KAKIMOTO & NAGASHIMA LLP

CERTIFIED PUBLIC ACCOUNTANTS
CONSULTANTS

NEWSLETTER

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Introduction

In reviewing the past year, we are very thankful and grateful to our clients and friends who have been instrumental in making the first year under the partnership a success. As the new year commences, many of us have resolutions to improve our personal lives or business. The Firm resolution is a renewal of our commitment to service our clients better and to expand the services in order to meet the high expectations of our clients. With our significant resources in the tax, accounting and auditing, and IT areas, we will continue to improve in providing the level of services that will meet the high expectations.

Again, we extend our sincere appreciation for the continuing business of our clients and the support of our friends. All of us at Kakimoto & Nagashima LLP wish you continued success and health in the future.

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Summary of Articles

SFAS No. 109 Accounting for Income Taxes - Deferred Income Taxes

We often receive inquires on our calculation of deferred tax assets and liabilities from our clients. What exactly is it? Most items accounted for in pretax "book" income would also be included in taxable income in the same year. However, the tax treatment of certain events could differ from those recognized for book purposes. Differences can be permanent in nature, but a majority occurs from "timing" differences. The tax effects that arise from these differences are the foundation of deferred tax assets and liabilities. In our current issue, we will illustrate the fundamentals by citing specific examples.

Summary of the 2004 Jobs Act

Typically, election years are not known to have significant tax law changes. On October 22, 2004, however, President Bush signed the American Jobs Creation Act of 2004 ("the Act") into law and significantly reformed U.S. business and individual taxation. What is the impact on us? Although advantages and disadvantages will differ depending on each individual or business, our current article will discuss major provisions of the Act highlighting areas of interest to U.S./Japanese taxpayers.

What is spyware?

Spyware is a rising dilemma in the computer and internet world. It is a problem substantial enough that the United States Government is proposing new laws to punish all those involved. But what is spyware? Am I at risk? How can I prevent it? These questions are answered in this issue.

Visit us on the internet at http://www.knllp.com.

Any Questions?

We are committed to providing our clients with quality and excellent services. If you have any questions or comments, please let us know by either e-mail or phone.

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SFAS No. 109 Accounting for Income Taxes - Deferred Income Taxes

Income taxes have a significant impact on your financial statements. Factoring in the requirement for expanded financial statement disclosures in the income tax area, one realizes that accounting for income taxes can be a complex and challenging matter. In February of 1992, the Financial Accounting Standards Board (FASB) had issued Statement of Financial Accounting Standards No. 109 "*Accounting for Income Taxes*" (SFAS No. 109). This brought about the adoption of the balance sheet ("asset and liability") approach to be utilized for the accounting of income taxes. SFAS No. 109 covers both current and deferred taxes; accounting for current income taxes principally remained unaffected. SFAS No. 109 concentrates on the proper measurement of deferred tax assets and liabilities that are presented on the balance sheet.

Deferred Tax Assets/Liabilities

Deferred income tax provisions (expense/credit) are the differences between deferred tax assets/liabilities from period to period. Deferred tax assets and/or liabilities on the balance sheet are primarily based on the tax effect of "temporary differences". Temporary differences can be categorized into either "taxable temporary differences" (which give rise to deferred tax liabilities) or "deductible temporary differences" (the basis for deferred tax assets). Taxable temporary differences will result in net taxable amounts on future tax returns; deductible temporary differences are net deductions that will be taken on subsequent tax returns.

Examples that may contribute to temporary differences are:

- Depreciation for financial reporting utilizing lives or methods different from those used on the tax return
- Unrealized foreign exchange gains/losses
- Uniform capitalization of inventory
- Accrued expenses or reserves (e.g. vacation accruals, allowances for bad debt, inventory reserves, deferred compensation)
- Differences in fixed asset basis (e.g. different capitalized amounts, treatment of trade-ins, impairment valuations)
- Certain related party transactions (e.g. interest expense, bonuses)
- Leases (e.g. capitalized vs. operating, different amortization periods)

Valuation Allowance

A valuation allowance for a deferred tax asset may be required under certain circumstances. The balance of the valuation allowance represents the amount of the deferred tax asset which "more likely than not" will not be realized in the future. Whether a deferred tax asset will be realized requires considerable judgment based on the potential effects of both positive and negative evidence.

Current Developments

As new accounting standards are issued and tax laws enacted, one must understand and determine the accounting impact on income taxes (current and deferred) which will result from these changes. Presently, the FASB has addressed certain income tax issues raised by the American Jobs Creation Act of 2004 (please see the related article on the following page) related to the repatriation of foreign earnings and tax relief provided to U.S. domestic manufacturers; final accounting guidance in these areas has been issued in December of 2004. As new standards and laws are passed, we will continue to address these topics in our upcoming issues as they develop.♦

The American Jobs Creation Act of 2004

On October 22, 2004, President Bush signed the American Jobs Creation Act of 2004 ("the Act") which significantly revises U.S. business and individual taxation. One major change includes the gradual repeal of the extraterritorial income exclusion (ETI), which gave qualifying U.S. exporters an exclusion from gross income. The World Trade Organization declared the ETI regime an illegal trade subsidy and the European Union (EU) voiced strong demand to repeal the ETI. Finally, in March 2004, the EU began levying sanctions to heavily penalize U.S. exports into the EU. While the new law will gradually repeal the ETI, it will also provide incentives to the more broadly defined "manufacturers," including U.S. manufacturers, energy companies, multinational operations, and agribusiness. The following are highlights of the major provisions of the Act which will be key points of interest to U.S./Japanese taxpayers.

ETI Gradual Repeal

Prior to the Act, in the case of export products manufactured in the U.S., generally taxpayers could exclude from their taxable income the greater of 1.2% of the taxpayers' foreign trading gross receipts or 15% of the taxpayers' foreign trade income. No more than 50% of the fair market value of the property produced outside the U.S. may be attributable to the sum of the fair market value of the items manufactured outside the U.S., plus the direct cost of labor performed outside the U.S. After the enactment, taxpayers can claim 80% of ETI benefits in 2005, 60% in 2006, with a complete repeal thereafter.

Domestic Manufacturers Deduction

Along with the gradual repeal of the ETI, the Act will introduce a deduction from income on U.S. manufactured, produced, grown or extracted property. The new deduction starts at a transition percentage of three percent for 2005 and 2006, increase to six percent for 2007 through 2009, and be computed at nine percent thereafter. However, the deduction is limited to 50 percent of the W-2 wages paid by the taxpayer during the tax year. The definition of "U.S. manufactured, produced, grown, or extracted property, or computer software items" is unclear; therefore, regulations and guidance will be issued by the IRS.

Small Business Expensing and Depreciation

Under the prior law, if the cost of qualifying property placed in service during tax years prior to 2005 was equal to or less than $400,000, the maximum dollar amount a taxpayer could expense was $100,000 (IRC Section 179). For years 2006 and after, the investment threshold was $200,000 and the limitation for expensing was $25,000. With the application of the Act, the earlier mentioned option of expensing $100,000 is extended to 2007, and will revert back to $25,000 in 2008. In addition, the annual expense limitation is adjusted for inflation starting in 2004, increasing from $100,000 to $102,000, with the investment threshold increasing from $400,000 to $410,000.

Previously, vehicles generally were excluded from qualifying for the Section 179 deduction; however, vehicles weighing more than 6,000 pounds were eligible for this deduction, and certain heavy sport utility vehicles (SUVs) could be expensed immediately. The new law, however, increased the weight requirement to more than 14,000 pounds; for those vehicles weighing below 14,000 pounds, the deduction is capped at $25,000.

Depreciation of Leasehold Improvement Property

Prior to the Act, lessees depreciated leasehold improvements using straight-line depreciation over a 39 year period, which was the same as nonresidential real property, regardless of the lease term. The Act provides that leasehold improvements made during the period October 23, 2004 through December 31, 2005 to buildings which have been in use for more than three years prior to the improvement, should be depreciated over a 15 year period. This method, however, does not apply to leases between related parties with over 80% direct or indirect ownership. In addition, under the Act, restaurant property improvements should also be depreciated over a 15 year period.

Deduction and Amortization of Start-Up and Organizational Expenditures

Under prior law, start-up and organizational expenditures incurred by taxpayers were amortized over a period of not less than 60 months. Currently, effective for expenditures paid or incurred after October 23, 2004, taxpayers can elect to deduct up to $5,000 of start-up expenditures in the tax year in which their business begins and amortize the remaining balance over a 15 year period if the total expenditures are less than $50,000. If the amount exceeds $50,000, then the $5,000 is reduced by the amount by which the expenditures exceed $50,000, and the remaining balance is amortized over a 15 year period. As a result, if the expenditures are over $55,000, then the $5,000 deduction is reduced to zero.

Election of State Sales Tax as an Itemized Deduction on Individual Tax Returns

When determining the taxable income on federal individual tax returns, taxpayers deduct the larger of the standard deduction or itemized deductions. Prior to the Act, state sales taxes were not deductible; however, the Act allows individuals to deduct the larger of state sales taxes or state and local income taxes for years 2004 and 2005 as part of their itemized deductions. State sales taxes are those taxes actually paid during the taxable year (this requires accumulating receipts) or using tables to be prepared by the Secretary of the Treasury based on average consumption and other factors. Since the filing of 2004 tax returns has already started, it may be a burden to accumulate and calculate the total sales taxes paid in 2004. Most taxpayers may have no choice but to use the prepared tables for 2004.

Other Provisions

Provisions for areas such as the following have been addressed in the 2004 Jobs Act; however, as the impact on U.S./Japanese taxpayers is not considered to be significant, we have excluded explanations of the following subjects:

- Foreign Tax Credit Reform
- Incentives for Agriculture
- Tax Shelters and Abusive Transactions
- Tax Breaks on Dividends from Certain Foreign Corporations

We have highlighted the major provisions of the 2004 Jobs Act, but if you have any questions or comments, please do not hesitate to contact us.♦

Spyware – The Internet's Newest Nuisance

It was once thought that computer viruses would be the only nuisance to be afraid of while partaking in the worldwide phenomenon known as personal computing. A little known program commonly referred to as spyware is on the rise as more and more people are "getting connected" to the Internet. Spyware has been around for quite a while but only now is getting bothersome enough to make people, and more importantly the Federal Government, worry.

As we speak, lawmakers are mulling over a variety of laws aimed at stiffening penalties and heftier fines against the Internet's newest nuisance. In addition, the Federal Trade Commission (FTC) will be instructed to more aggressively target spyware makers in hopes of eliminating this problem.

Spyware is the general name for a range of programs that are slipped onto a computer without its user's consent. Users most often get them by downloading free games or file-sharing software – and consenting to language buried deep within a licensing agreement. Programmers set up spyware to do anything from tracking a surfer's Web browsing to stealing personal information. Often the programs redirect users' home pages or cripple their computers with an endless stream of pop-up advertisements.

Recently, the FTC has filed what it now says is the first lawsuit against a spyware distributor. Sanford Wallace, infamous for his involvement in the spam community, is named in the lawsuit, as are Seismic Entertainment Productions Inc. and SmartBot.net Inc. The FTC states the firms installed spyware on victim's computers, and then attempted to convince Internet users to pay for software that would remove the spyware. In some cases, the software they installed would startle victims by opening their CD-Rom door, then flash a warning message to the victim that read:

"FINAL WARNING!! If your cd-rom drive(s) open…You DESPERATELY NEED to rid your system of spyware pop-ups IMMEDIATELY! Spyware programmers can control your computer hardware if you failed to protect your computer right at this moment!"

Over 50 percent of customer support calls to Microsoft Corp. are related to computer crashes caused by spyware. Dell Computer Corp. has reported that up to 12 percent of its customer support calls are of this nature.

Relevant information regarding spyware.

How to recognize it, avoid it, and what to do if you have it.

WHAT IS SPYWARE?

- It's software which is secretly placed on a person's computer and tracks their activities.
- Spyware can monitor which Web sites you visit or even each keystroke you make.
- The keystroke recording is particularly dangerous as it can lead to identity theft.
- Spyware can also change some of the settings on your computer.

TELLTALE SIGNS OF SPYWARE

- You get a barrage of pop-up ads.
- Your Internet browser takes you to sites other than the one you typed in.
- Your Internet home page suddenly or repeatedly changes.
- New and unexpected toolbars pop up.
- New and surprising icons appear at the bottom of the screen.
- Some computer keys don't work right (e.g. the "Tab" key might not move to the next field).
- You get random error messages.
- Your computer is sluggish or slow when opening files or saving them.

HOW TO PREVENT SPYWARE

- Update your Web browser and operating system software. They may offer spyware patches.
- Only download software from sites you know and completely trust.
- Make sure your browser is set at a sensitive enough level to pick up on unauthorized downloads. For example, you want at least the "medium" setting on Internet Explorer.
- Don't click any links within a pop-up window. Close only using the "X" in the top corner.
- Don't click links that claim to offer anti-spyware programs.
- Install a firewall to block uninvited users from gaining access to your computer.

IF YOU HAVE SPYWARE ON YOUR COMPUTER NOW

- Buy an anti-spyware program from a vendor you trust.
- Set it to scan at least once a week and every time you start your computer.
- Delete any software the program detects that you don't recognize or want.

Spyware has become a growing epidemic and will likely broaden throughout 2005 and beyond. Being knowledgeable in correct web surfing habits and being able to ascertain the telltale signs of spyware is a must these days. If you feel that your pc's exhibit any of the aforementioned behaviors or if you have any questions, please contact the professionals at Kakimoto & Nagashima LLP.♦

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