the debt with sufficient assets, obtain personal guarantees from customers and file proofs of claim quickly if there is a bankruptcy, to enhance your chances for being repaid. Incidentally, personal bankruptcies which account for about 98% of total bankruptcies are usually filed under Chapter 7 or Chapter 13 of the U.S. Bankruptcy Code. Under the former, debtors may keep essential assets (furniture, clothing, or a portion of the equity in cars and homes) and all other assets such as land, jewelry, art objects, stocks and bonds and other investments must be sold, and creditors are paid on a pro-rata basis. Under a special "no asset" Chapter 7 filing the debtor declares he or she has no assets available to pay any part of the debt. In either instance, the debtor is released from having to make payments on any remaining debt. Under a Chapter 13 filing, a debtor with steady income agrees to a plan to repay as much debt as possible over a three to

five-year period and a trustee appointed by the Bankruptcy Court administers the repayment. At the end of the agreed on period, any remaining debt is no longer the responsibility of the debtor.

- Have you been stuck with a bounced check? If you are not concerned about the customer relationship, you can call the customer's bank and request enforced collection of the draft. This requires the bank to pay you as soon as funds show up in the debtor's account. Of course, the bank will charge a fee for this service, but this may be your only chance to get paid.

PENSION AND ESTATE PLANNING

- Business valuations for estate planning and related purposes require consideration of many factors, including the taxpayer's overall family and wealth circumstances, the ever-changing laws which affect estate and gift tax planning and the inherently dynamic nature of business concerns. Furthermore the valuation of a business interest can be affected by lifetime gifting, the sale of a business interest to outsiders or a shareholder, stability and continuity of the business, the effect of generation skipping taxes, the earnings and dividend paying capacity of the business, the market price of stock of corporations in the same business and the lack of marketability of the business interest, which may often result in a discount. The latter situation arises when there are restrictions on the transfer of stock, when there are no dividend payments, when there are very limited prospects for either a public offering of the shares or a sale of the company, when buy/sell agreements place severe restriction on dispositions of the stock and when business earnings tend to be unstable. By now, you probably realize that business valuations for estate tax purposes are highly subjective and far more of an art than a science. Thus, in order to obtain a valuation which satisfies tax, retirement and estate planning needs it is essential to utilize an experienced professional who is highly conversant with business valuations for these purposes.
- Disclaimers are a useful tool in estate planning. For example, a father's or mother's estate normally goes to the spouse, free of estate taxes. But when the second spouse dies, all of the assets above the exempt amount are taxed at very high rates. Thus, assuming a parent dies, and the surviving spouse has considerable wealth in his or her own right, the spouse could disclaim the assets so the inheritance goes to children or grandchildren. Even though this may accelerate tax, it could be a viable strategy if the immediate taxes are significantly lower than the taxes which would be levied on the surviving spouse's estate at a future time. To make sound estate planning decisions and to implement tax minimizing strategies, it is important to engage in annual estate planning with a competent professional tax advisor, such as your CPA.
- Following are key fundamental arrangements which must be considered at the inception of estate planning.
 - < A will to direct estate distributions
 - < A revocable trust to enable distribution of assets without probate
 - < A power of attorney to entrust a trusted party to direct your financial affairs in the

- event you become incapacitated
- < Trusts for children to hold assets which meet individual needs and can restrict distributions until certain conditions are satisfied
- < Life insurance trusts to own your life insurance and remove it from the estate and the reach of potential creditors
- < Establishment of a fully funded pension plan to hold retirement savings which are protected from creditors
- < Creation of a limited liability company to own a business or rental real estate to protect the family from legal claims against the business or property.

Usually they require the services of an estate attorney to provide the legal documents for the establishment of the documents and entities above. Then, super-imposed on this framework is the estate planning and implementation of strategies designed to attain the objectives of the client. This usually requires the services of a professional familiar with the tax code and conversant with estate planning issues such as an attorney or CPA.

- One strategy for lowering estate taxes of small business owners is to use installment notes which lapse at death. In a recent case, upon retirement, the owner of a business decided to sell the business to his son. In payment, he received an installment note for an 11-year term (within the father's life expectancy), and the note contained a clause which excused any remaining payments in the event the seller died before the note was fully repaid. After only 3 payments were made on the note the father died unexpectedly and his estate claimed the notes had no value. The IRS disagreed, but the Court of Appeals for the 6th Circuit sided with the taxpayer. It ruled the note should not be counted in the estate because (1) the purchase price for the business was reasonable, and (2) since the note terminated upon the father's (seller's) death its value was zero.
- Life expectancy hit a new high for both men and women in the United States in the year 2001. The Department of Health and Human Services reports life expectancy is now 74.4 years for men and 79.8 years for women. Furthermore, if you are 65 years old and retiring today, the government says that you can expect to live to age 85. If a couple aged 65 retires today, there is a 90% chance one of them will live to age 81 and a 75% chance that one of them will live to age 86. And there is even a 50-50 chance one of the couple will attain age 91. All of this raises the question of how much money is needed to set aside to provide a suitable retirement. The answer depends on the life expectancy, the post-retirement lifestyle desired, the amount of assets available from savings, inheritances and other sources, and the length of time until retirement.

PERSONAL FINANCIAL PLANNING

- If you are the owner of a small incorporated business, converting to an S corporation has become more attractive since the top tax rate is now 35% for both corporations and individuals. Under the old tax law, with the maximum rate for individuals set at 38.6%, making an S corporation election was not as advantageous since business owners in the top bracket knew they would pay a higher tax rate on income passed through to them by the S firm. Before converting, however, you should be aware as a successful small business owner, you are likely to get closer scrutiny from the IRS.

The IRS says audits of small business owners and self-employed individuals were insufficiently thorough to ferret out unreported income. Thus, it intends to have agents perform more intensive audits of small business owners in upper-income tax brackets.

- Following are the major types of scams involving checks, credit cards, ATM machines and the Internet, to which you might be exposed.

Identity fraud - whereby the perpetrators steal information about you that is publicly available and then tricks you into revealing other personal information in order to gain access to your assets, take out loans or use your identity to engage in a theft;

Check fraud - whereby the criminal steals or finds a checkbook and obtains enough information about your bank account to issue fraudulent checks which are charged against your account;

Advance-fee scams - where you receive an unsolicited offer of a product, service, loan, credit card or business opportunity if you make a payment up front to cover handling, taxes or shipping charges and never obtain the promised product or service.

Credit/Debit or ATM card fraud - whereby someone steals your card, obtains another card in your name, counterfeits your card using an electronic skimming device, or obtains your PIN number by watching you at an ATM machine and then charges goods and services against your account or withdraws money from your account;

Fraudulent cashier checks - in which the perpetrator engages in a transaction with you and pays with a fraudulent cashier's check or money order and relies on your trust that money has been set aside by the bank to get you to accept the fraudulent instrument;

Automated payment fraud - whereby a telemarketer or some other individual obtains sufficient information from you to send an electronic command to your bank instructing it to transfer a specified sum from your checking account to the perpetrator's account; and,

Internet fraud - in which phony web sites are established which offer attractively priced goods or services with the intent of obtaining credit card numbers, PIN numbers, social security numbers and other personal data with the intent of stealing your identity and perpetrating a fraud.

While there is no way to fully protect yourself, some precautions you might take include:

- < Not revealing your social security, credit and debit card and PIN numbers unless you initiate a transaction
- < Dealing only with a reputable business
- < Obtaining key details of representations in writing and carefully checking them before entering into any deal

- < Never engaging in transactions which require money up-front
 - < Using caution in providing any personal data over the phone or the Internet
 - < Shredding your trash to prevent crooks from utilizing information it contains
 - < Removing all unessential confidential information from your wallet
 - < Reviewing credit card statement and bank statements as soon as they arrive
 - < Periodically monitoring your credit reports for warning signs of fraud
- The IRS per diem rate for incidental expenses for employee travel went up on October 1st. The new rate for travel in the United States is \$3 per day compared to \$2 prior to the change.
 - If you own a family business, you may be able to hire your children to work in your business and garner some tax and financial benefits. For example:
 - < No social security taxes are due when a sole proprietorship or a husband-wife partnership hire their children who are under 18 years old.
 - < Federal unemployment insurance taxes aren't owed until the children reach age 21.
 - < Since the children's pay is usually taxed at the children's low rate, the shift in income from parent to the children usually results in tax savings. In 2003, a child can earn up to \$4,750 without owing any income tax.
 - < Paying your children for working for you won't result in loss of a dependency exemption, regardless of the pay, as long as the child is either younger than age 19, or younger than age 24 and a full-time student.
 - < A Roth IRA can be opened based on the child's wages and provide a start for building lifetime financial security for the children.

Be aware though, you must provide the children with real jobs and the pay must be reasonable for the services the children provide or the IRS may disallow the arrangement. You should also remember while the payroll tax savings are not available if your business is organized as a corporation, the income tax savings remain.

- Veterans who would like to start their own business or who already own a firm can obtain general information about franchising loans from the Small Business Administration and other financial topics on the Internet at www.vetbiz.gov. The site is mainly suitable for generating some ideas, but detailed consultation with a professional financial and tax advisor is recommended before any funds are committed to a new venture.
- College tuition costs at 4-year private colleges have reached an average of \$18,273, while at public colleges they have passed the \$4,000 mark. If you add on the expense of books, transportation, housing, etc. the cost can easily increase by another \$10,000 per year. On the other hand, students are receiving about \$90 billion in financial aid, about triple the amount just one decade ago, significantly lowering their actual outlays, and parents are being advised to ask colleges to increase their financial aid.

It's not surprising in this environment that seniors at 4-year colleges are leaving school with average student loans of \$13,000, and currently about 18% of the population has some outstanding student loans. As tuition increases continue, it is expected the student loan burden will also rise, and there will be a negative impact on the economy. According to one study, 67% of those with outstanding student loans claim their debts are preventing them from making major purchases including homes and automobiles.

REAL ESTATE

- New IRS regulations require non-residents to obtain a taxpayer I.D. number before the IRS will issue a withholding waiver certificate for realty sales made after November 3, 2003. Without the IRS waiver, 10% of the sales price of the property has to be withheld, requiring the foreign seller to file a U.S. tax return to obtain a refund. The IRS has also tightened the rules on withholding waivers in tax-deferred like-kind exchanges that involve U.S. properties held by foreigners. The seller now has to get approval for the transaction from the IRS by filing Form 8288-B before withholding can be reduced or eliminated.
- While everybody seems to be focused on acquiring a home because of low mortgage rates and the appreciation in property values they have facilitated, few people are noticing the extensive availability of rental housing. Nationwide rents are rising at an annual 1.7% rate per year, and in many markets rents have actually been falling because of overbuilding of multi-family housing units. Thus, for a young couple, renting may be a financially sounder decision in many locations around the country than real estate ownership. For those who consider renting, here are some things to consider:
 - < Rent should not consume more than 30% of your take-home pay (40% with utilities).
 - < Photograph the premises when you move in, highlighting any damage so the landlord does not withhold part of your security deposit when you move out.
 - < Make sure you have a written lease agreement which spells out the rent and the utilities included, as well as maintenance and painting requirements.
 - < Utilize the weak rental market to obtain as many concessions as possible from the landlord.

Incidentally, while you may break a lease if unsafe living conditions exist, in other instances you remain liable for the rent until the landlord has found another suitable tenant or until the lease terminates, whichever comes first.

TAXATION

- Depreciation of light trucks and vans rated at a gross vehicle weight of 6,000 pounds or less is no longer restricted by limits on "passenger automobiles." For years, business groups have complained the annual depreciation limits make it impossible to fully depreciate these vehicles within the standard five-year recovery period even though they are used for a valid business purpose. Even with 50% first-year bonus depreciation, which allows for larger up-front deductions (the first year depreciation

limit can be claimed for a vehicles acquired after May 5, 2003), only vehicles costing about \$23,000 can be fully depreciated over 5 years. Accordingly, the IRS has indicated it will issue new regulations with respect to light trucks or vans placed in service after July 6, 2003, that will exclude them from the definition of "passenger vehicles" and the depreciation limits applying to them so they can be written off more quickly.

- A survey by the National Association for the Self-Employed found the nation's smallest business owners are becoming increasingly pessimistic about the outlook for the economy and their businesses. They believe the government's tax laws are largely responsible for their plight. In particular, they think the Federal "self-employment tax" penalizes small business owners and the government needs to find a better source of revenue than imposing this burden on the 16 million smallest businesses in the United States. At any rate, the percentages have dropped from nearly 50% who were optimistic in 2002, to just 31% who were optimistic about their business prospects in 2003.
- The IRS has delayed and reduced a controversial Earned Income Tax Credit (EITC) program. Instead of starting in July, 2003, the program will be initiated during the 2004 tax filing season. Rather than requiring 45,000 taxpayers to certify a child claimed for EITC purposes resided with them for at least half the year, only 25,000 taxpayers will be asked to make the certifications. The IRS has been aware this is a major area of tax abuse, but political pressure has resulted in the delay and revision. Incidentally, changes in the EITC rules last year have greatly increased the number of qualifying taxpayers.
- The IRS has finalized new procedures for individuals to automatically change their accounting period. The rules supersede rules issued in 1996, by:
 - < Allowing more individuals to automatically change their annual accounting period
 - < Excluding individuals with interests in pass-through entities from the scope of the procedure
 - < Limiting the carry back of net operating losses over \$50,000 or general business credits generated during the short period
 - < Eliminating the requirement certain related entities concurrently change their accounting period to conform to the new tax year of the individual owner
 - < Extending the deadline for filing Form 1128 to that for filing the individual's tax return, including extensions, for the first year the change is effective.
- The IRS has enhanced the tax break for giving stock to a private foundation. Donors may now deduct the full fair market value of listed stocks given to a non-operating private foundation, one that supports charities but doesn't operate charitable endeavors. If the shares are publicly traded, the tax deduction is not limited to the cost of the donated stock. The shares are also required to have been owned over one year prior to the gift. The IRS has indicated ADRs that are gifted also qualify, even though they are interests in foreign firms, because they trade on U.S. exchanges.
- The new Jobs and Growth Tax Relief Reconciliation Act of 2003 has a number of provisions that give tax relief for small businesses. For example:

- < The expensing limit that lets businesses take an immediate deduction rather than depreciate new assets has been increased to \$100,000 for years beginning after 2002 and before 2006.
- < Bonus depreciation for qualified property provides for additional first-year depreciation deduction for fledgling businesses has been increased from 30% to 50%.
- IRS activity in identifying abusive tax shelters in recent months has made a lot of taxpayers wary about investing in tax shelter schemes. The government is investigating 78 tax shelter promoters and has issued over 200 summonses to obtain investor lists, while 77 cases have been referred to the Department of Justice for further enforcement action. While it is difficult to determine whether a tax shelter may come under IRS scrutiny, there are some warning flags which suggest caution. These include:
 - < Use of a series of sales transactions to drive up the basis of assets and then used to generate artificial losses.
 - < Arrangements that leave the investor no worse financially off but produce a tax benefit
 - < Requirement by the promoter to have the investor sign a confidentiality agreement not to disclose any part of the transaction
 - < Absence of any economic gain or loss in connection with the transaction
 - < Use of an offshore trust or partnership as part of the arrangement

We recommend when an investment advisor or promoter approaches you about a tax shelter, obtain the details and check with your tax advisor before making any commitments. Meanwhile, deferred compensation arrangements, use of 401(k) plan, purchase of real estate, like-kind exchanges and use of charitable trusts are just some examples of strategies which that provide tax shelter without the need for concern about getting caught up in a tax evasion scheme.

PAYROLL TAXES

- The IRS has announced that it will discontinue processing of magnetic tape for Form 940, "Employer's Annual Federal Unemployment (FUTA) Tax Return," and Form 941, "Employers Quarterly Federal Tax Return (FICA)" for all users at all sites for the 2004 filing season, with a final date of February 2004. Taxpayers who have been using this medium need to find an alternative acceptable transmission medium.

Comments is an informative publication for our clients and friends of the Firm. It is designed to provide accurate information on the subject matter covered. We recommend you consult with your legal and other advisors to determine if the information is applicable in your specific circumstances. If these

advisors are not available to you, please feel free to contact Barry N. Finkelstein, CPA at 972/934-1577 or e-mail at info@facpa.com.