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CPA

JANUARY 1999

Client Bulletin

BUSINESS & TAX PLANNING IDEAS *for* OUR CLIENTS *and* FRIENDS

Don't Wait Any Longer—Plan Now for Year 2000 Problems

By this time, you have heard and read endless stories about the year 2000 problem (also known as the y2k problem). This problem can occur in computer programs where the year has been entered as two digits instead of four, e.g., '98 instead of 1998. Computers and any mechanism with a computer chip with a two-digit year field in its memory will read the year 2000 as the year "00." The result will most likely be that the program will go to its "default" setting, and depending on the program, this may cause no problems or some large ones. The y2k problem will not only affect personal computers, but any software application with a two-digit year field instead of four-digit field. This may include accounting software, computer operating systems, programs that run VCRs, time-controlled vaults, and hundreds of other types of date-dependent electronic equipment and programs.

IN THIS ISSUE

Don't Wait Any Longer—Plan Now for Year 2000 Problems
PP. 1, 2, 3

Other Tips for the Year 2000
P. 2

Tax Issues and Y2K P. 3

More Business Provisions from the 1998 IRS Restructuring and Reform Act
P. 3

Hotel Crime Prevention P. 3

New Year's Resolution: Review Important Personal Documents P. 4

Tax Calendar P. 4

**WISHING OUR CLIENTS
AND FRIENDS ALL THE
BEST IN 1999.**

It's not just computers that are affected

Hopefully, you have already ensured that your personal and business computer systems are compliant, and that you have back-up plans in case they are not. But you may not have considered other areas of your business or personal life that may also be affected. It may be these "small things" that could have a big impact on your daily duties and activities. For example, if you are in an office building, check with the landlord or management company to see if the building systems, such as security systems, are compliant. If a security door is not compliant, its default setting may be "unlocked"—a possible security hazard for your business. Other building systems could also be affected, and could cause nuisances. These include elevators, heating and air conditioning systems, sprinkler systems, and anything with automatic sensors, such as lights.

Other areas to look into are telephone systems and utilities. Almost every company has a telephone/voice mail system, and all should be checked to make sure they are y2k-compliant. If the system is not corrected, it could put out the wrong message on the wrong day. For a small business that is dependent on phone orders, this is a major problem; billing details could be erroneous, and date-stamped messages in voice mail could also be incorrectly recorded. To find out if your phone system is compliant, call your vendor or look on its Internet page. If your system requires a fix, install it as early as possible and test it to make sure it works with next-century dates.

Miscellaneous hardware devices

The y2k problem may also affect many other
continued on page 2

CPA

Client Bulletin

OTHER TIPS FOR THE YEAR 2000

Medical equipment

Hospitals, nursing homes, home health agencies, and physicians' offices all need to be aware that some medical equipment may have a y2k problem. For example, some medical devices and equipment have internal clocks tracking the time since the last maintenance. If the maintenance is not done in time, the equipment may stop functioning. The greatest risk involves medical equipment that is old and still in use. The best way to find out is either to test the equipment, or contact the manufacturer or vendor and question them about compliance.

Paper checks

Although paper checks don't have a y2k problem, you may want to make sure that any new checks you order no longer have "19" (e.g., 19____) prefacing the area where the date is written on the check.

continued from page 1

devices, such as personal digital assistants (PDAs) or sophisticated calculators. All of these should be checked for compliance. Other handheld devices, such as ones used for inventory control or point-of-sale ordering, must be considered as well. One large area of concern for credit card companies are the credit card readers used by most retail vendors; many are not compliant, and should be tested. When credit card companies began issuing new cards with a "00" expiration date a few years ago, many card readers were found to be non-y2k-compliant. The best way to check all of these devices is to contact the manufacturer or visit the Web site and search for y2k instructions. Other business equipment that should be reviewed includes copiers and faxes. Although, for most companies, these machines are considered low priority and noncritical, a simple test or phone call to the vendor should answer your compliance question.

Who do you depend on?

What is your bank doing about y2k? Has it told you about its compliance efforts? The size of the bank will determine the type of problems that may occur. A larger bank has more systems that it needs to fix and ensure are properly working, while a small bank may rely on an outside party to process its transactions. If you keep anything in a bank vault, make sure the vault is also compliant.

Does your local town, county, etc., have emergency plans? Do you know what they are? Are your customers and suppliers compliant? Even if your company does not have bugs of its own, it may be affected by the problems of suppliers, customers, business partners, and others. One way to protect your business is to inquire with your associates about their potential y2k problems and how they are handling them. It will be in both your interests to make contingency plans in case there is a temporary loss of data, rush deliveries need to be made, etc. No one can guarantee that they've fixed all y2k problems until the day actually arrives, so it is best to be prepared for anything.

Don't correct a failing system

Y2k should not be looked at as just a problem, but also an opportunity. Suppose you installed a software inventory system seven years ago that was to clean up your inventory woes, but ended up giving you more problems than it solved. Now, in addition, it has a y2k problem. Instead of trying to fix a system that doesn't work for you, perhaps the y2k issue is the reason to spur you to change systems. Any new or updated software program should guarantee that it has no y2k issues. You can then concentrate on things that will truly help your business, such as better inventory tracking, faster order fulfillment, etc.



Where to go for help

General information and help can be found on the Internet; free software (called freeware) is available to help run tests. To get such software, search for the following programs on the Internet (key word: freeware): DOSCHK, 2000Test, 2000Fix, and Year2000.

For business issues, more specific help can be found on the IRS's and the Small Business Administration's (SBA) Web sites. Both of these agencies are making many resources available to small businesses that want help with computer conversions. The IRS sent out a special, detailed notice to more than 6 million small businesses in its last issue of the Social Security Administration's *IRS Reporter*. The IRS also has a link to the SBA home page; the SBA allows taxpayers to go to a virtual classroom and go through

the compliance process step-by-step. In addition, through the SBA, small businesses can get guaranteed government loans to help with the cost of transition, and considers these loans financing for

an ordinary cost of business. (The SBA Web site can be accessed at [HYPERLINK http://www.sba.gov](http://www.sba.gov). The IRS site is at <http://www.irs.treas.gov>.)

Tax Issues and Y2K

Deducting costs

What if you have a year 2000 problem in your business and you incur costs fixing it: How do treat them for tax purposes? Currently, the tax law allows you to deduct most software development costs. However, not all costs involved in fixing the problem will be connected to software development. Some will be related to hardware, labor, and consulting, which may be more difficult to classify. Some could be considered replacement costs, for example, replacing a computer chip. However, if you have to replace an entire system, the IRS may consider it as part of a renovation plan, and require the company to capitalize and amortize the costs.

The year 2000 problem presents a wide range of issues in a company, including tax, professional liability, and operations issues that need to be analyzed and addressed before December 31, 1999. For tax purposes, make sure any fixes to your computer system are well documented and properly characterized.

1999 tax season at the IRS

Extra care should be taken when sending anything to the IRS next year. IRS Commissioner Rossotti says he doesn't expect a meltdown at the IRS due to year 2000 problems, but he is concerned about "localized" problem areas. Therefore, businesses should be especially careful when sending tax-related data and funds to the agency next year. Businesses should also sit down now with IRS personnel and review potential problem areas, and should be very vigilant and ensure that information and funds are being recorded properly and credited to the correct account. Individual taxpayers should send their returns and correspondence to the IRS by registered or certified mail, return-receipt requested, as evidence of mailing.

More Business Provisions from the 1998 IRS Restructuring and Reform Act

Last year's IRS Restructuring and Reform Act (the "Act") not only laid out a new framework for the IRS, it also contained many tax provisions for individuals and for businesses. Below are some of the business highlights from this important legislation.

Deduction for vacation and severance pay

Generally, an accrual-basis taxpayer is able to deduct compensation in the year it accrued, such as vacation or severance pay, if the compensation is paid within the first 2 ½ months of the following year. The Act specifically provides, however, that the accrued compensation is deductible only if the amount is actually received by the employee within the first 2 months of the succeeding year.

Deduction of unused employer Social Security credit

For owners of food and beverage establishments, there is a newly created deduction of the general business credit relating to some portion of an employee's tips. This deduction will occur when the carryforward period expires and the employers' Social Security credit remains unused. This is effective retroactively for tax years beginning after August 10, 1993.

AMT exemption for small corporations

For tax years beginning after December 31, 1997, a small corporation is exempted from corporate alternative minimum tax (AMT). If a corporation's first year of existence is after 1997, the corporation generally qualifies for its first year for the AMT small corporation exemption. (There are a few exceptions that apply, such as to a controlled group or successor entity.) The IRS determines that a corporation qualifies as a "small corporation" by applying a gross receipts test between \$5,000,000 and \$7,500,000. Once a corporation fails the gross receipts test, the corporation can never again qualify as a small corporation.

HOTEL CRIME: PREVENTION IS THE BEST MEDICINE

Although most hotels take many security measures to ensure the safety of their guests, guests themselves should take certain steps to avoid becoming a crime victim in a hotel.

Making a reservation. When reserving the room, ask what type of lock the room has. Room locks that are operated by traditional metal keys are the most vulnerable. Why? Guests often forget to turn in room keys, and the lock might not get changed until several keys are missing. The best type of hotel key is the magnetic card. The strip allows the code to be automatically reprogrammed every time a guest checks out. Next safest is the punch card style key card. This type of card can also be reprogrammed if it is not returned.

Hotel lobby. Hotel lobbies are busy areas and impossible to keep completely secure. Always keep briefcases and laptop computers on the counter or between your legs and the counter.

Room location. Request a room near the elevator, between the fifth and eighth floors. Rooms on lower floors are more at risk for break-ins. Above the eighth floor may be risky as well, since not all local fire departments have ladders that can reach above that height. A room near an elevator ensures that there is greater foot traffic near the room, preventing an intruder from going into your room unnoticed, and makes it more likely that a shout for help will be heard. Rooms at the ends of halls have less traffic, and are usually located near the stairs, making it easier for an intruder to escape.

Safe deposit box. The only type of room safe deposit box that is truly safe is the one that allows guests to program their own combination. If it needs a key, you are better off using the safe deposit boxes at the front desk.

New Year's Resolution: Review Important Personal Documents

Just as you get your car inspected every year and do yearly maintenance on your home, you should also do yearly maintenance on your financial plans and your will and other documents that name beneficiaries. Such documents include your IRAs, life insurance, pension plan, mutual funds, and bank accounts. Over the years, you may forget whom you have designated for what. To avoid costly mistakes, make sure these documents reflect your current wishes. By doing this, you will also become up-to-date on where your current finances stand.



After doing this, you may find that you need to do some financial and tax planning. Ask yourself: Do I have enough life insurance? Do I put enough away into my IRAs and 401(k)s? Are my investments diversified? These are not just one-time questions, but issues that should be reviewed regularly and updated as needed. Don't put it off knowing that a review might raise new issues. Fine tuning a little bit each year is easier than trying to revise an entire financial plan all at once. Checking beneficiaries is a good first step to keeping your personal, financial, and other long-term plans up-to-date.



The CPA. Never Underestimate The Value.

Tax Calendar

JANUARY

January 4

Employers. Stop advance payments of the earned income credit for any employee who did not give you a new Form W-5 for 1999. Make sure you give your employees their copies of Form W-2 for 1998 before February 1.

January 11

Employees who work for tips. If you received \$20 or more in tips during December, report them to your employer.

January 15

Individuals. Make a payment of your estimated tax for 1998 if you did not pay your income tax for the year through withholding (or did not pay enough that way). This is the final installment date for 1998 estimated tax. However, you don't have to make this payment if you file your 1998 return and pay any tax due by January 31, 1999.

Farmers and fishermen. Pay your estimated tax for 1998. You have until April 15 to file your 1998 income tax return. If you don't pay your estimated tax by this date, you must file your 1998 return and pay any tax due by March 1, 1999, to avoid an estimated tax penalty.

Employers. For Social Security, Medicare, withheld income tax, and nonpayroll withholding, deposit the tax for payments in December 1998 if the monthly deposit rule applies.

FEBRUARY

February 1

Individuals. File your income tax return for 1998 if you did not pay your last installment of estimated tax by January 15. Filing your return and paying any tax due by this date prevents any penalty for late payment of the last installment.

All businesses. Give annual information statements to recipients of certain payments you made during 1998. Payments that are covered include: 1) compensation for workers who are not considered employees, 2) dividends and other corporate distributions, 3) interest, 4) amounts paid in real estate transactions, 5) rent, 6) royalties, 7) amounts paid in broker and barter exchange transactions, 8) payments to attorneys, 9) profit-sharing distributions, 10) retirement plan distributions, 11) original issue discount, 12) prizes and awards, 13) medical and health care payments, 14) debt cancellation (treated as payment to debtor), and 15) cash payments over \$10,000.

All employers. For nonpayroll taxes, File Form 945 to report income tax withheld for 1998 on all non-payroll items, including backup withholding and withholding on pensions, annuities, and gambling winnings.

February 10

Employees who work for tips. If you received \$20 or more in tips during January, report them to your employer.

February 16

Individuals. If you claimed an exemption from income tax withholding last year on the Form W-4 you gave your employer, you must file a new Form W-4 by this date to continue your exemption for another year.