KAKIMOTO AND CO.

CERTIFIED PUBLIC ACCOUNTANTS

NEWSLETTER

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Inside this issue:

Finding New Ways to Improve

As we continually search for new ways to improve the value our newsletter brings to you each quarter, it is important to know your thoughts as well.

We would like to know your thoughts on our new format as well as any topic ideas or suggestions you might have. Send an email to the editor, at kaco@kakimoto.com or give us a call. We appreciate any comments you may have and thank you in advance for taking time in sharing them with us.

Summary of Articles

Corporate Loans to Related Parties: For any loan issued to or from a U.S. Corporation, or the U.S. business operations of a foreign corporation, the IRS requires charging a minimum rate of interest, otherwise an "imputed" or designated interest will be charged plus additional taxes. By utilizing the applicable federal rate ("AFR"), taxpayers can avoid the problem of "imputed interest".

Now is a great time to assess any existing related-party loans on your books and evaluate the possibility of making new loans to take advantage of the current low-interest-rate environment. Please give us a call if you have questions or want more information.

Differences between Japanese and United States GAAP: Conducting business in today's marketplace involves transcending well-established international lines. With companies rushing to access foreign markets and invest hard-earned capital, transparent financial reporting of foreign entities has become an absolute necessity in forming the right business decisions. In consideration of this, Japan has recently undertaken efforts to align its accounting standards with international norms and to enhance the credibility of Japanese financial reporting.

New Storage Device: New technology devices are constantly being introduced into the market, but one particular removable storage device, we feel is worth mentioning due to its ease of use. The USB key is a fairly new device available today. It is readable, write-able, small enough to fit in a shirt pocket, and is truly plug and play. With many of us now working from home, this new storage device makes transferring files to and from the office fast and easy. These new compact storage devices will eventually replace the traditional 3.5-inch floppy disks.

Corporate Loans to Related Parties

For various reasons, corporations may be engaged in related-party loans. In particular, the financial lives of shareholders and closely held corporations are often intertwined. As a result, it's not unusual to find loans between these corporations and their shareholders. Shareholder loans are particularly suspect, by the IRS, which may deem the transactions as either dividends to the shareholder or may designate a minimum interest rate to the transaction. Specifically, for any loan issued to or from a U.S. Corporation, or the U.S. business operations of a foreign corporation, the IRS requires charging a minimum rate of interest. In cases where a minimum rate of interest is not charged, the IRS

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can "impute" or designate an interest rate, and require payment of taxes there from. A significant concern exists for multinational corporations, since not only may an additional amount of tax be assessed, but also a duty to withhold tax may arise from imputed interest payments.

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To avoid adverse tax consequences associated with IRS inquiry, it is important for loans to be documented by a written promissory note containing the unconditional promise to repay the loan at some specific date or on demand. Additionally, if loans exceed $10,000, the loans should provide for an interest rate at least equal to a "market" interest rate, usually defined by the applicable federal rate ("AFR"). And, of course, interest and principal payments should be made on time.

As mentioned, there can be unfavorable tax consequences, under the "below-market loan rules," when too little or no interest is charged. When these unfavorable rules apply, the tax laws say you must calculate imputed (imaginary) payments between the parties. The imputed payments are usually calculated using the difference between the AFR and the interest rate actually charged, if any. Basically, the imputed amount is treated as though it were paid as either taxable compensation (interest) or as a taxable dividend distribution. Since such a payment was not actually made, the amount deemed paid is considered as an addition to the loan principle, or as a new contribution to capital.

Fortunately, you need not worry about the below-market loan rules if the aggregate outstanding loan balance is $10,000 or less. If you qualify for this exception, you can use low or zero interest without concerns about IRS examination.

Additionally, the below-market loan rules doesn't apply, if the loan instrument charges an interest rate at least equal to the AFR. Generally, the AFR is the minimum that can be charged without creating unwanted tax "side effects." The IRS publishes AFRs monthly in the Internal Revenue Bulletin. The relevant AFR for a "term" loan (a loan that has a specified "term" or duration) is the one designated for loans of the same duration, listed by the month the loan is created. For these loans, once the AFR is determined it continues to apply over the life of the loan regardless of how interest rates may later fluctuate. For "demand" loans, the AFR is redetermined annually by "blending" monthly short-term AFRs for that year. Thus, demand loans are less attractive in times of low interest rates, since unlike a term loan, demand loans do not lock-in the low interest rate.

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Temporary tax rules allow for even lower (than AFR) market interest rates to qualify within the below-market loan rules. This is a narrow exception, and applies only for loan situations where the lender is a foreign person, the borrower is a U.S.

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Differences Between Japanese and United States Standards: Closing the Gap

Japan has undertaken efforts to reform its accounting standard-setting process, in part, to narrow the gap between the accounting standards of Japan and other countries. In 2001, an independent private-sector entity, the Accounting Standards Board of Japan (ASBJ) was established in an attempt to further develop and reassess Japanese accounting standards; in addition, the ASBJ will also act as a liaison with the International Accounting Standards Board. Prior to the ASBJ's formation, Japanese generally accepted accounting standards (J GAAP) were primarily issued by the Business Accounting Deliberation Council (BADC) which was originally an advisory body to the Ministry of Finance. Standards and issues are also addressed by the Japanese Institute of Certified Public Accountants (JICPA) for practice and implementation guidance. As Japan's accounting principles further align with international accounting standards, it moves closer to United States accounting standards. However, there are differences between Japanese and United States generally accepted accounting principles (U.S. GAAP); as of our research to date, certain major differences are noted below:

	J GAAP (*Major Pronouncement*)	**U.S. GAAP** (*Major Pronouncement*)
Asset (long-lived) impairment	Currently no impairment loss provision standards in effect (anticipated adoption in next 3-5 years/*2002 BADC Opinion*).	Impairment recorded when an asset's carrying amount is not expected to be recovered over the remainder of its expected life (*Statement of Financial Accounting Standards (SFAS) No. 144*).
Lease accounting	Leases that do not transfer title to the lessee but meet criteria that would require capitalization under U.S. GAAP can be treated as operating leases (*1993 BADC Opinion on Accounting Standards for Leases*).	Generally, if one of four criteria stipulated by pronouncement is met, the lease must be capitalized (*SFAS No. 13*).
Inventories	Primarily, inventories are valued at cost; lower of cost of market can be used if elected by the company (*BADC Standard for Inventory*).	Inventories usually valued at lower of cost or market (*Accounting Research Bulletin No. 43*).
Business combinations	Accounting for business combinations using the purchase or the pooling method (*2001 BADC Issues Paper on Accounting for Business Combinations*).	Generally, business combinations are accounted for under the purchase method only (*SFAS No. 141*).
Comprehensive income	No provision for comprehensive income at this time.	Reporting and presentation of comprehensive income and its components as opposed to former "net income" concept (*SFAS No. 130*).

Accounting standards are constantly being issued or reassessed in keeping pace with the realities of the global marketplace. As the newly formed ASBJ moves forward, disparity between J GAAP and U.S. GAAP should become less significant. ♦

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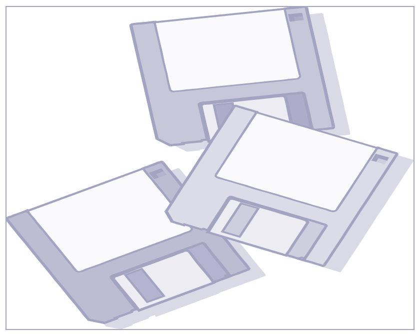
USB Key Storage Device

As with all technology devices, the floppy disk drive is prone for replacement. Although, the 3.5-inch floppy drive has been around for a while, with its now limited capacity and speed, it has become less desirable to use. With devices such as the CD-R, zip drives and the latest USB plug and play key, the floppy disk will soon be replaced.

The USB key is a new device to enter the market, and offers several advantages. It's smaller and lighter than a floppy drive with the capacity to store more data than ten or more 3.5-inch floppy drives. It uses flash memory and works by simply plugging into a PC's USB port. There is no additional hardware or software installation needed, since most PC's today come equipped with a USB port. (A driver is needed for PCs operating on Windows 98.) The drive is plug and play compatible with any operating system above Windows 98 SE. When connected, an active LED lights up and, files and folders can be



dragged and dropped, similar to other removable hard drives. But unlike the CD-R and zip drives, it is small enough to fit in a shirt pocket. It generally comes with a protective plug-in cap, and some have key rings or neck straps to prevent it from getting lost.

With file sizes becoming larger and larger, transferring files to and from the office has become a difficult task. A single presentation file or company accounting file can no longer fit onto a 3.5-inch floppy disk, but will easily fit onto one USB key with the various capacities available. While CD-R and zip drives are inexpensive, they are slow and are generally more difficult to use. The cost of the USB key is about fifty cents to a dollar per megabyte, although if you shop around, you may be able to find a 64MB key for about thirty-five dollars. Dell, IBM and Kingston are a few of the companies manufacturing the USB key, which are available starting from 16MB up to 1GB.

It will probably be a while before the 3.5-inch drives disappears completely, but consider sorting through your floppy disks and transferring any necessary files to the USB key or CD-R, until time when another device replaces them. ♦

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person, and the interest income imputed to the foreign lender would NOT be effectively connected with the conduct of a U.S. trade or business. You should note that AFRs are currently at a historically low level. For example, the rate published for March 2003, with monthly compounding is 1.56% for a short-term loan (term up to 3 years), 3.19% for mid-term loans (more than 3 and up to 9 years), and 4.69% for long-term loans (over 9 years). This makes it the

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best time in many years to issue term loans that charge the AFR minimum rate and, thereby, avoid the below-market loan rules. It is also a good time to consider repaying old loans and replacing them with new term loans utilizing currently low rates. Finally, now is also a great time to pay off any existing below-market loans and replace them with new term loans that charge minimum market interest at the currently low rates.

Locking-in a low rate now will allow you to minimize related-party loan rates, while, at the same time, avoiding application of the below-market loan rules. ♦