

Home-mortgage loans: associated costs may be deductible

With interest rates near record lows, many taxpayers are refinancing their home mortgages. Some costs associated with these loans may be deductible.

Paying for points & other services

For taxpayers who itemize their deductions on their tax returns, the "points" paid to obtain a home mortgage may be deductible as mortgage interest. Points paid to obtain an original home mortgage can be, depending on circumstances, fully deductible in the year paid.

However, points paid solely to

refinance a home mortgage usually must be deducted over the life of the loan and include loan origination fees, processing fees, maximum loan charges and premium fees.

Interest amounts paid for services provided by the lender, such as appraisal, recording and inspection fees and investigation charges, are not deductible.

However, if part of the refinanced mortgage money financed home improvements, and if the taxpayer meets certain other



requirements, points related to home improvements may be fully deductible in the year the points were paid.

Refinancing & home-equity loans

If a homeowner is refinancing a mortgage for a second time, the balance of points paid for the first refinanced mortgage may be fully deductible at pay-off of the first loan.

Generally, a taxpayer can obtain a home-equity loan for up to \$100,000 and treat it as home-equity debt. The interest is fully tax deductible (except for the alternative minimum tax) assuming the taxpayer has enough equity in the home and has no other home equity loans.

When more than \$100,000 is financed, the interest on the excess is not tax deductible as home-mortgage interest, except to the extent a portion of the loan is used to substantially improve the residence.

The good news: if loan proceeds over \$100,000 are used to buy stock or taxable investments, the interest paid on those funds is investment interest that may be deducted up to the extent of the taxpayer's net investment income.

Similarly, if the financing is

done to provide cash for a business, the interest on the first \$100,000 is deductible as mortgage interest and the interest on the amount above \$100,000 is treated as tax deductible business interest. □

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Tax shelters: BKD's position

by Rich Royster, Springfield

Several articles have appeared recently in major newspapers regarding Internal Revenue Service (IRS) challenges of tax-shelter strategies sold by others.

Nondisclosure agreements have been used with many of these tax shelters. **BKD, LLP** does not market tax shelters such as those

described in the articles and does not require our clients to sign a nondisclosure agreement in connection with the tax advice or strategies we recommend.

We do, however, routinely provide tax-planning strategies to our clients. When properly used, they are not the type of tax shelter targeted by the IRS, just good tax planning. □



Indirect taxes of multinational

by Rob Jennings, Indianapolis

Have you ever wondered why so much effort is devoted to devising strategies to reduce the income-tax burden of multinational corporations (MNCs)?

There are many answers to this question. At some level, however, the emphasis derives from a desire to manage the MNCs' effective tax rate (ETR).

In recent months, much has been published about strategies employed by MNCs, especially the

plan of several U.S. MNCs to engage in so-called "inversions" to reduce the impact of U.S. tax law on their global operations.

Yet, comparatively little has been published in the U.S. at least about the impact of indirect taxes on MNC profitability.

Value-added tax regimes

A recent U.S. government study compared the amount of income-tax revenue to federal indirect tax revenue for 1999, and

the result was approximately \$187 billion of corporate income tax receipts compared to approximately \$760 billion of federal indirect tax receipts.

At first blush, this statistic may not seem all that surprising when you consider the impact of payroll taxes on overall indirect tax receipts.

However, because the U.S. is the only member of the Organization for Economic and Cooperative Development (OECD) that does not have a value-added tax (VAT)

Expanding international tax solutions

BKD recently announced the formation of Expatriate Assignment Solutions (EAS), an international alliance to help mid-sized companies with employees working in other countries with visas, international tax issues and immigration law.

To launch this international network, we partnered with accounting firms and other service providers in the United Kingdom, Canada, The Netherlands, Hong Kong and Brazil.

"Sending employees to work in another country is incredibly complicated," says Rob Wagner, the BKD partner who manages the firm's international tax practice.

"Securing visas, working with immigration officials and remaining compliant with each country's tax laws are time-consuming and complex tasks," he says. "That's where BKD through EAS can lighten the burden for companies with a global workforce."

In addition to its international

tax resources, EAS provides access to ExpatEdge, Inc., a company whose human resources tools help employees before, during and after an international assignment. The ExpatEdge Virtual Handholding system helps companies streamline their international assignment programs.

"Seamless integration with other service providers is a critical aspect of serving our clients. The relationship with ExpatEdge is a direct result of responding to our clients' needs," says Wagner. "The ExpatEdge tools will provide additional efficiencies to the international assignment process."

Rob Jennings, CPA, and Greg Cislak, CPA, have joined Wagner to form the international tax services team, which complements tax resources in local offices.

Jennings, a partner, has more than 12 years of experience with cross-border international tax planning and consulting, including helping U.S. and non-U.S. multinationals with issues such as

mergers, acquisitions and intellectual property planning. His background includes six years with Ernst & Young's Washington D.C. practice and six years with PricewaterhouseCoopers.

Cislak joins BKD as a senior manager following eight years with Ernst & Young's expatriate practice, including a short-term assignment in Brussels, Belgium. As BKD's EAS leader, Cislak helps clients with the tax issues involved in sending employees overseas.

"We're excited about the addition of Jennings and Cislak to our firm," says Wagner. "International business opportunities are out there, but they don't always leave companies in a good tax posture. With the addition of these two leaders in the international tax field, BKD is positioned as a dominant provider of international tax services to mid-sized businesses."

Our global tax solutions help companies reduce their worldwide tax burden through consulting on issues such as implementing the



BKD's international tax team, from left, Rob Jennings, Greg Cislak and Rob Wagner.

appropriate business structure, determining arm's length charges for cross-border sales, services and property usage, utilizing foreign tax credits and facilitating employees' tax compliance when on international assignment.

"Many U.S. accounting and consulting firms no longer provide cutting-edge international tax consulting to middle-sized companies. That's not our approach," says Wagner. "We recognize that mid-sized as well as larger companies are players in the international marketplace, and we're committed to helping them compete successfully while complying with international tax rules." □

& profitability enterprises

regime, it suggests, while MNCs have tended to focus on income-tax planning, taxing authorities are increasingly focused on indirect taxes to generate tax receipts.

VAT rates in other OECD member states range from 12% to 25% of the value of goods or services in addition to the customs duty, if any, imposed on the importation of such goods or services. Thus, if the ratio of indirect taxes to corporate income taxes in the U.S. is approximately 4:1, the comparable ratio in other OECD member states with VAT regimes is likely even greater.

Reduce indirect taxes

In light of the foregoing dichotomy, why isn't there more emphasis on indirect tax reduction?

Three common themes are:

- ✓ Indirect taxes are above the line, and tax departments often have little influence over an MNC's operating decisions; therefore, little can be done to compel operating units to review/implement planning strategies to reduce indirect taxes
- ✓ The perception that it is more practical to reduce income taxes directly affecting MNCs' financial statements vis-à-vis ETR than it is to explore tax planning strategies for indirect tax reduction opportunities
- ✓ The customer typically bears the cost so there is little incentive for the MNC to reduce indirect taxes because they are often embedded in cost of sales, e.g., VAT and Customs duty, and, therefore, are invisible to the customer

However, can your company afford not to consider strategies to reduce the impact of indirect taxes on its bottom line in an environment where generating top-line revenue is increasingly difficult, and cost cutting is everyday news?

Unlock cash flow

Consider the impact on cash flow of delaying the imposition of VAT and Customs duty on goods exported outside the U.S.

For example, on \$20 million of export sales with a 30% VAT and Customs duty rate sold to related distributors, imagine the impact of unlocking \$6 million of cash flow from the MNC's supply chain. Could your company use

\$6 million dollars of additional cash flow?

Furthermore, the European Union online VAT directive is scheduled to take effect July 1, 2003, for non-European Union companies selling products or services in digitized format to nonbusiness organizations. Has your company begun to consider its impact?

Contact your BKD advisor for information about how your multinational enterprise might benefit from indirect tax planning. □



Accrual-basis taxpayer error: correcting billing shipments

Correcting errors related to billing items has always been tricky to handle from a tax perspective, particularly where the "error adjustment" was not recorded for financial statement purposes.

However, in a recently issued Internal Revenue Service (IRS) revenue ruling, an accrual-basis manufacturer that over billed a customer was permitted to avoid income recognition on the excess invoice amount in the year of billing.

The IRS opinion was to the extent the manufacturer discovered the billing error after filing the year's tax return, it was entitled to file a refund claim for the excess amount reported.

However, where the company

consistently treated billed amounts as a reasonable estimate of its income, reporting billing changes in the year it made to the billed accounts, the company should request IRS consent for an accounting method.

Finally, where the right to the income was largely disputed, the IRS views the accrual as being postponed until the controversy is resolved.

The ruling also describes income recognition issues some clients face related to incorrect shipments:

Goods retained - a manufacturer ships the wrong product and the customer disputes the sale in the same year. The IRS noted there was no right to

income in the year of sale, and likewise, the taxpayer could not reflect a reduction in cost of goods sold for such year.

Repetitive sales - a manufacturer ships goods monthly to a customer. At year end, the month after the seller's tax year closes, the customer discovers a shipping mistake. The manufacturer has a fixed right to the income for the year-end sale and/or shipment and would be required to recognize it under the all-events test. □



State legislators

by Joe O'Connell, Indianapolis

States are in dire financial straits, and today's sluggish economy worsens a situation that has been deteriorating for some time, contributing to significant budget deficits in many states.

A common theme for many 2003 state legislative sessions is to find new ways to increase revenue by increasing tax rates, the tax base and/or a combination of both.

There also are rumblings about the need for reductions in services, and some state legislatures are considering repealing various tax cuts and incentives passed within the last several years.

BKD is following legislative activity in the 11 states where our 26 offices are located.

Here is a synopsis of various tax bills and other proposals under consideration to help close serious budget gaps in the following states.

Arkansas

At press time, the Arkansas Legislature was in session to address which provisions of recent federal tax law changes the state will adopt.

Also under consideration are ways to fund education reforms in the current economy, including potential school consolidations.

Colorado

Colorado's TABOR Amendment limits the way budget shortfalls can be addressed by the general assembly; the amendment's complicated rules make it difficult to pass legislation to increase taxes. Across-the-board budget cuts are planned.

Illinois

To raise revenue, the state legislature will consider restoring the three-factor apportionment formula to compute corporate income taxes. The state is currently using the single sales factor formula.

Indiana

Effective January 1, 2003, the state's gross income and supplemental net income taxes were repealed, and the Indiana Special Corporation was eliminated. Also, effective January 1, 2003, the state's adjusted gross income tax rate was raised from 3.4% to 8.5%.

Kansas

Seeking new revenue sources, the Kansas Legislature is reviewing all current sales tax exemptions. These include many long-standing business-related exemptions such as manufacturing and farm equipment and professional services.

In addition, the legislature is considering requiring withholding of Kansas income tax on various payments to non-Kansas residents.

Kentucky

Governor Paul Patton, in a speech to University of Louisville officials, said he will propose a plan to replace the corporate income tax with a new business-activity tax.

In addition, the state's license tax would be increased and application would be extended to limited liability partnerships and limited liability companies.

Missouri

Governor Bob Holden's January 15, 2003, State of the State address proposed raising revenue by closing 11 corporate tax loopholes, including one that allows formation of out-of-state dummy corporations and one that allows corporations to avoid paying tax on royalties, dividends and interest income derived from out-of-state interest.

Nebraska

Nebraska's proposed L.B. 596 would require corporate taxpayers to add back any corporate dividend excluded or the amount of any additional depreciation received due to any federal law enacted.

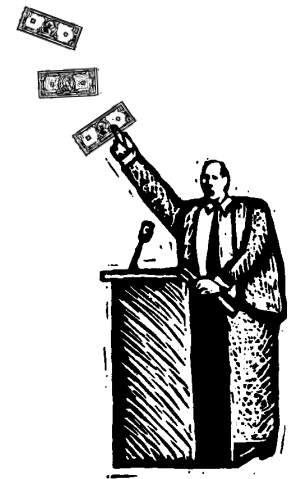
Ohio

Governor Bob Taft's proposal to raise an estimated \$159 million by increasing taxes on cigarettes and alcohol failed in both chambers of the general assembly this year, but he recently introduced his 2004 and 2005 budget to both bodies. Included are reforms related to municipal income tax, corporate franchise tax, sales and income tax.

In addition, Taft is expected to follow through on threats to cut education and senior programs because the general assembly failed to completely fill his administration's estimate of a \$720 million shortfall.

Oklahoma

To raise revenue, the Oklahoma Legislature is in session to consider increasing



sales taxes, but there are no initiatives to increase revenue taxes. Also under consideration is a statewide lottery to help fund education shortfalls.

Texas

In 2002, the Center for Public Policy Priorities released a report in which the group suggested the state raise revenue by extending the reach of the franchise tax to include partnerships and other businesses, thereby closing the Delaware sub-loop-hole.

Also, Texas Comptroller Carole Keeton Rylander is urging the upcoming legislative session to address a loophole that allows corporations to limit their Texas franchise tax liability by converting to limited partnerships.

According to Rylander, the loophole, while legal, cost the state approximately \$143 million in 2002 with a loss growth rate of 40% per year.

Simple changes can be effective

The initiatives described here may or may not solve every state

seek new funds

budget gap, but the battle isn't over yet. As legislative sessions continue, many additional ideas and opportunities may present themselves to state governors and legislators.

Sometimes, even simple

changes can reap big rewards. Complete restructuring may be a logical move considering the many strategies that, when properly implemented, may help reduce your state income-tax liability on an annual basis.

There still may be opportunities to decrease your state income-tax liabilities this year, but it's important to be proactive. Waiting to act may cost you additional state income tax dollars.

BKD can help. Your state tax posture changes every time your company grows through acquisitions or new service lines.

Contact your BKD tax advisor for more information. □

Affirmative-action compliance requires diligence from federal contractors

by Sarah Farrell, Kansas City

Is your company under contract to provide the federal government with goods, consulting or other services totaling more than \$50,000 a year?

If the answer is yes, then you qualify as a federal contractor.

(Note: Construction companies that are federal contractors operate under guidelines different

from those required of other industries.)

No doubt, you are already aware of your status, but how much do you know about affirmative action or the way in which equal employment issues interface with federal contractors?

The way in which some data must now be reported on the equal opportunity employer (EOE) survey has changed. Are you in

compliance with the new guidelines?

Prioritize training & documentation

Affirmative action laws require federal contractors with 50 or more employees to develop and implement programs that expand employment opportunities

for women, Vietnam-era veterans, minorities and the qualified disabled.

These efforts include outreach, recruitment and training company managers and supervisors about the meaning and implementation of an EOE affirmative action program and how to document compliance on a daily basis.

Federal contractors must comply with the following Equal Employment Opportunity Commission (EEOC) mandates:

- ✓ File annual reports with the EEOC that provide information on the number of employees you have in each job type and category of ethnicity
- ✓ Develop an affirmative-action plan and program, a working document that dictates the steps you must take; key points to document are the ways in which equal employment employer status will be implemented by your company
- ✓ Include the methods your company will use to recruit potential employees, such as a minority group that resides in your market area but not represented proportionately in your workforce

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Succession planning for family businesses

It is estimated approximately one-third of family businesses make it to the second generation, and of these, only about half survive to the third generation.

This is often because of the failure of preceding generations to develop a common family vision of the business objectives, coupled with a lack of succession planning.



Common goals can be established

The following suggestions may help your family business avoid negative consequences and achieve common goals:

- ✓ Hold regular family meetings
- ✓ Foster an environment that encourages open

communication so dissenting views can come to the surface and be addressed

- ✓ Extend communication to all members of the family whether they are engaged in the business or not
- ✓ Establish family and business policies well in advance of their need
- ✓ Form a board of advisors to provide experienced insight to enhance the business management
- ✓ Establish a succession plan before it is needed, and integrate it with strategic plans for the business
- ✓ Use professional advisors extensively to provide expertise in all aspects of planning



Market commentary: fourth quarter 2002

by Jeff Layman, BKD Wealth Advisors, LLC

The stock market rallied from the oversold condition of early October to post gains in the fourth quarter.

Still, looming concerns over the potential war with Iraq and uncertainty about the pace of corporate earnings growth caused the gains to be muted and year-to-date returns to remain in the red.

The major indices posted the following results:

- ✓ Indications the recovery in economic growth was beginning to stall during the quarter caused the Federal Reserve to lower the Fed funds rate by one half of one percent, to 1.25%, in early November.
- ✓ Declining interest rates and a

flight to safety allowed high-quality bonds (investment grade) to post strong gains in 2002. Meanwhile, the spread between high-quality bonds and lower-quality (junk) bonds reached extremely wide levels, as investors generally were less risk tolerant in their bond portfolios.

- ✓ Mortgage refinancing activity reached record levels, allowing for continued strength in consumer spending. Automobile sales continued at a robust pace, as consumers responded to incentives and rebates.
- ✓ The much anticipated pick-up in business spending failed to materialize in the quarter. The share of nominal GDP represented by business investment is now at a 50-year low, as companies have generally opted to use free cash flow to pay down debt

Fourth Quarter 2002		
	4Q2002	2002YTD
S&P 500	8.44%	-22.10%
NASDAQ Composite	13.95%	-31.53%
Russell 2000	6.16%	-20.44%
MSCI EAFE	6.48%	-15.94%
Lehman Aggregate Bond	1.57%	10.26%
Lehman Municipal Bond	-.01%	9.60%

Source: The Wall Street Journal

rather than pursue new investment.

- ✓ Signals about the health of the economy remain mixed, but point toward a continued slow recovery.
- ✓ As revenues and earnings have declined over the past two years, many companies have reduced overhead and cut staff. When sales eventually recover with an improving economy, the result

should be a more robust expansion of margins and profits. This ultimately leads to higher stock prices.

- ✓ Entering the new year, investors anticipate the positive implications of President Bush's proposed economic stimulus package, which includes the potential reduction or elimination of the taxation on dividends paid to individuals. □



Decline & recovery: recessions,

economy slows. Unlike analysts who define a recession as two consecutive quarters of decline in real gross national product, NBER defines a recession this way:

“... a period of significant decline in total output,

income, employment, and trade, usually lasting from six months to a year, and marked by widespread contractions in many sectors of the economy.”

When recessions drive corporate earnings lower, the stock

market often responds by contracting. When stock market declines near the 20% mark, analysts say we are in a “bear market.”

Because business cycles and financial markets are each affected by a variety of different factors,

Poorly performing financial markets, rising oil prices and the threat of war have combined to cast dark clouds over the U.S. economy.

While the situation looks bleak today, a look at the past suggests every cloud may indeed have a silver lining.

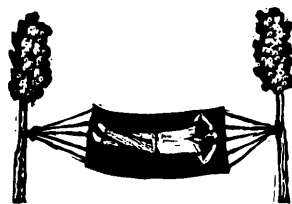
Our economy has experienced five recessions since 1973, according to the National Bureau of Economic Research, Inc. (NBER).

Recessions occur when the

Business Cycles 1973-2002 (Duration in Months)*

Peak	Trough	Contraction Peak to trough	Expansion Previous trough to this peak	Cycle Trough from previous trough	Cycle Peak from previous peak
3/01	?	?	120	?	128
7/90	3/91	8	92	100	108
7/81	11/82	16	12	28	18
1/80	7/80	6	58	64	74
11/73	3/75	16	36	52	47

* Data provided by National Bureau of Economic Research, Inc.



Actively plan for a satisfying retirement

What are some of the most common retirement planning mistakes people make? How do you relate to the following potential pitfalls:

- ✓ Delaying financial planning through sheer inertia
- ✓ Saving too little when you finally begin to save
- ✓ Being overly pessimistic about your ability to save sufficiently
- ✓ Becoming intimidated by 401(k) investment fund options
- ✓ Inattention to investment selections, assuming your

original allocations never need repositioning

- ✓ Over-managing investments and constant reallocation of investment funds
- ✓ Failing to imagine and plan one's retirement lifestyle
- ✓ Not preparing psychologically for retirement
- ✓ Neglecting your financial education

Awareness of how to spot even the most basic financial planning opportunities may help increase your chances for a satisfying retirement. □

Tale of the Tape Selected Returns through February 28, 2003

Benchmarks	1 Year	Year to Date
DOW	-23.90%	-5.40%
S&P 500	-25.68%	-4.40%
NASDAQ Composite	-25.81%	0.15%
Russell 2000	-24.63%	-5.89%

Selected Asset Classes - Mutual Funds

Large Cap Growth	-3.36%
Large Cap Value	-4.82%
Mid Cap Growth	-3.00%
Mid Cap Value	-4.60%
Small Cap Growth	-5.67%
Small Cap Value	-6.01%
Science & Technology	-0.19%
International	-6.51%

Source - The Wall Street Journal, March 3, 2003. As with a portfolio of all stocks and bonds, a diversified portfolio gives no guarantee of safety of principal, which is subject to fluctuation.

WealthPlan.

bear markets & rebounds

they do not always move in lock-step, as evidenced by the eight bear markets the Dow Jones Industrial Average (DJIA) has experienced during the five business cycles occurring since 1973.

Decline & recovery patterns

While bear markets and recessions don't always demonstrate a perfect correlation, they do share a number of similarities.

Both are cyclical, and both hurt. When you're in them, it seems like they'll never end. Historically, they always do. When they end, recovery follows.

While past performance is no guarantee of future returns, the

cyclical pattern of decline and recovery in business cycles and market cycles has a 100% track record before the current situa-

tion, and those are good odds by any standard.

Yes, the markets have been in decline for three years with no

clear signs of a turnaround, but history suggests nothing lasts forever, not even bear markets. □

DJIA Market Cycles 1973-2002*

Start	DJIA	Finish	DJIA	Gain/Loss	# Months Decline	# Months Recovery
1/14/00	11,723.00	?	8,314.63	(29.07%) as of 12/31/2002	36	?
7/17/98	9,337.37	8/31/98	7,539.10	(19.26%)	2	2
7/16/90	2,999.75	10/11/90	2,365.10	(21.16%)	3	4
8/25/87	2,722.42	10/19/87	1,738.74	(36.13%)	2	21
11/29/83	1,287.20	7/24/84	1,086.57	(15.59%)	8	5
4/27/81	1,024.05	8/12/82	776.92	(24.13%)	16	2
9/21/76	1,014.79	2/28/78	742.12	(26.87%)	17	32
1/11/73	1,051.70	12/6/74	577.60	(45.08%)	23	14

*Data provided by Yahoo Finance.com

Affirmative-action compliance. . .

(continued from page 5)

Build timetable for action

The language of the affirmative-action plan also commits your company to building goals and timetables for increasing the number of women, minorities, Vietnam-era veterans and qualified candidates with disabilities in your workforce.

Three federal laws require the development of proactive methods to provide equal opportunity and affirmative action:

- ✓ Executive Order 11246
- ✓ Section 503 of the Rehabilitation Act of 1973
- ✓ Vietnam Era Veterans Readjustment Assistance Act of 1974

The policies and procedures you develop and practice should also be compliant with Title VII of the Civil Rights Act of 1964, as amended, the Americans with Disabilities Act of 1990, and the Family and Medical Leave Act of 1993.

Implement effective plan

Affirmative action plans are complicated and difficult to develop. You must devote time to job analyses, identify the number of employees in each category (race, age, sex, etc.) and determine what percentages are in the labor pool.

Narrowly tailored plans are usually the most effective way to protect the rights of innocent parties.

The most common mistakes businesses make include:

- ✓ Inaccurate or incomplete job descriptions
- ✓ Inconsistent hiring practices, which could have an adverse impact on minorities and women
- ✓ Inconsistent and/or undocumented hiring criteria

You are required by law to track the status of employment applicants from the above referenced categories. It is important to analyze how well your compa-

ny recruits these applicants and develop realistic hiring goals.

Don't take compliance risks

Compliance requires daily documentation; it's difficult for a company to catch up once it falls behind.

The Office of Federal Contract Compliance Programs (OFCCP), working under the authority of the EEOC, will do an estimated 60,000 additional com-

pliance reviews of federal contractors this year.

Some companies take chances, convinced they will not be tapped for an OFCCP review. Noncompliance fines are high and not worth the risk, especially for marginally profitable companies that could lose everything.

BKD can help you develop affirmative action plans, and do the required calculations that must be submitted to the OFCCP. □

Designate IRA's beneficiary

New rules governing individual retirement accounts (IRAs) make it easier than ever to leave an IRA to a beneficiary in a way that enables a person to keep the account going for many years and earn tax-deferred income.

However, the new regulations state an IRA's beneficiary has to be named by its owner

in the IRA documentation before the owner dies. If instead, a beneficiary is named through a will, it will not be deemed a beneficiary designation.

This can result in a significant loss of potential tax benefits. Make sure your IRA beneficiary designations are in place as part of the IRA documentation. □

to How
Reach
BKD

P.O. Box 1900
Springfield, MO 65801-1900

A member of
Moores Rowland
International 

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