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August 2001

To All of Our Valued Clients and Friends:

We are pleased to be able to send you our August 2001 newsletter. Our topics for this newsletter are as follows:

- AUDIT OF THE FINANCIAL STATEMENTS
- COMPUTER NETWORK
- THE NEW TAX LAW

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, August 2001

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AUDIT OF FINANCIAL STATEMENTS

Starting with the year ended March 2000, Japanese accounting standards require Japanese public companies to prepare half-year and annual audited financial statements on a consolidated basis. U.S. subsidiaries are part of business operations and must be included in the audited consolidated financial statements.

Aside from providing high quality audit services for U.S. subsidiaries, our firm at Kakimoto and Co. can communicate directly with Japan audit corporations to assist in easing the parent company consolidation process. We have been able to meet the specialized needs of our clients by working closely with the following major Japan audit corporations: ChuoAoyama Audit Corporation (member firm of Pricewaterhouse Coopers), Shin Nihon & Co. (company having strategic alliance with KPMG and Ernst & Young), Tohmatsu Audit Corporation (member firm of Deloitte Touche Tohmatsu), and Futaba Audit Corporation.

Our firm has received high evaluations from the practice-monitoring program conducted by the AICPA peer review for performing in accordance with the professional accounting and auditing standards. Auditors other than the parent company audit corporations are readily allowed to conduct audits for subsidiary companies, and we can offer the auditing services with significantly lower fees compared to the Big 5 firms and at competitive fees with other local firms. Furthermore, our bilingual staff allows us to provide assistance in Japanese. The half-year and annual audit fees can be a financial burden to the U. S. subsidiaries. We can assist you in cutting costs while still maintaining high professional standards. We look forward to serving you.

COMPUTER NETWORKS

Earlier, only large businesses, government agencies and universities could afford the cost of a computer network system. Due to the development of new technology, hardware prices have dropped steadily, and creating a network system has become easier and more cost effective.

There are many benefits from implementing a network system, but the most noticeable benefit is the effective use of resources. The sharing of expensive devices, such as laser printers or large removable storage drives, makes sharing resources a cost-effective alternative to purchasing a hardware device for every user. With one DSL line, users can connect to the Internet concurrently at high speeds to conduct research and exchange information around the world. The sharing of resources will eliminate the exchange of floppy disks, or waiting for someone to disconnect from the Internet so someone else can connect.

Network supported resource sharing contributes to reliability, by providing alternatives to a critical resource. For example, if a particular printer is down or busy, another may be available. If a disk fails, another copy of the needed file may remain accessible. Having a secure place to store all your data is an important factor. Network file servers can provide large amounts of easily accessible storage to everyone on the network. This gives users the opportunity to save their data in a centralized location to free disk drive space on their computer. The centralizing of user files also facilitates backups and can protect against data loss.

A computer network system is a way of using computer hardware and software to further increase the productivity of personal computers and those who use them. If you answer "yes" to any of the following questions, your business should consider implementing a network system.

- Do you have two or more computers?
- Do more than two employees share one printer?
- Do employees regularly share files?

- Does the company have, or plan to have, broadband Internet access?
- Do you have important data that should be backed up on a regular basis?

If you would like further information on computer networks or feel your company can benefit from one and need assistance with the implementation, please give us a call.

THE NEW TAX LAW

As many of you have probably heard, earlier this year the United States Congress passed, and the President signed into law, new tax legislation. The Economic Growth and Tax Relief Reconciliation Act of 2001 (the "Act") provides some immediate tax relief in 2001, but most of its benefits are delayed for one or more years. The Act's greatest impact will be on individual taxpayers, although a few of its provisions will impact businesses.

Provided below is a brief summary of some of the more important changes made by the Act.

CHANGES IMPACTING BUSINESSES

Decreased Employee Withholding

Effective July 1, 2001, tax rates begin a gradual phase-down from the previous income tax brackets (see Income Tax Rate Cuts, below). The IRS has published new withholding tables for the period from July 1 through December 31, 2001 that reflect the reduced income tax rates. The new withholding tables are contained in Publication 15-T, which is available at the IRS's website at http://www.irs.gov/forms_pubs/pubs.html. Also, a revised 2001 tax rate schedule for sole proprietors' calculation of estimated tax payments is available at http://www.irs.ustreas.gov/graphic/estimatepaynts.gif.

Retirement Savings and Pension Reform

- *Participant protections* – The Act includes numerous measures to increase protection of retirement plan participants, including provisions that shorten vesting schedules, enhance the portability of pension assets, and permit workers to become vested and eligible for employer matching contributions in three (rather than five) years.
- *Business benefits* – Among its provisions, the Act raises the limit on an employer's deduction for contributions to certain types of defined contribution plans from 15% to 25% of compensation, and modernizes and streamlines pension laws in order to encourage small businesses to offer pension plans.

CHANGES IMPACTING INDIVIDUALS

Income Tax Rate Cuts

Rate cuts start with the creation of a new 10% rate bracket, which is carved out of the existing 15% bracket. For 2002-2007, the new 10% bracket will apply to the first $12,000 of income for married couples, $6,000 for singles, and $10,000 for heads of household ($14,000/$7,000/$12,000 after 2008, and adjusted for inflation thereafter).

The new 10% rate technically starts January 1, 2002. However, a credit in the form of an advance refund check will be issued to taxpayers in 2001 that will effectively accelerate the 10% income tax rate bracket benefit into 2001. For each taxpayer, the amount of the refund will be determined by the taxpayer's 2000 filing status. Single taxpayers will get $300, married-joint taxpayers will get $600, and heads of household will get $500. The advance refund checks will be issued to most taxpayers by October 1, 2001. Certain taxpayers are not eligible for the advance refund checks. Nonresident aliens, taxpayers that were claimed as dependents on another's income tax return, estates and trusts are not eligible.

For brackets above the 15% bracket, 28%, 31%, 36%, 19.6% tax rates will be reduced gradually until they reach 25%, 28%, 33%, 35% in the 2006 tax year.

Elimination of Itemized Deduction and Personal Exemption Limitations (starts in 2006)

The limitation on itemized deductions for high income taxpayers will be reduced by 1/3rd in 2006-2007, by 2/3rd in 2008-2009, and completely eliminated starting in 2010. The personal exemption phase-out will similarly be reduced by 1/3rd in 2006-2007, by 2/3rd in 2008-2009, and completely eliminated starting in 2010.

Alternative Minimum Tax

There will be no reduction in the alternative minimum tax ("AMT") rate. Rates are still 26% for the first $175,000 of AMT income (after applying the AMT exemption), and 28% for the balance. According to projections, the number of taxpayers subject to the AMT under its current form will increase six-fold by the time all benefits under this new tax law are phased in. Taxpayers susceptible include those with large state income tax deductions, since state income tax is not deductible for AMT purposes. Therefore, more and more of our individual clients may find themselves paying AMT.

The Act, however, increases the AMT exemption amount by $4,000 for married-joint taxpayers (to $49,000), and $2,000 for single and married-separate taxpayers (to $35,750 and $24,500, respectively), but only for the years 2001 - 2004. The Act also makes permanent the use of the child tax credit to offset AMT.

Marriage Penalty Relief (starts in 2005)

The Act increases the standard deduction for joint filers to twice the amount of the standard deduction for single filers, phased in over a four-year period starting in 2005. The Act also phases in, over the 2005 - 2008 period, an increase in the upper-end of the 15% rate bracket for married taxpayers to an amount that is twice the upper-end of the 15% rate bracket for single taxpayers.

Child Tax Credit

The child tax credit will be increased from $500 per child to $1,000 per child over the next ten years. The credit is increased to $600 in calendar years 2001-2004, $700 in 2005-2008, $800 in 2009, and $1,000 in 2010. The credit is made refundable to the extent of 10% of the taxpayer's earned income in excess of $10,000 for 2001-2004, increasing to 15% after 2004. Existing AGI levels for qualification for the child tax credit ($110,000 for married filers and $55,000 for single filers) are left unchanged.

Dependent Care Tax Credit (starts in 2003)

The dependent care credit rate will be increased from 30% to 35% of eligible employment-related expenses. Also, the maximum amount of eligible employment-related expenses that may be used to calculate the credit will be increased from $2,400 to $3,000 if there is one qualifying child or dependent and from $4,800 to $6,000 if there is more than one qualifying child or dependent. The beginning point for phase-out of the credit will be increased from AGI of $10,000 to AGI of $15,000, starting in 2003.

Estate Tax Relief

The new law repeals the estate tax for one year – 2010. The estate tax continues with an increasing exemption from $1 million to $3.5 million, and a reduced rate of tax, through 2009. The current (2001) estate tax rules will be automatically reinstated in 2011.

Education Tax Cuts

- *College Tuition Deduction (NEW)* – For 2002-2003 an above the line deduction up to $3,000 paid for college tuition can be deducted by single taxpayers with AGI less than $65,000 and joint filers with AGI less than $130,000. For 2004-2005 a deduction of $4,000 per year is allowed, with the same AGI limitations. In addition, single taxpayers with AGI between $65,000 and $80,000 and joint filers with AGI between $130,000 and $160,000 will be permitted a maximum deduction of $2,000 in 2004 and 2005. No deduction is allowed after 2005. This deduction cannot be claimed in the same year as a Hope or Lifetime Learning credit for the same student.

- *Education Savings Accounts (Education IRA)* – Distributions from education IRAs are free from federal taxation if they are used to pay for qualified education expenses. The annual contributions limit is raised to $2,000 from $500. Starting in 2002, contributions will be allowable not only from individuals but also from corporations, tax-exempt organizations and other entities. Contributions counted toward any tax year will be permissible until April 15 of the following year. The current contribution phase-out range for joint filers of $150,000 - $160,000 jumps to double that of single filers, to $190,000 - $220,000.
- *Student Loan Interest Deduction* – The new law raises the income phase-out thresholds for the student loan interest deduction (to $55,000-$65,000 for singles and to $100,000-$130,000 for joint filers). It also repeals completely both the annual dollar limit on the amount of the deduction and the 60 months limit.
- *Qualified Tuition Plans* – Distributions from state-sponsored qualified tuition programs will be excludible from gross income if made after December 31, 2001. Distributions from non-state programs would be excludable if made after December 31, 2003.
- *Other Education Tax Breaks* – HOPE and Lifetime Learning tax credits can be claimed in the same year as education IRA distributions, as long as the IRA distribution is not used to pay for the same costs used to claim the education credit. Penalty-free contributions to education IRAs and qualified state tuition programs can be made in the same year.

Retirement Savings and Pension Reform

- *IRA contribution limits* – The limits for both traditional and Roth IRAs will rise from the current $2,000 annual cap to $5,000 ($3,000 for 2002-2004; $4,000 for 2005-2007; and $5,000 for 2008 and thereafter).
- *Catch-up contributions* – Taxpayers who are age 50 and above will be permitted to contribute "catchups" to their IRAs. They can contribute to an IRA an additional $500 in 2002 – 2005 and $1,000 in 2006 and all years thereafter.
- *Defined contribution plan limits* – Starting in 2002, the limit on annual additions to a defined contribution plan will rise to $40,000.
- *401(k) contribution limits* – The limit on salary reductions to IRC section 401(k)-type plans (including 403(b) annuities and salary reduction SEPs) will rise from $10,500 to $15,000 by 2006 (scheduled to rise to $11,000 in 2002, and increase by an additional $1,000 each year until 2006).
- *Contribution tax credit* – Lower income workers will be entitled to a tax credit, instead of just a tax deduction, for contributions to retirement savings.
- *Other qualified plan breaks* – The limit on maximum annual elective deferrals to a SIMPLE plan will increase to $10,000 by 2005.

Conclusion

The Act is focused primarily on providing tax benefits to individual taxpayers, and imposes a complicated array of time-delayed benefits, with varying effective dates that span 10 years. With tax planning you can take advantage of the new tax laws to maximize your tax savings. If you have any questions about the new rules, or would like to discuss the impact of the changes on your situation, please feel free to contact us.

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