February 8, 2001

COMMENTS - FEBRUARY, 2001

ACCOUNTING AND AUDITING

Cutthroat competition in many industries may leave small and mid-size companies that seek to grow quickly with no other alternative than to acquire other companies. This also means there are a lot of companies vying for available businesses. It is a dangerous environment in which one can easily overpay or obtain a business which has major problems, or conversely, miss out on a good deal because a competitor offers more desirable terms. We periodically come across unhappy situations caused by:

1. Failure to utilize experienced professional legal and financial advisors.
2. Negotiating a price without having an underlying pricing strategy or a specific price objective in mind.
3. Unwillingness to be flexible about structuring the deal in terms of the cash, debt and stock elements.
4. Attempting to deal directly with the seller rather than going through its advisors, which may stir animosity and cause a deal to flounder.
5. Failure to make a thorough due diligence examination covering the status of all elements of the business and the overlap with your business.
6. Unwillingness to walk away from a deal once doubts arise about the prospects for the business or the price.
7. Inability to integrate the business and its people into your organization.

ADMINISTRATION, SYSTEMS AND EDP

Records retention is an ongoing concern for many business owners. Unfortunately because laws vary from state to state, it is difficult to generalize about how long specific records must be kept. However, many firms use a rule of thumb and retain all records for a minimum of four to six years. According to the Association for Information Management Professionals, here are some specific guidelines relating to employment and other records:

1-year - (after resolution) records of complaints and legal actions.
2-years - time cards, schedules, pay rates and other basic earnings records.
3-years - expired insurance policies and personnel records of terminated employees
4-years - Former employees names, addresses and social security numbers.
5-years - Documents related to job related injuries and illnesses.
6-years - Attendance records.
7-years - Expired contracts, vendor invoices, vacation and sick leave records, canceled stock and bond certificates, tax records.
Permanent - Legal documents and related correspondence, insurance records, tax returns.

FEDERAL REGULATIONS

Although the Electronic Signatures law provides documents sent electronically in interstate commerce have the same force as documents containing physical signatures and signed documents transmitted as facsimiles, a number of documents are specifically exempted. Thus electronic signatures are not valid with respect to such family law matters as prenuptial agreements, divorce decrees, adoption papers, wills, various landlord-tenant documents including evictions and foreclosures, the recall or notification of a material failure of a product, court documents and insurance terminations. Readers who might be affected by the law should seek professional legal advice.

INSURANCE

Questions we frequently receive from clients indicate many people are confused about the similarities and differences between annuities and IRAs. Both of these investment vehicles provide tax deferral on income and appreciation; permit tax-free transfer between investment choices and provide for early withdrawal penalties. But here are some of the ways in which they differ:

1. Whereas contributions to an IRA may or may not use pre-tax dollars, annuity contributions usually are made with after-tax dollars.
2. IRAs require annual mandatory tax reporting by the custodian while these requirements do not apply to annuities.
3. Individuals can make unlimited annual contributions to annuities whereas IRA contributions are restricted by law.
4. In general, IRA distributions must begin at age 70 1/2 (except for Roth IRAs), while there is no mandated starting date for annuity distributions.
5. Premature IRA transfers do not involve any surrender fees or insurance charges, but surrender and insurance charges are associated with early annuity cancellations.

Although annuities provide many of the same benefits as IRAs they generally are inappropriate for most people because of high cost and because capital gains stemming from the annuity investments are taxed at ordinary income tax rates up to 39.6% while investments outside an annuity are subject to a maximum 20% long-term capital gains tax rate. On the other hand, when people are in top tax brackets, and unable to make further contributions to IRAs, 401(k)s or other retirement plans because of legal limitations, an annuity could be a suitable investment. The increasing complexity of IRAs and annuities, has prompted many clients to seek our assistance with financial and tax planning designed to effectively accumulate retirement wealth while minimizing taxes.

LABOR RELATIONS

If you are an executive who has incentive stock options (ISO), rather than waiting to exercise them just before the expiration date, a better tax strategy might be to exercise a portion each year. The reason is upon exercise of an ISO, the difference between the fair market value of the stock and the exercise price is a tax preference item which must be included in computing whether you are subject to the Alternative Minimum Tax (AMT). The exercise of the entire ISO grant in a single

year makes it almost certain you would be subject to this tax. In the event you are required to pay the AMT, you should also utilize the AMT credit to offset taxes owed stemming from the sale of shares purchased with the option. We assist many executives with compensation and tax planning designed to minimize overall tax liability.

MARKETING

Although inflation has been benign in recent years, higher energy prices and increased cost of many commodities and the tightness of the labor market are starting to change the overall outlook. Many of the larger companies which were unable to raise prices because of keen competition are expected to raise the prices of their products. Overall, price increases in 2001 are projected to be about 3.5% compared to only .8% this year, and a survey by the Financial Executives Institute indicates 60% of firms intend to raise prices. In light of the changed conditions small businesses need to also evaluate modifications in their selling prices based on demand for their products, changes in costs, and competitive factors.

MONEY, BANKING AND CREDIT

Even relatively savvy clients may occasionally succumb to a smooth talker on the phone. To protect yourself from telemarketing fraud, we'd like to offer some suggestions:

1. Do not deal with anyone who calls and promises little or no risk, requires immediate action (usually a payment), or tells you that you've been specially selected.
2. Do not provide any information or deal with a stranger making a cold call.
3. If you are solicited about purchasing stock, ask the salesperson for the state's attorney general's office and securities agency telephone numbers so you can check out the legitimacy of the broker and the company.
4. Do not sign any documents without reading or understanding the fine print.
5. Make no investment and sign no contracts without a prior discussion with family, friends and/or professional advisors.
6. Do not give out any personal data such as social security, credit card or bank account numbers over the telephone.
7. If you suspect fraud call the National Fraud Information Center at (800) 876-7060.

Since some of our clients live in retirement communities, often quite distant from their adult children or other close family members, we encourage them to inform us of any financial solicitations from telemarketers or other strangers. This permits us to review all of the information before they make any commitments, provide information or transfer funds, and enables us to possibly protect the client from a fraudulent deal.

Are you better off with a credit card or a debit card? Off the top of your head, you would probably say a credit card since it allows you to defer payment on purchases for a period without interest. But it's not as simple as that. The answer depends on your personality and your financial habits. If you are a financially disciplined person who pays the balance owed each month, you'll definitely be better off with a

credit card, since there may be a 3 to 5 week lapse between a charge for goods or services and the time of payment, during which you receive an interest-free loan. However, if you can't control your impulse to buy and you find you can only make the minimum payment when your credit card statement is due, your purchases will cost you a bundle because credit card issuers charge enormous interest rates which can keep you in debt indefinitely. In this case, a debit card would be much better. Although you don't get the benefit of the float since payments are taken immediately out of the account which is linked to the debit card, you also can't become a credit junkie. If there is no money in the account, your purchase won't be approved. For some people this is the best way of keeping their spending under control.

PENSION AND ESTATE PLANNING

Although many planners will have you believe the combined estate and income taxes on an inherited IRA will dissipate 80% to 90% of an inherited IRA or qualified pension plan, these claims are erroneous and often used to scare people into buying insurance. While it is true, for example, inheriting a $200,000 IRA can result in a Federal estate tax of about $80,000 as well as income tax on the tax-deferral which has accumulated, the estate tax is deemed as "income in respect to a decedent." As such, it is tax deductible as a miscellaneous itemized deduction not subject to the 2% of adjusted gross income limitation on the income tax return. This deduction may be huge, and at a higher rate than the estate tax, significantly lowering the overall tax cost of inheriting the IRA or qualified plan assets. If you'd like to discuss the implications of this further and let us review your retirement and estate planning, please contact our firm.

PERSONAL FINANCIAL PLANNING

Are you teaching your children about proper money management? According to a study by Merrill Lynch, 66% of parents tell their children the best way to save is by opening a bank account; 14% counsel them to stuff their piggy bank or some other repository, and only 9% make kids aware stocks and bonds may be a suitable investment medium. A surprise in the study was contrary to common belief, all teenagers do not dissipate their money on foolish extravagances. Instead, the study found:

1. 25% saved all their money.
2. 56% spent half their money and saved the other half.
3. 18% spent all of their money immediately at the nearest shopping mall.

Among the teenagers surveyed: 40% received a regular allowance in exchange for performing household chores; 77% earned money from odd jobs; 24% had part- or full-time jobs, and 86% were able to obtain money from their parents as the need arose. Over 500 youngsters ranging in age from 12 to 17 years participated in the survey. If your child held a job this past summer you can begin the lessons by opening a Roth IRA for the youngster. Parents can fund the IRA for up to $2,000 a year as long as their contributions don't exceed the child's earnings. If contributions start at age 16 and continue to age 65, and the account earns 8% per year, it would be worth $1.2 million at age 65, and all of the withdrawals made after age 59 1/2 would be tax-free.

Current tax laws permit an individual to (1) qualify for a tax credit of up to $5,000 for certain expenses in adopting an eligible child, or (2) exclude from income up to $5,000 paid or reimbursed by an employer under an adoption assistance program. When a child has "special needs" the credit and exclusion increase to $6,000. Qualifying adoption expenses include reasonable and necessary adoption fees, court costs, attorney fees, traveling expenses and other costs directly related to the legal adoption of the child. The credit and exclusion for qualifying adoption expenses are subject to both the dollar limit per adoption stated above, and an income limit, and beginning in 2002 the adoption credit will only be available if the child is a "special needs" child, and the exclusion for amounts paid by an employer will be eliminated. The income limit is as follows:

Modified Adjusted Grosss Income	Impact on Credit or Exclusion
$75,000 or less	None
$75,000 - $115,000	Reduced by a formula based percentage
Over $115,000	Credit or exclusion eliminated

Would you like more information about the adoption credit or exclusion, such as when the claim is to be made, the amount of the credit and exclusion may be claimed when both the taxpayer and the employer cover adoption expenses for the same child, and how to file a claim for the credit or exclusion? Our firm will be glad to assist you.

REAL ESTATE

If you are a commercial property manager, you are storing considerable tenant information electronically. Much of the data may be financial information or confidential data can be sold or used with criminal intent. When it is stored online, it is vulnerable to attack by computer hackers or to unauthorized use by unethical employees. Obviously, it is important every effort be made to keep the records secure. This requires:

1. Adequacy of internal controls over the records storage site.
2. Restriction on acccess to records.
3. Avoiding capture and storage of unnecessary data.
4. Screening employees who have access to tenant files.
5. Establishment of an overall privacy policy.

If tenant records you have accumulated come into the wrong hands for a criminal motive, proving you took steps to protect tenant privacy in the storage and handling of tenant data may help you to avoid liability. Real estate managers who are uncertain about the security of their electronic information systems may benefit from an independent internal control review and evaluation.

TAXATION

One strategy for avoiding the corporate Alternative Minimum Tax is to lease rather than purchase new equipment. The reason is companies that buy equipment have to add back depreciation deductions taken, to determine their Alternative Minimum

Tax liability. Conversely, expenses for lease payments are not included in the tax preference items which must be added back to arrive at Alternative Minimum taxable income. Of course, this strategy is only effective in certain limited situations. Similarly, the decision whether to trade-in or sell old equipment could also impact on your tax liability. For example, if you trade in machinery or equipment, for a newer model, it is treated as a like-kind exchange even though you make an additional cash payment, and no gain or loss is recognized for tax purposes. Conversely, if you sell the old equipment and then buy new replacement property, gain or loss is recognized. Your tax situation may determine how to fashion the transaction. For example, if replacement of old equipment with new would result in a gain because you would realize more from the sale or trade-in than your adjusted basis in the property, a trade-in would probably be advantageous tax wise since the gain would not be taxable. On the other hand, if a loss would result because the adjusted basis in the property exceeds what could be realized from a sale or trade-in, outright sale would make the most tax sense since the loss would be immediately deductible.

PAYROLL TAXES

No report this month.

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.