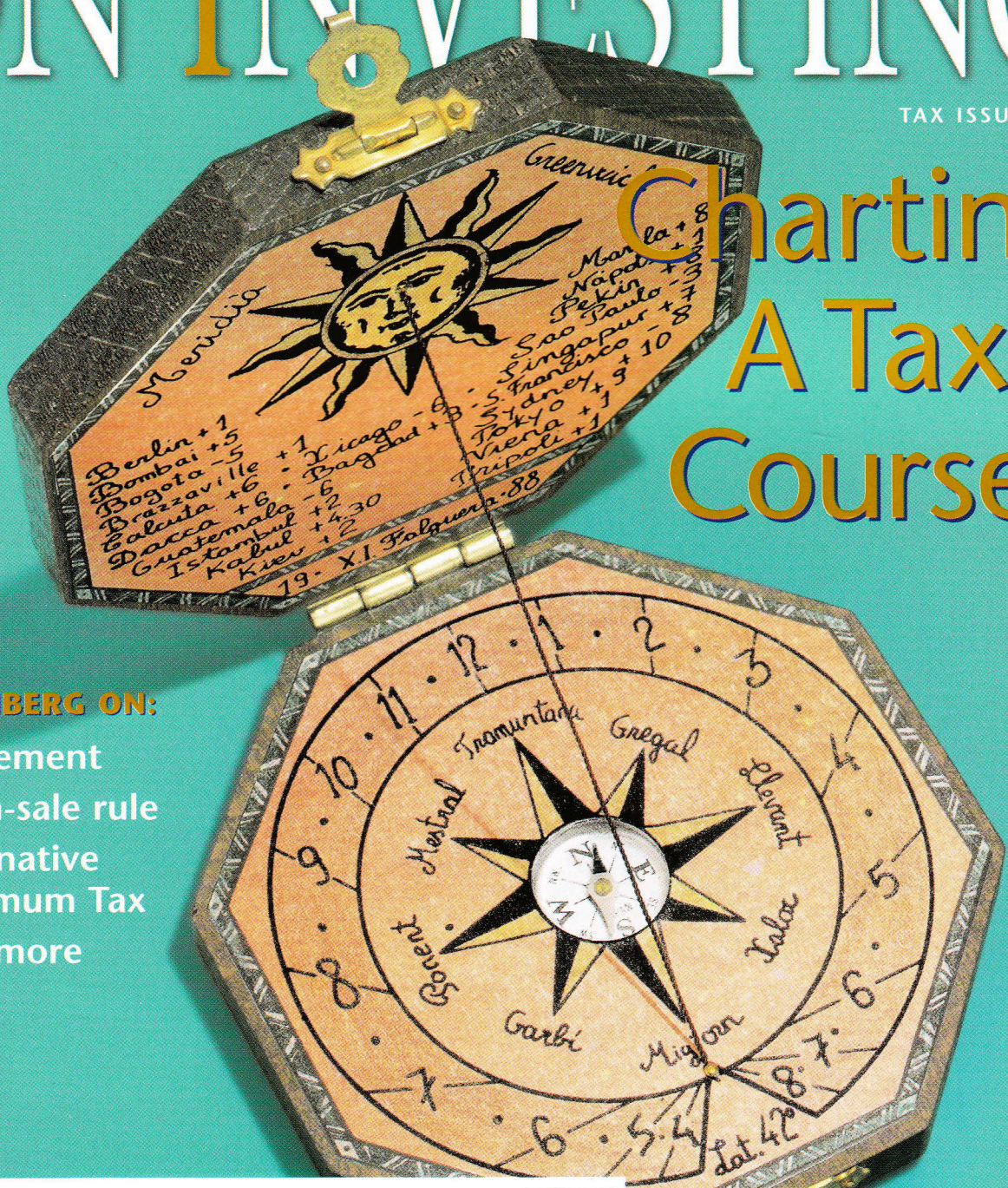
SPECIAL TAX ISSUE

A BLOOMBERG MAGAZINE FOR SCHWAB SIGNATURE SERVICES CLIENTS

ON INVESTING

TAX ISSUE 2001



Charting A Tax Course

BLOOMBERG ON:

- Retirement
- Wash-sale rule
- Alternative Minimum Tax
- And more

CHARLES SCHWAB ON:

- Understanding the new tax cut
- Year-end tax tips
- Tax-efficient funds

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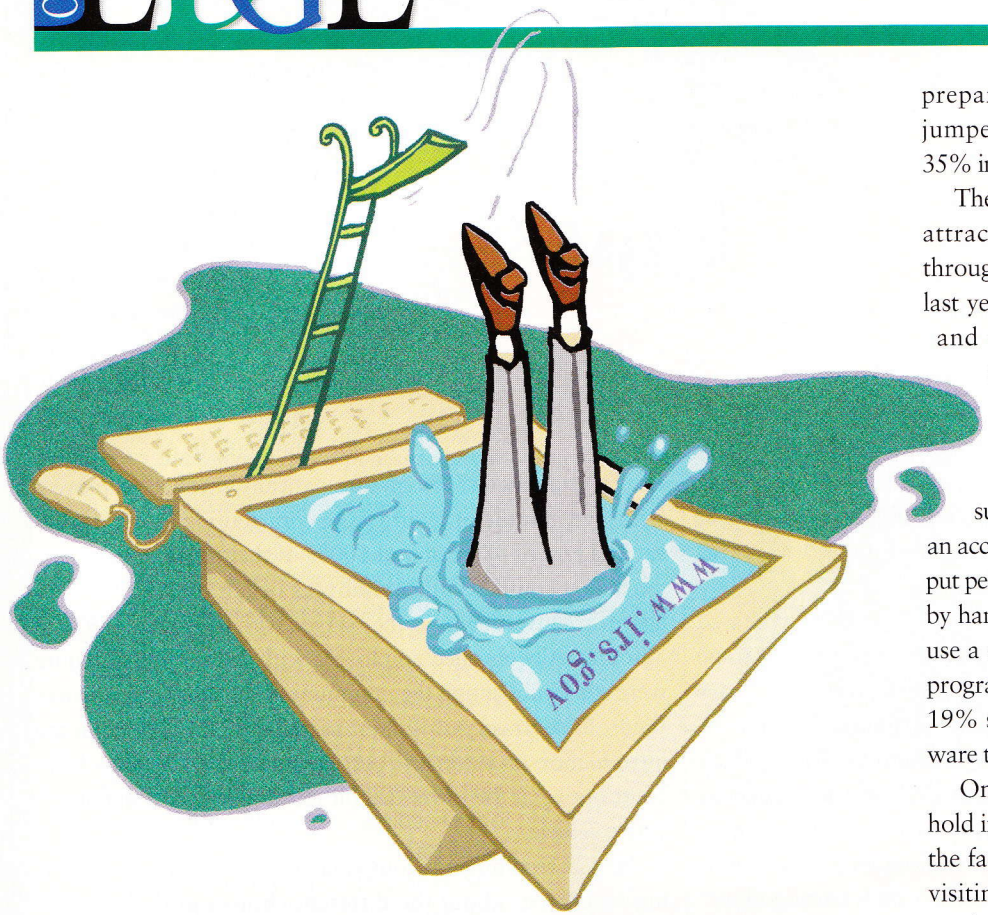


IRS Expects More Taxpayers to Dive into E-Filing

Some people may be wary of submitting their federal and state tax forms via the Internet. And why not? If something goes wrong, the consequences loom. But more and more taxpayers are taking the leap of faith and filing electronically.

The top concerns among those reluctant to prepare their taxes online include security and privacy, according to a survey conducted by Jupiter Media Metrix. Thirty-three percent of the survey's respondents say they're not reluctant to self-prepare their taxes online.

According to the Internal Revenue Service, through April 20, taxpayers filed nearly 39.5 million returns electronically, breaking the 35.4 million record for all of the year 2000. By the end of the e-filing program later this year, the IRS says it expects to have received about 40 million returns via the Internet; that's more than 30% of individual U.S. taxpayers. The IRS says that the number of people using home computers to self-prepare and file income tax returns jumped to more than 6.6 million—a 35% increase over last year.

> "TAXPAYERS WHO E-FILE ARE FAR LESS LIKELY TO GET A LETTER FROM THE IRS THAN THOSE FILING A PAPER RETURN"
>
> *—Charles Rossotti, IRS Commissioner*

The IRS Website itself (www.irs.gov) attracted more than 1.5 billion hits through April 16, a 57% increase over last year. And the number of tax forms and other documents downloaded from the site topped 103 million through February, a 100% increase over last year.

Jupiter reports that 38% of those surveyed say they plan to stick with an accountant, and 24% say they plan to put pencil to paper and fill out their forms by hand. But 5% of online users plan to use a do-it-yourself, Internet-based tax program to prepare their returns, while 19% say they plan to use desktop software to self-prepare their returns.

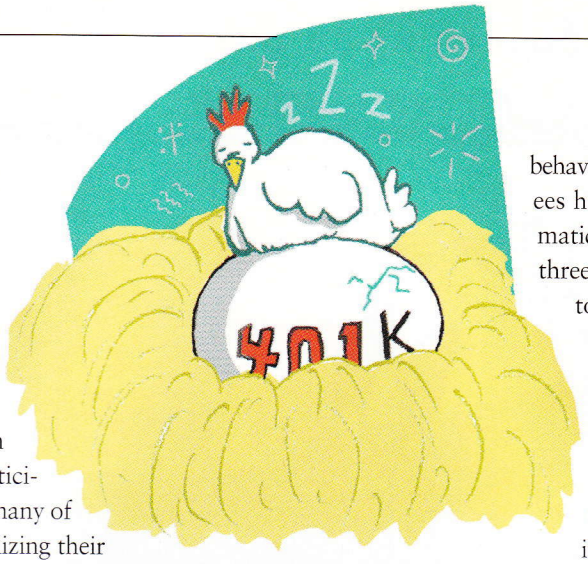
Online users with an annual household income of more than $100,000 are the fastest-growing demographic group visiting tax-related Websites since the peak month of last year's tax season (February 2000), the report reveals. Traffic to tax sites hailing from this income bracket increased 45%, to 3.2 million in February 2001 from 2.2 million unique visitors in February 2000.

What tax Websites are self-preparers visiting? Jupiter reports that the top tax-related sites visited by self-preparers with household incomes over $75,000 a year are accountantsworld.com, cch.com, irs.org, taxes4less.com, and quicken.com.

John Q. Public is becoming more comfortable receiving funds via the Internet, too. More than 31 million taxpayers requested direct deposit of their tax refunds—a 14.5% increase over last year. Through April 20, $66.5 billion in refunds were directly deposited into taxpayer accounts. *—Diana Ascher*

ILLUSTRATIONS BY LISA FERLIC

Automatic Enrollment in 401(k) Plans



It is accepted as fact that participation in a 401(k) plan at work is a smart idea for people who want to retire comfortably. So some companies automatically enroll their workers in retirement-savings plans to ensure participation. But recent studies indicate that many of those automatic enrollees aren't maximizing their retirement investments. In fact, automatic enrollment seems to hinder many of them, according to research by management consultant Hewitt Associates in conjunction with Harvard University and the University of Chicago.

"While automatic enrollment clearly results in increased and immediate participation, our research shows that in some cases it can actually work against employees over time," says Lori Lucas, a defined-contribution consultant for Hewitt. "Employees tend to remain at the rate and fund into which they are defaulted for years, even though these defaults may be inappropriately conservative for their situations. For employees who would have participated even without automatic enrollment, this can offset much of the benefit of early participation."

The Hewitt study examined the participation and default behavior of 100,000 eligible employees hired before and after automatic enrollment was initiated at three U.S. companies over a two- to three-year period.

The researchers concluded that many employees remain at the contribution-rate and asset-allocation elections from the automatic-enrollment default even after years in the plan. In one company Hewitt examined, 76% of automatically enrolled employees with five months of tenure were contributing at the default savings rate of 3% and had 100% of their funds in a money market account. While employees began moving to more aggressive investments as they stayed with their plans, 39% of automatically enrolled employees with 26 months of tenure were still contributing the minimum to the most conservative funds. In contrast, only 2% of participants hired prior to the introduction of automatic enrollment at this company were contributing at the lower default rate and in the most conservative vehicle.

Hewitt recommends companies do a better job of educating employees about the different choices in their 401(k) retirement plans. *—James A. Ambrosio*

To Tax or Not to Tax?

The 1998 moratorium on federal and state tax imposed on Internet sales expires in October, and legislators are debating whether to apply laws similar to those of catalog sales to electronic commerce.

A U.S. House of Representatives panel voted in early August to extend the moratorium. However, at press time 40 state governors were poised to call for an Internet-sales tax in a letter to Congress.

The 1998 moratorium has protected Internet businesses from federal and state taxes on everything from user access to data downloads. The goal of the tax-relief measure was intended to nurture a fledgling industry. Now, three years later, brick-and-mortar companies are calling for equitable taxation under the law.

More complex, though, is whether the Senate Commerce Committee should require states to consolidate their tax systems before Congress grants them authority to collect taxes on e-commerce. Even e-retailers with the most sophisticated tax software would be hard-pressed to comply with the sales-tax laws in about 7,500 taxing jurisdictions nationwide.

The Senate Commerce Committee has been struggling to come up with a solution. Several bills have been sponsored that would let states collect sales taxes from Internet and catalog retailers, but only if states simplify their sales-tax rules. Other bills would impose tougher conditions on local governments.

But the first scheduled vote on an Internet-tax bill was scrubbed in May after negotiators failed to reach agreement. And then President Bush's federal tax-cut initiative took center stage and the Internet-sales-tax issue returned to the wings.

A potential pact would encourage states to simplify sales taxes by creating one sales-tax rate per state or a blended sales-tax rate. Under the hypothetical bill, if at least 25 states simplify their sales-tax rules, Congress would vote on granting states the ability to collect sales taxes from Internet sales. *—Diana Ascher*