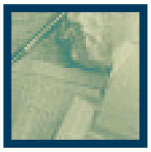
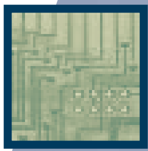
Spring 2003

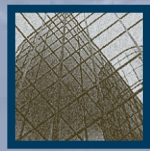


TAX

FINANCE



TECHNOLOGY

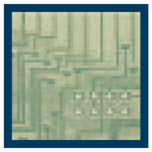


GROWTH

BUSINESS INSIGHTS

INSIDE

Instant Messaging Finds A Role In Business



COMPUTERS

What started out as a neat feature by which teenagers chatted amongst themselves on AOL is now invading the business world. Instant messaging (IM) is picking up where e-mail leaves off to provide a method of real-time communication among staff, customers, and suppliers. While IM holds great promise, it also presents management and security challenges.

What Is Instant Messaging?

This computer application allows two or more people to collaborate or "chat" online through the use of text messages. When users sign-on to IM, their presence is noted in a directory that can be seen by other pre-authorized users on the system. Messages are delivered almost instantaneously to a pop-up box on the other party's screen. That person can then type a response into the box and a stream of conversation develops. E-mail is like sending letters or memos. IM is like holding a phone conference.

Business Uses

IM is a great tool for customer support. It allows customers to have online conversations with support people. If interfaced to an online system, remote sales persons or even customers can check availability of a product and get an immediate response. It's cost effective for providing international support since it eliminates phone charges. Some businesses have had success connecting home-based or remote office employees in collaborative IM conferences. IM is even useful within a single facility. For instance, a receptionist can let a salesperson know that an important customer is waiting on hold.

IM Challenges

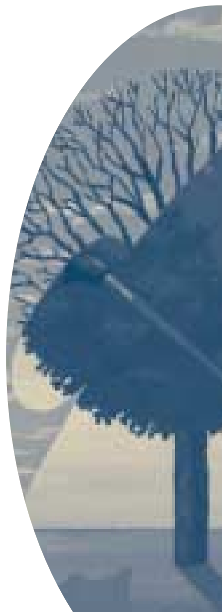
Today, most business users access IM through AOL, Yahoo, or the Microsoft Network. As you can imagine, connecting to one of these services punches a hole through the company's firewall that can let in viruses and hackers. The services are also incompatible. An AOL IM user cannot communicate with an MSN or Yahoo IM user.

Another shortcoming – particularly important to financial services and healthcare businesses – is that consumer IM services provide no audit trail or record of the communications. To address these concerns, the major providers are introducing new business gateways and servers. Other companies offer software to build private IM networks. The incompatibility issue will still be a factor until the industry can agree on common standards.

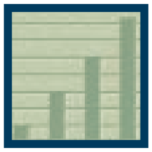
Constant interruptions can hurt employee productivity and the real-time nature of IM can make personal IM even more of a problem than personal e-mail. Guidelines on if, how, and when IM can be used should be added to company Internet usage policies.

With proper precautions in place, instant messaging could soon be an invaluable communications vehicle within your organization as well as with customers and other stakeholders. However, proceed with caution until the technology matures. Even when it does, don't let computerized communication replace telephone calls or face-to-face visits that are so important for building and maintaining strong professional relationships. ■

INSIDE



Marketing Budget Limited This Year? Try Grassroots Marketing



CHARTING YOUR FUTURE

With the glut of advertisements, press releases, direct mail, and other promotional vehicles crying for attention, it's become quite a challenge to get your message out to clients and prospects. Word of mouth is often the best sales tool for rising above the clutter. But how do you get those mouths talking?

Grassroots marketing is a great way to ignite the enthusiasm of a relatively small group of people who can share the excitement with others, who, in turn, do the same – creating a snowball effect. Here are some tips for lighting that fire to get the word out…

Let grassroots marketing create the "buzz" which will help build your sales.

Identify Your Objectives

Grassroots marketing should be part of an overall marketing strategy, with very specific objectives. The objectives include identifying the target audience and spelling out exactly what you want to achieve through the marketing effort.

Identify Key Influencers

Underlying grassroots marketing is the concept of diffusion theory – that every successful idea is first embraced by a small group of influential people before it's picked up by the masses. These influential people could be current customers or others in the target market, but they share several characteristics. Effective influencers are early adopters – the types of people that always want to be first to try something new. They must also have the credibility by virtue of their position or other factors to affect the opinions of others. Finally, they are individuals with the desire to share their opinions. A prime example of the use of influential individuals is in the marketing of drugs and medical devices to physicians. Manufacturers identify prominent physicians to try their new products, with the hope that they will then write and speak about their positive results with the products. Trade journalists are another key group to attempt to recruit.

Promote Your Expertise

Through public speaking and seminars, a knowledgeable company representative can bring in new business. This can be a particularly useful technique for professional service organizations. Attorneys, financial and management consultants, and other professionals often either hold their own seminars or speak at conferences and other events to pull in new customers.

Associating your organization with an event that targets a similar customer base can accomplish the same objectives. For instance, a bicycle shop may regularly provide repair services at bicycle races to promote a high-quality reputation among an influential group of riders and spectators.

Ask For Referrals

Your best customers may not realize that your company is seeking more business. Let them know that referrals are welcome. When you receive a referral, send a thank you note even if it doesn't ultimately produce a sale. If the opportunity arises, also make referrals to your customers, fellow business owners, and professionals, and they'll be likely to return the favor.

In these days of tightened budgets, few businesses can afford the type of advertising dollars or saturation sales force necessary to rise above the clutter of the competition. Let grassroots marketing create the "buzz" which will help build your sales. ■

Should The Government's Business Be Your Business?

PROFIT IMPROVEMENT

In good times and bad, there's one customer that always has a shopping list and that always pays its bills – Uncle Sam.

Our federal government procures around $200 billion of goods and services annually. This isn't just the exclusive playground of giant government contractors – 95% of sales to the government are for amounts less than $100,000. Even on large contracts, prime contractors are encouraged to make extensive use of small business subcontractors. State and local governments spend plenty, too.

Getting a piece of this lucrative pie is within the realm of many smaller businesses if they are willing and able to play the government contracting game.

Knowledge Is Key

Federal procurement is governed by extensive sets of rules known as the Federal Acquisition Regulations (FAR). Different size procurements have different requirements and different agencies may also do things differently. Vendors may also have to pre-qualify by getting listed on a General Services Administration (GSA) schedule. The Small Business Administration is a valuable resource for learning how to procure government jobs.

Most federal procurements are announced in the *Commerce Business Daily,* which is available by hardcopy subscription or free online. Often, a government agency will put out a request for proposal (RFP), which lays out exactly what is wanted and, very importantly, the criteria that will be used to select the winning vendor. Understanding and complying with the RFP is critical to successfully gaining contracts.

Successful government marketers also develop relationships with the agencies' contracting officers and other decision makers. By doing so, they can better understand the needs and sometimes help influence requirements before an RFP is issued. They also then have the opportunity to develop credibility as a qualified bidder.

Understand The Added Costs And Risks

Developing a stream of government revenue is a long-term undertaking that can have substantial risk. Preparing proposals can be expensive. Even though many RFPs discourage extensive proposal packages, most competitors ignore this requirement.

To qualify for some contracts, vendors must have affirmative action programs in place and meet minimum wage standards. Many government contracts are fixed price. That means the supplier holds all the risk if costs escalate during the term of the contract. Some contracts are also for an indefinite quantity and are nonexclusive. In other words, the bidder makes a promise to sell at a specified price and terms, but the government has no obligation to buy. In other instances, competition may be too great, driving margins down.

Local Opportunities

States, counties, and cities are also tremendous consumers of goods and services. They typically follow procurement processes similar to those of the federal government, but often (though not always) with less red tape. And like the federal government, many states have set up technical assistance centers and Web sites to provide information to potential suppliers as well as small business set aside programs.

If you're willing to learn from experience, focus on opportunities where you have a competitive advantage, and manage your risk, you can have a profitable piece of this huge market. If you need accounting and financial advice in competing for government contracts, give us a call. ■

Opportunities And Information Online

www.sba.gov
The Small Business Administration is one of the best sources of information on doing business with the government.

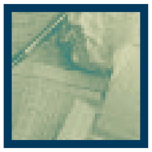
www.fedbizopps.gov
Online version of the *Commerce Business Daily,* which prints notices of all federal government procurements over $250,000.

www.dodbusopps.com
Information on business opportunities with the Department of Defense.

www.arnet.gov/far
Federal Acquisition Regulations online. These are the regulations that govern federal purchasing activity.

www.bidnet.com
Private subscription service listing state opportunities.

Do Pay-For-Performance Incentives Work?



HUMAN RESOURCES

Incentive pay has become widely used as an employee motivational tool. Once primarily limited to commissioned salespeople and top executives, various pay-for-performance schemes are now in place to compensate employees at many levels and in many different positions.

Given the less robust economy, much of the revenue and profit growth that fueled these plans has moderated, making it harder for employees to achieve the results necessary to get their anticipated rewards, and companies have less cash to pay them.

Some experts are questioning its role for another reason as well – their research has shown that pay-for-performance tends to promote the achievement of short-term objectives at the expense of long-term business success.

Making It Work

Despite these problems, pay-for-performance schemes do have their place, but must be put in perspective. Incentives need to be clearly linked to desired performance; and performance needs to be measurable. If achieving the desired goals depends heavily upon factors that the employee cannot control (such as the general economic condition, competition, or internal business decisions), the incentives lose their ability to motivate behavior. If achievement of objectives cannot be easily and fairly measured from the employee's perspective, it's also hard for rewards based upon them to be good motivators.

Plus, not all employees are equally motivated by economic rewards. Many people get greater satisfaction through other means such as professional growth, the ability to help others, recognition, or personal relationships.

Match Incentives With Culture

New research finds that pay-for-performance tends to reward short-term actions at the expense of a company's long-term welfare. By their very nature, pay-for-performance reinforces short-term behavior because almost all plans are based on measuring short-term actions, such as how much sales went up this quarter or this year, if cost reduction targets were achieved, and so forth. This is fine if the business is in a steady state, but researchers found it can stifle innovation. That's because individuals are unwilling or unable to focus much effort on innovation or change when a significant portion of their income is tied to short-term results.

They also found that heavy financial incentives aimed at longer term success such as opening up new markets, new product development, or new process development, are not easily tied to pay-for-performance because it may take several years to measure success.

So then, how do you balance short-term performance with long-term business development? According to the researchers, the best performing organizations have created a culture where engaged employees feel that their interests and fortunes and those of the company are aligned. In this type of environment, employees will be self-motivated to achieve both short and long-term results. Building upon this cultural base, they recommend the selective use of moderate, but not heavy, financial performance incentives.

Now is a good time to review your firm's compensation system. Are you getting the results you want? Is it effectively supporting your business objectives, and is it consistent with the culture you are trying to achieve? If not, give us a call. We can help you design the type of incentive programs that your employees will respond to and which can help your business gain that winning edge. ■

Charitable Giving – Good For The Heart *And* Your 1040!

TAX PLANNING

While you're digging through receipts to find every last deduction for 2002, take some time to look ahead and consider making charitable donations part of your tax-reduction strategy for 2003. A well-planned gift to charity could provide:

- The chance to be more involved in charities close to your heart,
- An income tax deduction or reduction, and
- A reduction (or avoidance) of estate tax.

But, your donation could also mean:

- The ability to maintain financial security,
- The ability to exercise control over assets both during your lifetime and after death, and
- The opportunity to take care of your heirs in the manner you choose.

You will need a plan tailored to your facts and circumstances, but following are some of the possibilities. These can be mixed, matched, and combined to provide just the right plan for you.

Gifts Of Appreciated Property

Give appreciated property to charity and escape the capital gain tax (which you would have had upon sale) while receiving an income tax deduction, usually at fair market value. You also remove that asset from your estate, thereby reducing your potential estate tax burden.

Charitable Remainder Trust (CRT)

Need the security blanket of some money coming in for a period of time, or hate to give up use of your vacation home until the grandkids are grown? A CRT may be the charitable vehicle for you. CRTs work particularly well with appreciating assets, and can be used with stock in a family owned business or real estate. No income tax is imposed on income remaining in the trust. You also get a current income tax deduction (based on the future value when transferred to charity) and you remove the remainder value of the asset from your estate, reducing your potential estate tax. As a result, you obtain the tax benefits of giving to charity while postponing when they will receive it.

Charitable Lead Trust (CLT)

A CLT is the flip side. Give the charity the use of the asset and the right to the income generated for a period of years. Then the asset can revert back to you, or go to whomever you choose. This could be income-producing stocks and bonds, or your rare book collection or a painting that you transfer to a museum for a while. You get a current income tax deduction for the value given to charity (but the trust pays income tax on its income). If a CLT is created upon your death, potential estate tax is reduced.

Give Away Your 401(K)

Instead of leaving your retirement plan assets to your heirs, think about leaving the balance in your 401(k), or other plan, to charity. A charity receiving plan assets isn't taxed on the income and your estate gets an estate tax deduction for the value of the assets passing to charity. Consider leaving your heirs something that won't be taxed, such as appreciated capital gain property for which they get a basis step-up at your death. They could turn around and sell the property with no taxable gain.

GST, FLP, GRATS, et al

These acronyms stand for a variety of more complex strategies, which are best explained in person. Suffice it to say… there are other possibilities available. We can help you sort through this alphabet soup of charitable-giving strategies.

If it's a question of supporting the IRS or supporting favorite charities, most people will opt for the charities. So, why not plan for that charitable giving and take advantage of these added benefits? ■

Watch Out For Installment Sale Tax Traps!

If you're buying a single asset or a whole business, you may want to pay in installments over time. If you're the seller, having your payments coming in over several years or more than one may be a concession you have to make in order to clinch a sale. No one wants to pay income tax on sales of property before they have received payment. But that's exactly what can happen if you don't properly plan an installment sale. Here are some pitfalls you should be aware of:

Non-Qualifying Property – Not all property qualifies for "installment sale reporting," such as real or personal property sold by dealers in such property, and publicly traded property.

The Double Whammy – Even if you aren't a dealer in property, if you sell depreciable real or personal property which will be used in the trade or business of a related person, the sale cannot be set up as an installment sale. Plus, *all* of the gain from the sale will be taxed at ordinary tax rates – not at capital gains tax rates. The definition of "related person" includes business entities, which are more than 50% controlled by the seller or by family members of the seller, or estates or trusts in which the seller or his/her spouse are beneficiaries.

Prior Deductions Bite Back – Structure installment sales of business assets to make sure you receive the best tax treatment. For instance, gain from depreciation on tangible personal property and certain real property acquired before 1987 is taxed as ordinary income in the year of sale, even if no payments are received. This is referred to as depreciation recapture. For example, if you sell some equipment for $60,000, and you have previously taken $50,000 in depreciation deductions, you must pay tax on the lesser of the gain received or $50,000 of ordinary income, regardless of how much money you receive from the purchaser in that year. Make sure you get enough cash at the time of sale to cover this tax bite.

Headaches From Related-Party Dispositions Of Property – You can't postpone your gain if your related buyer decides to sell the property. Typically, if you sell property under an installment sale to a related party who then sells the property within 2 years, you must recognize the gain on the original sale much sooner. A "related party" in this instance includes family members and controlled business entities, as well as certain estates and trusts, making this rule broader than the depreciable property rule. So, for purposes of your installment sale reporting, sale by your relative or company within 2 years of your sale is considered income or payment received by you.

You Lose On Big Installment Sales – Interest is due the IRS on sales of over $5 million. This rule applies to any installment sale with a total sales price greater than $150,000 if the total amount of installment obligations that arose during the year and remained outstanding at the end of the year was greater than $5 million. In that case, interest must be paid on the tax that was deferred as a result of the installment sale. This isn't as bad as having to pay the entire amount of the tax, but the benefit from deferral is lost because you have to pay for the time value of the money.

Heirs Pay The Price – Ordinarily, if a person dies owning appreciated property, the income tax basis of the property is stepped-up to its fair market value on the date of death. This rule does not apply to installment sale obligations owned by a decedent. Instead, the decedent's heirs continue to report the gain on the sale as installment payments are received. Installment sale planning intersects with estate planning when you want to minimize the income tax hit to your heirs.

Remember, you aren't stuck with installment sale reporting – you can elect out of installment treatment and pay the tax all in the year of sale. This might be beneficial if the sale is in a year where your taxable income is unusually low, or if you have capital losses, which can offset the capital gain portion of a sale.

Be sure to consult with us before you finalize the paperwork on any proposed installment sales. ■

They Lurk Everywhere… Those Nasty Hidden "Taxes"

If you're like most people, you focus on your *marginal* tax rate, the top rate used to calculate your tax. But what counts is what you are really paying. Your *effective* rate can significantly top your marginal rate due to add-ons and limitations. These can easily push the top effective rate over 40%! For instance…

Deductible Or Not?

That expense or loss you incurred may not be fully deductible due to a variety of deduction restriction or limitation provisions. These limitations can be a percentage of income amount, a specific amount, or a percentage amount. They may be allowed to the extent of some income or other item, or may be phased out based on income level, as shown below.

Percentage of income	
Medical expenses	7.5% of Adjusted Gross Income (AGI)
Miscellaneous itemized deductions	2% of AGI
Contributions – individual	Generally 50% or 30% of AGI
Specific amount	
Capital losses	$3,000 annually (in excess of capital gains)
Higher education expenses	$3,000
Percentage of expense	
Meal & entertainment expenses	50% allowed
Deduction to the extent of income	
Capital losses (in excess of $3,000 annually)	Allowed to extent of capital gains
Investment interest expense	Allowed to extent of investment income
Passive activity losses	Allowed to extent of passive income

The Disappearing Act

You may be familiar with the deductions and credits that are phased out at certain income levels. These phase-outs apply to: exemptions, deductible IRA contributions, child and adoption credits, education credits and benefits, and other items.

What may be overlooked is the phase-out of overall itemized deductions. This begins at different income levels based on your filing status. Those at the top end could lose up to 80% of itemized deductions! A typical taxpayer's situation won't be that extreme, but they may lose 5% to 10% of their itemized deductions. These phase-outs are scheduled to be repealed gradually, starting in 2006.

A Merciless Tax Trap

The phase-out limitations may sound bad; but, alternative minimum tax, or AMT, is surely the most insidious hidden tax. Meant as a safeguard against the wealthy paying little or no tax, AMT now affects millions of taxpayers who claim exemptions, deductions, or credits that don't offset AMT.

AMT can be more than your regular tax since it is broader based, and its two tax brackets (26% of the first $175,000 and 28% over that) are higher than most of the regular tax brackets.

What To Do?

Now that you're aware of these hidden taxes, what can you do about them? Following are a few ideas to consider in your tax planning for 2003:

1. Offset capital losses with capital gains; match up investment interest expense and investment income.
2. Postpone or accelerate deductions to bunch more in one year and exceed the percentage limitations.
3. Consider filing separately if one spouse has significant expenses subject to percentage limitations (don't forget that the married filing separately rate is higher than the joint rate).
4. Make sure that your expenses are properly categorized. Don't apply the 50% meal and entertainment expense limitation to amounts which can be gifts, employee fringe benefits, company dinners, or other fully-deductible expenses.
5. See if your child can benefit from claiming education credits when you exceed the income limitation and are getting minimal benefit from their exemption.
6. Always consider AMT in your tax and transactional planning.

Finally, call us. Our goal is to help you develop a tax strategy that will keep those nasty hidden taxes at bay. ■

WASHINGTON ALERT

Bush Proposes More Tax Cuts

Earlier this year, President Bush announced an economic stimulus package, called the 2003 Economic Growth Plan, which contains more than $670 billion in individual and business tax cuts over 10 years. Not all of these cuts will make it through Congress, but we will probably see a new tax law in 2003. Here are the highlights of Bush's proposal:

The ***individual income tax rate cuts*** scheduled to take effect in 2004 and 2006 would be made retroactive to January 1, 2003. The individual rates for 2003 would be: 10%, 15%, 25%, 33%, and 35%. Withholding tables would be adjusted so that wage earners would see an immediate boost in take-home pay.

Beginning in 2003, ***the 10% bracket would be expanded*** so that it applies to the first $7,000 of taxable income for single filers (up from $6,000), and $14,000 for married filers (up from $12,000). These amounts would be indexed for inflation beginning in 2004.

Tax relief for married taxpayers would be accelerated. In 2003, the standard deduction for married filers would be twice that for single filers. The top dollar amount of the 15% bracket for married couples filing jointly would be double that for single filers in 2003.

The ***child tax credit*** would be set at $1,000 per child in 2003 (up from $600). Advance refund checks for the increased amount of $400 per child would be sent out this summer.

To keep these tax cuts from throwing more people into the ***Alternative Minimum Tax,*** the individual AMT exemption amount would be increased by $8,000 for joint filers and $4,000 for single filers through 2005.

The proposal would ***exclude dividends from taxation*** at the individual level if those dividends come from income that was taxed at the corporate level. This exclusion for only "double taxation" dividends would mean more recordkeeping for corporations and wouldn't apply to stock in retirement accounts.

The ***expensing limit for depreciable business assets*** would be "supersized" from $25,000 to $75,000. The investment limitation phase-out would also increase from $200,000 to $325,000, with the amount phasing out dollar-for-dollar up to $400,000. The $75,000 and $325,000 amounts would be indexed for inflation beginning in 2004.

Qualifying persons would receive $3,000 in a ***personal re-employment account*** for job training, childcare, transportation, or other expenses. Unemployment benefits (which had expired in December 2002) are also extended.

We will keep you updated on this proposed plan as it wends its way through Congress.

IRS Relaxes Distribution Rules

In an effort to help investors preserve their retirement savings in this down market, the IRS recently announced that IRA owners and pension plan participants can slow their distributions. They can begin receiving fixed payments based on the value of the account as it changes from year to year instead of the value at the time payments commenced.

Without this guidance, issued as Revenue Ruling 2002-62, investors might find themselves either prematurely depleting their retirement accounts, or being subject to excise tax for reducing their distributions. We can help you determine whether a change in distributions would be beneficial.