COMMENTS - JULY, 2003

ACCOUNTING AND AUDITING

The Financial Accounting Standards Board has issued Statement No. 149, *"Accounting for Certain Financial Instruments with Characteristics of Liabilities and Equity."* It establishes standards for the issuer's classification as liabilities in the Statement of Financial Position of financial instruments that have characteristics of both liabilities and equity. The Statement will generally be effective at the beginning of the first interim period beginning after June 15, 2003, and it also provides a special rule for non-public companies.

It wasn't very long ago that business managers were gobbling up every business that came under their scrutiny. Now, many are discovering some no longer fit into their business model, or the growth potential of others has become significantly diminished. Therefore, it is not surprising business managers trying to survive in this difficult economic environment are facing this dilemma and disposing of businesses which no longer meet their financial criteria or business objectives. Principal reasons underlying these divestitures include:

< Enhancing shareholder value
< Improving overall profitability
< Reemphasizing core competencies
< Improving competitive performance
< Sharpening organizational focus
< Need to raise cash

Looking for an accountant or auditor? Here is a logical way to go about it:

1. Evaluate your needs based on the size of your firm, the industry it is and the requirements of your credit grantors.

2. Interview several firms to assess their strengths and weaknesses and to obtain a sense of whether there is compatibility with the person you will be dealing with.

3. Check references thoroughly.

4. Provide complete information about your business and services.

5. Negotiate a fee that is fair.

6. Get a written engagement letter spelling out the terms of your arrangement.

Some of the information you should obtain in the interview to differentiate among prospective CPA firms include:

- Areas in which the CPA firm specializes.
- Size of the clients.
- Industries in which the firm has clients.
- Level of personnel that will be assigned, and the position in the firm and accessibility of the person who will be in charge of your account.
- Billing rates of the firm.
- Estimated time requirements for performing the work.
- Method of billing and details provided.
- Work your firm could perform to facilitate the engagement.

ADMINISTRATION, SYSTEMS AND EDP

- Does your company have a web site? How successful has it been in generating business for your firm? Different companies use alternate measurement criteria for determining the success of a web site. Among the most common measurement techniques are the following:

Number of visitors to the site	58%
Number of new customers obtained via the site	43%
Amount of revenue generated	35%
Reduction in customer service calls	27%
Customer service cost savings	25%

The responses add up to over 100% since respondents were allowed multiple responses. Incidentally, the reason for utilizing reduction in customer service calls as a measure of web site success is that it indicates visitors are able to easily navigate the web site and become self-reliant customers with just a few mouse clicks. Perhaps your firm can use some of the above criteria to determine the success of its web site.

- Radio frequency identification tags have gained wide acceptance in E-Z pass systems that let cars pass through toll booths without stopping and they are used by marathon runners to accurately monitor race time, just to mention two applications. But now, some firms are using them to revolutionize supply-chain operations and track individual items. The cost to produce the tags may be as low as 15 cents each, and users claim they have cut supply chain costs by 3% to 5% and increased revenue by 2% to 7% compared with using traditional bar code labels for tracking items. Among the advantages of the radio frequency I.D. tags is the fact that more information can be stored on them than on the bar code labels. On the other hand, to use the radio frequency tags companies have to make a substantially investment in wireless infrastructure which may more than offset any benefits derived from use of the tags.

Want to cut your postage outlays? It doesn't necessarily require a rocket scientist. Instead, there are some simple way of minimizing these costs. Here are some ideas:

< Make sure your staff is familiar with current postal rates and mailing options.
< Weigh all mail before affixing postage.
< Check your postal scales regularly for accuracy.
< Utilize an up-to-date postal rate chart in your mail room.
< Restrict access to postal meters and stamps to prevent personal use.
< Be aware of mail pick-up times to minimize use of Priority or Express mail.
< Cull mailing lists regularly to avoid duplications and eliminate defunct addresses.
< Utilize pre-sort, bulk mail and other discounts.
< Consider the use of fax, e-mail and other means of communication.
< Give someone the responsibility for controlling postage costs.

Web sites are valuable assets on which companies spend substantial resources and as such, they should be protected. Here are some ideas:

< Be sure you have a legally binding written agreement with the site developer granting you ownership of all site content including logos, graphics, software, icons, etc.

< Register the site with the U.S. Copyright Office, and follow registration procedures in foreign countries in which you conduct business.

< Protect your ownership rights by placing the copyright symbol, the year of the copyright and the name of the copyright owner on each page of your site.

< Publish a terms-of-use section that tells users they may not copy, modify, redistribute or publish any part of the site or display the content within the window of another site.

< Monitor the Internet for unauthorized use of your trade name or the use of close derivatives at other sites.

It's important to obtain professional legal advice to make sure that your Web site is adequately protected.

FEDERAL REGULATIONS

The Securities and Exchange Commission has issued final regulations requiring Wall Street analysts to certify that they actually believe the information they put into their research reports and public statements. The analysts are also required to sign statements verifying they did not receive any compensation related to their stock recommendations and research. Aside from wanting to provide more reliable research reports to investors, the SEC will find it easier to bring civil charges

against someone who has given false statements. Investors are cautioned that the certification requirement is no panacea, and they must continue to do their own careful research in making investment decisions.

The IRS has finalized pension plan loan regulations that address: (1) refinancing transactions; (2) multiple loans (new loans made while a deemed distribution loan remains unpaid), and (3) participants on leave of absence for military service. Among other things, the regulations: (1) provide that, except for a principal residence loan, the maximum term of a plan loan is 5 years; (2) do not prohibit multiple loans; (3) indicate a loan that is deemed to be distributed under Internal Revenue Code section 72(p) is no longer treated as an outstanding loan, and (4) provide for suspension of a participant's loan repayments during a period when the participant is performing military service.

INSURANCE

The Department of Veterans Affairs has announced a special dividend will be paid to veterans who own government life insurance policies and who served in the military between 1917 and 1956. Included are payments of about $462 million to World War II veterans who own National Service Life Insurance policies.

One way of lowering the cost of life insurance coverage is to use blending. It substitutes low-cost term insurance for a portion of the face amount of a whole-life policy. Blending may result in a higher cash value and death benefit for the same premium than a whole-life policy can provide. Since commissions on blended insurance tend to be lower, you'll seldom be told about this possibility for maximizing insurance protection without specifically asking your broker.

Retention of life insurance may still be important for employees in their 50s and 60s, but the cost is often prohibitive. The solution might be to use pre-tax dollars to obtain the insurance coverage. This can be achieved if your company has a tax-deferred retirement plan which provides a life insurance option. Although "self-dealing" by a plan sponsor is prohibited under ERISA, there are specific exceptions which allow for the transfer of life insurance policies and annuities to a tax deferred retirement plan under certain circumstances. For example, according to the Department of Labor, a transfer of life insurance policies into a profit-sharing plan would pass muster if the plan acquires the insurance policies for the lesser of the cash surrender value or the participant's account balance. To qualify for such transfer, there can be no outstanding policy loans or liens with respect to the transferred policy, and the underlying employee benefit plan documents must permit the purchase of life insurance.

Terrorism insurance is back in vogue. A number of companies have developed these products for worried vacationers and an estimated 20% of travelers now purchase them. If you are considering a policy read the fine print carefully. Some policies:

< Include protection only for travel within the United States.
< Provide for trip cancellations within a very limited period from a terrorist strike.
< Exclude specific destinations where there has been terrorist activity in the prior six months.
< Impose time requirements within which a policy must be purchased after a trip is booked.

Cost of the policies can typically run between $200 and $400, depending on the coverage provided and risk factors at the vacation destination. Of course, if it's a relaxed vacation you are looking for, you might seriously consider going to a place where terrorism protection isn't needed.

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 having a high employee turnover rate, utilizing a lot of temporary employees or having a decentralized employee base, making 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.

< The Tax Court says that low compensation taken in earlier years by the owner of a struggling business, in order to conserve enough liquid assets to enable the firm to meet bonding requirements and help it secure larger contracts, should not be an impediment for granting a huge pay increase to the owner. Here, after the firm got back on its feet financially, the owner quintupled his salary, and the Court concluded, over the IRS' objection, the increased pay was reasonable compensation to make up for the earlier under-compensation necessitated by the dire financial condition of the firm.

< A recent survey of over 1,000 publicly held corporations indicates about 3/4 have established a supplemental executive retirement plan. Based on specific position levels, following are the percentages of executives who may participate in these plans:

< Presidents and chief executive officers	72%
< Boards of directors	7%
< Executive vice presidents	64%

< Senior vice presidents	57%
< Vice presidents	41%
< Division or unit managers	10%
< Highly compensated sales personnel	13%

Companies claim the following as the primary reasons for establishing these plans:

< To replace benefits lost by Internal Revenue Code restrictions such as 401(k) salary caps
< To provide additional incentives for high-level executives to join the firm
< To provide executives with retention incentives
< To replace benefits lost by tax limitations
< To provide targeted retirement compensation
< To provide retirement benefits that exceed those under qualified plans

There has been much publicity about violence in the workplace. Recent data from the Bureau of Labor Statistics indicates the major source of workplace homicides (73-82%) occurred during a robbery or commission of a crime rather than from disputes between co-workers. Only 4% to 6% of all workplace homicides were attributed to the latter. However, there are variations in the homicide rates in different industries. According to the Bureau, the workplace homicide rates per 100,000 workers were as follows:

< Retail trade	1.60
< Public administration	1.30
< Transportation & communications	.94
< Agriculture, forestry & fishing	.50
< Mining	.40
< Service	.38
< Construction	.37
< Wholesale trade	.27
< Manufacturing	.24

The most dangerous occupations, according to the Bureau, per 100,000 workers were: taxi drivers (22.7% homicide rate); police officers (6.1% homicide rate) and security guards (5.5% homicide rate). Employers in industries with high homicide rates need to be particularly conscious of the risks, observe workers for unusual behavior, encourage staff to report threatening incidents and establish security procedures and other measures for dealing with distraught workers.

MARKETING

How many of your new customers are attracted by a sign on your premises? A 2-year study in California, of 165 independent small businesses and 2,475 new customers revealed that the way they first learned about the business was from the business' signs. Furthermore, the survey concluded that between 15% and 45% of

a small firm's revenue is directly attributable to its signs. These are effective in identifying the business, building brand awareness and promoting impulse sales, and they also help a small business compete against larger stores and franchises according to the survey. Because of the significant impact the on-premises signs may have on business marketing and profitability, it is important to carefully negotiate signage rights with landlords at the time of lease renewal.

When customers return merchandise retailers have two objectives: To minimize the cost of the return process and to evaluate the vendor to assess whether there is a recurring problem. Here are some thoughts for accomplishing these objectives:

< Obtain sufficient information to facilitate an analysis of the reason for the merchandise return.
< Have customers return goods directly to the manufacturer to minimize cost.
< Consider the possibility of refurbishing and reselling returned goods online or in the store.
< Evaluate whether outsourcing of return processing could reduce overall cost.
< Develop vendor/product score cards to determine whether some suppliers sell an unusual amount of defective products.
< Consider the merchandise return process in terms of minimizing shipping costs.

Although merchandise returns have negative profit implications, a periodic analysis of a company's return policies and procedures can increase goodwill and aid both customer acquisition and retention.

MONEY, BANKING AND CREDIT

When a person has a debt forgiven by a creditor, the person receives taxable discharge of indebtedness income (DOI) in the amount of indebtedness that was forgiven. This DOI income must be reported to the IRS on Form 1099-C by financial institutions and other entities that forgive debt, and it may be reported by others. For example, some businesses issue a Form 1099-C to induce customers to pay past due debt to the vendor and threaten that, if they refuse, they'll end up paying the IRS. However, this can backfire if the open balance is a disputed amount because the IRS will assume a tax bill is due while the debtor doesn't believe he owes any debt at all. Similarly, if a Form 1099-C is filed while a debtor is still willing to negotiate a settlement, there may be no agreed amount of indebtedness between debtor and creditor, yet the IRS will be attempting to tax a debt forgiveness. Finally, even if there is a formal debt discharge and a Form 1099-C is filed, it may not properly reflect the year in which the debt became uncollectible, which is the year in which the income should be taxed. This error could impact on the amount of tax due. Our advice is for creditors to carefully evaluate the use of Form 1099-C with their professional tax advisor and also, that debtors examine any Form 1099-C they receive for accuracy about the date and amount of debt discharge claimed.

If you want to improve the effectiveness of your collection personnel, the easiest

way may be to devise a system of incentive pay for your collectors. One approach is to provide:

- < A base salary equal to roughly 20% of the normal monthly collections
- < A percentage of all collections above the base amount
- < An annual bonus to reflect the collector's overall contribution to the company's success

There is no magic formula to fit every situation. However, by providing an incentive compensation arrangement that fairly reflects collection effort and success, workers will generally be positively motivated.

Unfortunately, if you are in the habit of making minimum payments on your credit card bills, it's almost impossible to ever get out of debt. Assuming you pay the minimum 2% balance on the outstanding debt and the credit card company has 17% annual interest rate, here would be the result:

Credit Card Balance	Total Time to Pay Off Debt	Total Cost
$1,000	17 years and 3 months	$ 2,590.25
2,500	30 years and 3 months	7,733.49
5,000	40 years and 2 months	16,305.34

We suggest that if you get into the credit card debt syndrome, recognize that you have a problem that is out of control. You should prepare a reasonable budget, prioritize the payment of your debts, try to negotiate reasonable bill-paying options with your creditors and establish an overall debt repayment and financial plan to help you get your financial life back in order.

PENSION AND ESTATE PLANNING

New IRS regulations permit employer plans to establish IRAs and Roth IRAs inside their employee benefit plans and to receive employee contributions into them via payroll deduction. Employers who want to provide this option can use model amendments furnished by the IRS to set up these accounts. The new regulations are intended facilitate workers' ability to save for retirement.

The inflation adjusted amount that a taxpayer can lend to a qualified continuing care facility at a below market interest rate without the IRS imputing interest on the loan was increased this year to $151,000, up from $148,000 last year. This pertains to loans made by a person who is 65 or older to a qualified continuing care facility for lifetime care provided the principal amount of total loans made by the lender or the lender's spouse does not exceed the inflation adjusted limit.

The Court of Appeals for the 4th Circuit says extra pension benefits given exclusively to retirees can be dropped, and only pension benefits earned as an employee cannot be reduced. The case involved cost-of-living increases paid to workers who were already receiving pension benefits pursuant to a pension plan

amendment. When the company decided, 5 years later, to eliminate the inflation adjustment, the union representing the retirees sued. But the Court held, since the yearly cost-of-living adjustments were paid only to workers who were already retired, anti-cutback rules do not apply. This is an issue that is going to crop up more frequently as companies look for ways to reduce the cost of retiree benefits in light of deteriorating business conditions.

The IRS has approved a new type of cash balance plan that is a hybrid of a pension plan and a profit sharing plan and provides a pension-like benefit that's funded by contributions to employee accounts. Here, pension plan contributions are lowered, and benefits accrue faster for younger workers than in a traditional pension plan. If a plan converts the new plans also provide that older workers can't get less of a pension than they had in the former plan, although the amount placed into the cash balance plan in their behalf may be a lesser amount than that sum. It may also take a number of year before older workers obtain a greater benefit under the cash balance plan arrangement. Recently issued IRS regulations also indicate cash-balance conversions don't violate age discrimination laws, despite the fact some older workers may have to work longer under the new plan before their benefits will exceed those under the former plan.

Ready to shift funds from your 401(k) plan at your employer into an IRA? Think twice about it if you are engaged in litigation. Federal law protects all qualified employer-based retirement plans (401(k), pension and profit-sharing plans) from being attached by any creditor. While most states provide some protection for IRA funds, the level of protection differs from state to state. Thus, before moving funds, obtain professional advice to determine whether the funds in the IRA could be attached to satisfy a creditor's claim. Incidentally, self-employed individuals with a one-person Keogh plan, such as doctors or other professionals, need to be aware these also lack protection against claims of creditors under Federal law. If protection under state law is similar for IRAs as for qualified benefits plans under Federal law, it may also make sense to roll the funds over into an IRA upon retirement, to take advantage of greater retirement planning options.

PERSONAL FINANCIAL PLANNING

The Internal Revenue Code (Section 215) provides that alimony payments, to be deductible by the payor, must be includable in the income of the recipient. Nevertheless, the IRS has just held that a taxpayer may deduct alimony paid to a foreign recipient even though the payment is exempt from U.S. income tax because of a tax treaty which provides for an exclusion from the foreign resident's income. The IRS says this is consistent with the rules when there is a statutory exclusion. For example, the Agency has allowed a deduction for alimony paid to a citizen and resident of Puerto Rico even though the payments were excludable from the recipient's income under the Internal Revenue Code.

If you have a lifetime hobby that has business potential, why not turn it into a business venture? For the undertaking to be treated as a business, you must have a

profit motive. But the government recognizes you may not make a profit immediately, and will automatically treat the venture as a business, if you make a profit in three out of 5 years. This enables you to take all of your business expenses as deductions over the 5-year period and offset losses against other income reported on your tax return. Should you fail to meet the 5-year test, the IRS would consider the venture a hobby and limit your deductions to the income the hobby generates. Furthermore, the expenses would be treated as miscellaneous expenses and could only be deducted to the extent the miscellaneous expenses exceed 2% of your adjusted gross income. At any rate, you can request the IRS to delay, up to 5 years, in making the decision of whether your business is conducted for profit or is merely a hobby. Even if a business fails the 5-year profit test, you may be deemed to have had a legitimate business motive if you:

< Maintain complete accounting records as well as other supporting documents
< Conduct the business in a professional manner (attempt to generate business and control costs)
< Devote significant time to the venture
< Depend on the income from the venture for your livelihood
< Show your losses were incurred as a result of circumstances beyond your control
< Modified your operations to prevent recurrence of losses
< Show you and your professional advisors had the experience and expertise to run the business successfully
< Explain you have a reasonable plan for generating profits from the venture

Even if you do not succeed in convincing the IRS of your legitimate business motives, the worst thing that will happen is you'll need to pay added taxes and interest.

Many people have suffered severe stock market losses in recent years, and, because of low interest rates that don't generate adequate income, are opting for other types of investments which have become severely inflated. It's one of the most difficult periods since the Great Depression for engaging in sound money management. We'd like to make some suggestions that should be effective in preserving wealth:

< Maintain adequate diversification between stocks and bonds, as well as within these categories.
< Minimize debt and avoid home equity loans that could put your home at risk in the event of a severe financial setback.
< Be cautious about making real estate investments because rising interest rates could dampen the market for housing in areas with inflated prices.
< Retain a cash reserve for health emergencies, unanticipated repairs and a possible job loss.
< Avoid over-insuring, with respect to life, long-term care and disability insurance by evaluating your actual needs rather than use of a rule-of-thumb formula.

  - Consider the after tax consequences of financial decisions, and engage in ongoing tax planning.
  - Establish a budget to control expenditures and to enable you to pursue a financial plan that will let you accumulate wealth.

- Owners of family businesses lack adequate financial diversification, according to Bank One. It found that 44% of participants in a survey had more than half their wealth invested in the business, and the business owners typically hold only one other type of asset - namely, stock in companies in the same industry, treasury bills or real estate.

REAL ESTATE

- A reverse mortgage is a loan available to homeowners aged 62 or older, which allows them to convert part of the equity in their home into tax-free income without having to sell their home, or give up title. The borrower makes no monthly payment on the reverse mortgage during its term, and the loan comes due when the borrower permanently moves out of the home. Reverse mortgages are usually obtained by people who own a property outright and who want to tap the equity in the home for living expenses or other purposes. Lenders determine the amount of the payments they provide the borrower based on the person's age, current interest rates and the equity they have in the home. The payments may be made either monthly or in a lump-sum, or as a line of credit. One of the enticements for homeowners who opt for these mortgages is that when the loan comes due for the borrower or the estate, it can never exceed the current value of the property which secures the loan. If a home has been bequeathed to a beneficiary at death, the individual can either pay off the loan with other funds or sell the house to pay the lender the balance owed under the loan. Stock market losses and declining incomes for many older people have made reverse mortgages very popular recently. However, it is important for homeowners to shop around carefully to obtain reverse mortgages with the most favorable terms, and they understand they are losing the equity in their home.

- High natural gas prices resulting from the cold winter weather, and uncertain oil markets coupled with high vacancy rates have all taken their toll on the profits of landlords. Although commercial building tenants usually pay for their own heat, landlords usually are responsible for gas that heats water boilers, and the gas that heats stoves and ovens and provides power to laundry rooms in apartment buildings. To pay for these costs, landlords can either enter into a fixed price contract where the rate the customer pays is set for the duration of the contract and based on expectations of what the price of gas will be in the future, or they can opt for an index-based contract, covering a period of one to two years, where the rate is based on current market prices, so bills fluctuate every month depending on market activity. The fixed price contract provides for greater stability and predictability of operating costs, but this can backfire if market prices fall below the price set in the contract. It is possible for landlords to switch to the index-based contract to the other, even if the old contract has not expired, and some contracts actually provide for renegotiation during the term of the contract. In light of the historically high prices, building owners and managers need to review their natural gas and electric supply contracts regularly to minimize energy costs. This entails:

- Being aware of the price situation and recognizing that inaction represents a costly option
- Communicating with utility company account representatives to determine the potential impact of energy prices on their market
- Explaining the difficult conditions to tenants so they understand their rents may be affected by the higher operating costs
- Investigating use of alternative energy systems
- Recasting budgets if necessary to reflect the changed conditions

TAXATION

- Some people decide not to file a tax return because they know that they are unable to pay their tax bill. That's an extremely foolish strategy since the penalty for failing to file a return is about 10 times greater than the one for not paying the taxes owed. The non-filing penalty is 5% of the tax owed per month, up to a maximum of 25%. Conversely, the late payment penalty on any tax owed if one files on time is only 0.5% per month, and this can be reduced by half if the taxpayer enters into an installment agreement with the IRS. To avoid, getting into worse trouble with the IRS than is necessary, we recommend delinquent taxpayers obtain immediate tax advice from a competent professional such as a CPA or a tax attorney.

- Interest rates in the second quarter will remain unchanged on tax overpayments and tax under payments. Thus, the rate on under payments of tax will be 5% (7% on corporate under payments of more than $100,000) and the rate on overpayments is also 5% to individuals and 4% to corporations. The IRS also indicates interest won't be paid on 2002 tax refunds made prior to May 31st for returns filed on or before April 15, 2003. For returns filed after April 15, the IRS won't be required to pay interest on refunds for 45 days after the return is filed.

- Costs covering a spouse who accompanies you on a business trip, are a favorite target of IRS auditors and you'll have to prove the spouse had a legitimate business purpose to deduct many of the expenses. However, this would not be true with respect to costs that would have been incurred regardless of whether your spouse came along or not. Thus, the cost of a rental car would be fully deductible. Similarly, the single person occupancy cost of a hotel room would be deductible. (Often this is identical or just slightly less than when 2 people occupy the room.) Also, you could pay for and deduct the cost of a single airline ticket for yourself, and utilize frequent flier miles to purchase a ticket for your spouse. Finally, if business associates invite their spouses to meals, you would be eligible to deduct the cost for yourself and your spouse with respect to those meals.

Each year the IRS warns taxpayers about common tax scams that promise to lower their taxes for a fee, but are illegal. The IRS has identified a "Dirty Dozen" for this year, and here is a listing of some of them:

1. Use of offshore credit cards, trust or other arrangements to hide or under-report income or claim false deductions
2. Identity theft schemes, where information is used from the client's return by an unscrupulous preparer to perpetrate an identity theft
3. A refund for slavery reparations for African Americans
4. Avoidance of tax withholding from wages
5. Improper reporting of the existence of a home-based business to obtain tax deductions
6. Winning a prize, that can't be obtained until the victim pays the tax on it
7. Use of frivolous arguments such as "taxes are voluntary" to avoid payment of tax
8. Social security refund scams that promise refunds of life-long social security taxes for an up-front fee
9. Sharing or borrowing dependents with another taxpayer to provide both with an earned income credit
10. Obtaining a "disabled access" phone credit for installing a pay phone

The IRS urges people who have been exposed to anyone pushing these fraudulent tax schemes to call the Agency at (800) 829-0433. Of course, taxpayers who utilize a legitimate professional tax advisor year-after-year don't have to worry about being scammed, and they'll also be protected against getting caught up in fraudulent tax schemes that could be costly and even land them in jail.

There has been a huge drop in IRS computer matching of information returns against tax returns between 1991 and 2000, according to research done by Syracuse University. It found that the number of IRS notices sent to taxpayers regarding potential tax underpayments dropped by more than 70% to just 1.4 million annually, from 4.8 million at the beginning of the period. Part of the decline stems from more accurate reporting by information return providers. Over the period, the number of mismatches that resulted in IRS notices going to taxpayers declined from one in two to one in six. Meanwhile, the IRS launched a computerized K-1 matching program to compare information returns filed by partners, S corporations and trusts for 2000 and 2001 with the owner's personal tax returns. The Agency believes that the K-1s report about $1.2 trillion in income annually, and that as much as 20% of the income may be incorrectly reported. The program was interrupted because notices of tax payment deficiencies went out to many taxpayers who had filed proper returns. But now the Agency believes it has sorted out the bugs and will restart the program later this year.

The IRS is conducting about 50,000 random audits of taxpayers to obtain information regarding tax compliance. Recently, the agency indicated that there will actually be 4 levels of audits. They are:

Blind audits of tax returns where the taxpayer has no knowledge that the return has been audited. About 7,000 household will be subjected to these.

Mail audits where IRS asks the taxpayer to clarify or provide documentation for tax return items. Another 7,000 households will be audited this way.

Interviews which will require taxpayers to call for an appointment and clarify return areas the IRS is questioning. This will affect about 32,000 households.

Intense interview or calibration audits which will be a line by line examination of each item on the tax return. About 1,700 taxpayers will be subject to these.

Depending on the complexity of the tax return, it will probably be desirable to have a CPA or tax attorney involved with interview and calibration audits. The new IRS scrutiny is another strong argument for having your tax returns prepared by a competent professional tax advisor.

A new study reveals there were 2.2 million tax filers who could have reduced their taxes by almost $1 billion had they itemized. Only 30% of taxpayers file itemized returns. If you took a standard deduction in the past three years, go over your return and determine whether your itemized deductions would have exceeded the standard deduction you took. If so, file amended returns.

PAYROLL TAXES

An employee who exercises a non-qualified stock option realizes compensation income equal to the excess of the fair market value of the stock received over its purchase price. On Form W-2 this income has been included with other wages. In 2000, the IRS announced it wanted this to be reported separately in Box 12, starting in 2001. Employers and payroll managers raised an outcry about the change, and the IRS made the requirement optional for 2001 and 2002. Now, after considering public comments, it concluded none of the suggested alternatives were reasonable or would provide such accurate information as separate reporting. Accordingly, for 2003 and later years, the IRS is requiring the compensation from exercise of non-qualified option has to be reported in Box 12 using Code V.

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.