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COMMENTS - AUGUST, 2001

ADMINISTRATION, SYSTEMS AND EDP

The contraction of the economy is inducing companies of all sizes to look for fertile areas to reduce costs. One which usually comes under scrutiny are travel costs. According to American Express, total travel outlays of mid- to large-size firms break down as follows:

Airfares	45%
Lodging	17%
Meals	10%
Car rentals	10%
Entertainment	8%
Telecommunications	8%
Miscellaneous (tips, taxis, etc)	2%

If your costs allocation differs significantly from these percentages it might be wise to analyze costs to determine whether the problem results from unusual travel patterns or reflects waste or inadequate control over travel outlays. Incidentally, rising hotel occupancy rates have led to projections of increases in daily room rates from an average of $120.93 in 2000 to $124.95 in 2001.

Filing is a tedious task and often a tricky one, but here are some tips that can make any filing system more user friendly and improve the efficiency of any business or professional practice:

1. Always place the last name first, even when it comes to businesses named after an individual.
2. Last names without a first initial or first name always come before last names with a first initial or full first name.
3. Prefixes precede the rest of the name. Prefixes should be arranged in the files exactly as they are spelled.
4. Spell the name of a business exactly as the business spells its own name, regardless of whether you think it is misspelled.
5. Ignore "The" at the beginning of a name when filing.
6. Disregard hyphens in hyphenated words.
7. Government or political organizations should be filed with the major name first i.e. "Department of Motor Vehicles, Maine" rather than"Maine Department of Motor Vehicles."

FEDERAL REGULATIONS

The Federal Trade Commission is warning online retailers they face potentially big fines for violating the "Mail or Telephone Order Merchandise Rule." The rule requires merchants who sell products via the mail, telephone and the Internet (since it uses telephone lines) to notify customers by specified deadlines if delivery

of an order is being delayed and to offer the option of canceling the order or agreeing to a new shipment date. When it comes to Internet orders, the clock starts running the moment the online shopper clicks the "send" key.

INSURANCE

Business owners often ask us whether it is better, taxwise, to have the company provide employee benefits such as group term life insurance or health insurance and other fringe benefits or rather to raise the workers' pay and let them obtain the benefits on their own. In general, from a financial and tax standpoint it is better for everyone concerned if benefits are provided by the employer. For example, the cost of group insurance is fully deductible as a business expense, and usually, tax-free to your employees. Furthermore insurance is usually obtainable at lower cost when there is group coverage than when individual insurance contracts are purchased. Alternatively, if wages are raised to enable workers to purchase their own benefit arrangements, the additional compensation may result in extra FICA taxes for the business and each employee as well as additional income taxes for the employees. The cost of medical and hospital insurance is a tax deductible expense for employees as well as for the business. However, a 100% deduction is available to the business for the insurance cost, while employees can obtain a deduction for the premiums <u>only</u> when overall tax deductible medical expenses exceed 7.5% of adjusted gross income. Obviously, having the employer provide insurance and other fringe benefits is advantageous all around.

LABOR RELATIONS

It's no secret there has been a general deterioration of ethics and one area where this is particularly evident is in the information provided on resumes. According to one background search firm, the two most common areas of dishonesty are omission of criminal records and falsification of educational achievements. The former was present in 32% of resumes and the latter occurred in 27% of resumes which were investigated. Many employers are aware of the limited reliance which can be placed on data included on resumes. First check for inconsistencies within the resume and for inconsistencies between the resume data and information included on the employment application. Then, as a further step, an estimated 40% now order criminal searches on job candidates; 31% request employment verification reports; and, 15% verify education claims before hiring. How thoroughly does your firm investigate new hirees?

MARKETING

Poor website design is costing E-retailers almost $4 billion in revenue according to A.T. Kearney, a consulting firm. The losses occur when potential purchasers do not complete transactions they were prepared to engage in. Here are the primary reasons:

1. Excessive information requests.
2. Unwillingness to provide required credit card details.
3. Malfunction of the website.
4. Inability to find the product.
5. Unable to specify the product.

6. Unsatisfactory return policies and procedures.
7. Lack of real-time online help with navigating the website.
8. Inadequate information for determining the quality of the product.

It's a good idea to keep these problem areas in mind if you already have or are preparing to launch a website for conducting E-business.

MONEY, BANKING AND CREDIT

Many people are afraid to use their credit cards on the Internet for fear their credit card numbers would be stolen and they might be liable for large bills someone else runs up. That worry is unfounded since the cardholder is only liable for a maximum of $50. However, the merchant, who is duped by a fraudulent user, is the real victim. Credit card issuers often take back the money they have paid merchants via chargebacks when they become aware of a fraudulent transaction and they may also impose an average 2.5% fee, which is typically charged per transaction, as well as a 20 to 30 cent charge for fraud protection using transaction risk scoring services. Merchants are virtually helpless in this situation because currently there is no way of collecting a legally valid signature in conjunction with online credit card transactions to prove a product was ordered. Retailers who are contemplating selling over the Internet must evaluate the risk associated with internet sales and develop systems and procedures for mitigating it.

Check fraud is escalating at an alarming rate and sophisticated copier, scanner and printer technology is aiding crooks who make copies of legitimate check stock which are virtually indistinguishable from the original. Business owners and individuals who accept checks don't need to become experts, however, to detect a phony check. You should be alert to the following signs before accepting a check:

1. Smudging of the print on the check when it is rubbed with a moist fingertip.
2. Raised print on the check rather than flat.
3. Misspelling of words on the check.
4. Poor paper or print quality.

Conversely, to prevent someone from copying your checks and drawing them against your account, use check stock which has a copier void feature that appears on the check when it is passed through a color copier or has a rainbow prismatic design which is virtually impossible to duplicate via a scanner, copier or printer. You should also ask your bank about its policies in the event, despite your precautions, someone passes you a bad check or manages to write a phony check against your account.

PENSION AND ESTATE PLANNING

Is it always advisable for older clients to defer income taxes? In general, older people are usually advised to take minimum distributions from IRAs and qualified retirement plans so most of the assets are preserved in their accounts and continue to earn tax-deferred income. However, because of relatively high graduated personal income and estate taxes, this could be the wrong strategy. For example, if an older person is in a low tax bracket it may make sense to increase the amount

that's withdrawn from the retirement accounts. Otherwise, heirs and beneficiaries of these accounts, who may be in much higher tax brackets, will not only find the assets in the accounts could be subject to estate taxes, but the assets will be taxed at higher income tax rates when the funds are eventually required to be withdrawn. The payment of taxes on distributions taken by the elderly individual also reduces the size of the potential estate which may lower estate taxes. In effect, sometimes it is advisable to increase pension plan withdrawals and use the funds for living expenses, while conserving savings which are not in tax-favored retirement plans for the next generation.

What is the purpose of a will? The answer is not so simple and many people can only give a vague or incomplete answer. Here, is what a will should achieve:

1. Provide for an orderly transfer of all of the property by means of bequests, operation of law and the establishment of trusts.
2. Appoint fiduciaries such as executors and trustees who are both professionally competent and trustworthy together with provisions for their compensation.
3. Provide for guardians if there are minor children.

The will should also be supplemented with a durable general power of attorney which delegates the ability to make and implement financial decisions to a specific individual. And, a durable power-of-attorney designation to someone to make and implement medical decisions. Many people also establish a living will which is also known as an advance directive. This describes the type and extent of life-sustaining medical treatment an individual desires in the event he or she cannot communicate those preferences and there is no reasonable expectation of recovery. The living will is often coupled with a health care power-of-attorney which designates someone to implement these wishes. Those who have not dealt with these matters are urged to do so with the assistance of legal and financial advisors.

PERSONAL FINANCIAL PLANNING

Many people have established "revocable living trusts" to preserve the confidentiality of their financial affairs at the time of death and to avoid long and costly probate procedures in their state. When such accounts are established at banks they are treated as "payable on death" (POD) accounts and are insured up to $100,000 per qualifying beneficiary. Qualifying beneficiaries may be the account owner's spouse, children, grandchildren, siblings and parents. Thus, a $300,000 account payable upon death to a spouse, parent and a sibling would be fully insured ($100,000 for each beneficiary) by the FDIC. However, to obtain this favorable insurance treatment, the funds must pass directly to the named beneficiaries without any preconditions. In effect, if the underlying revocable trust imposes a condition such as the beneficiary must have a college degree or be married in order to receive the funds, the account would be disqualified for POD coverage and would be treated as the account owner's individual account which would be insured only for up to $100,000 in total and not $100,000 per beneficiary. We recommend people with revocable trust accounts at banks review the underlying trusts with their attorneys for restrictive conditions and discuss the insurance coverage with the bank. The FDIC also has insurance consultants who can be reached at (800) 934-3342.

REAL ESTATE

Even though in many instances homeowners won't be taxed on the sale of a home because of the generous exclusion of gain ($250,000 for singles or $500,000 for a couple), there are still many good reasons to maintain records for establishing the tax basis in a personal residence. For example:

1. If appreciation exceeds the exclusion so a portion of gain is taxed.
2. If a gift is made of the home for estate planning purposes.
3. When beneficiaries obtain a home which was included in a qualified personal residence trust.
4. If the property is converted to rental or other commercial use.
5. When a part of the home was used as a home office.
6. If there is a casualty loss for purposes of determining the loss computation.
7. For determining the itemized interest deduction in connection with a home equity loan.
8. To substantiate insurance claims.
9. For determining the return on investment of a home purchase in personal financial planning.

If you fail to maintain ongoing records, it is often virtually impossible to obtain documentation for some past events. Therefore, as a homeowner you should regularly check with your professional tax advisor to determine record retention needs for personal financial, tax and estate planning purposes as well as to discuss tax strategies in connection with home ownership.

TAXATION

Investors get some capital gains tax breaks beginning this year. Tax rates on long-term capital gains of taxpayers who are in the 15% tax bracket are reduced from 10% to 8% if the stock which was sold had been held for at least 5 years. Taxpayers who are in the 28% or higher bracket, who are normally subject to a 20% capital gains tax, obtain a lower 18% capital gains rate on stock which is bought in 2001 and held for 5 years before being sold. In effect the earliest the 18% rate would apply is 2006. Stock bought before 2001, is also eligible for this capital gains tax treatment but to obtain the rate reduction, the taxpayer must elect to treat the stock as though it had been sold on January 2, 2001, and pay tax on the appreciation at the standard capital gains rate. Then if the stock is held for 5 additional years and then sold, the 18% rate would apply. The election is required by the extended due date of the 2001 tax return.

Taxpayers are entitled to take an entertainment deduction, generally equal to 50% of the cost, of entertaining a customer, client or business associate if the cost is "directly related to" or "associate with" the conduct of the business. To be "directly related to" your business the following test must be satisfied:

1. You must have more than a general expectation of deriving income or a specific business benefit from the entertainment.
2. You must engage in a bona-fide business discussion during the entertainment.
3. You must engage more in business than in entertainment.

4. The entertainment expenses must be incurred for you, the business guests and the respective spouses.

For an entertainment expense to be "associated with" the conduct of the business, and be deductible, there must merely be a substantial business discussion which directly precedes or follows the entertainment. To obtain the deduction the taxpayer must also make a contemporaneous record that includes:

1. Place, date and description (lunch, dinner, etc.) of the entertainment.
2. Amount of each separate expense.
3. Date, place and duration of the business discussion.
4. Business relationship of the person entertained and nature of the business discussion.

We find that frequently clients jeopardize their legitimate deductions by either failing to maintain appropriate records or by not recognizing their activities are eligible for deduction.