

## COMMENTS - SEPTEMBER, 2003

### ACCOUNTING AND AUDITING

- The Financial Accounting Standards Board has issued SFAS No. 150, *"Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity."* It requires certain types of free-standing instruments which have characteristics of both liabilities and equity be recorded as liabilities rather than as temporary equities. One example is mandatorily redeemable stock which is commonly used by private companies in agreements with employee stockholders, and requires the company to buy back the shares upon the executive's retirement. Similarly, obligations which can be settled with shares whose price is fixed or tied to a market index, or which varies with the value of the issuer's shares would also need to be reflected as liabilities under the Statement. SFAS No. 150 applies to almost all relevant financial instruments entered into or modified after May 31, 2003. Privately owned companies which may find the shift in accounting for mandatory redeemable financial instruments to be problematic, will not have to meet the new requirements until the first fiscal period beginning after December 15, 2003.
- The SEC has issued regulations directing the national securities exchanges and national securities associations to prohibit the listing of any security of an issuer not in compliance with the audit committee requirements of the Sarbanes-Oxley Act. These requirements are that:
  - < Each member of the audit committee of the issuer has to be independent according to specified criteria.
  - < The audit committee must be directly responsible for the appointment, compensation, retention and oversight of the work of any registered public accounting firm engaged to prepare or issue an audit report or to perform other audit, review or attest services for the issuer.
  - < The audit committee must establish procedures for the receipt, retention and treatment of complaints regarding accounting, internal accounting controls or auditing matters, including procedures for the confidential, anonymous submission by employees of concerns as to questionable accounting or auditing matters.
  - < The audit committee must have the authority to engage independent counsel or other advisors it deems necessary to carry out its duties.
  - < The issuers must provide appropriate funding for the audit committee.

Domestic and foreign listed issuers will be required to comply with the new regulations by the date of their first annual shareholder meetings after January 15,

2004, but no later than October 31, 2004. Foreign private issuers and small business issuers have until July 31, 2005 to comply.

- *Does it take an inordinate amount of time to do monthly closings of your books?*

*Are you incurring huge audit fees because independent auditors are required to obtain excessive evidence to satisfy themselves about your financial statements?*

*Are your "days sales outstanding" ballooning?*

*Do you frequently make duplicate payments to vendors?*

*Are you required to make numerous adjusting entries in connection with your closing?*

*Is there a high staff turnover rate in your accounting department?*

Answers to these questions may indicate that your accounting system is in serious need of a thorough review and that the underlying systems and procedures may need a vigorous overhaul.

## **ADMINISTRATION, SYSTEMS AND EDP**

- Are you aware that many large companies such as airlines, telephone companies and utilities have established mutual aid arrangements whereby they assist one another in the event of a disaster to one or more of their key facilities? The arrangements may cover use of the competitor company's space, data systems and even expert personnel in an emergency. We think that there is no reason why small firms should not make similar assistance arrangements with competitors in their industry located in their business area. This can be achieved by contacting a competitor directly or by utilizing an industry trade association as a go-between to find another firm interested in making an emergency aid arrangement. It's good business to protect your firm and it may significantly reduce your cost in the event of a major business interruption.
- Until recently, the primary catalyst for information technology spending in the health care field has been focused on transaction systems such as improving payment efficiency. However, there is now a shift towards utilizing information technology to enhance patient safety and reduce medical errors. Developments include:
  - < Remote patient monitoring.
  - < Digitizing of patient records.
  - < Use of wireless platforms for entering patient medical data.
  - < Medication tracking using bar code readers.
  - < Simultaneous diagnostic evaluations by a team of doctors in diverse geographic locations.

While it is apparent these developments would greatly enhance information accuracy, improve patient outcomes, minimize hospital treatment errors and add to the productivity of doctors and nurses, progress towards their implementation is likely to

be slow. The major reason is hospital and other medical care providers are strapped for cash and unwilling or unable to make the necessary capital expenditures because of other priorities.

- According to the Food Marketing Institute, 24% of retailers, mostly grocery chains, are implementing self-checkout systems. According to one manufacturer, the systems cost about \$100,000 per store and the payback period stemming from reduced cost for checkers and baggers is about 12 to 18 months. It's estimated that currently about 10% to 20% of customers are utilizing self-checkout systems. Whether yours is a large food retail business or you are only a small retailer, it is important to regularly monitor your point-of-sale system to insure you are keeping up with competitors and your system provides inventory and other information which will enable you to manage in the most effective manner.
- According to the FBI, the cost of computer crime reached \$265,337,940 in 2000. But the number is probably vastly understated because many companies do not report criminal activity outside the organization, and because the number of cases of cyber attacks is constantly rising. Just in the first half of this year, there has been an estimated 28% increase in computer crime. Nevertheless, here, based on year 2000 data, are the 10 major areas of computer crime in terms of total annual losses reported to the Agency:

	<u>Total Annual Loss</u>
Theft of proprietary information	\$66,708,000
Financial fraud	55,996,000
Computer viruses	29,171,700
Insider abuse of net access	27,984,740
Sabotage of data networks	27,148,000
Unauthorized insider access	22,554,500
Laptop theft	10,404,300
Denial of service	8,247,500
Systems penetration by outsiders	7,104,000
Active wiretapping	5,000,000

In view of the fact that the total cost of computer crime reported to the FBI in 2001 was double the amount reported for 2000, it is obvious that business organizations and their financial advisors must make renewed efforts to secure computer systems against the sources of criminal activity. This might entail restricting employee access, enhancing passwords, utilizing virus protection software, establishing redundant logging systems to deter malicious behavior and performing a risk analysis with respect to key data assets to identify their value, potential damage from loss and their vulnerability to loss.

## **AGRIBUSINESS**

- The IRS has ruled that the split-off of a family farm in order to further an estate plan by adding to family harmony as well as enhancing overall prosperity of the family meets the business purpose requirement for treatment as a tax-free spin-off. In the ruling, the parents and their two children each owned 25% of a family farm which was held as a controlled corporation. Although the parents participated in major

decisions, the children managed the farm's day-to-day operations. However, the siblings disagreed about the farm's future. The son wanted to expand the farm's livestock business and its debt load, while the daughter wanted to sell the livestock business and concentrate on the grain business. Additionally, the son and daughter's spouses failed to get along. Thus, to enable each child to pursue a consistent business strategy for the business in which each was interested and to enhance their own estate planning, the corporation transferred the livestock business to a new corporation. It distributed 50% of the livestock company to the son in exchange for all of his shares in the farm, and the farm distributed the remaining livestock shares to the parents in exchange for half their farm stock. The result: The daughter managed and operated the farm with no interest in the livestock business and the son managed the livestock company with no interest in the farm. The parents, who now owned 25% of both business, intended to amend their estate plan so the son and daughter would each inherit stock only in the livestock or farming operations respectively. According to the IRS, the stock distribution satisfied the business purpose requirement because it eliminated disagreement on the future of the business, enabling each child to devote his or her undivided attention and apply a consistent business strategy to their respective businesses. The fact that each business would benefit was a sufficient non-tax business purpose to provide for tax-free spinoff treatment even though family harmony and estate planning, two non-tax considerations were present, according to the IRS. Family discord is not unusual when it comes to family businesses, but with the help of a capable professional tax advisor, strategies can often be found to remedy the personal disagreements without incurring any adverse tax consequences.

## **FEDERAL REGULATIONS**

- Since April 15th, resident and non-resident aliens applying for an Individual Taxpayer Identification Number are required to use a revised Form W-7. It requires that, along with the application, applicants submit documents proving their alien status and identity.
- Businesses that issue or redeem or transmit money orders or traveler's checks are required to use a new Form TD F 90-22.56 "Suspicious Activity Report by Money Services Business" to report a money service transaction that is both suspicious and over \$2,000. The new Form replaces Form TD F 90-22.47 "Bank Suspicious Activity Report" and must be filed within 30 days of becoming aware of a suspicious transaction. The report and supporting documentation are required to be retained for a period of 5 years from the date of the filing. An estimated 200,000 businesses, including service stations, convenience stores and grocery, drug and liquor stores will be subject to the new filing requirements when confronted with a suspicious transaction.
- The Supreme Court has ruled that states can force health maintenance organizations (HMOs) to open their networks to all doctors and other health care providers located in their network's geographic region who agree to follow the network's terms and conditions for participation. The decision is considered to be a victory for health care providers and patients but a defeat for health insurers and HMOs. The American Association of Health Plans says the Court's ruling will have little impact since about half the states already have laws requiring health insurers to admit any physician,

pharmacist or other health care provider into a plan.

## **INSURANCE**

- The IRS has issued new guidance with respect to when a viatical settlement provider will be treated as state-licensed for tax purposes. In a viatical settlement, a life insurance policy holder transfers ownership of the policy to the viatical settlement provider in exchange for a percentage of the policy's face value. The provider pays the premiums and when the policy holder dies, the provider receives the full amount of the proceeds. In the usual arrangement, a terminally ill individual utilizes the services of a broker to obtain the most valuable settlement and also to retain confidentiality, and, if the provider is licensed, there are no tax consequences. The IRS guidance provides three scenarios in which states have licensing laws for viatical settlement companies, but in one situation, the state has not yet established a procedure for licensing the viatical settlement providers. Accordingly, the settlement provider would be considered licensed except in the instance where the licensing procedures have not been established. In turn, sellers or assignors of life insurance would be unable to exclude amounts received from the insurance buyer from tax, since the buyer would not be considered licensed under the IRS regulations.
- The IRS says it will more closely monitor offshore insurance scams. It is especially concerned about foreign firms claiming to be insurance companies but are actually passive investment companies. Typically, their objective is to allow investors to convert their untaxed profits into capital gains when the stock is sold. According to the IRS, if these companies are not insurance companies at all, their profits would be subject to regular U.S. income tax.

## **LABOR RELATIONS**

- The IRS says that local communities can set aside up to \$3,000 each, for retirement plans for volunteer firefighters and emergency medical personnel without tax consequences even though they don't get any salary. As long as these arrangements are based on length-of-service, they are deemed to be qualified deferred compensation plans. Thus, the plan contributions are not taxed until they are withdrawn and the distributions are exempted from FICA taxes.
- The IRS and the Treasury Department have overhauled the incentive stock option (ISO) regulations by revising key definitions, deleting obsolete provisions and clarifying the tax treatment of premature dispositions. The revised regulations indicate an ISO is a stock option granted to key employees giving the grantee the right to purchase stock without realizing income when the option is granted or when it is exercised. The grantee has a capital gain or loss when he or she sells or disposes of the stock, which is also the point at which the option is first taxed. Generally, an option must express:
  - < An offer to sell at the option price.
  - < The maximum number of shares acquirable under the option.
  - < The period of time the option is open.

The regulations also specify that ISOs must be granted under a shareholder-approved plan and that they must be exercised within 10 years from the date of grant. Whereas, previously, the plan granting the option and the option itself had to be in paper form, the new regulations permit them to be expressed electronically. Also, the regulations indicate that an ISO may:

- < Provide for cashless exercise;
  - < Give the grantee the right to receive additional compensation when exercised; and
  - < Be subject to permissible conditions.
- How do you get workers to be more productive? Motivate them! According one recent study, the 10 most important employee motivating factors are:
1. Having a challenging environment and increasing responsibility.
  2. Obtaining flexibility in the work schedule and the work environment.
  3. Having job stability.
  4. Getting a pay package which offers base pay as well as incentive compensation.
  5. Receiving ongoing professional development.
  6. Receiving esteem and recognition in the organization.
  7. Having managers and supervisors who neither micro-manage nor ignore workers.
  8. Having an interesting and intellectually challenging job content.
  9. Feeling valued and desired.
  10. Being located in a desirable community.

Unfortunately, many employers still fail to recognize that a stimulative work environment and the opportunity for advancement play a major role in building a motivated and loyal workforce.

- Do you tape employment interviews? Here are some good reasons why it is desirable:
- < It enables you to replay the tapes, refreshing your memory about the interview.
  - < You can review specific answers to key questions without relying on your memory.
  - < Those interviewed are likely to be more careful in providing answers if they know they are being taped.

- < The tapes may provide a record which may protect you if someone claims there were discriminatory reasons for failure to be hired.

## **MARKETING**

- VISA and MasterCard have agreed to settle a lawsuit filed by merchants against the credit card company policy of requiring them to honor all cards, credit and debit, if they want to do business with these card issuers. The policy resulted in the merchants having to pay high fees to banks for processing of debit card transactions. Now that the card companies agreed to accept just a personal I.D. number and no longer require a signature for debit card purchases, the merchants will be able to use lower cost networks such as NYCE, to process the debit card transactions. For some merchants, this could translate into significant reductions in the cost of doing business.
- What do you do if a competitor suddenly lowers the price on a key product your firm sells. You can ignore the reduction and assess the impact on sales, or match the cut in the hope of retaining your market share, or cut even deeper to try and force the competitor to renege on the cut. But there may be a better solution! Provide an extended guarantee, free delivery, faster delivery or some other new feature to the product that will please your customers but will be less costly in terms of lost revenue than matching the price reduction. Here is just one example of a pricing strategy that could fend off a competitor's attempt to take market share away from you.

## **MONEY, BANKING AND CREDIT**

- The sluggish economy is putting greater pressure on company managements to make sound credit decisions. A conservative approach may be to utilize the "Quick Ratio" rather than the "Current Ratio." The Quick Ratio measures a customer's ability to convert assets to cash, and it is obtained by:

1. Adding the customer's cash, securities and accounts receivable
2. Dividing the result by the current liabilities

In general, a ratio of 1:1 is deemed to be satisfactory and reflective of a financially sound business. However, to be even more careful, credit grantors may want to benchmark the Quick Ratio results against industry norms.

- Identity theft is the fastest growing financial crime in the United States. In the most significant case, the criminals made off with \$2.7 million by pilfering over 30,000 passwords used by financial institutions and reselling them for \$30 each to a gang of 20 I.D. thieves in New York. The group used credit report information to take over a number of consumer checking accounts, obtain credit cards and open brokerage accounts in the consumers' names. The crime came to light, when a number of banks whose customer were victims of the identity theft noticed that they were being billed for credit reports they never requested. Experts are predicting that annual losses from identity theft will reach \$1 billion at financial institutions even though banks are rapidly deploying fraud detection software and are also being helped by provisions of

the Patriot Act. It's important for bankers, business owners and the general public to be aware of the enormity of identity theft and to utilize all possible means of preventing its proliferation.

- Companies that use a web site and sell over the Internet must be particularly careful not to be victimized by a customer out to commit an online fraud. Here are some red flags that should make you alert:
  - < Receipt of an unusually large order.
  - < Orders containing a number of units of the same item.
  - < Requirements for overnight or express shipment.
  - < Orders shipped to alternative addresses.
  - < Use of an anonymous e-mail address by the customer.
  - < Repeat orders on the same account at short intervals.
  - < Multiple orders from the same internet provider address using multiple accounts.
  - < Multiple orders to the same shipping address using multiple accounts.

Unfortunately, there is no foolproof way of discerning whether someone is trying to perpetrate a fraud. Therefore, if a customer is unknown to you, require a credit check and obtain bank references before shipping any merchandise. You may lose a sale, but usually this is far better than ending up with a bad debt.

## **PENSION AND ESTATE PLANNING**

- The IRS has sent out inquiries to over 300 companies who claimed deductions for pension plan contributions but failed to file the Form 5500 information returns. This is the second time the IRS has embarked on this project. A previous attempt to find non-filers failed because the IRS used outdated employer I.D. numbers in its search.
- The IRS says the value of an estate cannot be discounted to give effect to the income taxes the beneficiaries will eventually have to pay on distributions from the decedent's IRAs. However, the beneficiaries do get an income tax break on the IRA withdrawals. They are entitled to an itemized deduction for the prorated amount of estate taxes that are attributable to the IRAs. The deduction is not subject to the 2% of adjusted gross income limit that applies to most itemized deductions. This is an often overlooked tax break.
- Although an increasing number of small businesses have some kind of retirement plan, we frequently find mistakes are made which jeopardize the plan and the tax benefits that have been provided participants. Common errors include:
  - < Failure to update plans to comply with changed legal requirements.
  - < Engaging in unauthorized transactions because of failure to adhere to specific plan provisions regarding loans and other matters.
  - < Failing to obtain current and complete beneficiary forms from participants.
  - < Carelessness in communicating benefit options to participating employees.

- < Failure to obtain required spousal waivers when the spouse decides to give up a legal interest in the participant's benefits.

One way of insuring that these shortcomings are avoided is to ask the firm's CPA to provide an annual pension plan review to make sure that the plan is operating in accordance with its terms and that all regulatory filings are made.

- The difficult business environment is causing numerous firms to cut back on employee retirement benefits. An area that is particularly vulnerable because costs are rising rapidly is retiree health insurance. Currently, firms pay about 50% of the premiums on retiree health insurance policies, but about one-fifth of firms are telling new hires they will have to pay the full amount of retiree health insurance premiums themselves. It's projected that only about 10% of workers will eventually have employer provided retirement health insurance. Fidelity Investments estimates a couple retiring at age 60 today would need at least \$200,000 in savings to cover their medical expenses during retirement if they do not have employer provided health insurance protection, even though they would be covered by Medicare starting at age 65. The new environment must be considered in overall pension and retirement planning, and people have to make realistic assessments of their post-retirement financial needs and the strategy for achieving them.
- The IRS has postponed the deadline by which qualified defined benefit plans have to be amended to comply with the final and temporary regulations under Internal Revenue Code sec. 401(a)(9) on required minimum distributions, which were issued in April, 2002. Thus the compliance deadline is postponed until the end of the "Economic Growth and Tax Relief Reconciliation Act of 2001" remedial amendment period which ends no earlier than the first day of the plan year beginning on or after January 1, 2005. We can provide further guidance.
- The IRS has issued new guidance for 457(b) deferred compensation plans with respect to annual deferrals and contributions. The changes were needed because of modifications required by the Growth and Tax Relief Reconciliation Act of 2001. The latest guidance addresses:
  - < Income tax withholding and reporting for annual deferrals made to a 457(b) plan
  - < Income tax withholding and reporting for distributions from 457(b) plans
  - < FICA payment and reporting for annual deferrals

## **PERSONAL FINANCIAL PLANNING**

- Section 529 college savings plans have fared poorly during the period of the declining stock market, and many people who intended to build a tuition nest-egg for children and grandchildren are finding they have suffered significant losses. One bit of good news is the losses are tax deductible. IRS regulations provide for deduction of losses in excess of 2% of adjusted gross income. However, the determination of whether you actually incurred a loss is deferred until the time you withdraw the funds. Then, to the extent the account balance is less than the contributions you actually made to the account, you'd be entitled to take a loss deduction.
- Have you made a loan to a family member or a friend which was not repaid? Have

you been required to make good on a guarantee for which you received a consideration, or have you incurred losses on loans in connection with your investments? In each case you have incurred personal or (non-business) bad debts. Personal bad debts are deductible only if they are worthless, and they result in short-term capital losses regardless of how old they may be. That means if they and your other capital losses exceed your capital gains, you can only write-off up to \$3,000 of the excess against your ordinary income. However, when it comes to personal loans, you must establish that there was a valid debt which is now worthless or the IRS may characterize the transaction as a gift and deny any deduction. To overcome such an IRS assertion, you'd have to be able to show there was (1) an underlying promissory note which included the terms of the loan including interest and the repayment schedule, and (2) you made an effort to collect the loan, such as taking court action. Since the deduction is only available in the year the debt becomes worthless, you'd also have to pinpoint an event in the year as proof, such as the borrower's declaration of bankruptcy. Because worthlessness of a personal bad debt is so difficult to establish, the tax law provides a special 7-year statute of limitations for amending a prior return to claim a bad debt write-off. In effect, you have a 7-year period from the due date of the return for the year in which the debt became worthless, to file an amended return and make a refund claim. Although intra-family loans and other personal loans are often unavoidable, we frown upon these transactions because of the difficulty in obtaining tax relief in the event they go bad, but more so, because they can be the source of great bitterness and permanent alienation among friends and family members.

- Not all tax shelters are on the IRS "abusive" list. Here are 5 tax shelter areas that are perfectly legal. They may make investment sense for people looking for yield as interest rates on conventional investments decline.

1. Low income housing
2. Rehabilitation tax credits
3. Equipment leasing
4. Research and development
5. Oil and gas drilling

Of course, these are often high-risk ventures, so it is essential to fully understand these investments, the track record of the promoters and managers, and the risk before any funds are committed.

- Many people are unaware alimony may be used to fund an IRA. The reason is that it is considered "taxable compensation" under the tax code. Therefore, a taxpayer can use it to fund an IRA contribution even if he or she has no other earned income.
- Although the stock market decline of the past 3 years hurt all investors, elderly people between the ages of 50 and 70 were especially hard hit according to the AARP. In this age group:
  - < 70% said they lost money in the market over the past two years, and one-third acknowledged losing over 25% of their investments.
  - < 67% indicated their losses have caused them to change their lifestyles, to take

fewer vacation and to budget daily expenses.

These revelations are particularly regrettable since these people have the least chance in the population of recovering their losses. Now they are being hit with a second whammy - the deliberate policy of driving down interest rates. Since many of the elderly are pensioners and dependent on the income from investments, they are being driven into taking on excessive risk in order to meet their living needs with potentially dire consequences. In light of this situation, it is not surprising that the suicide rate among the elderly is six times as great as for any other age group. Incidentally, we urge readers who are being squeezed to seek professional help with financial planning rather than engage in some desperate act.

## **REAL ESTATE**

- In general, if a taxpayer is forced to sell a principal residence before owning and using it for at least two years, gain on the sale can be excluded from income only if the sale was due to a change in place of employment, health reasons or unforeseen circumstances. Since "unforeseen circumstances" is a vague term, the IRS issued temporary regulations towards the end of last year, providing a list of safe harbor events which would be considered to be "unforeseen circumstances." One of these events is divorce or legal separation under a decree of divorce or separate maintenance. Thus, if there is a qualifying sale, the taxpayer would be entitled to claim a reduced maximum exclusion based on the exclusion limit of \$250,000 (\$500,000 for certain joint filers), prorated for the portion of the two-year period in the five years prior to the property sale, that the taxpayer owned and used the home as a principal residence. The IRS temporary regulations can retroactively benefit a home seller, and recently the IRS issued a private letter ruling to a taxpayer who sold her home in 2001 after being divorced, indicating she could claim a reduced exclusion limit under the 2002 temporary regulations. She was forced to sell the property because she could not afford the mortgage payments after her divorce. The IRS said the amount of the exclusion depends on her ownership/residence period prior to the sale. Thus, if she sold the property after meeting the ownership/residence requirements exactly for one year at the time of the sale, her exclusion limit would be \$125,000, half the amount of the exclusion limit for a taxpayer who satisfied the two-year test. Homeowners are favored by the Internal Revenue Code in a number of ways, and it is important to obtain professional tax advice with respect to home sales, refinancing, renovations and improvements, use of a home office and similar matters to maximize the tax benefits.
- Recent IRS regulations clarify that the gain from the sale of the home office portion of a home can qualify for the full \$250,000/\$500,000 capital gains exclusion on the sale of a principal residence. Thus, there no longer is a need to allocate the exclusion amount between the portion of the home that was used for business so long as the business and personal portions of the property are within the same dwelling. However, any depreciation the taxpayer may have taken on the home office after May 6, 1997, has still to be reflected in income and is subject to a 25% capital gains tax. Many homeowners did not take home office deductions in the past because they were fearful that the deduction could impair their capital gains exclusion in a subsequent sale of the property.

- Do you own or manage commercial or rental property of modest size? If you are looking to find economical means of attracting potential tenants, here are some suggestions:
  - < Form alliances with Realtors, employers in the area, bankers and others who are likely to have contact with people desiring to rent.
  - < Get on the Internet to look for sites that list rental vacancies and contact the companies to determine whether your listings can be included.
  - < Have eye-appealing flyers printed and distributed at key places in the neighborhood where there is extensive traffic.
  - < Make arrangements with major employers to place listings for residential vacancies on company bulletin boards.
  - < Join local community organizations and attend community meetings as a source of potential referrals.
  - < List your property with an Internet-based marketing company that's directed at the real estate market from which you hope to attract tenants.
  - < Organize continental breakfasts, donuts and bagels, and free rent contests to attract renters and promote apartment rentals.

These procedures usually involve very little cost, and can often be effective in filling vacant space.

## **TAXATION**

- The IRS says relatives of men and women in the military and individuals with e-mail accounts are being targeted by new tax scams. In the first, the scammer claims that because they have a relative in the service, they are entitled to a special tax refund if they pay for postage using a credit card. The scammer then steals the credit card number and the person's identity. In the second situation, the e-mail account holder receives an e-mail which claims to be from the IRS and requests personal financial information from the recipient. Again, the purpose is to steal the taxpayer's identity in order to carry out a theft. Taxpayers who are the targets of either of these scams should immediately contact the Treasury Inspector General for Tax Administration at (800) 366-4484.
- The IRS is providing a variety of tax relief for all regular and reserve members of the Armed Forces in Operation Iraqi Freedom. The relief applies to those serving in the "Arabian Peninsula" area under the combat zone designation which remains in effect after being established in the 1991 Gulf War. Thus:
  - < For enlisted members or warrant officers who serve in the combat zone for any part of a month, all military pay received during the month is excluded from gross income. For commissioned officers the combat pay exclusion is limited to the highest enlisted pay plus hostile fire/imminent danger pay. The maximum

exclusion for 2002 was \$5,532.90 per month, and for 2003 it is \$5,882.70 per month.

- < Deadlines are extended for filing tax returns, paying taxes, filing claims for refunds and taking other actions such as making IRA contributions. The extensions apply to military personnel serving in the combat zone and those outside the zone who directly support combat forces and are generally for up to 180 days after the last day in the combat zone. During the extension period, IRS assessments and collection deadlines are also extended and no interest or penalties attributable to the extension period are charged. The extension deadlines also apply to spouses of combat zone personnel regardless of whether a joint or individual return is filed.
- < To obtain a tax refund, a civilian spouse in the U.S. may sign a joint return for the overseas spouse without a power of attorney to act as agent, provided the return is accompanied by a signed written statement explaining that the spouse is serving in a combat zone.
- The IRS has announced percentage depletion on marginal oil wells will remain at 15% for 2003. Thus, independent producers and royalty owners can take 15% depletion on oil and gas extracted from stripper wells and wells producing heavy oil this year. According to the Agency, the rate won't change until crude oil drops below \$20 per barrel.
- The IRS has made the Fast Track Settlement and Mediation Programs permanent. The Mediation program is available to taxpayers in the Small Business and Self-Employed Division while the Settlement program is operated by the Large and Mid-size Division. Both programs provide a process for quick resolution of disputes with the IRS before an audit of the tax return is complete in order to avoid lengthy litigation and appeals.
- The IRS says taxi cab companies can avoid cash information reporting rules on rent paid by drivers. As an accommodation to some owners of taxi fleets who have failed to file cash reports on drivers who lease their cabs daily and pay a total of \$10,000 or more in a year. The Agency says it will waive the cash reporting requirement if the rent paid is \$150 or less per day and the rental agreement can be ended at will. The cab companies claimed that keeping track of the rental payments was too complicated.
- The IRS is conducting about 50,000 random audits of taxpayers to obtain information regarding tax compliance. The most thorough of these are intense interview and calibration audits which call for a line by line examination of each item on the tax return. IRS agents are free to ask for bank records in random audits, and when a taxpayer who filed a Schedule C or F is selected for audit, the request for banking records is automatic, regardless of whether the examining agent suspects the existence of unreported income. Depending on the complexity of the tax return, it will probably be desirable to have a CPA or tax attorney involved with intense interview and calibration audits. The new IRS scrutiny is another strong argument for having your tax returns prepared by a competent professional tax advisor.

## **PAYROLL TAXES**

- The new tax law lowered the income tax rates of most workers, so employers need new withholding tables to give effect to the change. The IRS says it now has the tables on its Web site and that copies should have been received by employers. Although the tax cuts are retroactive to January of this year, the revised tables are not retroactive. Therefore, employees who want to adjust for this and lower their total withholding for the year might file a revised W-4 form claiming an extra exemption. Unless Congress modifies the law, after 2004 the tax rates will revert back, so withholding will have to be adjusted again.

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](mailto:info@facpa.com).