

instruments to eliminate any future other than temporary losses related to these marketable equity securities. See "Market Risk" for a discussion of other-than-temporary losses.

Also in 2002, U.S. Cellular recorded a \$38.1 million write-down in the value of notes receivable related to the 2000 sales of certain minority interests. Additionally, U.S. Cellular recorded losses of \$8.5 million related to the withdrawal from a partnership in which it had owned an investment interest and \$4.2 million related to the reduction in value of a land purchase option.

Income Taxes

Income tax expense (benefit) totaled an expense of \$73.7 million in 2004, an expense of \$37.2 million in 2003, and a benefit of \$7.5 million in 2002. The corresponding effective tax (benefit) rates were 38.3% in 2004, 35.1% in 2003 and (60.9%) in 2002.

Net Income (loss) for each of the three years ended December 31, 2004, includes gains and losses (reported in the captions gain (loss) on investments, loss on impairment of intangible assets, and (gain) loss on assets held for sale in the Statement of Operations).

2004

- Tax expenses of \$22.1 million were recorded on gains from the sale of assets to ALLTEL and to AT&T Wireless.

2003

- Tax benefits of \$19.7 million were recorded on (gain) loss on assets of operations held for sale.
- Tax benefit of \$19.6 million was recorded on loss on impairment of intangible assets.
- Tax benefit of \$1.6 million was recorded on loss on investments.

2002

- Tax benefit of \$99.1 million was recorded on investments in marketable equity securities as a result of management's determination that unrealized losses with respect to the investments were other than temporary.
- Tax benefits of \$13.1 million were recorded on impairments of investments.

The effective income tax rate excluding the items listed above was 33.2% in 2004, 37.8% in 2003 and 37.0% in 2002. The 2004 effective tax rate includes the effects of settlements of several tax issues in 2004. During 2004, the Internal Revenue Service ("IRS") substantially completed its audit of U.S. Cellular's federal income tax returns (through its parent company, TDS) for the tax years 1997 – 2001 and claims for research tax credits for the years 1995 – 2001. Primarily based on the results of the audit, U.S. Cellular reduced its accrual for audit contingency by \$7.3 million in 2004. Also in 2004, based upon the results of the federal income tax audit, U.S. Cellular recorded a \$3.3 million benefit for the research tax credits. See Note 2 – Income Taxes in the Notes to Consolidated Financial Statements for further discussion of the effective tax rate.

TDS and U.S. Cellular are parties to a Tax Allocation Agreement, pursuant to which U.S. Cellular is included in a consolidated federal income tax return with other members of the TDS consolidated group.

For financial reporting purposes, U.S. Cellular computes federal income taxes as if it was filing a separate return as its own affiliated group and was not included in the TDS group.

Cumulative Effect of Accounting Change

Effective January 1, 2003, U.S. Cellular implemented SFAS No. 143, "Accounting for Asset Retirement Obligations." The cumulative effect of the implementation of this accounting standard on periods prior to 2003 was recorded in the first quarter of 2003, decreasing net income by \$14.3 million, net of income taxes of \$9.7 million and minority interest of \$0.5 million, or \$0.17 per diluted share.

Effective January 1, 2002, U.S. Cellular adopted SFAS No. 142, "Goodwill and Other Intangible Assets," and determined that licenses have indefinite lives. Upon initial adoption, U.S. Cellular reviewed its investments in licenses and determined there was an impairment loss on certain licenses. The cumulative effect of the initial impairment upon the adoption of SFAS No. 142 reduced net income in 2002 by \$12.7 million, net of income taxes of \$8.2 million, or \$0.14 per diluted share.

Effective January 1, 2002, U.S. Cellular began deferring expense recognition of a portion of its commission expenses in the amount of deferred activation fee revenues. The cumulative effect of this accounting change on periods prior to 2002 was recorded in 2002 increasing net income by \$4.1 million, net of income taxes of \$3.0 million, or \$0.05 per diluted share.

Net Income (Loss)

Net income (loss) totaled income of \$109.0 million in 2004, income of \$42.7 million in 2003 and a loss of \$26.9 million in 2002. Diluted earnings (loss) per share was \$1.26 in 2004, \$0.49 in 2003 and (\$0.31) in 2002. In 2004, operating income and gains on investments increased significantly compared to 2003, leading to the increase in net income and diluted earnings per share. In 2003, losses on investments were significantly reduced compared to 2002, leading to the increase in net income and diluted earnings per share.

Inflation

Management believes that inflation affects U.S. Cellular's business to no greater extent than the general economy.

Recent Accounting Pronouncements

Share-Based Payment

SFAS No. 123 (revised 2004), "Share-Based Payment," was issued in December 2004 and becomes effective for U.S. Cellular in the third quarter of 2005. The statement requires that compensation cost resulting from all share-based payment transactions be recognized in the financial statements. U.S. Cellular has reviewed the provisions of this statement and expects to record compensation expense for certain share-based payment transactions, primarily related to stock options, in the Statement of Operations upon adoption of this standard. See the "Stock-Based Compensation" section in Note 1 – Summary of Significant Accounting Policies for a pro forma impact on net income and earnings per share.