

December 26, 2002

PAYROLL TAX RATES 2003

This is our annual update of the payroll tax rates and withholding requirements for your employees. As an employer, you are responsible for withholding Federal income taxes, State income taxes, Social Security [FICA], Medicare taxes, and State disability insurance [SDI]. In addition, you are responsible for paying Federal unemployment tax and State unemployment tax and a matching amount of FICA and Medicare taxes. Also, be aware that all persons responsible for payroll (usually the officers, owners or signatories to bank accounts payroll is taken from) have a personal responsibility to pay all taxes withheld from employees to the government or personal penalties equal to the amount of withholding can be imposed.

RATES AND LIMITS FOR THE 2003 PAYROLL TAX YOU ARE REQUIRED TO WITHHOLD

Federal Income Tax Withholdings

See the withholding tables in the Circular E, Employer's Tax Guide (Internal Revenue Service [IRS] Publication 15, 2003 Revision) forwarded to you by the IRS. These tables take into account the change in rates.

California Income Tax Withholdings

See the withholding tables in the California Employer's Guide sent to you by the State Employment Development Department.

Social Security [FICA] and Medicare Taxes

The withholding percentages for 2003 are the same. FICA is 6.2% of the first \$87,000 in wages paid during the calendar year. The maximum amount of FICA is \$5,394.00. The Medicare tax of 1.45% has no limit.

State Disability Insurance [SDI]

The withholding percentage for SDI is .9%. This rate applies to the first \$56,916 of wages. The maximum amount of SDI withholding is \$512.24.

EMPLOYER'S TAX RATES FOR 2003

Federal Unemployment Tax [FUTA]

The rate is .8% of the first \$7,000 in wages. The total dollar limit per employee is \$56.00.

California Unemployment Insurance

The rate is set by the state on an employer by employer basis and is sent to you directly. The wage limit used is the first \$7,000 in wages.

Social Security [FICA] And Medicare Taxes (Employer)

The employer's rates and limits are the same as for employees. The FICA rate is 6.2% of the first \$87,000 in wages plus 1.45% of all wages for Medicare.

FORMS YOU ARE REQUIRED TO COMPLETE FOR NEW EMPLOYEES

W-4, Employee's Withholding Allowance Certificate

Do not forget you need a W-4, Employee's Withholding Allowance Certificate, for all employees. Be sure to get a W-4 from each new employee and a revised one from any employee who wants to change marital status or dependent deductions. The form still shows 2002, as the IRS has not released the 2003 version. You may use this one for 2003.

Exempt Employees

If you have any exempt employees, they must complete, sign and give to the employer a new Form W-4/DE 4 by February 15, if they wish to continue to be exempt from personal income tax withholding. If an employee fails to submit a new, completed W-4 (and DE 4 if California withholding status is different) claiming exempt by February 15, the employer must change the employee's withholding status to single with zero (0) withholding allowances and begin withholding personal income tax.

Form I-9, Employment Eligibility Verification

For all new hires, you are required to obtain a completed Form I-9 and verify the prospective employees' right to work in this country. This should be kept in the employee's personnel file.

Form DE-34, Report of New Employees

All employers, regardless of the number of employees, must report any newly hired or rehired employees to the State Employment Development Department [EDD]. Either the required information is reported to the EDD by completing the Report of New Employee(s), Form DE-34, or you may submit a copy of the employee's Form W-4. This information must be submitted to the EDD within twenty (20) days of the date you hire an employee.

OTHER INFORMATION YOU SHOULD BE AWARE OF

Minimum Wage Requirements

Effective January 1, 2002, the minimum wage is \$6.75 per hour.

Worker's Compensation Insurance

Just a reminder, as an employer in California, you are required to maintain worker's compensation insurance. There are a variety of carriers who offer this insurance. Check with your broker.

Automobile Reimbursement

For 2003 the mileage rate at which you are allowed to reimburse your employees for business use of their personal automobiles is .36 cents per mile. You are not required to withhold any taxes on automobile reimbursement and the amount will not be included on their W-2. If you include the reimbursement as part of their paycheck, please be sure you do not withhold taxes on it, and show it as a separate item on the pay stub.

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The Donovan Company

Very truly yours,

Thomas G. Donovan