December 1, 2003

COMMENTS - DECEMBER, 2003

ACCOUNTING AND AUDITING

- The Securities and Exchange Commission has issued Staff Accounting Bulletin No. 103, *"Update of Codification of Staff Accounting Bulletins".* It revises and rescinds portions of the interpretive guidance included in the codification of staff accounting bulletins for the first time in 20 years to make this guidance consistent with current authoritative accounting and auditing guidance and the SEC rules and regulations. This is an initial step in the Agency's plan to make the entire collection of SABs available on the SEC web site.

- Pursuant to Financial Accounting Standards Board Statement No. 142, identifiable intangible assets must be recognized separately from goodwill and <u>may</u> have to be amortized. But, if there has been no impairment of value, amortization is not required, although these assets become subject to impairment testing annually. Managements of many companies are pleased with the change since it no longer requires automatic annual charges for amortization and may provide earnings enhancement. Before celebrating, though, we suggest management carefully consider the consequences of the new accounting rules. There are very few and rare intangible assets which have immortal value. Thus, instead of having annual predictable write-offs against earnings, these are being replaced with a lot of potentially unpredictable and lumpy write-offs stemming from legal, regulatory, contractual, competitive, economic or other factors that limit an asset's useful life. In turn, this can play havoc with earnings from period to period and investors' perception of a company's value.

- A recent study by two University of Kansas professors refutes recent arguments by Federal regulators that non-audit services being provided by independent auditors compromise the quality of audit services being rendered. The study was based on results from 944 companies covering the period from 1995 to 2000. It found:

  - Information obtained by independent auditors providing tax services had a spill-over effect which actually enhanced audit services.

  - When fees were obtained for rendering financial information systems design and implementation, or for internal audit services there was no indication that auditor independence was compromised.

  - Among the 72% of companies sampled that purchased no other services than audit services from their audit firm there was no discernible difference in the rate of financial statement restatements versus those firms that purchased non-audit services from their auditing firms.

  A number of Federal regulators who have been accused of lax supervision of publicly-held companies and their auditors have tried to fend off criticism by blaming the audit failures and massive frauds that have been publicized in the press on unseemly relationships between companies and their independent auditors.

ADMINISTRATION, SYSTEMS AND EDP

- Although more people are turning to the Internet for information about airline tickets, hotel reservations, automobile purchases and a variety of other matters, the number who are using the Internet to get assistance with medical concerns or to obtain health care information is hardly growing because the data available is inadequate to meet their needs. To find out what information would be useful, CIGNA, the insurance company, conducted a survey of 1,000 Internet users. Here are the results:

  - 91% said an online service that lets them learn more about a disease or condition which may affect them and their family would be useful.

  - 81% indicated they would value an online tool which helps them compare the quality ratings of hospitals before going in for a medical procedure.

  - 82% said that an online tool lets them compare the effectiveness, cost and alternatives for prescription drugs would be highly desirable.

  - 80% believed information enabling them to determine the chances of developing certain diseases and conditions would be very beneficial.

  Medical care providers who want to enhance traffic to their web site might pay particular attention to these survey results.

- Do you have outdated compact disks that contain confidential data about customers, vendors, employees or business associates? Common practice is to store them for a specified time after which they are disposed of. We urge you to make the CDs unreadable before throwing them out. They may contain vital information such as social security numbers, bank account numbers, investment account information, insurance data and other confidential information which may be used to perpetrate identity theft or to obtain company or personal assets. For about $50, you can obtain an embossing machine that makes CDs unreadable. Alternatively, there are CD shredders, but their cost may run as high as $1,000. Of course, if you maintain data on CDs in connection with your personal record keeping, similar security measures are required.

- The Gartner Group, a management consulting firm, claims 60% of mid-sized businesses will deploy wireless local-area networks within their premises by the end of the year. This shift is a byproduct of low cost and wireless connectivity that has pushed middle-sized businesses towards utilizing mobile personal computers in the past few years as PC vendors incorporate wireless capabilities into their products. It's expected mid-size businesses which have invested in wireless technology to lower their operating costs should break even on their investments within two to three years. Incidentally, wireless Internet access in the home and in public places is also increasing rapidly as PC vendors incorporate wireless capabilities into their products.

- Uncertain business conditions have caused businesses to tighten up travel policies, lower the amount of travel and use more stringent criteria about providing reimbursement. According to business travel news, in 2003, one can expect:

  - Reduction in business trips at 62% of respondents

  - Use of non-refundable tickets and advance purchase of air travel to cut costs at 52% of respondent companies

- Utilization of low-cost airlines to reduce cost at 42% of responding firms
- Restrictions on meeting attendance at 39% of firms to reduce travel outlays
- Tightening of expense report procedures at 43% of respondents

When it comes to failure to provide proper documentation in support of expense reports, respondents pursue the following policies:

- Refuse reimbursement of undocumented expenses
- Submit an exception report to the traveler's supervisor
- Issue a formal reprimand to the traveler
- Submit an exception report to the employee

Only 21% of the companies participating in the survey take no action when expenses are inadequately substantiated. Incidentally, in a Private Letter Ruling dealing with reimbursement of travel and entertainment expenses, the IRS recently indicated use of a plan that allows employees to fill out reports online and use online credit card statements instead of paper receipts would be treated by the Agency as an "accountable" plan because it met IRS accounting and record keeping requirements. This could facilitate more efficient processing of expense reports for many businesses. In light of the changed business climate and IRS substantiation policy modifications it is desirable for all company managers to evaluate whether existing travel and expense reporting practices are appropriate.

■ Following are the leading corporate security threats. If you have not evaluated the possible impact of these problems and established protective systems and procedures, you should act without further delay.

- Employee theft
- Workplace violence
- Fraud and other forms of white collar crime
- Hardware and software theft
- Unethical business conduct
- Kidnaping and other executive threats
- Internet systems break-ins
- Intellectual property theft
- Property crime

AGRIBUSINESS

■ In Advice Memorandum 200325002, the IRS' Chief Counsel has indicated annual rental payments received by an individual taxpayer for land enrolled in the Conservation Reserve Program (CRP) constitute self-employment income is subject to SECA taxes where the taxpayer (1) was engaged in the trade or business of farming prior to enrolling the land in the CRP, and (2) and had personally fulfilled the CRP contractual obligation.

FEDERAL REGULATIONS

- The SEC has adopted rules governing management's reports on internal control over financial reporting and certification of disclosures in Exchange Act reports. The rules require each annual report of a company, other than a registered investment company, to contain: (1) a statement of management's responsibility for establishing and maintaining an adequate internal control structure and procedures for financial reporting, and (2) management's assessment, as of the end of the company's most recent fiscal year, of the effectiveness of the company's internal control structure and procedures for financial reporting. The rules also require management to disclose any material weakness and won't permit management to conclude the company's internal control over financial reporting is effective if there are one or more material weaknesses in such controls. Company auditors are also required to attest to and report on management's assessment of the effectiveness of the company's internal controls and procedures for financial reporting. Compliance with the regulations regarding management's report on internal control will be phased in as follows:

  - Companies other than foreign private issuers meeting the definition of an "accelerated filer" in Exchange Act Rule 12b-2. Generally, U.S. companies that have equity market capitalization over $75 million and have filed an annual report with the Commission will have to comply with the requirement for fiscal years ending on or after June 15, 2004.

  - All other issuers will be required to comply for their fiscal years ending on or after April 15, 2005.

- Here is a reminder that money service businesses (MSBs), must register with the Department of the Treasury and report "suspicious transactions" pursuant to the Bank Secrecy Act, in order to prevent money laundering and terrorist financing. MSBs are businesses which provide any of the following: money orders, check cashing, traveler's checks, money transmission or currency exchange services. Registration is not required if a business providing these services is the agent of another MSB. For example, if a business sells money orders issued by another company, it is not required to be registered. Also, businesses which do not conduct $1,000 or more in business with any one person on any day are not classified as an MSB and may not need to register. However, this threshold does not apply with respect to money transmission services. If you are uncertain about the applicability of the rules for your business, you can obtain information by calling (800) 800-2877.

INSURANCE

- The American Society of Aging reports 70% of respondents to a survey indicated they think it is important to have long-term care insurance, yet only 17% have purchased this type of protection. The reason for the disconnect is probably two-fold. On the one hand, the rise in health care costs, nursing home costs and in-home care costs and the marketing skill of the insurance industry have made many older people fearful a major illness may bankrupt them. On the other hand, the high cost of adequate long-term care insurance has put this protection out of the reach of many older individuals. However, competition among insurers has heated up, and many people find flexibility built into newer types of insurance products can now make this insurance affordable. For example, modifications in the level of coverage provided, in the benefit period and in the waiting period before benefit payments begin, are just some examples of factors that can lower the cost. There has also been favorable tax legislation governing long-term care insurance which may make it possible for policy owners to deduct policy premiums as medical expenses and to obtain benefits tax-free, further lowering the cost of this type of insurance.

- The litigation "epidemic" can impact many homeowners. An increasing number of domestic workers such as chauffeurs, cooks, gardeners and nannies, are suing their ex-employers and claiming wrongful termination, sexual harassment and employment discrimination. As a result, several insurers are now providing employment practice liability insurance to homeowners to protect against these types of lawsuits. Policy premiums are about $650 per year. They provide coverage for up to $250,000 for a judgment or settlement plus legal fees, and include a $10,000 deductible. There is little available data about how prevalent these lawsuits are, but the risk has, generally, been considered minor, since many of the domestic workers are here illegally and unlikely to expose themselves to possible deportation.

- Are your workers' comp insurance costs going up steadily? Here are two possibilities for minimizing the escalation:

  1. Review your worker classifications. Classifications are based on the likelihood workers will collect premiums from the insurer for work related injuries and accidents. Frequently, workers can be reclassified and premiums reduced because they are engaged in low-risk activities.

  2. Pay premiums monthly rather than annually based on projected estimates determined by the insurer. Frequently, companies that pay annually pay in too much. Although the excess premiums are eventually reimbursed, in the interim the insurer is provided with an interest-free loan, and there is also a negative impact on cash flow.

LABOR RELATIONS

- The IRS is trying to help companies minimize costs while providing employee benefits in the face of rising medical expenses. In a new ruling, the Agency says it will allow tax-free payment/reimbursement of flexible spending accounts to be made via debit or credit cards and other electronic media, provided adequate controls are in place to insure only medical costs are reimbursed. The IRS ruling covers two situations: In one, employees are issued a debit or credit card restricted for use for eligible medical expenses at employer-authorized merchants or service providers. In the other, credit cards are issued to employees carrying a limit equal to the coverage available under the health plan and usable only at employer-authorized merchants or service providers. In both situations, the IRS has indicated it would consider the charges on the credit or debit card fully substantiated as medical expenses and are excluded from the employees' gross income provided the arrangements have the following attributes:

  - The employee retains receipts or documentation for any expenses paid with the card;

  - Transaction dollar limit equals the co-payment for that service;

  - Recurring expenses match previously approved expenses as to amount, provider and time period;

  - Point-of-sale verification is made by the merchant or service provider that the charge is for medical expense; and

< There is pre-authorization for additional charges for treatment at a physician's office.

The IRS says approval of these types of plans is also contingent on existence of adequate employer procedures: for identifying improper payments; requiring employees pay back any improper expenses charged, and requiring the employer furnish doctors and other health care providers with Form 1099 if payments made to them are $600 or more.

- The IRS is targeting abusive welfare benefit trusts. Welfare trusts are often established by employers to provide workers with such benefits as medical insurance, disability protection and life insurance coverage. When such plans are collectively bargained, severe restrictions on tax deductible pay-ins do not apply and the cost of the benefits provided can be pre-funded. The IRS is looking for situations where the employer negotiates a plan with a promoter which provides most of the benefits for key employees with little going to rank and file workers. The IRS claims that the deduction caps don't apply because the plan was "negotiated" and not the result of good faith bargaining. The IRS says that employers who utilize this tax scam must disclose it on their tax return or face severe penalties but, obviously, this flags the abusive welfare benefit trust for IRS auditors.

- Under the current tax law, capital gains and dividends are taxed at a maximum rate of 15%. On the other hand, capital gains and dividend distributions from 401(k) plans are taxed at ordinary income tax rates as high as 35%. This provides an opportunity for tax planning for 401(k) plan participants who own appreciated stock of their employer in their 401(k) plan. The law provides that 401(k) participants can take distributions "in kind" of the employer stock without paying current tax on the appreciation. Furthermore, the appreciation becomes subject to the lower capital gains tax only at the time the stock is sold. For example, if the employer stock in your 401(k) account was worth $20,000 when you acquired it and today it is worth $60,000 and if you take the stock's value in cash from the 401(k), you will owe tax on the full $60,000 at ordinary tax rates. Conversely, if you took the shares themselves from the 401(k) you will owe tax at ordinary rates only on $20,000 while the $40,000 of appreciation in the stock's value is taxed at the tax favored long-term capital gains rates, only when you sell the shares. Meanwhile, any dividends you receive an the employer stock will also be taxed at a maximum 15% rate. Of course, before taking any distributions from a 401(k) plan, it is essential you obtain professional tax advice.

- Wrongful termination lawsuits are growing by leaps and bounds. One way an employer can protect itself is by devising a disciplinary action form that is filled out and signed by both the company and the employee whenever a disciplinary action occurs. The form should provide for a brief description of the circumstances and the corrective action required of the employee. Not only could the form provide evidence if there is eventual litigation between the company and the employee, but more important, use of the form may be effective in modifying employee behavior so termination is entirely avoided.

MARKETING

- A number of supermarkets are adopting automated cash-back checkout systems that provide for free cash withdrawals. These point-of-sale systems let the customer withdraw funds using their personal identification number-based debit card accounts. This enables the customers to withdraw cash without paying surcharges or fees. Because of the popularity of these cash-back systems, some chains are now extending them to their automated self-checkout systems. Since these systems are already designed with ATM hardware, it is a relatively simple process to program them for cash withdrawals.

- You've heard of "driver-rage" and now there is "customer-rage." The Customer Care Alliance reports an increasing number of frustrated consumers are taking out their anger on customer service representatives with whom they are dealing. It conducted a survey which indicated 8% of customers have cursed the service rep and 28% admitted to having raised their voice and shouted. The Alliance also found 45% of households experienced at least one serious problem with a purchase and more than two-thirds became enraged over the way the merchant handled the incident. One reason for customer rage is people try to resolve their problems over the phone instead of in writing, and they are bounced to different service representatives each time they call. That's because the service representative with whom they make initial contact is not empowered to resolve serious complaints. In turn, the customer feels he or she is getting a run-around. Fortunately, these incidents usually do not end in violence, although in 3% of the cases there is litigation. One way to pacify an unhappy customer and prevent a retailer from being bad-mouthed is to send a personal letter of apology over the incident.

MONEY, BANKING AND CREDIT

- The IRS has eased the reporting requirements for financial institutions in connection with Coverdell Education Savings Accounts. New regulations reduce the requirements for reporting 2003 distributions from these accounts on Form 1099-Q and also lower the reporting requirements for basis and earnings information. This is because many financial institutions had not collected the historical account information necessary to calculate the basis and earnings portion of gross distributions for reporting 2003 distributions. The new rules provide that, if a custodian or trustee cannot calculate the earnings and basis portion of a 2003 distribution from a Coverdell ESA, it will be deemed to satisfy the reporting requirements if 5 items are reported on Form 1099-Q. They are:

  - Gross distributions, including the amount of an excess contributions and earnings distributed during the calendar year in box 1;
  - All other required information except for earnings and basis information in boxes 2 and 3 which, generally, should be blank;
  - Amount of any earnings on excess contributions in box 2;
  - An indication that the amount in box 2 includes excess distributions; and,
  - The fair market value of the Coverdell ESA.

  The IRS says it will provide more guidance about reporting distributions next year, but until then, custodians and trustees may rely on the current modifications.

- Is your firm providing purchasing personnel with prepaid cash value cards that enable them to make purchases from office suppliers and other vendors? If so, remind the employees that, if they have a small balance left on the card, to have the vendor transfer it to the new replacement card. Research shows that about 10% of the stored value card's original balance is usually left when the card is replaced, giving the vendor an unintended loan, and possibly, a permanent windfall.

- Many hospitals and medical practices have large outstanding receivables stemming from an inability to properly code claims and also because they failed to compare the organization's fee schedule with the payer's schedule and did not identify opportunities for increasing their claims. Because of this, some accounts receivable collection firms are now offering a full menu of services ranging from pre-registration to collection of charged-off debt to the hospitals and other medical care providers. Among other things these "charge masters" offer:

< Review medical records and send in certified coders to be sure all documentation and billing is done correctly and to clear up backlogs

< Review codes for validity and reportability to maximize revenue

< Identify opportunities to enhance revenue by comparing the organization's fee schedule with that of payors

Since the amounts that can be recovered are often substantial, hospitals and medical practice groups are increasingly outsourcing their billing and collection practices to these charge master firms.

- Some businesses are utilizing lawyers to write collection letters to customers as a more economical means of recovering receivables than litigation. Attorneys' fees are much lower for this service than if litigation is undertaken. Since the envelope with the attorney's return address could indicate a legal notice is enclosed, that might indicate the initiation of litigation or worse, these letters get considerable respect from delinquent debtors and often lead to payment or a negotiated settlement of the amount owed. However, if there is no response, the business owner must follow up, since threatening legal action without any intent is illegal.

PENSION AND ESTATE PLANNING

- In order to help small business retirement plans become compliant with Federal regulations, the IRS is granting them more leeway to correct minor flaws without fear of disqualification. New regulations allow plans to fix inadvertent errors involving eligibility, limits on contributions, anti-discrimination tests and make other corrections, while paying only a modest penalty. The relief program has also been expanded to cover SEPs and SIMPLE-IRAs. The Agency has sample petitions to facilitate the ability of firms to obtain help. For more information about the new IRS rules and assistance in correcting retirement plan flaws, get in touch with us.

- The Employee Benefits Research Institute reports the bear market in stocks and lack of savings have not diminished worker confidence they'll be able to retire comfortably. Sixty-seven percent of the workers polled indicated they were "very" or "somewhat" confident about their retirement. At the same time, 61% of the workers acknowledged they had not calculated the amount they needed to save in order to retire and among those who claimed to have made a calculation, 36% could not recall how much they needed to save. Furthermore, 66% of those claiming to have made a retirement savings calculation admitted it was based on personal financial data prior to the stock market demise. The blind optimism reflected by many in the survey is unfortunate because it delays any serious planning and implementation of retirement strategies. We urge people to have a retirement savings plan in place by the time they reach the prime of their working lives so they will be able to enjoy a comfortable retirement.

- The IRS has issued final regulations enabling workers over age 50 in the years 2003 to 2006 to make extra catch-up contributions into their 401(k) plan, 403(b) annuities and 457 governmental pension plan. as well as into SIMPLE IRAs, SEPs and SARSEPs. The amount of extra contributions are limited as follows:

2003 - $2,000; 2004 - $3,000; 2005 - $4,000, and 2006 - $5,000

Note: Employers are <u>not</u> required to accept extra 401(k) contributions, and the pay-ins are permitted only if all eligible workers other than union employees, can make them. The exclusion of union employees is designed to prevent a union that refuses a firm's offer to add the catch-up feature from having veto power over excess contributions for all of a company's workers.

■ The IRS has lowered the penalty on pension plan reversions. Thus, the 50% excise tax on the funds the employer retains has been lowered to 20% if at least one-fourth of the reversion is put into a replacement plan covering most of the pension plan's members. Earlier, the IRS had taken the position that employers qualifying for the lower rate had to pay the excise tax on three-fourths of the reversions even if they contributed more than 25% of the excess funds to a replacement plan.

■ Following are some of the most common and serious mistakes people make in estate planning:

- Failure to develop an individualized estate plan
- Neglecting to properly fund a living trust
- Forgetting to take advantage of the applicable estate tax credit amount when the first spouse dies
- Failing to maximize the use of gift tax exclusions
- Titling property incorrectly

The result is that far greater amounts of taxes end up being paid to Uncle Sam than might other wise have been necessary. That's one reason we have for urging readers not to delay estate planning with their professional tax advisor. After all, none of us can be sure about our longevity.

■ The IRS has extended the deadline for pre-approved plans to apply for GUST determination letters once again to January 31, 2004. The Agency has also given defined contribution plans more time to comply with recently issued required minimum distribution regulations that simplify the computation of required minimum distributions and give participants a longer period over which they can take distributions. The deadline for amendments to comply with the minimum distribution regulations is now extended to the end of the GUST remedial amendment period or the last day of the first plan year beginning on or after January 1, 2003.

PERSONAL FINANCIAL PLANNING

■ Huge golden parachute awards to executives and lavish displays of wealth by some highly visible people such as entertainers, athletes and stock exchange regulators have many people concerned there is an ever widening gap developing between a small affluent minority and the rest of the nation. Although the politicians have used the wealth disparity for political gain, now there is some hard data dealing with the wealth distribution in the United States. Ernst & Young reports that:

- Households with incomes under $100,000 comprise 82% of all households but control just 11% of the wealth.

< Households with between $100,000 and $1 million of income comprise just 15% of all households but control 33% of the wealth.

< Households with $1 million to $5 million of income represent just 2% of all households, but control 31% of the wealth.

< Finally, households with between $5 million and $10 million of income, an insignificant number of households, control 10% of the wealth.

The data seem to support those who argue that the 1990s created a huge disparity of wealth that could polarize the society. Fortunately, we've had a fairly effective self-balancing economic system that tends to smooth out wealth bubbles which benefit only a few.

■ The Oppenheimer Funds recently surveyed 1,000 people with children and grandchildren ages 8 or under to determine whether they were making adequate financial preparations to enable them to attend college. It found that 58% weren't saving at all for college education expenses and 68% had never bothered to project the amount that might be needed to pay for a college education. Meanwhile, 56% of those who did try to figure it out thought they would need to save less than $75,000, an amount that is clearly inadequate. When advised of the true costs, 20% said they would rely on financial aid; 20% hoped for an academic or athletic scholarship; and 19% said they would start saving in the future.

■ Want to sell your business to your children and avoid gift and estate taxes? Here are some possibilities:

< Sell the business on the installment basis. It lets you defer the capital gains tax over the life of the arrangement and lets you remove the value of the shares and any future appreciation from your estate. Low interest rates are favorable for this type of strategy because the payments the children must make will be less burdensome than when rates are high.

< To avoid having a portion of the business value revert back to your estate in the event all of the installment payments have not been received upon your death, sell the shares to the children and take back self-canceling installment notes that have a zero value upon your death.

< Let the company make a corporate redemption if the company has surplus cash. Here, the company buys back the shares. Assuming one or more of your children are also shareholders, if the company redeems your shares they will become the sole owners of the business.

< Utilize a private annuity. Here, the shares are transferred to the child (children) who agree to make lifetime payments to you with the amount based on your life expectancy and the valuation of the business. This can remove the value of the business and any future appreciation out of your estate and also avoid gift taxes. One advantage of using an annuity is that if the seller dies before reaching his or her life expectancy no further gift, estate or income tax will be due. This strategy might be suitable to a seller who is in poor health.

These are just some possibilities and ideas to mull over. Development of a business transfer strategy requires exhaustive evaluation with your financial and tax advisor of many factors beyond merely the tax and financial considerations, including the ability of one's children to carry on the business, willingness of children to run the business, the seller's psychological state with respect to surrendering control and family rivalries which exist or might be initiated.

- Consumers booking vacation tours next year will be at greater risk of losing their money if the tour operator goes out of business. The National Tour Association (NTA) which represents about 640 tour companies is discontinuing its 15-year old consumer protection program has refunded customer payments if member firms went out of business. The reason for the change is the cost of the program has become too expensive. This year alone, the NTA has paid $565,000 in refunds in connection with six member firms that closed down. You can protect yourself against the added risk by paying tour expenses with credit cards since the Fair Credit Billing Act enables credit card customers to obtain refunds within specified time limits if goods or services paid for are not received. Alternatively, you can purchase travel insurance which may provide protection against trip cancellation or delays, or financial default (bankruptcy), and can even provide medical coverage if a traveler becomes sick or injured. Some insurers also post lists of companies they won't cover in the event of bankruptcy or default. Insurance typically costs between 7% and 10% of the trip's total cost.

REAL ESTATE

- The IRS has issued a procedure and a ruling which allow greater flexibility in the treatment of section 1031 like-kind exchanges (typically automotive, heavy equipment, rail car and medical equipment leasing programs). The revenue procedure provides safe harbors with respect to programs involving ongoing multiple exchanges of tangible personal property using a single intermediary, and the revenue ruling facilitates, by means of "netting" treatment, deferred like-kind exchanges of properties with liabilities that span two tax years, particularly in a partnership setting. To qualify as a like kind exchange program, there must be an ongoing program involving 100 or more properties and the program must meet numerous characteristics spelled out in the regulations for obtaining safe harbor tax treatment. The regulations also explain that, where a partnership enters into a transaction that qualifies as a deferred like-kind exchange in which the property subject to a liability is transferred in one taxable year while the exchange property is received in the following year, the liabilities may be netted under Internal Revenue Code section 752. In these circumstances, any net decrease in a partner's share of partnership liability is taken into account in the initial tax year, while any net increases in the partnership's share of partnership liability is taken into account in the second taxable year of the partnership.

- Here is a reminder to taxpayers that home sales made after a divorce can qualify for a reduced exemption under the home sales exclusion rules even though the two year use-and residency tests have not been satisfied. In one recent situation, a woman who got the house in a divorce settlement had to sell it quickly because she was unable to make the mortgage payments on her own. The IRS advised her a partial exclusion is available on the sale. The percentage of the $250,000 capital gain exclusion the seller can claim depends on the portion of the two-year period she owned and used the home. For example, if the property was sold after one year, $125,000 of the gain or 50% of the maximum amount could be exempted could be excluded.

- Many people have been afraid to take a home office deduction because they worry the deduction would raise their taxes when they sold the home and also the deduction would be a red flag for an IRS audit. But recent tax law changes eliminate the tax cost of having a home office in a home that is sold and also make it easier to support a deduction for a home office. The new rules indicate that, even though a home office is treated as a business property when taking a business deduction, it still qualifies as a residential property at the time the home is sold. In effect, if you use part of your home for business, you can treat the entire dwelling as your residence for purpose of taking the capital gain exclusion at the time of sale, provided the home was used as your primary residence for at least two of the prior five years before the sale. Under former regulations, the gain attributable to the home office would be treated as taxable gain on business property and not qualify for the exclusion. The new rules still require recapture of depreciation claimed on a home office after May 6, 1997, which is taxed at a 25% rate.

Another change in the regulations makes it easier to qualify for a home office deduction. Under the old regulations, the IRS said in order to qualify for the deduction, the home office had to be the principal place of business. For example, if a doctor worked at a hospital but had no office there, and had to keep his or her records at home, the home office was not deductible. Under the new rules, the necessity of having to have a home office justifies its deduction even if most of one's work is done elsewhere. The new rules indicate a deductible home office can be used for record keeping (if no other office is available for this purpose); holding sensitive records and valuable business items (if another office is not secure); and storing inventory even if selling takes place elsewhere. Once a taxpayer qualifies for a home office, such previously non-deductible home ownership expenses as home insurance, maintenance and repairs, utilities, private mortgage insurance and mortgage interest in excess of normal limits for a personal residence become deductible. Furthermore, establishment of a home office may also convert nondeductible commuting to a deductible business driving expense because the drive from the home office to another work site would be treated as a drive between two work locations. The rules are quite complicated, but the amount of the home office deduction can result in a tax savings. Therefore, this is a subject homeowners should be discussing at length with their professional tax advisor.

TAXATION

■ The IRS targeting of abusive corporate tax shelters rolls on. Lease-stripping is one of the latest targets identified. Here, usually, one taxpayer claims to realize rental or other income from a property and another taxpayer claims the deductions related to that income. The deductions may arise from depreciation, rental expenses and other sources. According to the IRS, the separation of the income from the related deductions is frequently improper, and, therefore, it requires the taxpayer and promoter to flag it so the Agency can examine it more closely. Situations where the registration and disclosure requirements apply are:

< Transferred basis transactions whereby a taxpayer transfers the right to receive future payments under a lease of tangible property

< Partnership transactions where the partnership assigns the right to receive future payments under a lease of tangible property

< Single participant transactions in which a taxpayer is entitled to receive payments under a lease of tangible property and assigns its right

The IRS says it will utilize every tool at its disposal to challenge lease stripping transactions and will disallow them as shams and transactions without any economic substance or a business purpose.

- The IRS is eliminating a tax shelter scheme involving non-qualified stock options. Here, stock options would be transferred to family members or a family limited partnership in exchange for an installment obligation. Then, after the options had been exercised, the executive who transferred them would claims that he or she could avoid tax until the payments are made on the note. However, the IRS now says the executive is liable for tax upon exercise of the option.

- Although it's only a small consolation, the Tax Court has clarified you may deduct some expenses if you have been the target of an IRS audit. Expenses which qualify include: the standard mileage deduction for driving your car to and from the IRS office where the audit is being conducted; mileage for driving to a law library to do tax research; and, copying costs you incur related to the audit. Unfortunately, the deductions as itemized miscellaneous expenses are deductible only to the extent they exceed 2% of your adjusted gross income.

- A new school year has started, and we'd like to remind teachers and other education workers to save their receipts for books, equipment and other supplies they buy for their classroom. This is the last year in which educators can deduct up to $250 in eligible expenses from their taxes. To be eligible for the deduction, an individuals must work at least 900 hours during the school year as a teacher, instructor, counselor, principal or aide in either an elementary or secondary public or private school. Qualifying expenses include books, supplies (glue, paper, pens, scissors, etc) and computer equipment or software. The deduction is available regardless of whether you itemize or not.

- If you've bought a big sports-utility vehicle this year, here is a reminder you can expense up to $100,000 of the cost in 2003. To qualify for the deduction, the vehicle must have been placed into service in a business this year, and have a loaded gross vehicle weight of more than 6,000 pounds. Heavy automobiles may also qualify if they have a curb weight in excess of 6,000 pounds.

- The IRS has upgraded the Internet version of the Electronic Federal Tax Payment System to include several improvements to help taxpayers. Taxpayers will now be able to schedule at one time: a) all four estimated tax payments, Form 1040-ES without logging out; b) access payment history for a 16-month period of time; and c) search, print or download payment history by date, tax type, amount, tax form and other factors. They'll also be able to switch bank accounts by phone without completing a new enrollment, and access links to states with electronic tax payment systems directly from the EFTPS web site.

PAYROLL TAXES

- The IRS says the stipends paid to medical residents are exempt from social security taxes. The exemption applies to residents who are students and who worked in a teaching hospital not affiliated with a medical school. The residents had enrolled in the taxpayer's graduate studies program and, although they did not take any courses, they were students because they had a mandatory series of rounds, conferences and peer review discussions. The stipends were not exempt from Federal income tax, however.

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.