June 1, 2002

COMMENTS - JUNE, 2002

FEDERAL REGULATIONS

Hit by rising costs resulting from the anthrax letters, the Postal Service is raising various rates this Summer. Among them:

- An increase in the first ounce, to 37 cents for single piece first class mail and to 23 cents in the basic post card rate.
- A decrease in the Priority Mail flat 1 pound rate from $3.95 to $3.85 and an increase in the pick-up fee from $10.25 to $12.50.
- An average increase of 9.4% in Express Mail rates including the same increase in the pick-up fee as for priority mail.
- An average increase of 7.3% in overall standard mail rates.

You may want to review your mail and delivery practices to maximize efficiency and to minimize cost by either altering the level of mail service or utilizing private carriers.

INSURANCE

Workers' compensation insurance coverage is much more difficult to obtain since September 11th, and premiums in many areas are rising by anywhere from 30% to 100%. If you are renewing an existing policy, you need to make sure your premiums are being minimized by your insurer. Therefore, you should:

- Assess when your experience multiplier was last reviewed. The experience multiplier is based on your business risk and your claims experience, and the lower the multiplier the lower your premiums.
- Determine whether the current employee classifications being used are correct, and determine whether lower risk classification might be appropriate for some workers.
- Ascertain whether discounts promised by the insurer are actually being provided, and whether you may be entitled to additional discounts.
- Review the accuracy and timeliness of your company's loss information reporting over the past 7 years to determine whether the insurer should have provided premium rebates.

It is estimated almost half of all employers are being overcharged annually for workers' compensation costs by their insurers, so a thorough review may be effective in lowering current and past workers' compensation costs.

Here is a reminder that a larger amount of long-term care insurance premiums are tax deductible this year as medical expenses. The daily limit on pay-outs under these policies have been increased to $210 per day, and allowable deductions are:

$240 for those aged 40 or younger
$450 for those between ages 40 and 50
$900 for those between ages 50 and 60
$2,390 for those between ages 60 and 70
$2,990 for those aged 70 and older

If you are self-employed you should also be aware 70% of your medical insurance premiums are tax deductible in 2002 and the deduction is also available to more than 2% owners of S corporations.

LABOR RELATIONS

According to the Profit Sharing/401(k) Council of America, 69% of employers provide both a profit sharing and a 401(k) plan for their employees, 20% offer only a 401(k) plan and 11% provide only a profit sharing plan. The survey also revealed it generally requires a longer period for employees to become eligible for profit sharing plan participation than for a 401(k) plan. Eligibility within the first three months was available in 55% of 401(k) plans, but only in 20% of profit sharing-plans. Among companies which offered both plans to employees, the following eligibility patterns emerged:

- 54% of companies use identical eligibility requirements for both plans.
- 22% have a 1-year period before employees become eligible for both plans and 10% provide for immediate eligibility for both plans.
- 20% provide for immediate eligibility for the 401(k) plan but establish a 1-year eligibility period requirement for participation in their profit-sharing plan.

We do not know the logic behind the differing arrangements which were reported in the survey. However, such issues as the kinds of incentive fringe benefit arrangements to offer, length of employment for participation eligibility, vesting of benefits and tax consequences of alternate arrangements must be evaluated at length in order to devise an employee benefit program which achieves objectives such as enhancing employees retention, achieving maximum productivity, maximizing tax benefits and minimizing cost.

PENSION AND ESTATE PLANNING

Limits on various pension plan contributions and deferrals were raised for 2002. Here is a reminder: (1) elective deferrals for 401(k), 403(b) and SAR-SEP retirement plans increased to $11,000; (2) SIMPLE retirement contribution limits rose to $7,000; (3) contribution limits to traditional and Roth IRA's increased to $3,000 and (4) state and local governments and tax exempt organization plan contribution limits for 457 plans were raised to $11,000. Catch-up, pay-in caps for people born before 1953 are $500 for IRA's and Roth IRA's and $1,000 for

401(k), 403(b) and 457 plans. IRA deduction phase-outs start at $54,000 of adjusted gross income for married taxpayers and at $34,000 for singles.

Normal retirement age for social security increases once again in 2002. To collect social security, workers who turned age 62 this year will have to wait an additional two months before they become eligible to receive payments. To get the full benefit, workers must wait until they reach the age of 65 ½. The Part B Medicare premium was also increased from $50 to $54 per month this year.

PERSONAL FINANCIAL PLANNING

The size of the adoption tax credit was doubled for 2002. Now it can be claimed on $10,000, rather than just $5,000 of qualified adoption expenses. Furthermore, the credit phase out starts at $150,000 of adjusted gross income this year, twice the amount of last year. Finally, the exclusion from income of company-provided adoption assistance has also been increased in 2002, to $10,000.

TAXATION

The Job Creation and Worker Assistance Act of 2002 was enacted on March 9th. It contains a variety of tax relief provisions, primarily for businesses. Here are some of the highlights of the legislation:

- Companies are eligible to write off 30% of the cost of new assets placed in service after September 10, 2001, and before September 11, 2004, with the remainder of the cost recovered pursuant to regular depreciation schedules. Some assets acquired in 2001 would be eligible, but those contracted for prior to September 11th, would not be eligible. Qualifying assets are, generally, those with depreciable lives of 20 years or less, including machinery and equipment, leasehold improvements, land improvements and farm buildings.

- Maximum first-year depreciation on automobiles and light trucks used for business is raised to $7,660 for vehicles placed in service subsequent to September 10, 2001.

- Carryback of net operating losses has been extended to five years from two years. This is retroactive for years ending after 2000, so it applies to firms with a loss in the 2000-2001 fiscal year. Also, for tax years ending in 2001 and 2002, loss carryovers can offset 100% of the Alternative Minimum Tax instead of 90%.

- S corporation owners are precluded from raising their tax basis in the company by the amount of tax-free income from debts which are forgiven after October 11, 2001, and, in certain bankruptcy cases after February 28, 2002, limiting the amount of losses the S firm owner can deduct.

- The exclusion from income for accrual basis filers when experience indicates the income will not be collected is being restricted to firms grossing under $5 million per year or personal service companies such as law, accounting or engineering firms effective for years ending after March 9, 2002.

- Teachers will be eligible to make a modification to adjusted gross income, of up to $250 per year for 2002 and 2003, for classroom materials they purchase.

- For 2002 and 2003 plan years, defined benefit plans will be able to use higher interest rates to calculate required pension paying and government insurance premiums, reducing both the plan contribution and government premium payment requirements.

- A series of expiring tax provisions have been extended, including: (1) Alternative Minimum Tax relief for claiming dependent care, tuition and low income savers credit through 2003; (2) the work opportunity and welfare-to-work credits through 2003; (3) the credit for energy from non-conventional sources (wind, bio-mass, etc.) was reinstated through 2003 and the tax credit for electric vehicles will not be reduced until 2004.

- Archer medical savings accounts will remain in effect through 2003 and the regulations requiring parity between physical and mental health benefits are extended through 2003.

- The ceiling on percentage depletion for marginal oil and gas wells is suspended through 2003, meaning it can exceed 100% of the property's net income.

Since some of the provisions affect 2001, taxpayers who have already filed their taxes may have to file amended returns in order to obtain benefits provided in the legislation.

The IRS has announced interest rates on tax overpayments and underpayments for the second quarter remain unchanged at 6% and remain at 5% for corporate overpayments; 8% for large corporate underpayments and 3.5% for the portion of corporate overpayments that exceed $10,000.

PAYROLL TAXES

The IRS says fewer employers are bothering to pay taxes for household workers. Employers who engage nannies, maids, gardeners and other household employees are supposed to pay Social Security and Medicare taxes if they paid these employees $1,300 or more in 2001, and they are also supposed to file a schedule "H" with their tax return. According to the IRS, it received only 280,190 "nanny" tax returns for year 2000, which was down from 294,284 in the prior year. Three reasons for the low reporting rates are: (1) treating the household workers as independent contractors; (2) relying on an agency to engage the workers and handle all the paperwork and taxes, and (3) just plain tax cheating. On the other hand, "nanny tax" does not have to be paid for:

- Household work by one's child under age 21, or one's parent.

- A household employee under age 18 whose principal occupation is not domestic work (a student, for example, who does baby sitting).

- Any worker employed by a firm which assigns the position and pays the worker.

- A worker who comes in once a week whose total daily payment is under $25.

For 2002, FICA taxes must be paid for a domestic worker with annual wages of $1,300 or more.