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November 1998

To All of Our Valued Clients and Friends:

We are pleased to be able to send you our November 1998 newsletter. Our topics for this newsletter are as follows:

- INTERNATIONAL ACCOUNTING STANDARDS
- INTERNET CONNECTIVITY
- FORM 5472: REPORTING RELATED PARTY TRANSACTIONS

Cutting Costs

The global economy has been experiencing much volatility. Enterprises in Japan have been hit especially hard under the current recession. The resultant ripple effect has required many companies to cut costs to remain competitive. Often times, the most logical area to cut costs is in operating expenses such as professional fees. It is not always advantageous to utilize large accounting or law firms for every engagement. Kakimoto and Co., LLP can provide the same services at lower costs.

- ***Selection of CPA Firms Based on Company Needs* -** Companies need to be very selective on who can provide the best value for services rendered. For medium to larger sized organizations, utilizing local firms for specific projects, individual and corporate tax returns, and when appropriate, audits, may make sense.

- ***Cutting Costs on Audit Services* -** Japanese accounting standards have been under scrutiny in the move towards the "Big Bang". With fiscal years beginning April 1, 2000, Japanese public companies may be required to present half-year audits on a consolidated basis in addition to the annual audited financial statements. Accordingly, U.S. subsidiaries may have to comply with the same audit requirements. We offer high quality audit services at significantly lower fees than the Big 5 firms and at competitive fees with other local firms.

- ***Cutting Costs on Individual and Corporate Tax Returns* -** We currently provide tax only services to a number of our clients. These clients are taking advantage of our competitive fees, which are generally about 40% less than those charged by most Big 5 firms. This is yet another area we can assist you in cutting costs, while still maintaining the high professional standards offered by Kakimoto and Co., LLP.

For any of our services, please call us for a free consultation and fee quotes.

If you are interested or have any questions, please call Gerald W. Kakimoto or Edward Y. Valparaiso at (310) 715-9100. For more information about our firm, please visit our website at *http://www.kakimoto.com.*

And lastly, the Japanese version of this newsletter is available by request or through our website.

Kakimoto and Co., LLP

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INTERNATIONAL ACCOUNTING STANDARDS

Due to the globalization of the economy, financial statement reporting has become increasingly complex. Much of this complexity is the result of the different accounting standards in each of the countries that issue financial statements. Also, the users of the financial statements are expanding worldwide. In order to resolve these differences, the IASC (International Accounting Standards Committee) has activity to promote international harmonization of accounting standards. With harmonization, the IASC would expect all nations to use the same accounting standards, reporting disclosures, and measurement rules.

IASC was founded in 1973. There are two basic accounting frameworks in use in the global marketplace now. The first type is the "Investor-oriented" or "Anglo-American" framework, which is used in predominantly English-speaking nations such as the United States, Canada, and England. It is identified by a strong accounting profession, the importance of economic substance and capital markets, and limited government roles in accounting standard setting. The financial accounting is independent from the tax accounting.

The second major accounting framework is the "Creditor-oriented" or "Continental" framework, which is used in most of Europe, including France and Germany, and in some parts of Asia, including Japan. This framework is identified by strong government influence over the accounting profession, an emphasis on creditor interests over investor concerns and debt, not equity financing of business. Calculation of tax is important role of accounting for this framework.

Some of the major differences between the two frameworks are in the areas of measurement and disclosure. The former framework requires a "market valuation", while the latter allows a "cost valuation". Although consolidated and interim reporting is required in the Anglo-American nations, no interim reporting is required for Europe and most of the Far East. In addition, disclosure requirements are more rigid in the Anglo-American framework.

As one can imagine, the prospect of changing accounting standards that a nation has used for many years can be onerous. This has caused great concern among the member nations of the IASC, especially between those two frameworks above. Compliance with IAS (International Accounting Standards) would be voluntary. Besides the IASC, IFA (International Federation of Accountants), OECD (Organization for Economic Co-operation and development), and IOSCO (International Organization of Securities Commissions) are all urging harmonization. In Japan, as a part of "Big Bang", some of Japanese accounting rules would be revised to come near to "Investor-oriented" or "Anglo-American" framework.

INTERNET CONNECTIVITY

Increased efficiency and profits are often the result of improvements in your business's ability to communicate and access information. Over the last few years, the Internet has become a communication and information tool that no business can afford to ignore. Once you opt to connect your business to the Internet, choosing the type of connection your business has to the Internet becomes a major decision. Choosing the wrong type of connection may end up causing information bottlenecks and or wasting hundreds or thousands of dollars annually on something that you don't need. To help you make a wise decision we will review four of the choices commonly available to businesses today.

56k Modems
Almost every personal computer sold presently either has a 56k modem or can have one easily installed. These modems use ordinary phone lines to connect you computer to the Internet. The label '56k' is misleading since current government regulations limit these modems to 53k. An Internet service provider (ISP) will give you unlimited access to the Internet for $20 to $30 a month. Most businesses will want to dedicate a separate phone line to the modem which will bring the total monthly cost to about $50 to $60. 56k modems are adequate for businesses that are experimenting with the Internet or those who use it lightly.

ISDN
Integrated Services Digital Network (ISDN) is currently widely used by businesses. ISDN offers speeds of 64k to 128k. The higher bandwidth (the ability to transfer information) makes ISDN more suitable for those who use the Internet heavily or those looking to connect an entire small office. With the help of a router, a small network of computers can share one connection. ISDN is usually billed on a per hour basis, although some flat rate fees can be found. ISDN service costs are approximately $100 to $300 per month.

T1
Leasing a T1 line from your local telephone company will give you bandwidth that is more than 10 times greater than ISDN. T1 lines are usually connected to a router, which allows entire offices to access the Internet. Since T1 lines may end up costing over $1000 per month, quite a few employees must be using the Internet regularly to make this a cost-effective solution.

DSL
Digital Subscriber Line (DSL) is the newest technology available to businesses. DSL allows connections that rival T1 bandwidth over regular phone lines. DSL is exciting because this T1 class speed will cost $100 or less per month once it is widely available. The downside to DSL is that it is not currently widely available.

So if you haven't already connected to the Internet, you have many choices. Your selection should be based on what your business needs are now and in a few months. New types of connectivity with higher speeds and lower costs will soon grow in availability. Therefore, long term contracts with phone companies or ISPs should be avoided. However, once connected and used effectively, the Internet will become one of your most valuable business tools in your office.

FORM 5472: REPORTING RELATED PARTY TRANSACTIONS

Internal Revenue Code (IRC) section 6038A requires domestic corporations that are "25% foreign owned" (defined below) to report related party transactions to the IRS. Similarly, IRC section 6038C requires foreign corporations engaged in business in the United States to report related party transactions. Corporations that fall under the requirements of section 6038A or 6038C are referred to as "reporting corporations."

Form 5472 is the form the IRS has developed for reporting corporations to provide the information required under sections 6038A and 6038C. A reporting corporation must file a separate Form 5472 for each related party with which it had transactions during the tax year. Thus, for example, if a reporting corporation had transactions with four related parties during the tax year, it would be required to file four Forms 5472.

A corporation is "25% foreign owned" if at least one foreign person owns, directly or indirectly, 25% or more of the corporation. "Foreign person" includes individuals who are not U.S. citizens or residents, and partnerships, corporations and trusts organized outside of the U.S. For purposes of determining the percentage of "indirect" ownership, certain "attribution rules" apply. Under these rules, a person who has at least a 10% interest in a corporation that, in turn, has an interest in another corporation, will be considered to have a proportionate interest in that other corporation. Thus, for example, assume that JP, a Japanese corporation, owns 60% of US1, a U.S. corporation, and that US1 owns 50% of US2, another U.S. corporation. Under the attribution rules, JP will be considered to own 30% (60% x 50%) of US2, and US2 will therefore be a 25% foreign owned corporation.

"Related party" for purposes of Form 5472 is broadly defined. It includes not only the common concept of relatedness, such as through familial relationships or majority ownership, but also includes relatedness through "common control." Common control means "any kind of control, direct or indirect, whether legally enforceable, and however, exercisable or exercised." Thus, for example, although a particular entity may only own a small percentage of a reporting corporation, if that particular entity exercises any control over the reporting corporation, the reporting corporation must report transactions it had with that particular entity on Form 5472.

A reporting corporation's transactions with related U.S. persons need not be specifically identified on the Form 5472. Thus, for related U.S. persons, the reporting corporation need only provide the gross amount of all transactions between the parties during the tax year. However, a reporting corporation's transactions with related foreign persons must be separately identified in several specific categories on the Form 5472 (in Parts IV and V). For example, purchases of inventory, commissions paid and interest paid (in addition to other categories) must all be separately identified on a Form 5472 that is filed for a foreign related person. IRC section 6001 requires corporations to keep the records necessary to file complete Forms 5472.

A reporting corporation must file Form 5472 by the due date (including extensions) of the reporting corporation's federal income tax return (Form 1120 or 1120F). The reporting corporation must include the Form 5472 with its federal income tax return. However, if the reporting corporation files its federal income tax return late, it must file Form 5472 on time, separately from the income tax return. The reporting corporation must also file a copy of the Form 5472 with the IRS's Philadelphia Service Center (IRS Service Center, Philadelphia, PA 19255). The IRS may impose a $10,000 penalty for each Form 5472 that a reporting corporation is required, but fails, to file. The IRS considers a "substantially incomplete" Form 5472 to not have been filed.

California also requires that a reporting corporation file with the Franchise Tax Board (FTB) a copy of each Form 5472 that the reporting corporation is required to file with the IRS. The reporting corporation must file Form 5472 with the FTB by the due date (including extensions) of the corporation's franchise tax return (Form 100). As at the federal level, however, if the reporting corporation files its franchise tax return late, it must file Form 5472 on time, separately from the Form 100. The FTB may also impose a $10,000 penalty for each Form 5472 not filed.

Because of the potentially severe penalties, meeting the requirements of sections 6038A and 6038C are very important. Therefore, corporations that fall under the requirements of either of these sections should take care to maintain necessary records, and to properly complete and file required Forms 5472 with the IRS and, for California taxpayers, with the FTB.

If you would like to have additional information or have any questions, please do not hesitate to contact us.

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