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COMMENTS - MARCH, 2002

ADMINISTRATION, SYSTEMS AND EDP

Are you considering selling, donating or otherwise disposing of an old PC? Make sure birth dates, social security numbers, bank account numbers, tax information and other data which can be used to engage in identity theft, or in other electronic crime, are irretrievably expunged from the computer's files and memory. According to a brochure published by the National Aeronautics and Space Administration for NASA employees, just choosing to delete files using the basic commands for your keyboard or mouse is insufficient because the information can still be retrieved from the computer's hard drive. Instead, use special software obtainable from computer vendors which is formatted to completely erase computer files.

Although there has been much talk about the paperless office for over a decade, the fact is, paper documents still support many processes and tasks in the typical business office. Since the files contain information which has to be accessed, it is important there is an efficient system underlying the handling of this data. Here are some good practices for making the filing system accurate and efficient:

- Always alphabetize regardless of how your filing system is structured.
- Use color coding of folders or file tabs for quick identification of files.
- Avoid duplicating documents and filing them in two places, since this just creates more bulk and added work.
- File documents in folders so the most recent are up-front, and so on.
- Identify computer disks clearly on labels to avoid having to load them onto the computer to determine the content.
- File all documents with which you are finished at the end of the day.
- Staple together multiple documents dealing with the same matter, with the most current on top. (Paper clips are unsuitable because they come off easily).
- Place destruction dates on documents at the time they are filed, to avoid unnecessary accumulation or re-reading to determine when they are obsolete.

Of course attention has to also be paid to indexing, cross-referencing, equipment needs, designation of current and non-current files, destruction methods and dates by categories of filed materials.

FEDERAL REGULATIONS

- # Taxpayers should soon be receiving reminders the IRS will begin offsetting outstanding tax liabilities against their Social Security benefits. It is estimated that approximately 200,000 social security beneficiaries could be affected. Under the Federal Payment Levy Program, Social Security benefits may be reduced by up to 15% after the taxpayer has been notified of an intent to levy and received an explanation of appeals rights and procedures. Social Security payments to minors, lump sum death benefit payments, supplemental security income payments, payments to taxpayers in bankruptcy and payments to taxpayers seeking innocent or injured spouse relief are exempted from the Federal Payment Levy Program.

- # If you were enrolled in a Medicare+Choice plan you could switch plans on a monthly basis. But in 2002 and 2003 the rules are changed as follows:

  - Enrollees are allowed to change plans only once between January 1, and June 30, 2002.

  - From July 1, through December 31, 2002, the choice will be <u>locked in</u> so no change in plans will be permitted during the second-half of the year.

  - In 2003, enrollees will be able to change plans once between January 1, and March 31, 2003. No changes will be allowed between April 1st and December 31st.

  The new rules make it more important than ever for Medicare+Choice plan enrollees to carefully select their insurer.

INSURANCE

- # Do you have teenage children who are ready for their first drivers' license, or who obtained a license recently? Undoubtedly they will want to use the family car, and you probably assume they are covered by your automobile insurance policy. That assumption may be a mistake. Unless you notify the insurer of the newly licensed family member who will be using the car, your child may not be covered under the policy. For instance, the insurer probably will not cover the loss in the event your child is in an accident. You can also be retroactively billed by the insurer, or worse, you may find that your coverage is dropped. This is just one example of uninsured risk many people overlook.

- # Although only 6,000 long-term care insurance policies were sold during the 1990s, sales of long-term care insurance policies are now increasing at the rate of 20% per year, and this type of policy is considered to be one of the hottest insurance products around. Essentially, purchase of a long-term care policy can:

  - Protect retirement and estate assets.

  - Provide the resources to avoid nursing home care and remain independent.

  - Prevent dependence on welfare and other government programs.

  Whether the purchase of a long-term care policy is appropriate depends on such factors as: (1) the financial resources of the person(s) considering the policy; (2) Federal and state tax provisions whereby in some instances, the government shares the cost of the premium through tax deductions or tax credits; (3) the type and amount of benefits being provided, and (4) the incapacity which would trigger benefit payments. Even if clients have evaluated long-term care insurance within the past three years, we recommend another look because the features of these policies are constantly changing as are the tax regulations surrounding this coverage. For example, legislation is being drafted by Congress which would establish a $3,000 per year tax credit toward care giving expenses for severely impaired people with long-term care needs and would allow qualified long-term care insurance purchasers to deduct their premiums on their Federal income tax return whether or not they itemize. The amount of the deduction would be directly related to the premiums paid.

LABOR RELATIONS

Although employees won't be taxed on employer reimbursed education expenses up to $5,250 for both graduate and undergraduate courses under the new tax law, employees should be reminded not all expenses qualify. For example, the cost of courses or other educational expenditures involving sports, games or hobbies do not qualify for tax-free reimbursement unless the education: (1) had a reasonable relationship to your work, or (2) is part of a requirement under a degree program.

MARKETING

Many people who purchase travel services such as airline tickets via the Internet are pleasantly surprised by the low fares they are quoted to their desired destination. However, if they use the site again for another trip, the bargains may no longer be there. Some travel service Web sites intentionally provide rock bottom prices to new customers but maintain electronic records of the transaction. Then, when the customer visits the site for repeat business, prices are automatically raised because the customer is presumed to have been hooked to the site. To avoid overpaying, always shop at several sites for fares and compare costs rather than just dealing with a vendor whose site is familiar to you.

PENSION AND ESTATE PLANNING

Social security recipients will receive a 2.6% increase in their social security checks in 2002, which translates into a $22 increase for the average social security recipient and raises the maximum monthly social security benefit to $1,660. However, those enrolled in Medicare Part B will receive only an $18 increase because the Medicare Part B monthly premium will also rise from $50 to $54. The Medicare Part A deductible for hospital stays for 2002 will be $812 per benefit period. Social security recipients who are under 65 and who continue to work will also be able to earn more in 2002, without losing social security benefits. The new earnings limit is $11,280 compared with $10,680 in 2001. If you are 65 and older, you can earn an unlimited amount without loss of social security benefits.

The IRS has issued cost-of-living adjustments to benefit and contribution limitations under qualified retirement plans effective for calendar year 2002. The list is smaller than usual because of the many changes under the Economic Growth and Tax Relief and Reconciliation Act of 2001 which first went into effect in 2002. Here are the new limits:

- The annual compensation limit for the definition of "highly compensated employee" goes up from $85,000 to $90,000 for 2002.

- The compensation amount for qualifying employees under SEPs remains $450.

- The compensation amounts under IRS sections 1.61.21(f)(5)(i) and (iii) for fringe benefit valuation purposes increase to $80,000 and $160,000 respectively.

PERSONAL FINANCIAL PLANNING

Here is a reminder the annual gift tax exclusion increased to $11,000 per donee per year in 2002. If a couple splits gifts, the amount of the exclusion can be doubled. Also, the estate tax exemption which is currently $675,000 increased to $1 million. Taxpayers may make gifts in excess of the gift tax exclusion and still avoid current tax as long as the total of the gifts does not exceed the exclusion and exemption. Also donors can make an unlimited amount of direct tuition and medical payments to the institution(s) in behalf of a donee without impact on the gift tax exclusion or the estate tax exemption.

Many people who wish to make a large gift to a child or grandchild who is a minor utilize a Uniform Gift to Minors Account or a Uniform Transfer to Minors Account. Banks, brokers and other financial institutions which offer these accounts may tell the donor that setting up one of these accounts in the child's name is as good as establishing a formal trust and avoids legal and other fees associated with a formal trust. Unfortunately, the advice may be unwise. The Uniform Gift and Transfer to Minors accounts contains provisions that when the child or grandchild reaches majority (age 18 in most states) the proceeds are distributed to the person for whom the account was established. At which point the youngster can take the money and use it in any way desired and the donor loses all control over how the money is spent. By setting up a formal trust, distribution can be delayed, and the donor or another trustee can be named to manage the funds for the child, grandchild or other heirs if the original donee disqualifies him or herself from receiving the money. While it is true the costs are higher and administration is more complicated, establishment of a formal trust can prevent a young person from dissipating a large sum of money foolishly. Also, establishment of custodial accounts and formal trusts may have estate tax consequences and could lead to loss of college financial aid.

REAL ESTATE

Some lenders are offering no-cost mortgage refinancing to attract your business. Since they will pick up your closing costs including title insurance and mortgage tax, it sounds like a good deal to many homeowners trying to refinance. But don't be taken in. In exchange, they will increase the interest rate on the new mortgage by 1/8 to ½ percent, and, frequently, they will insert a clause requiring the borrower to repay the closing costs if the mortgage is prepaid within the first five years. To determine whether no-cost mortgage refinancing makes sense, compare the saving in closing costs with the additional interest cost you are required to pay on the mortgage. In general, if you plan to stay at least 6 years in the property, you will almost always be better off paying the closing costs on the refinancing and opting for a lower rate mortgage.

Under the old tax laws, tax on the gain on the sale of land adjacent to your main residence could be avoided if you also sold the house within a two year period and replaced it with a more expensive property. Then, in 1997, the law was changed to provide an exclusion of up to $500,000 on the sale of property owned and used as a primary residence in two of the five years before the sale. According to the IRS, the gain on the sale of the adjacent

land may also be eligible for the $500,000 exclusion. That could be the case if the tract is sold as part of a series of transactions which includes the sale of the home. However, to qualify, the land must be used residentially in at least two of the five years before the sale and the use must coincide with the two years which the house was occupied as a principal residence. The IRS also clarified the gain on the sale of the adjacent land is subject to tax if the house is not sold.

TAXATION

Because of inflation indexing a variety of tax breaks for individuals will rise in 2002. For example:

- The personal exemption for 2002 will be $3,000.

- The standard deduction for married non-itemizers will rise to $7,850; $8,750 for those 65 years old, and $9,650 if both taxpayers have reached age 65. For single taxpayers, the amounts are $4,700 and $5,850 if 65 or older, and for heads of households $6,900 and $8,050 if 65 or older.

- For those listed as dependents (children, elderly parents, etc.) on someone else's return, the standard deduction remains $750.

- The itemized deduction phase-out begins at $137,300 of adjusted gross income in 2002 and is then phased out at the rate of 3% of the amount by which the adjusted gross income exceeds $137,300.

- Personal exemptions will begin being phased out in 2002 when adjusted gross income reaches $206,000 for joint returns, $137,300 for singles and $171,650 for heads of households. The personal exemptions are reduced by 2% for each $2,500 of adjusted gross income above these limits.

- The top 38.6% tax bracket will start on taxable income of over $307,050 for married joint filers, singles and heads of households; the 35% bracket will start above $171,950 for married filing jointly and at $141,250 for singles; the 30% bracket begins on incomes above $112,850 for joint filers and $67,700 for single taxpayers; the 27% bracket starts above $46,700 for joint filers and $27,950 for singles; and, the 15% bracket starts above $12,000 for joint filers and $6,000 for singles . There is also a new 10% tax bracket for lower income taxpayers on income up to $6,000 if single and $12,000 if married filing jointly.

The IRS reports 295,000 of the 85 million advance payment checks which were mailed to taxpayers this past summer have been returned as undeliverable. Taxpayers who believed they were eligible to receive a check but failed to receive one had until December 5th to inform the IRS, since the Agency had a statutory year-end deadline for processing the checks. Often taxpayers do not receive IRS checks because of marriage, a name change or change of address. The Agency says that if you have not received an advance payment check, you should contact your tax return preparer or call 1-800-829-1040 to determine whether the IRS has an undeliverable check for you. Taxpayers who have missed the notification deadline and for whom the IRS is not holding a check, but who believe they should have been entitled to an advance payment check can claim the advance payment

they should have received as a credit against the tax liability on their 2001 tax return.

PAYROLL TAXES

The social security wage base for old age and survivors insurance rises to $84,900 for 2002. The tax rate will remain the same as last year, 7.65% each for employees and employers, and 15.30% for self-employed persons. There is no limit on the 1.45% Medicare portion of the tax. As a result of the change, the maximum social security paid by employees and their employers will rise by $279 each, and by $558 for self-employed individuals.