COMMENTS - JUNE, 2003

ACCOUNTING AND AUDITING

- The Financial Accounting Standards Board has issued Statement No. 148, *"Accounting for Stock-Based Compensation - Transition and Disclosure."* It amends Statement No. 123 by providing two additional methods of transition for companies voluntarily planning to use the fair value method of accounting for option related expenses in order to avoid significant fluctuations in compensation expense from what they had previously disclosed. Thus, Statement No. 148 enables companies to avoid these fluctuations by recognizing expense for the fair value of their past and present stock-based compensation awards as soon as those entities convert to the fair value method. The Statement also requires companies not using that method to improve the clarity and prominence of their footnote disclosure about the pro forma effect using the fair-value method, and to include this information in their interim as well as their annual reports. The Statement's transition guidance and annual disclosure provisions are effective for fiscal years ending after December 15, 2002, while the interim disclosure requirements are effective for financial reports containing financial statements for interim periods beginning after December 15, 2002.

- Lack of adequate internal controls and high-tech accounting software make it easier for fraudsters to alter cash disbursements after the fact, enter prior period adjustments and void extra payroll checks or fictitious vendor payments. Many small business owners appear to be oblivious of their exposure risk. If you manage a small business, here are some common sense suggestions:

  - Engage a CPA to examine your books and opt for, at least, an annual audit
  - Develop a written code of ethics for your business and your employees
  - Treat employees fairly and provide access to management for reporting suspected fraud
  - Restrict access to bank accounts
  - Perform bank reconciliations on a regular basis
  - Establish physical controls over inventory and supplies and institute a perpetual inventory system
  - Pre-screen prospective employees to insure that they have no criminal background

- Despite building a successful business and engaging in business succession planning, it is not uncommon for a business owner to discover he or she has no one to pass the business along to. The reasons may be there are no children with the ability to operate the firm, or the next generation is not interested in continuing the business. In these circumstances, the business owner will usually have to make a decision to sell the business as a going concern, or else, to liquidate the business and maximize the amount obtained for the individual assets. In general, when a business can be sold, more value will be derived than when a business is dismantled and liquidated. Factors that enter into the decision to sell or to liquidate include:

    - Availability of an heir to take over the business

    - Ability of available managers to take charge of the business

    - Existence of marketable products or services that do not require participation by current owners or managers

    - Existence of trademarks, copyrights, patents, trade names and other intangibles and the value that may be derived in either a sale or liquidation

    - The competitive position of the firm

ADMINISTRATION, SYSTEMS AND EDP

- The worries of small business owners change as business conditions fluctuate. According to a recent survey by the National Federation of Independent Business, here, in order of importance, are the primary concerns:

	% of Respondents
Obtaining adequate insurance	20
Lack of turnover	19
High taxes	19
Excessive regulations	11
Competition from large businesses	9
Obtaining qualified workers	9
High labor costs	5
Inflation	4
Obtaining credit at reasonable interest rates	4

- Online merchants report that despite increased spending and added precautions to protect against fraud, credit card fraud continues to be present in about 3% of all transactions. The primary sources of customer fraud were:

Use of stolen credit cards	31%
Identity theft	28%

Use of card numbers stolen off the internet	22%
Miscellaneous other fraud sources	19%

Major security tools used by the electronic merchants to minimize fraud include address verification, data encryption, penetration audits designed to determine whether a Web site has been hacked and use of a paid risk management employee to protect the system . Also, both Visa and MasterCard have developed a variety of other anti-fraud tools to help protect electronic merchants.

Application Service Providers (ASPs) are companies that deliver and manage applications and computer service from remote data centers to multiple users via the Internet or a private network. The software used by the ASP is licensed to the user, rather than purchased, and the user retains ownership of the data which is stored and run on the ASP's server and network. In effect, the ASPs rent their software and system to their customers at a fraction of the cost that would be incurred if the customer were to purchase the software and equipment. Although the cost argument is convincing there are a variety of factors for and against the use of ASPs. Principal benefits claimed are:

< Easy access to technical skills possessed by the ASP

< Enhanced business performance and competitiveness for the user

< Fast implementation of the application

< Management can focus on its core business

< Lowered information technology cost outlays

< Enhanced information technology return on investment

Conversely, undesirable aspect of using an ASP providers are:

< Loss of control and in-house expertise

< Uncertainty as to whether cost savings will actually be realized

< Concern about whether the ASP can meet desired service levels

< Possible security concerns and disaster recovery considerations

< Inability to devise measurement criteria for evaluating the ASP

< Establishment of dependence on the ASP's management and financial stability

Use of an ASP may be appropriate for a particular business in the right circumstances. Thus you should approach an evaluation with an open mind when determining whether renting a software application via an ASP or buying it outright makes the most business sense.

Each year the American Institute of Certified Public Accountants surveys its members to determine the top 10 technology concerns of business managers. Here are the the most recent survey results in order of importance:

1. Information security protection of equipment, software and processes against internal and external threats.

2. Business information management (capture, indexing, storage, search and electronic management of documents).

3. Application integration (ability of different operating systems, applications and data bases to talk to each other).

4. Web services (applications that use the Internet as their infrastructure and access tool).

5. Disaster recovery planning.

6. Wireless technologies (cellular, satellite, infrared, two-way paging, etc.).

7. Intrusion detection which is built into many of today's firewall applications.

8. Remote connectivity.

9. Customer relationship management.

10. Privacy concerns.

Voice authentication, facial scanning, fingerprint scannning, keystroke scanning, traditional passwords and signature scanning comprise the major methods of personal authentication that are under review for maximizing security when accessing computers, ATM machines, buildings, offices, airports etc. What are users most comfortable with? According to the International Biometric Group, in order of preference, consumers choose the following authentication methods:

< Fingerprint scans
< Voice authentication
< Facial scans
< Signature scans
< Keystroke scans
< Traditional passwords.

Which of these technologies will eventually win out will depend on more than just consumer taste. They include, ease of use, cost of equipment and scanning process, compactness of equipment and reliability in identifying individuals who may gain access. According to a survey of biometrics professionals, fingerprint scans have the most potential in terms of user authentication. Whatever the eventual outcome, in light of the concern about the need for heightened security, it is almost certain that the days of memorizing and using passwords to gain access are numbered and that they will be replaced by biometric technology.

FEDERAL REGULATIONS

- The IRS has announced that businesses that issue or redeem money orders or traveler's checks are now required to use a new Form TD F 90-22.56 to report suspicious activity which could indicate money laundering. There are an estimated 200,000 non-bank money service businesses including convenience stores, grocery stores, service stations, drug stores and liquor stores that will have to file the suspicious activity reports when they engage in a money service transaction that is both suspicious and for an amount of $2,000 or more. Transactions that must be reported are those the money service business knows or suspects:

    - Involve funds derived from illegal activity;

    - Are intended to hide or disguise funds or assets derived from illegal activity;

    - Are intended to evade the requirements of the Bank Secrecy Act; or

    - Serve no business or apparent lawful purpose.

  The new requirements were announced in IRS News Release IR-2003-26.

- The Department of Labor has announced that in 2002, it recovered $175 million in back pay for 263,593 workers. This is a greatest recovery of back wages the Department has made in the past 10 years. The reasons are more aggressive activity by the Labor Department, an increase in the enforcement hours by Wage & Hour investigators and an increase in complaints by whistle blowers. While any company can be targeted for investigation, the focus is primarily on low-wage industries such as garment manufacturing, agriculture and health care. Principal problem areas are violations of the Fair Labor Standards Act and violations of child labor laws. In light of the increased activity by the Labor Department, this may be a good time to obtain an independent audit of your company's pay policies and procedures to insure they conform to the requirements of major payroll related laws.

- Some professional investors have been increasing the return on investments by purchasing savings bonds which provide a higher interest rate, rather than purchasing short-term Treasury bills to make short-term investments. Investors were able to obtain the interest on savings bonds if they held them for 6-months. Then, they'd invest the money in another issue of savings bonds. To stop this practice of bond flipping and to force professional short-term investors to buy

Treasury bills, the Treasury Department recently extended the holding period on savings bonds to 1 year, to obtain any interest payment. The lengthier holding period took effect for bonds dated February 1 or later.

INSURANCE

Some labor unions have negotiated contracts with employers whereby they accept a lower wage scale in exchange for the employers providing disability insurance coverage utilizing pre-tax dollars. Recently the Tax Court held that benefits from the plan were taxable to the covered employees, even though the plan was funded with give-backs by the workers. The only way the payouts would be tax-free is if the employees paid into the plan using <u>after-tax</u> dollars. The ruling suggests these types of arrangements be reviewed to determine that the assumed tax consequences are valid.

The IRS is easing up on permitting the deduction of premiums paid to captive insurers (subsidiary companies formed to insure the risk of the parent company). The IRS says it will allow the deductions when the captives earn more than 50% of their revenue from unrelated companies. Conversely, no deductions will be allowed if less than 10% of the earnings are derived from unrelated companies. (Courts have allowed premium deductions even when as little as 30% of the captive's earnings come from outside companies.) The IRS also says that when a subsidiary of a holding company insures their risks through another subsidiary, it will allow a full deduction for the premiums even if this is the captive company's only business.

The rise in insurance premiums can at least be partly blamed on widespread insurance fraud. This is borne out by a recent survey in which 1 in 4 respondents said it was all right to defraud insurance companies. Among the respondents, 16% also thought it was acceptable to overstate the value of claims, and 39% stated they would not report someone who had committed insurance fraud. It's estimated the annual cost of insurance fraud is $24 billion and, unfortunately, all of us end up paying the premium increases necessitated by the dishonesty.

LABOR RELATIONS

Although most companies still pay their workers by check, this is both inefficient and costly. As a result, many firms have attempted to utilize direct deposit (electronic funds transfer into the employee's bank account) to lower their costs. Unfortunately, use of this approach is often impossible because there may be a significant percentage of workers who have no bank accounts. Therefore, some employers are now turning to the use of pay cards issued by credit card providers such as VISA or MasterCard. Here, the employee's pay is loaded onto the card, which can then be used like a credit card or at ATMs to draw cash. After an initial fee in the $3 range per card, the card issuer charges about 25 cents per transaction to load the pay electronically on the worker's cards. The use of pay cards is ideal for firms that have a high employee turnover rate, utilize a lot of

temporary employees or have a decentralized employee base that makes it difficult to use direct deposit to an employee's bank account. The hospitality, food service, retail and health care industries are among those where pay cards are making rapid inroads. If you are thinking of ways to lower payroll preparation costs, you might want to discuss pay cards and other wage payment systems.

Here is a reminder that, although the ceiling for tax-free transit passes provided by employers was unchanged at $100 for 2003, there has been a slight increase in the amount an employer can pay tax-free for parking expenses of employees. For 2003, the limit is $190 per month.

The U.S. Chamber of Commerce says that in 2001, employee benefits made up 39% of total payroll costs, an increase of 1.5% over 2000. Following is a breakdown of what each payroll dollar comprises:

< Wages	61%
< Medical benefits	11%
< Pay for time not worked	11%
< Legally required payments (payroll taxes, insurance)	8%
< Retirement and savings	8%
< Other benefits and costs	1%

One bit of good news is that, despite significant increases in benefit costs and adverse business conditions, employers have pretty much left their benefit programs intact.

An estimated 82% of U.S. firms implemented at least one strategy for lowering labor costs in 2002. Here is a breakdown of the principal cost reduction measures they instituted:

< Staff reduction	53%
< Reduction in salary increases	46%
< Reduction in or freeze on hiring	46%
< Increased employee contribution for benefits	38%
< Eliminated or reduced bonus payouts	21%

MARKETING

The President has signed legislation creating a national "Do-Not-Call" list aimed at helping consumers block unwanted telemarketing calls. The program should go into operation this summer, and it will be funded with fees collected by the Federal Trade Commission from telemarketing firms. The legislation requires telemarketers to check the list every three months to find out who does not want to be called, and imposes fines of up to $11,000 per violation. The legislation exempts calls in behalf of charities, surveys and politicians from the requirements, as well as companies with whom you do business, such as your bank or phone company. In the meantime, if you are annoyed by an unwanted call, rather than hanging up, instruct the caller to place your phone number on its do-not-call list. Alternatively

write to the Direct Marketing Association at: DMA TPS, Box 1559, Carmel N.Y. 10512, and request to have your phone number placed on its Telephone Preference Service (TPS) do-not-call list. The latter move provides protection against telemarketing calls for 5 years.

Tax-exempt organizations can be taxed on exclusive marketing, deals such as allowing only one brand of soft drinks to be sold on campus. IRS regulations indicate that payments received for limiting a competitor's sales or for providing a company with a competitive edge are taxable because they offer the sponsor a substantial benefit. On the other hand, exempt groups will not be subject to unrelated business income tax on links to a sponsor's web site unless the sponsor's site indicates the charity endorses its products.

Increasing numbers of online shoppers are visiting online comparison shopping sites. Recent data shows that 1 in 4 online shoppers (13 million) visited a comparison shopping site in November. But here is the surprise. Rather than attracting low income or elderly individuals on fixed incomes, 55% of the comparison shoppers had household incomes in excess of $60,000. Incidentally, the primary reasons given by people for being online shoppers are: price, selection and convenience.

MONEY, BANKING AND CREDIT

Try to encourage your customers to pay by credit card rather than obtaining credit from your firm. Your principal advantages are:

1. You get paid by the credit card company within 24 hours, accelerating your cash flow.

2. You avoid collection hassles.

3. You don't have to assess whether the customer is a credit risk.

4. Your cost is negligible because the credit card company usually charges about 2%, an amount roughly equal to the discount you might normally offer.

To persuade customers to pay by credit card, you might point out:

1. By careful timing of the purchase they can create an interest-free credit cycle for themselves of between 50 and 60 days.

2. They may obtain frequent flyer miles if that is a condition of their credit card agreement.

3. They might be able to obtain rebates, points, warranty extensions or other benefits provided by their credit card company.

Surprisingly, many merchants make no effort to have customers pay by credit card even though there is a mutual benefit.

- It's much cheaper to handle transactions electronically than using paper and the mail. No wonder many firms are offering customers online billing. Usually the companies inform customers months in advance of offering the option. Then, if the customer accepts, the bills are transmitted via E-mail or posted on a secure web-site where they can be accessed via the Internet using the customer's password. As an incentive to encourage electronic billing, firms such as insurance companies and telephone companies may impose charges of $12 to $48 if you want to be billed by mail. However, you should not feel pressured. If a company tries to impose a significant charge, call their customer service department, indicate you lack Internet access and try to negotiate a reasonable arrangement. If the company refuses, take your business elsewhere.

PENSION AND ESTATE PLANNING

- The IRS has indicated the 60-day rollover IRA rule for IRA and pension plan distributions is not set in stone. It has indicated it would waive the requirement in hardship situations. Examples of situations which might qualify include delays caused by casualties (fire or theft or a natural disaster), mistakes by the Postal Service, hospitalization of the plan participant or other events beyond the person's control. Relief would also be provided if a bank or other retirement plan custodian or trustee puts retirement funds in a non-retirement account in error.

- The IRS indicates more retirement plans are going to be audited this year. It intends to conduct about 8,000 examinations of companies in different industries to look for trouble spots. It also plans to concentrate 50% of its audits on firms in the banking, construction, health care, manufacturing, insurance and professional service industries, where non-compliance with regulations has been a problem. This will enable the Agency to target its audit capabilities in future years to areas where non-compliance is most likely.

- The top estate and gift tax rate declined 1% this year, to 49%. The rate applies to estates and gifts in excess of $2.5 million. However, the estate and gift tax exemption remains at $1 million, and the annual gift tax exclusion also remains unchanged at $11,000.

- If you opened a Roth IRA in 1998, the 5-year requirement for tax-free distributions was met on January 1 of this year. Thus, if you have reached age 59 1/2, you can take distributions from the plan without tax, regardless of how the distribution is used. Also, if you converted a regular IRA to a Roth IRA in 1998 but have not yet reached age 59 1/2 you can withdraw the converted amount, but not the earnings, both tax and penalty-free. Of course, to maximize the compounding of tax-free investment growth, it's best to delay taking any money out as long as possible. Since there are no annual distribution requirements with respect to these accounts, all kinds of strategies can be utilized to benefit from the tax-free accumulations. Some people are even using these accounts to provide bequests that are spread out over the lives of beneficiaries tax-free.

What if an older person ends up with an illness that requires long-term care, but he or she lacks long-term care insurance? The situation is not unusual because many people don't buy this type of protection because of its high cost. However, that isn't necessarily disastrous. There are a number of alternative ways of financing long-term care, even though one doesn't qualify for Medicaid. Possibilities include:

< Self-funding, if family resources are sufficient

< Use of a reverse mortgage

< Utilizing a sale and leaseback transaction

< Use of life insurance with a long-term care option

< Obtaining an annuity

It may be a good idea to evaluate these alternatives long before there is a need, and determine the relative cost for obtaining a roughly identical benefit as with long-term care insurance. Then determine whether financially, you'd be better off with or without the insurance.

PERSONAL FINANCIAL PLANNING

If you have your own business or operate a family business, your salary provides only one opportunity for taking money out of your company. There are a variety of possible fringe benefits that can be effective in lowering the company's income at a much lower tax cost. Possibilities include:

< Company purchase of a significant term insurance policy on your life

< Company paid medical insurance

< Establishment of an education assistance program

< Company reimbursement of disability insurance premiums paid by the policy owner in a year in which no claims are made

< Establishment of a qualified age based retirement plan that lets business owners obtain a greater benefit than other employees.

Whether these or other possibilities are suitable depends on a variety of financial and tax considerations as well as the ability of business owners to utilize the benefits.

Buy-sell agreements can enable the estate of an owner of a family business to raise cash to fund testamentary bequests and pay estate taxes. Such agreements may also be effective in valuing an estate for tax purposes. However, such traditional

agreements, which are usually funded by life insurance, may not be suitable where only the immediate family operates the business. For example, if a spouse and children of the owner carry on the business, and among two or three children, only one wishes to be active in the business, this creates an estate planning uncertainty, since the business is likely to comprise most of the wealth of the estate. Here, leaving the business to this child may be unfair to the siblings or the surviving spouse. Conversely, leaving the business to the surviving spouse may make no sense if the surviving spouse lacks the knowledge or interest to actively manage the business. One possibility for equalizing the estate in these circumstances is to create additional estate assets by purchasing life insurance so each child is left with assets of approximately equal value, and the surviving spouse would also be provided for. If the arrangement is properly structured, the life insurance proceeds would also be excluded from the decedent's gross estate. Still, another solution would be for the parent and child to enter into a modified buy-sell agreement obligating the parent to sell, and the child to purchase the business at a price determined in the agreement. The consideration for the purchase could again be provided for by life insurance carried on the owner's life. Alternatively, an installment note could be used in place of, or in conjunction with a life insurance policy, but in that case, the child would be obligated to make cash payments from the cash flow generated by the business. Furthermore, to prevent family discord and also minimize the possibility for an IRS valuation dispute, a professional appraisal of the business should be obtained initially and at regular intervals so the value specified in the buy-sell agreement would result in an equitable distribution among the siblings and the surviving spouse.

The IRS has clarified its regulations governing donations of automobiles to charity. Thus:

< A donor's transfer of a car to a charity's authorized agent may be treated as a transfer to the charity, and the agent may provide the contemporaneous written acknowledgment.

< The donor may use an established used car pricing guide to determine the fair market value of a single donated car, provided the guide lists a sales price for a car that is the same make, model and year sold in the same area and in the same condition as the donated car.

Since the IRS has been cracking down on abuses by so-called charities and by taxpayers in connection with used car donations, we recommend readers make sure about the legitimacy and charitable status of any organization to which they donate a vehicle.

What's the profile of the average millionaire? According to Forrester Research, he or she is a 55 year-old with an average income of $194,000 per year who works about 42 hours per week. About 69% of millionaires have a college degree; 87% are married or live with a domestic partner and 24% are retired. But perhaps, what distinguishes them the most is their mind set. They:

- < Believe it's important to increase their assets during their earning years.

- < Want to manage and arrange their affairs during their working years to ensure comfortable retirement.

- < Place a high value on family and want their children to be well off when they die

- < Want to avoid having an excessive amount of their wealth taxed by the Federal and state government.

- < Appreciate the value of financial planning, and begin the process when they are fairly young.

- < Rely on accountants, lawyers, insurance agents and stockbrokers to help them manage their wealth.

A new millionaire is created in the United States about every four minutes.

REAL ESTATE

- # In general, leasehold improvements have to be depreciated over their estimated useful life. But, according to the Tax Court there are exceptions. In one instance, a business rented space in a building under construction. Under the lease terms, the tenant had to finish the construction for the lessor and, in exchange, the landlord waived rent for 6 months. It turned out that the construction costs far exceeded the amount of the rent holiday. The IRS wanted the lessee to capitalize the entire cost of the improvements and recover it via depreciation deduction. However, the Tax Court held, to the extent the costs were equal to the amount of the rent holiday, they could be treated as rent and expensed at once by the lessee and only the additional outlays were required to be capitalized and depreciated. The Internal Revenue code provisions are frequently subject to interpretation, and sometimes taxpayers and their professional advisors who can support their positions with sound arguments succeed in lowering their overall taxes.

- # Loan origination fees, loan discount fees, maximum loan charges or discount points, all commonly known as points, are charges paid by the borrower in order to obtain a mortgage. Frequently, points are also paid to obtain a loan at a lower interest rate. In general, points are tax deductible in the year they are paid, if the following Internal Revenue Code requirements are met:

  - < The mortgage is secured by the principal residence

  - < Paying points is an established business practice in the area where the loan is provided

  - < The points are comparable to points generally charged in the area

- The points are calculated based on the principal amount of the mortgage
- The points are not being paid as a substitute for other ordinary payments such as appraisal fees, title fees, inspection fees, legal fees or property taxes
- The funds provided (not borrowed) at or before closing, plus points paid by the seller, are at least as much as the points charged
- The mortgage proceeds must be used to acquire or build a principal home
- The amount is clearly identifiable on the settlement statement as points.

If points are paid but fail to meet these criteria, they may still be tax deductible, but the deductions would have to be taken over the period of the mortgage loan. Incidentally, points paid for the purchase of a second home and points paid to refinance a mortgage must also be deducted over the term of the mortgage loan. Conversely, if part of a refinancing was used to improve the principal residence, the points attributable to the improvement are deductible in the year they are paid if they meet the other requirements outlined above.

TAXATION

- If you are one of the 300,000 taxpayers who paid their taxes last year using a credit card to earn frequent flyer miles, you were charged about 2.5% of the amount of the payment by the service provider as well as interest, if you failed to to pay the credit card company immediately. You need to be aware the fee paid for the transaction is a non-deductible personal expense and cannot be deducted as a tax preparation expense because the cost is incurred after your tax liability has been determined. Clearly, you paid a hefty fee to obtain the frequent fliers miles; but, you can take some solace in the fact that the miles earned are not taxed as income. In general, the only time it makes sense to use plastic to pay your taxes is if the card provides frequent flier miles or rebates that exceed the processing fee.

- The IRS has significantly tightened its tax shelter disclosure rules which require taxpayers to disclose, and promoters to maintain investor lists, for the following six categories of transactions:

  - Listed transactions that have been specifically identified by the IRS as tax avoidance transactions
  - Transactions marketed under conditions of confidentiality
  - Transactions with contractual protection that taxpayers will be made whole if the tax breaks are denied
  - Transactions generating a tax loss exceeding specified amounts

< Transactions resulting in a book-tax difference exceeding $10 million

< Transactions generating a tax credit when the underlying asset is held for a brief period of time.

The new regulations also provide for more severe fines than earlier regulations for not reporting deals that fit into these categories, and provide that material advisors (persons required to register a transaction under Internal Revenue Code Section 6111, or persons who receive at least a minimum fee with respect to the transaction and make a tax statement to certain taxpayers) must register transactions that are potentially abusive tax shelters. The new IRS tax shelter disclosure rules apply to investments made after February 28, 2003.

The IRS has obtained the credit card records of thousands of taxpayers who it suspects have under-reported income by using cards issued on foreign accounts to cover their expenses. Although having an offshore credit card is no crime, it is illegal to use the account to avoid U.S. income taxes. Since it lacks the resources to audit all individuals who used the offshore credit cards, the Agency is now offering those who come forth voluntarily, partial tax amnesty. This requires taxpayers to provide full details about who promoted or solicited the offshore arrangement in exchange for avoiding civil fraud penalties. Taxpayers will, however, still be required to pay back taxes, interest, and certain accuracy and delinquency penalties if they come forth voluntarily. To be eligible for the amnesty, they must have applied by April 15th.

Although the Internal Revenue Code provides for limited deductions for business entertainment, in general, it prohibits deductions for facilities that are used for entertainment. In one case, recently, a broker owned a beach house at which he held regular business meetings, but on occasion he also invited the family members of the attendees to come to the house, in effect, entertaining them there. Despite the fact the entertainment was minimal, the Tax Court denied deduction of any depreciation associated with the house. As a precaution, if you intend to deduct costs associated with a boat, apartment or other property you use for business, entertain business associates and their families elsewhere to avoid a hassle with the IRS or the Tax Court.

Pressured by states that are experiencing severe budget problems, a number of major retailers agreed recently, to start collecting sales taxes for merchandise sold online. The retailers include Walmart, Toys "R" Us, Target, Marshall Field's, Mervyn's and 5 other chains. In return, 38 states and the District of Columbia won't hold the retailers liable for uncollected Web taxes. The states are in the process of creating a centralized system for collecting the roughly $200 million in sales taxes they estimate they are losing annually on Internet sales. Web shoppers will find their purchases will become more expensive as a result of the agreement reached with the retailers.

The IRS is cautioning taxpayers who use cell phones for business that they must

keep detailed records of business use of the phones just the same as records must be maintained for business use of automobiles and computers. Failure to maintain proper records will lead to disallowance of the deductions for lack of substantiation, according to the Agency.

PAYROLL TAXES

Owners of S corporations need to be careful about having the company treat them as independent contractors in order to reduce taxes. In a recent case, a construction firm filing as an S corporation failed to pay a salary to its president and sole owner. Instead, he reported the company's profits as earnings on his tax return, so that the company would avoid paying any payroll taxes to the government. The IRS challenged the tax treatment and the matter ended up in the Tax Court. It ruled the S corporation owed back employment taxes. Since the owner performed services for the firm, he is deemed to be its employee. Therefore, the S-corporation's profits are his wages. The Court was deaf to the owner's argument that since the firm did not exercise control over the performance of his services, he was an independent contractor. The IRS is on the lookout for abusive payroll tax schemes such as this. It also decided to look at the return preparer's own company, only to find that it also was an S corporation that used this scheme with respect to the owner's compensation. Then it decided to look at the tax returns of its clients. Again, all of the client returns used the same scheme to avoid paying payroll taxes.