

November 1, 2001

## COMMENTS - NOVEMBER, 2001

### ACCOUNTING AND AUDITING

# Why bother to obtain monthly financial statements for my business? Although most clients fully recognize the value of obtaining monthly financial statements, a significant minority still are not convinced of the potential benefit. Monthly financial statements enable owners to know how much money they have made each month and the net worth of their business and facilitate:

1. Decision making about which area of the business to grow and which to cut back.
2. Tax planning.
3. Lowering year-end tax preparation fees.
4. Complying with business loan reporting requirements.
5. Providing quick responses to financial information requests by vendors and customers seeking current financial data.
6. Management's understanding of the differences between profits and changes in the monthly cash balance.

### ADMINISTRATION, SYSTEMS AND EDP

# A number of retailers and many major manufacturers are expanding the capability of their point-of-sales (POS) terminals to make them accessible over the Internet and capable of providing inventory data. The idea is to use the POS terminals to provide information on stock carried in stores as well as on the status of other inventory the company has available for sale. Also, based on inventory status, sales personnel and customers can obtain information about delivery time frames, thereby enhancing the overall customer service capability of the store. This is accomplished by having the POS terminals able to access and update a central inventory data base and assess inventory status. While the purpose is to increase marketing capability, customer satisfaction and sales by adding the additional capabilities to the POS system, so far, there is no reliable data as to whether this objective is being realized.

# Ready to upgrade your desktop PC? Undoubtedly, you'll be urged to buy the fastest machine available. Actually speed is no longer of primary importance, because a machine which operates at 800 megahertz won't be discernibly faster than one which operates at 500 megahertz, but it will cost a lot more. The most important consideration should be the amount of memory available. Such applications as digital music, photo and video editing require the use of substantial memory, so any desktop PC you may be contemplating should have at least 128 megabytes of memory. Incidentally, the same considerations should apply to

laptop computers. The greater the speed the more power is required, shortening the battery running time. Furthermore, faster laptops generate more heat which has to be dissipated. This involves configuring the laptop with more sophisticated and cumbersome cooling systems. In turn, this increases the weight of the machine and the overall cost. You should also be aware performance specifications for computers and peripherals often exceed actual performance levels. This is particularly true with respect to memory, screen size, laptop weight, battery life, CD-Rom speed, printer speed and modem speed.

## FEDERAL REGULATIONS

# Just before President Clinton left the White House the Occupational Safety and Health Administration finalized regulations governing the kinds of businesses which are required to maintain detailed records of on-the-job injuries. In general, those industries with low worker injury rates will be exempt from the record keeping under the regulations while those with higher injury rates will have to comply with detailed record keeping requirements. Businesses which had to keep records under old regulations but will be exempt under the new, include: hardware stores, retail food markets, furniture repairers, music and dance halls, medical practitioners and bowling alleys. Conversely, those not required to keep records under the old regulations, but required to under the new, include: auto and home supply stores, boat and RV dealerships, furniture and home appliance stores, real estate operators and developers, dry cleaners, residential care providers, zoos and botanical gardens. The new regulations went into effect on January 1, 2001. However, all companies with 10 or fewer employees are exempt from the record-keeping requirements regardless of the industry.

## INSURANCE

# FedEx, UPS and other freight haulers usually build the cost of the first \$100 of loss into their rates. However, if you want to insure against bigger losses you'll be charged between 35 and 50 cents per \$100 of additional declared value. Rather than being forced to pay these high insurance rates, many businesses without extensive loss exposure either self-insure by setting aside a fund to cover possible losses or they obtain their own freight insurance policy. The latter approach makes sense if you are incurring annual costs in excess of \$1,000 on declared value insurance. And, incidentally, avoid duplicating insurance on the first \$100 of losses if it's already included in the freight company's rates.

# Mortality tables which are used by insurers in developing life insurance policies usually have a "terminal age," the age at which the probability of death is treated as 100%, usually at age 95 or 100. While attainment of age 95 or 100 was extremely remote just a few years ago, an increasing number of people are now living into their 90's and might survive to the "terminal age" used by the insurer. Whole-life policies, which have a cash surrender value, reach their full value, "endow", at the "terminal age." This means the insured could receive the full value of the policy as if he or she had died, triggering adverse income tax consequences for the insured. Estate planning might be fouled because the insured, rather than

the beneficiaries, could receive the insurance proceeds. You should question what "terminal age" is used by the insurer and what the company's policy is with regard to paying out the proceeds when the insured reaches the "terminal age". While some companies might mandate policy proceeds be paid out to the insured, others might not require a payout until after the insured's death. Since the insurer's payout policy can have major income and estate tax consequences, this is a matter which warrants discussion with your professional tax and financial advisor.

## LABOR RELATIONS

# Employee surveys reveal the typical worker sends up to 10 e-mail messages per day from work and workers frequently spend time browsing the Internet for personal purposes. Employers are well aware of the abuses and, according to the American Management Association, 75% are implementing electronic monitoring systems and 47% are storing and reading e-mail messages to stop these practices. However, to avoid serious problems, the following steps are suggested:

1. Clearly communicate the Internet use policy in company literature which is given to employees.
2. Let workers know what is being monitored and for what purpose. Options include filtering Web sites, video surveillance, e-mail monitoring, etc.
3. Establish the monitoring policy and communicate it to all workers.
4. Indicate the disciplinary action you will take for policy violations and follow through consistently.

Most employees realize personal e-mail use and Internet browsing on the employer's time is wrong and will appreciate a frank and honest discussion about the problem as well as understand the need for monitoring. By providing workers with a formal written e-mail usage policy and informing them of the firm's surveillance practices you may also be able to protect your firm against possible claims for invasion of privacy if disciplinary action is taken against a violator.

## MARKETING

# The increase in Internet fraud is a major concern of companies selling products online. According to a survey by Marketing News, online fraud is costing many businesses between \$1,000 and \$10,000 per year, and among large Internet players, losses run \$100,000 or more. Major problems cited by e-businesses were:

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|--|-----|
| 1. Difficulty in prosecuting those engaging in web-based fraud | 33% |
| 2. Use of stolen credit cards                                  | 22% |
| 3. Absence of security standards on the web                    | 19% |
| 4. Identity theft  | 12% |

If you are conducting business over the Internet, you should be aware of the latest software applications designed to provide protection against online fraud.

## **MONEY, BANKING AND CREDIT**

# The use of prepaid cards to pay for transportation, tolls, use of copy machines and countless other purchases is growing by leaps and bounds. Retailers are aware of the potential boon to their business as well. A recent survey of 50 major retailers by Dun & Bradstreet revealed 44 were offering prepaid cards as gift cards to customers. The most popular amount prepaid on the cards is \$25, and, of course, the retailers must have a system whereby the cards are activated at the point-of-sale if they intend to offer gift cards.

## **PENSION AND ESTATE PLANNING**

# Federal Appeals Courts generally protect IRAs from bankruptcy creditors even though the bankrupt individual could tap these funds and pay a 10% premature withdrawal penalty if he or she is under age 59½. However, the situation is quite different when, as a result of a divorce, an ex-spouse receives a portion of the other spouse's pension benefit. In a recent case, the divorced wife of a pension plan member received \$60,000 of the ex-husband's pension plan balance pursuant to a domestic relations order, with her portion remaining in the plan.

Subsequently, she declared bankruptcy. According to the Court, plan assets split-up by court order are not exempt from creditors and alternate payees are not entitled to bankruptcy protection. Thus, her creditors were entitled to her share of the plan. The result might have been different if the funds were needed for the bankrupt's support, but the decree under which the retirement plan account was split was intended to provide for an equitable property settlement between the parties.

# The IRS says it is about to begin garnishing the social security checks of taxpayers who owe back taxes. The Agency intends to withhold 15% from the social security checks of taxpayers who receive more than \$750 per month in social security and who are at least 6 months in arrears in their tax payments. Taxpayers whose checks will be garnished will receive a warning from the IRS. In turn, they may be able to convince the Agency their income doesn't exceed hardship levels, so their tax accounts will qualify for "Currently Not Collectible" status. People who are disabled and Supplemental Security Income program recipients won't have their checks garnished either.

## **PERSONAL FINANCIAL PLANNING**

# If you take educational courses related to your work, you may be able to deduct some of the cost as business expenses. To do so you must be working; you have to itemize your deduction on Schedule A of Form 1040, if you are an employee, and; the expenses must be qualifying educational expenses. Expenses which satisfy at least one of the following two tests are considered qualifying education:

1. The education is required by your employer or by law to maintain your present salary, status or job, and the required education must serve a bona-fide

- business purpose of the employer.
2. The education maintains or enhances skills needed in your present work.

Courses which maintain or improve your skill include refresher courses, courses on current developments in your field and academic or vocational courses. To the extent you receive more education than your employer or the law requires, the additional education is qualifying only to the extent it maintains or improves skills in your present work. Conversely, non-qualifying education costs include those: (1) needed to meet the minimum educational requirements of your present trade or business, or (2) part of a program of study that can qualify you for a new trade or business. When educational expenses are qualifying, here are some common deductible expenses:

1. Tuition, books, supplies, lab fees and similar items.
2. Certain transportation and travel costs.
3. Other educational expenses such as research costs and typing costs in connection with a project that is a required part of an educational program.

Keep in mind, if you are entitled to reimbursement by your employer for the educational costs, but fail to claim them, your deduction of qualifying educational expenses will be disallowed.

## REAL ESTATE

# If you have a vacation home, or even a primary residence in a resort area, you might be able to generate some seasonal tax breaks. For example:

1. If you rent out your vacation home or your regular home for up to 14 days per year, the rental income you obtain is totally tax-free.
2. Interest and real estate taxes may be deducted on both a primary residence as well as a vacation home.
3. A vacation home retains its second residence status, even if it is rented out, provided you use it during the year for the greater of 14 days or 10% of the number of days it is rented out.
4. Boats and recreation vehicles can qualify as a second home, provided they contain sleeping quarters, a kitchen and a bathroom.

These are just a few general rules regarding vacation homes and tax breaks. For a more complete discussion geared to the use of a specific property, contact your professional tax advisor for more specific details.

## TAXATION

# Some taxpayers are confused by IRS rules governing an underlying profit motive with respect to a business and believe if they fail to make a profit in three of the first five years, they will lose their deduction for start-up losses. Here is a clarification. The IRS regulations specify for a proprietorship's losses to be deductible, there must be a profit motive underlying the business venture. If a

business is profitable for three of its first five years, there is an automatic presumption the business has a profit motive and the IRS will not throw up any challenges with respect to losses in the other years. However, if there are no profits during the first five years, the IRS will raise the issue the business was just a hobby in order to disallow deductions for losses. Nevertheless, even if there are no profits in the first five years, a taxpayer can still demonstrate there was a profit motive underlying the venture. This can be done by showing start-up losses are common for the type of business; the business was operated in a business-like manner by the owner because he maintained proper books and records and consulted with experts, such as CPAs, in conducting the business, and there was a reasonable business plan. In short, a profit motive can be demonstrated even if a business is unprofitable, so start-up losses can be deducted.

# Beware of tax scams on the Internet. There are over 2000 web sites designed to dupe naive taxpayers into believing they can avoid income taxes. Claims made and products sold to achieve this include:

1. Statements that income taxes are voluntary.
2. Offshore tax shelters that are supposed to protect you from taxes.
3. Use of "pure trusts" that avoid taxes.

The tax scams are being offered via web sites as well as via e-mail. Anyone being solicited should be aware that serious problems can result from the tax schemes. Instead, utilize a professional tax advisor, such as a CPA, to provide legal tax strategies which result in tax avoidance rather than evasion.

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