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COMMENTS - DECEMBER, 2001

ADMINISTRATION, SYSTEMS AND EDP

Are you relying on a number of "stand-alone" PCs to administer your business? It's a common situation as companies grow. But you might find declines in the cost of computer network installation could make this investment worthwhile. Productivity gains which might arise from network installation include:

1. Backup procedures automatically back up data to a secure central location.
2. Remote access enables any authorized employee to access the system from anywhere, seven days a week and around the clock.
3. Enhanced security provides greater protection against loss or theft of data than free-standing computers.
4. Ability to transmit in-house e-mail without the use of an outside e-mail provider.
5. Ability for several employees to access the same web page and electronic document simultaneously.
6. Enhanced file transfer, since floppy disks don't have to be physically transferred from one computer to another to transfer data.

Besides these potential productivity gains from network installation, there are also likely to be significant cost reductions. These arise from the ability to share printers, reduction in the need for fax machines, lower cost for Internet access since the network can be connected to a single high-speed digital subscriber line instead of separate dial-up connections for each free-standing computer and lower paper costs since many in-house documents such as employee manuals, sales catalogs, etc., can be stored electronically. If your systems have not been reviewed and evaluated in at least the past three years, you might want to discuss benefits your firm may derive from systems upgrades.

About 1,000 laptop computers are stolen daily in the United States and there is evidence the thieves are less interested in the theft of the computer, than in the data which is stored in the memory. Typical information they often contain includes: e-mail addresses; passwords; DNS information; remote access procedures and other data which allows the thieves to gain access to information technology systems in addition to sensitive business and personal information. Unfortunately, most businesses utilize security measures designed to protect the perimeter of their system but fail to take into account the data on notebook computers which might enable someone to gain unauthorized access to the system. According to computer crime experts, the best defense against laptop theft and data theft is a multi-layered strategy which includes use of anti-theft cables for physical

protection and installation of powerful data encryption software in every notebook computer, capable of encrypting all data stored on the computer. Have you taken the necessary steps to protect your personal or business computer systems against possible theft or intrusion?

FEDERAL REGULATIONS

- # The IRS has indicated small employers (10 or fewer workers) will be able to file W-2 forms online with the Social Security Administration beginning on January 7, 2002. Employers wishing to do so must go to the web site www.ssa.gov/employer and click at "Employer Services Online." Electronic filing of W-2 forms with the government still does not eliminate the employer's responsibility to provide employees with copies of their W-2 forms.

INSURANCE

- # Whether you have a rapidly growing small business or just have a sideline business which provides some added income, it is important you protect yourself with appropriate business insurance. This would include adequate liability and property damage coverage and, possibly, one or more of the following:
 1. Business interruption insurance if destruction of the premises makes it impossible to carry on operations.
 2. Extra expense insurance designed to cover added costs of having to move your business temporarily to another location.
 3. Fidelity bond protection designed to protect the business against losses stemming from a dishonest employee's embezzlement.
 4. Employment practices insurance to cover legal fees and damages if you are sued for defamation, slander or harassment.
- # The Courts have rejected the IRS position tax deductions may not be taken for premiums paid by a company to its captive insurance subsidiary. In separate cases courts held the premiums paid were a deductible expense of the parent company. An Appeals Court went even further and allowed premium payments by subsidiary companies to the captive insurance company to also be deducted. The IRS contention was that the establishment of captive insurance subsidiaries and the associated premium payments were a mere attempt to shift earnings and avoid taxes by the parent company. The Agency has also refused to throw in the towel and acquiesce to the court decisions. Instead, it says it will continue to contest situations which indicate flagrant abuse of the tax system, such as where the insurance subsidiary is thinly capitalized.

LABOR RELATIONS

- # The recent terrorist strike in New York may induce more workers to try to telecommute. Some employers may also favor the idea. However, before agreeing to a telecommuting arrangement, employers need to make sure it will not entail any extra liability for them, and the worker's actions and performance are carefully

controlled. Thus, it is recommended:

1. The employer visit the off-site location to determine its suitability.
2. The employer prescribes work hours and the work week.
3. Specific telephone contact procedures be established.
4. Expense reimbursement (telephone calls, supplies, etc.) arrangements are worked out in detail.
5. Termination arrangements, including return of company equipment and data are specified.
6. Special insurance requirements be reviewed and established.
7. Telecommuters be made aware of their responsibility for any tax consequences stemming from the arrangement.
8. Employees are made aware of confidentiality of file content and data, and procedures are established for protecting the information.

One of the greatest sources of failure of telecommuting arrangements is haste in their establishment and resultant failure to establish precise detailed directives for carrying out the operation.

MARKETING

Do you evaluate customer profitability? It's not only important to know the revenue produced by each customer, but also to know what the cost is to service the customer and how much profit is generated from the merchandise ordered. Some high volume customers require so many trips and so much service their business contributes very little to your profit. Also, service being provided to satisfy these customers' requests detract from the ability of sales personnel to service more profitable customers or to generate new business. Have you considered charging customers who are only marginally profitable a higher price for merchandise or services they purchase from your firm? Profitability measurements would enable your firm to target those customers whose prices need to be raised.

One measurement which is commonly used to measure advertising expenditures is the ad-to-sales ratio, which measures advertising outlays as a percent of sales. Here, according to Schonfeld & Associates, Inc, a consulting firm, are the ratios for some key industries for the year 2000:

Natural resources & materials	3.3%
Oil, gas & chemicals	3.0%
Consumer products	7.4%
Health care	6.2%
Retail	2.3%
Financial services	1.4%
Electronic & scientific instruments	2.6%
Computers & software	3.0%
Industrial equipment & furnishings	2.3%
Transportation & travel	2.4%
Services (other than health care)	2.6%

Construction & real estate	1.3%
Communication products & services	2.9%
Wholesale	1.4%

Individual businesses can look at the data for their industry and compare their own advertising expenditures against the industry average. Additionally the percentage increase in advertising spending for the current year over the prior year can be calculated and compared with the change in the percentage of sales growth for the same periods. If the sales growth percentage does not increase in line with the advertising outlay percentage increase it could indicate the wrong media was used for the added advertising, the advertising message was ineffective, that market saturation has occurred or general economic conditions are adversely affecting sales.

MONEY, BANKING AND CREDIT

We generally encourage clients to do business on line because this is the direction in which technology is headed. But great care must be taken to avoid dealing with a "fly-by-night" company who takes your money and never sends you the goods. Fraud on the Internet is considerably higher than when business is conducted via mail, the phone or in person, and is particularly prevalent with respect to online auctions. To protect yourself and your business from losses when making Internet purchases we suggest:

1. Always pay by credit card.
2. Resist being lured by flashy web sites to make a purchase.
3. Deal online only with vendors who you know are authentic.
4. Buy only from sites which inform you about their privacy policies.

There is no rational reason to fear Internet transactions so long as you've determined the party at the other end is legitimate and information you provide is kept confidential. As an added assurance you are adequately protected, consider taking the precautionary steps suggested above.

PENSION AND ESTATE PLANNING

The 2001 Tax Relief Act increases the contribution limits for traditional and Roth IRAs and for qualified retirement plans. The maximum annual IRA contribution limits increase to \$3,000 in 2002 through 2004, \$4,000 in 2005 through 2007, and \$5,000 in 2008. For purposes of determining deductibility, income limitations and employer-sponsored plan coverage rules remain unchanged. There are also provisions for "catch up" contributions for individuals age 50 or older beginning in 2002. The additional contributions are limited to \$500 for 2002 through 2005, and \$1,000 for 2006. Thus, for example, the contribution limit for someone over age 50 in 2002 will be \$3,500. Contribution limits for 401(k) plans increase to \$11,000 in 2002, and then go up \$1,000 annually to \$15,000 in 2006, and there is also a "catch up" provision of an extra \$1,000 in 2002 for individuals age 50 and older. This increases by \$1,000 annually until it reaches \$5,000 in 2006.

Incidentally, although called "catch up" contributions, the additional contribution amounts are solely based on age of the participant, and have nothing to do with past contributions the person made. The tax law changes are likely to create a retirement savings boom since early surveys show about 80% of IRA, 401(k) and 403(b) plan participants intend to take advantage of the higher contribution limits and the "catch up" contribution provisions starting next year.

- # In general, when making gifts by check, the gift is not complete until the check clears the bank, because until that moment, the maker can stop payment on the check. The courts have sometimes been lenient and upheld gifts in situations where checks were cashed or deposited by the recipient before year-end but didn't clear until the following year. However, the IRS is more strict. Thus, if you intend to make gifts to family members before year-end, do so on a timely basis and tell them to deposit the checks promptly to insure they will clear this year. Otherwise, the gift tax exclusion could be lost.

PERSONAL FINANCIAL PLANNING

- # Although the IRS, in various rulings, held that a variety of restitution payments to victims of Nazi persecution were to be treated as nontaxable personal injury awards or tax-free property recoveries, the Economic Growth and Tax Relief Reconciliation Act of 2001 specifically provides for a broad exclusion from gross income for restitution payments. Thus, tax-free treatment applies to payments received after December 31, 1999, by persons persecuted by Nazi Germany or any Nazi controlled or allied country, as well as by heirs or estates of such persons. Persecution based on race, religion, physical or mental disability or sexual orientation is covered by the law. Excludable restitution includes compensation for assets which were stolen or lost before, during or after World War II, and for life insurance issued by European insurers immediately before and during the war. The tax-free treatment also applies to interest earned on escrow accounts and funds established in settlement of holocaust victim claims against European banks and corporations. The non-taxable payments under the Act are not taken into account either in determining taxable Social Security benefits or in other tax computations which require adjusted gross income to be increased by "excludable gross income." We can assist you if you have questions regarding these provisions.
- # The wide ranging announcements of business layoffs mean many people will be looking for new employment in coming weeks and months. It's important to keep records of outlays incurred in seeking a new job to obtain the benefit of the related tax deductions. Regardless of whether your efforts are successful in landing a new position, here is what's allowed:
 1. Qualifying job hunting expenses if you are looking for work in your current trade or business, but not if you look for a new line of work.
 2. Qualifying deductible job hunting expenses include employment agency fees, typing and printing costs, telephone charges and advertising expenses.
 3. Qualifying job hunting expenses are tax deductible as a miscellaneous itemized deduction i.e. they are deductible only if miscellaneous expenses

exceed 2% of adjusted gross income.

4. Travel expenses including meals and lodging when away from home overnight, if the primary purpose of the trip was job hunting. If the trip was primarily personal, only the expenses directly connected with job hunting are deductible. For example, cost of a taxi from the hotel to a prospective employer.

Job hunting expenses which are reimbursed by your prospective future employer may not be deducted by you. However, if you were not reimbursed and took a deduction, and you land the job and are reimbursed by the new employer in a subsequent year, the reimbursement must be included by you in income to the extent you took an earlier deduction.

REAL ESTATE

- # Most states provide residents over a certain age a property tax break either in the form of a property tax credit or an exemption which limits the value of assessed property subject to tax. In some states there may also be an income limit designed to enable only seniors with low incomes to qualify. There may also be other types of property tax benefits, such as freezes on the assessed value of property once an owner reaches a certain age. In fact, all 51 states provide some kind of property tax breaks for their senior citizens. In addition, there may also be added property tax relief provided by county governments and by local municipalities.

TAXATION

- # There is still time to acquire some equipment and obtain a tax deduction for 2001. Qualifying businesses can deduct up to \$24,000 of the cost of equipment put into service in 2001 as a business expense, instead of having to depreciate the amount. However, the expense deduction is limited to the taxable income from the business, including wage income from employment.

Comments is an informative publication for our clients and friends of the Firm. It is designed to provide accurate information on the subject matter covered. We recommend you consult with your legal and other advisors to determine if the information is applicable 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.