April 1, 2002

COMMENTS - APRIL, 2002

ADMINISTRATION, SYSTEMS AND EDP

Computer virus incidents continue to increase and over half stem from e-mail transmissions. According to Computer Economics, Inc., it's estimated one e-mail message out of every 1,000 messages sent has a known computer virus attached to it. Based on a survey of 1,330 security professionals, 70% indicated their company was the victim of a virus attack while only 15% or fewer reported their company was victimized by any of the following; Unauthorized network entry, data systems integrity loss, information loss, manipulation of software applications, fraud, theft of data or trade secrets or manipulation of systems programs. Considering the vulnerability of computer networks to virus attacks, it is essential that companies institute fast and easy backup procedures. One possibility is the utilization of 100Mb removable disk drives which are much faster and easier to use than tape drives. Other precautions include: (1) installing anti-virus software on individual PCs and network servers; (2) scanning all disks and files which originate outside your organization before introducing them into your systems; (3) choosing the "Disable Macros" or "Do Not Open" command when you receive a macro dialog protection warning for a document you did not expect to contain macros, and (4) monitoring web-sites such as www.microsoft.com and www.cert.org for information about new virus outbreaks. Remember, when a virus brings down your computers, the cost to your business is just as real as if your employees were all laid up with the flu.

INSURANCE

Do you have an inventory of your life insurance coverage? We find many people own numerous policies but fail to maintain adequate records in connection with the insurance. To develop an appropriate inventory, you should locate all policies and riders and list the following information:

1. Name and address of the insurance carrier
2. Policy number
3. Policy owner
4. Beneficiaries
5. Annual premium
6. Term of coverage
7. Death benefit amount
8. Policy type
9. Cash value
10. Dates of any changes made to the policy
11. Rating of the insurance company

Once the data has been obtained, each policy needs to be evaluated to be sure overall insurance is neither excessive nor inadequate. It's also desirable in connection with making the evaluation to obtain an in-force illustration from the insurance companies showing the premiums, cash values and death benefits to age 100, as well as illustrations at rates 1% and 2% below current interest rates for whole life and universal life insurance policies.

Have you been denied reimbursement for medical claims you've made? It's a common occurrence and the reasons given are usually:

- The provider coded the claim incorrectly.

- Required pre-authorization was not obtained.

- The insurer regards the treatment as experimental.

- The treatment was not medically necessary for the condition.

- The treatment was specifically excluded by the policy.

- An out-of-network health care provider was used.

Whenever a claim is rejected, you should receive a written notice giving the reason for the denial. If you want to appeal, you usually have a 30 to 90 day window of opportunity from the date the claim is rejected. But, before going through this process, you should obtain a copy of the policy to determine whether the claims denial conforms to the policy's terms. Frequently, insured's are successful in appealing a denial. For example, if the insurer says a procedure was experimental, by providing articles from medical journals and by citing the results of research you may be able to persuade the insurer to reverse a decision. Often, your employer may support your appeal against a claims rejection because it believes the coverage you are being denied was included under the policy.

LABOR RELATIONS

The IRS has just issued a set of proposed regulations and two administrative notices which:

- Make the exercise of a statutory stock option subject to FICA and FUTA employment taxes beginning on January 1, 2003.

- Clarify the income tax withholding rules that apply when statutory stock options are exercised or otherwise disposed of.

- Provide administrative rules designed to lessen the burden of complying with the proposed regulations.

The regulations indicate the amount of wages the employee receives for FICA and FUTA tax purposes on the option exercise is the excess of the fair market value of the acquired stock over the amount paid for it. Withholding on the exercise of the option would not be required as long as income is not recognized under IRC section 421(a)(1). In response to concerns which this would make stock options less attractive to employees and employers and create a significant administrative burden, the IRS has indicated the employer could treat FICA and FUTA wages resulting from option exercise as paid on a pay period, quarterly, semi-annually, annually or another basis, including as paid over more than one period. However, all payments would be required to be treated as paid on or before December 31st of the year of exercise. Although the IRS has indicated employers generally have no income tax withholding obligation on an employee's exercise of an incentive stock option or an option under an employee stock purchase plan, the employer is not released from a reporting obligation in connection with the exercise. Thus, the employer is required to report any payment in excess of $600 on Form W-2. Finally, the IRS indicates it will not assess any FICA or FUTA taxes with respect to exercise of a stock option prior to January 1, 2003.

MONEY, BANKING AND CREDIT

If you are dealing with a foreign customer, you are not only exposed to the normal credit risk, but you may also be exposed to currency risk if the transaction is denominated in the foreign currency and it declines against the dollar. But there are a variety of ways you can protect yourself. Among them:

- Purchase of a forward contract which locks in a specified exchange rate. However, there is an up-front fee, and you'll also lose out if the foreign currency value rises.

- Buying a currency option. This also involves a fee and places a floor on the exchange rate you'll obtain, but you'll get the benefit of a rise in the foreign currency. (The sales price can be adjusted to give effect to the minimum you'll receive if the foreign currency drops.)

- Purchasing a forward collar. Here, you can protect yourself from a collapse in the foreign currency and also participate in an upswing in the currency. In general, there are no up-front fees.

- Obtaining payment in advance, a prospect which is unlikely in most situations.

Some web sites where you can obtain more information about foreign trade include the Association of Finance, Credit and International Business at www.fcibglobal.com; The Export-Import Bank of the United States at www.exim.gov; the World Bank at www.worldbank.org, and the International Chamber of Commerce at www.iccwbo.org/home/menu_ibcc.asp.

PENSION AND ESTATE PLANNING

The IRS has indicated that employer stock from company plans is entitled to favorable tax treatment. It says when a lump-sum payout includes employer stock, the payee owes tax up front only on what the plan paid for the stock, and the tax (at a maximum 20% rate) on the appreciation of the stock to the payout date is delayed until the stock is sold. Any cash received in the payout may be transferred directly into an IRA without endangering the tax break, but if the stock is rolled over into an IRA the benefit is lost, because IRA payouts are taxed as ordinary income even if they result from capital gains. This private letter ruling provides

plan participants with new opportunities for pension planning.

The Tax Act which was signed into law last June has a number of pension provisions which go into effect in 2002. They include:

- An increase in the limit an employee can contribute to a 401(k) and 403(b) plan to $11,000, with additional $1,000 increments until it reaches $15,000 in 2006.

- Provisions for catch up contributions for workers age 50 or over in 2002 to 401(k) and 403(b) plans above the normal contribution limits. The maximum additional contribution amounts will be phased in from 2002 to 2006 in $1,000 increments. For SIMPLE 401(k) plans and IRAs the catch up contribution limits are $500 in 2002; $1,000 in 2003; $1,500 in 2004; $2,000 in 2005, and $2,500 in 2006 and thereafter. (Low- and moderate-income employees with incomes up to $50,000 on a joint return will be eligible for a tax credit, which is subject to phaseout, to match their retirement contributions up to $2,000.)

- Faster vesting of benefits, either after 3 years, or on a 2 to 6 year graduated schedule.

- Elimination of payment options other than lump-sum distributions at the employer's option.

- Increases in the IRA contribution limits from $2,000 to $6,000 by 2008 and thereafter.

- Increases in tax deductible employer contribution limits to profit sharing plans, and in the maximum benefit that can be provided to a participant in a qualified defined benefit plan.

The IRS has indicated it has model language qualified pension plans can adopt to be in compliance with the pension changes established by the legislation. The sample language for most of the changes will have to be adopted by the end of the 2002 plan year.

PERSONAL FINANCIAL PLANNING

The Economic Growth and Tax Relief and Reconciliation Act of 2001 has liberalized some of the key rules governing tax-favored section 529 tuition plans for 2002 and subsequent years, to make the plans even more desirable for parents and grandparents seeking to accumulate education funds. Among the new rules:

- All distributions from qualified tuition programs will be excluded from gross income to the extent they are used to pay for qualified higher education expenses.

- Private institutions will also be able to establish qualified tuition programs in 2002, and the exclusion of distributions from income for these plans will take effect with distributions beginning in tax year 2004.

- The definition of qualified higher education expenses has been extended to cover special needs services for special needs beneficiaries enrolled in an eligible education institution.

- The dollar limitation on the amount of room and board expenses which are includable in qualified higher education expenses has been eliminated and replaced by: (1) an allowance determined by the institution, for students without dependents who live at home; (2) the standard allowance determined by the institution based on the amount normally assessed most of its residents for room and board, for students without dependents who live in institutionally owned or operated housing, and (3) an allowance based on the expenses reasonably incurred for room and board for all other students.

- The rule requiring a Qualified Tuition Program to impose more than a de minimis penalty on refunds has been replaced with a 10% penalty tax on the amount of the distribution includible in income. This relates to situations where distributions from a qualified tuition program savings account exceed the qualified higher education expenses.

- Taxpayers will be able to claim a Hope or Lifetime Learning Credit in the same year in which a distribution is made from a qualified tuition program for the same student, provided the distribution is not used for the same expenses for which a credit is claimed.

- Transfers will be able to be made from one qualified tuition program to another for the same beneficiary without being treated as a taxable distribution.

- The definition of "family member" has been extended to include first cousins of the original beneficiary with respect to a change in beneficiaries or to a rollover to another plan for the benefit of a family member of the designated beneficiary without the change being treated as a taxable distribution.

Investments in a section 529 account may be changed once per calendar year and upon a change in the designated beneficiary of the account. Section 529 programs provide a double tax benefit because they enable parents and grandparents to each utilize the annual gift tax exclusion and set aside up to $11,000 per year per beneficiary, and also remove the income and future appreciation associated with the funds set aside from their estates.

Furthermore, a taxpayer can accelerate estate planning by electing to treat a $55,000 contribution to a single beneficiary in one year as having been made in equal installments over 5 years, so the contribution is gift tax free. Of course, if there are two parents or two grandparents, and they split gifts, the amounts set aside tax-free can be doubled and the amounts can be multiplied by as many qualified beneficiaries as the contributors decide to establish 529 plans for.

In today's complex world, many people find personal record keeping a tedious chore, complicated by a constant search for vital documents. Here are some ideas which we hope will be helpful for organizing your records:

- Obtain a safe deposit box, and use it to store documents you need to refer to only occasionally, such as birth certificates, property deeds, marriage licenses and death certificates. Register the box in two names so another family member has access to the box, and also keep an inventory elsewhere, of what is in the box, to enable you to determine whether anything is missing.

- Keep documents such as wills, living wills, powers of attorney, trusts, life insurance policies and passports in a secure place in your home (a safe or fireproof lock box so they can be accessed in an emergency). Place a summary of these records in your safe deposit box, just in case the home based records are lost or damaged in a fire.

- Let your broker hold your stock and bond and other investment certificates. Their service is free and reliable, and you avoid the hassle of having to mail or deliver documents necessary to conclude investment transactions.

- Retain all records pertaining to the original cost of your home and to home improvements since these will be needed by you or your heirs to substantiate cost of the property and to calculate the gain on its sale. These records can probably be kept in a lockbox in your home.

- Establish a master list of all of your records and their location and keep copies in your lockbox at home and in your safe deposit box.

Incidentally, don't be fooled into believing that scanning and digitizing your records and placing them on a computer will allow you to dispense with the originals. That's fine for developing a back-up so you can make duplicate copies of records; but, records copied from a computer file have limited legal use. On the other hand, the use of computers and suitable software can make your whole record keeping process easier and faster.

TAXATION

The IRS has announced the new 2002 optional standard mileage rate for business use of an automobile will rise from 34.5 cents per mile in 2001, to 36.5 cents per mile. The standard mileage rate for the medical or moving expense deduction rises to 13 cents per mile in 2002 from 12 cents per mile. The rate for charitable use of an automobile remains unchanged from last year at 14 cents per mile. The IRS says the increase in the standard mileage rate stems primarily from higher gasoline prices that added to the cost of operating an automobile. The standard mileage rate for business use of a car is an alternative to deducting actual automobile expenses.

PAYROLL TAXES

The Social Security Administration says beginning January 7, 2002, small employers with no more than 10 Forms W-2 can complete and file their wage reporting forms over the Internet. The offer is designed for employers who prepare paper W-2 Forms and those with household employees. To be eligible: (1) only four codes can go in the online version of Box 12; (2) no foreign or military wages can appear on the online W-2, and (3) the employer's computer will need Adobe

System's "Acrobat Reader" software to view the online W-2 form.