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July 2000

To All of Our Valued Clients and Friends:

We are pleased to be able to send you our July 2000 newsletter. Our topics for this newsletter are as follows:

- DIGITAL SIGNATURES (INFORMATION TECHNOLOGY)
- NEW WITHHOLDING RULES TO TAKE EFFECT JANUARY 1, 2001

Our Services Promotion

Kakimoto and Co. provides a wide-range of services for reasonable fees.

- **Information Technology** - Technology continues to be an important factor in making our businesses more efficient. Are you utilizing your computer system to its fullest? Are you experiencing computer problems and not getting the proper support? Most commonly, improper support results from insufficient accounting knowledge. As CPAs, we can combine our knowledge of accounting and information systems to provide you with the following services *better*:
 - Computer networking for small to medium sized companies
 - Accounting software selection, installation, training, and support
 - General computer usage maintenance, consultations, and training
 - Internet consultations
- **Transfer Pricing** – As the IRS becomes more assertive in the transfer pricing area, and the risk of transfer pricing adjustments increases, multinational taxpayers must take steps to minimize their transfer pricing exposure. We can assist you in doing so, by conducting a transfer pricing exposure analysis and, if warranted, a transfer pricing study for your company. Please call us for more information.
- **Employee Benefit Plan Audits** – 401(k) plans are a popular way for employers to provide retirement benefits for employees. The Employee Retirement Income Security Act of 1974 (ERISA) contains a requirement for annual audits of plan financial statements that meet certain criteria. We are available to help you determine whether you are required to provide such financial statements, and if necessary, conduct the audit of your 401(k) plan.

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

The Japanese version of this newsletter is available by request or through our website.

Kakimoto and Co.

enc. Newsletter, July 2000

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DIGITAL SIGNATURES

On July 16 the senate unanimously passed The Digital Signatures Act, which President Clinton has indicated he will sign. This law will give electronic documents signed with a digital signature the same legal status as traditional documents.

The government defines a digital signature as a “cryptographic checksum computed as a function of a message and a user’s private key.” In simpler terms, a digital signature is not a computerized picture of an ordinary signature, but instead is a secret code unique to the “signer” and the document.

This act will allow American companies to eliminate the processing of printed copies of electronic documents that were made to ensure their legal standing. For example, online lenders will be able to process any applications and loan documents in a 100% electronic manner instead of sending out hard copies for clients to sign and return.

However, companies must ensure that their clients have the proper equipment to process these digital documents and have agreed to conduct business electronically. In addition, the law states that certain documents such as notices of termination must be delivered in the traditional fashion. Since the government has yet to set security and other standards that will affect the enforcement of this law, it may be quite a while before the use of digital signatures becomes widespread.

If you would like any help using this or any other form of Information Technology to benefit you or your business, feel free to schedule an appointment with a Kakimoto and Co. IT consultant.

NEW WITHHOLDING RULES TO TAKE EFFECT JANUARY 1, 2001

Background

Under Internal Revenue Code (“IRC”) sections 871(a)(1) and 881(a), nonresident alien individuals and foreign corporations are subject to a 30 percent tax on several categories of “nonbusiness” income received from U.S. sources. The more common types of income to which the tax applies include interest (except portfolio and bank account interest), dividends, rents, royalties, commissions and nonemployee compensation. Under IRC sections 1441(a) and 1442(a), the taxes imposed under sections 871(a)(1) and 881(a) must be withheld and remitted to the IRS by the payer of the income upon which the tax is imposed. Because the tax is collected through this withholding procedure, the tax is referred to as the “withholding tax.” The person obligated to withhold the tax is termed the “withholding agent.” Generally, the withholding agent is the last person in the U.S. who handles the item of income before it is remitted to the foreign taxpayer (or a foreign agent of the taxpayer). The foreign taxpayer is termed the “beneficial owner” of the income.

Detailed procedural rules governing the withholding tax are set forth in the Regulations. In 1997, the Treasury Department substantially revised the withholding regulations. The effective date of the revised regulations, after a postponement, is now set for January 1, 2001. The new regulations significantly impact the obligations of withholding agents and beneficial owners. Some of the more important changes likely to impact our clients are discussed below.

Procedures for Claiming Reduced Treaty Withholding Rates

Under the U.S.-Japan income tax treaty (as well as under numerous other U.S. income tax treaties), the withholding tax rate for several categories of income is reduced below the statutory 30 percent rate. For example, the withholding rate on dividends paid to a Japanese person is 10 percent if the person is a corporation and 15 percent if the person is an

individual. Under the new regulations, the documentation required to justify a reduced withholding amount under the treaty has changed.

With respect to dividends, the old rules permitted a withholding agent to rely on the shareholder's address in determining whether the treaty rate applied. So, for example, if the shareholder had a Japan address, the withholding agent was permitted to withhold tax at the reduced treaty rate. With respect to other types of income subject to the withholding tax, the withholding agent was required to obtain from the beneficial owner a Form 1001. The beneficial owner was required to provide its U.S. taxpayer identification number ("TIN") on the Form 1001, if it had one. However, if the beneficial owner did not already have a TIN, it was not required to obtain one in order to qualify for the reduced treaty rate.

Under the new rules, the withholding agent is required to obtain from the beneficial owner a Form W-8 in order to apply the reduced treaty withholding rate (for all type of income). Also, the beneficial owner is required to provide a TIN on the Form W-8 (except in the limited circumstance where the Form W-8 is being provided with respect to dividends and interest earned on securities traded on a U.S. stock exchange). This means that, generally, foreign persons who do not currently have a U.S. TIN, and who wish to have tax withheld at the reduced treaty rate, must obtain a TIN.

Fortunately, the Treasury Department recently removed from the regulations a requirement that the foreign person obtain "certification" of the TIN from the IRS. Certification is a procedure whereby the IRS "certifies" that the holder of the TIN is a resident of the applicable treaty country, based on documentation provided to the IRS by either the taxpayer or the treaty country. Although the regulations have eliminated this certification requirement, the regulations provide the IRS with authority to "issue guidance on requirements that a treaty claimant must follow to establish residency" in the treaty country. The IRS will "delay" such guidance, however, "while withholding agents and beneficial owners implement other requirements under the regulations."

New Form W-8

The IRS has created four new Forms W-8 for use under the new regulations. These forms are:

- Form W-8BEN, Certificate of Foreign Status of Beneficial Owner for U.S. Tax Withholding;
- Form W-8ECI, Certificate of Foreign Person's Claim for Exemption From Withholding on Income Effectively Connected With the Conduct Of a Trade or Business in the United States;
- Form W-8EXP, Certificate of Foreign Government Or Other Foreign Organization for United States Tax Withholding; and
- Form W-8IMY, Certificate of Foreign Intermediary, Foreign Partnership, or Certain U.S. Branches for U.S. Tax Withholding.

These forms replace the existing Form W-8 (Certificate of Foreign Status), Form 1001 (Ownership, Exemption, or Reduced Rate Certificate), Form 4224 (Exemption From Withholding of Tax on Income Effectively Connected With the Conduct of a Trade or Business in the United States) and Form 8709 (Exemption from Withholding on Investment Income of Foreign Governments and International Organizations).

The payee provides Form W-8BEN to the withholding agent if the payee is the "beneficial owner" of the income. As discussed above, the beneficial owner is required to provide a TIN on the Form W-8BEN if the owner is claiming benefits under an income tax treaty (except for benefits related to dividend and interest income from actively traded securities).

The payee would provide Form W-8ECI to the withholding agent if the payee is the beneficial owner of the income *and* is claiming that the income is "effectively connected income" ("ECI"). ECI is income that is directly connected to the beneficial owner's conduct of a trade or business in the U.S. Income that would otherwise be subject to the withholding tax is *not* subject to the tax if it is ECI because the owner is required to report the income on a U.S. tax return. A TIN must be provided on the Form W-8ECI; otherwise, the withholding agent cannot rely on the form, and must withhold at the maximum rate.

Form W-8EXP has limited applicability. The form is provided to the withholding agent by foreign governments, international organizations, foreign central banks of issue, foreign tax-exempt organizations and foreign private foundations.

The payee must provide Form W-8IMY if the payee is an intermediary acting as custodian, broker, nominee, trustee or executor, or other type of agent for the beneficial owner. If the payee is a “qualified intermediary,” the payee must provide the TIN that the IRS issued to the payee in such capacity. A qualified intermediary is a foreign financial institution or clearing organization that has entered into a withholding agreement with the IRS, subjecting the intermediary to the U.S. withholding requirements.

Effective Periods for Form W-8

Generally, a Form W-8BEN or Form W-8EXP provided *without* a TIN remains in effect for a period starting on the date the form is signed and ending on the last day of the third succeeding calendar year (or on the day that a change in circumstances makes any information on the form incorrect). The same validity period applies to a Form W-8ECL. A Form W-8BEN or a Form W-8EXP provided *with* a TIN generally remains in effect until a change in circumstances makes any information on the form incorrect. A Form W-8IMY remains in effect until the status of the person whose name is on the certificate is changed in a way relevant to the certificate or circumstances change that make the information on the certificate incorrect.

Reliance on Form W-8

The withholding agent is permitted to rely on the information contained in a Form W-8, unless the agent knows, or has reason to know, that the information is untrue or incorrect. The agent is responsible, however, for ensuring that all information contained in the form is complete and appears to be accurate. A withholding agent “has reason to know” that a Form W-8 is untrue or incorrect if the agent has knowledge of relevant facts or statements contained in the form or other documentation that would cause a reasonably prudent person in the position of the agent to question the claims made. For example, if the agent possesses information that contradicts information contained in the Form W-8, the agent may not rely on the form.

A withholding agent must request a new Form W-8:

1. Before the expiration of an existing Form W-8;
2. If the existing Form W-8 does not support a claim of reduced rate for a type of income that the agent has not previously paid to the payee; or
3. The agent knows or has reason to know of a change in the beneficial owner’s circumstances which makes any information on the existing Form W-8 incorrect.

Summary

The new withholding regulations take effect January 1, 2001. For any payment you make on or after that date that is subject to the withholding tax, you should obtain from the payee a *new* Form W-8 *prior to* making the payment (any old withholding forms you have on file will expire on December 31, 2000). Additionally, any payee claiming a reduced rate of withholding under the U.S.-Japan, or any other, treaty *must* include a U.S. TIN on the Form W-8. You should advise any such payees to obtain a TIN as soon as possible, if they do not already have one.

If you, as the withholding agent, do not obtain a valid Form W-8, you are required to make certain assumptions about the payee and, as a result, may be required to withhold tax at either a 30 or 31 percent rate. You would be liable for any tax due that you failed to withhold, plus interest and penalties.

It is important to note that actual knowledge of the beneficial owner’s status as a resident of the treaty country is *not* a substitute for obtaining a valid Form W-8. Even if you correctly withhold at a reduced rate based on such actual knowledge, if you do not have a valid Form W-8 from the beneficial owner, you may be liable for interest and penalties on the difference between tax computed at the 30 percent rate and the actual tax. Therefore, it is very important that you timely obtain the proper forms for your records.

If you have any questions concerning the new withholding rules, please contact us.