

For the Record

Watson Rice LLP

WINTER 2001



Raymond P. Jones (left) was promoted to Managing Partner of Watson Rice LLP, succeeding Bennie L. Hadnott, who becomes Chairman of the firm's Executive Committee. Mr. Jones had been Partner-in-Charge of the firm's New York HQ office. Mr. Hadnott continues to serve as President of Watson Rice Consulting Group, Inc.

CONGRESSIONAL TAX MEASURES

The 106th Congress, which adjourned in December, passed a few changes to the tax laws, among them a two-year extension of medical savings accounts, described by House Ways and Means Committee chair Bill Archer as "the best patient checks on doctors and HMOs." He also said it would help the uninsured and underinsured afford health insurance. The same bill specifies that investments in securities futures would be treated for tax purposes as if the investor held the underlying asset itself.

Also passed: reinstatement of the installment method of accounting for accrual method taxpayers, overturning a 1999 revision that "unexpectedly and adversely affects the sale of closely held businesses by dramatically increasing the cost of closing the sale," according to the bill's summary.

Meanwhile, the 107th Congress is expected to repeal the so-called

Marriage Penalty Tax under existing codes by a wide margin, with support from both sides of the aisle.

DOT-COM ACCOUNTING EARNS SEC SCRUTINY

GAAP rules for public companies leave lots of wiggle room for emerging dot-com companies, and enough of these entrepreneurial operations are taking advantage of them to attract SEC attention. More than that, the SEC has asked the FASB to examine 20 issues related to Internet company filings.

Heading the list: revenue recognition. Companies that can command billions in market capitalization before they earn one red cent have caused Wall Street to look beyond the bottom line to buy in. So the new yardstick has become revenue. In turn, a growing number of Internet bookkeepers have been inflating sales figures through accounting gimmicks. Says Paul Brown, accounting professor at New York University: "We've gone from worrying about 'quality of earnings' to 'quality of revenues.'"

While technically legal, here are some of the questionable practices under SEC scrutiny: 1) "Grossing up" revenues by reporting the entire sales price paid at a customer's site when the company keeps only a small percentage; 2) barter transactions, translated as cash, particularly on deals involving media, where deals typically can never amount to more than 5% of sales; 3) using coupons, discounts and loss leaders, i.e. where an online customer buys something marked down by 40%, and the Internet company reports the sale at its 100% value; 4) Classifying "fulfillment costs" for warehousing, packaging and shipping as "marketing expense" rather than expenses for cost of sales. This

bypasses a direct charge into gross profit margins; 5) "Listing fees" charged for putting someone's product into an on-line auction. The dot-com often also takes a percentage of the price when the product is sold. Instead of realizing listing revenue over the whole time that a product is up for auction, on-line sites often recognize all revenues immediately, despite the fact that transaction fees should be recognized only after the goods were shipped.

IRS STREAMLINING TAX PAYMENTS

2001 marks the first time that taxpayers can file electronically without submitting one shred of paperwork. The system is available to those who self-select a Personal Identification Number (PIN) – along with the adjusted gross income from their last year's tax return. These will serve as a signature.

The agency has also added a checkbox authorizing direct telephone communication between the tax preparers and the IRS. At the same time, a new call routing system promises to improve efficiency for those calling the agency for assistance.

LOOPHOLE CLOSING IN ROTH IRA PROGRAM

When the Roth IRA first came into play, the law failed to cover certain contingencies. Example: a taxpayer could convert funds from a traditional IRA to the Roth variety, pay the associated tax, then withdraw funds immediately with no penalty even though rules for a qualified withdrawal from the Roth IRA had not been met.

Recently, the US Federal Court of Claims concluded that Congress never intended the law creating Roth IRAs to



Bennie L. Hadnott (right), Chairman of Watson Rice LLP's Executive Committee and President of the Hadnott Family Foundation, presents a mock-up check for \$50,000 to North General Hospital President and CEO Harold P. Freeman. Mr. Hadnott established the Foundation to honor the memory of his wife, Chase Bank Vice President Earlene Hampton Hadnott, who succumbed to breast cancer. The donation is earmarked for research to help reduce fatalities among breast cancer patients, particularly in the hospital's neighboring Harlem community where the need for early diagnosis is especially acute.

MORE RELIEF FOR INNOCENT SPOUSE

The Taxpayer Relief Act of 2000 clarifies IRC Section 6015 with some important procedural issues such as refunds made available to the innocent spouse (the spouse in a joint tax liability assessment who is entitled to relief from the tax liability) through the administrative process, the courts and notification rights. Other favorable modifications have also been made in this area of the tax laws that grant more relief to the innocent spouse.

CAMPUS RECRUITING CULTURE EXPERIENCING RAPID CHANGE

With unemployment at low levels not seen in decades, professors nationwide are reporting dramatic changes in traditional campus recruiting. The pace of sequencing from an introduction to an offer for employment has undergone radical change, and the techniques employed by accounting firms have been meeting the challenge.

One national firm now interviews students only twice on campus before determining a "next step:" a visit to its offices. That visit now always concludes with a job offer. Another firm's "SWAT team" pares it down even more. Says a professor observing the practice: "Students sign up for a 1-hour interview and meet with two people on a Thursday. If they pass that, they come back the next day and meet with two other people. The firm tries to let them know by the following Monday whether or not there'll be an offer."

AVOID VIRUS WOES

Accounting operations are particularly vulnerable to computer viruses. Even where records are meticulously protected by back-up files, who wants to deal with "search and rescue" missions that can steal hours away from far more productive use?

It's important to regularly update software. Practitioners should employ anti-virus software programs to scan

existing files and folders, to check new documents and programs, and for periodic checks on systems against a virus invasion. When detected, use available tools to locate and remove viruses, especially the macro variety.

Dozens of programs are readily available. A short list of Trend products includes these InterScan programs: VirusWall, VirusWall Windows NT Server, and WebProtect; these from ScanMail: for Microsoft Exchange, Microsoft Mail and Microsoft Outlook; OfficeScan; ServerProtect for Windows

AICPA OFFERS TIPS TO SECURE WEBSITES

The Association lists 10 ways to secure your website:

- 1) Conduct a risk assessment of your online business
- 2) Develop security standards, policies and procedures so employees will first, understand the cause and effect of security breaches, and second, know how to respond to a threat.
- 3) Test, test and test again how vulnerable your system is to hackers.
- 4) Develop procedures for prevention and use independent third-parties to test them.
- 5) Limit the number of individuals who may access controls to your e-commerce business.
- 6) Utilize firewalls.
- 7) Utilize surveillance tools.
- 8) Monitor your networks for unusual activity.
- 9) Contact your Internet Service Provider (ISP), if your site uses one, to determine the level of protection it already has in place.
- 10) Report computer violations to the proper law enforcement authorities.

INCOME EXCLUSION FOR PARKING BENEFITS RAISED

Employers now can exclude parking benefits from employee wages to a maximum of \$180 per month for 2001, a \$5 increase over last year. While the IRS left the combined transit pass and van pooling expenses unchanged at \$65 per month, the Employee Benefits Institute of America forecasts an increase to \$100 at the end of this year.

allow for non-qualified withdrawals without penalty. The penalty now stands, as corrected, and can be applied retroactively to untimely withdrawals previously made from Roth IRA accounts.

IRS TAX ON-LINE ASSISTANCE: RIGHT (JUST OVER) HALF THE TIME

A US Treasury Department study finds that the IRS provides correct answers only 54% of the time on its Web-based Tax Assistance Program. That doesn't surprise the National Federation of Independent Business, which complains that small business owners find the tax code to be so complicated that it easily can confuse a trained IRS official.

STATE OF NEW YORK TAX CHANGES

Effective for the 2000 tax year, married couples can deduct up to \$10,000 in contributions to a single account rather than two separate accounts for the same beneficiary. There is also relaxation in the law relating to the recapture provision.

Earned income credit has been increased from 22.5% to 25% of the Federal earned income credit.

There are also new credits available for replacing or removing residential oil tanks.