

# KAKIMOTO & NAGASHIMA LLP

CERTIFIED PUBLIC ACCOUNTANTS  
CONSULTANTS

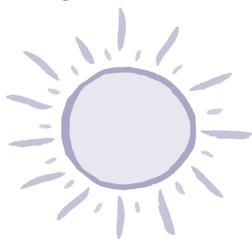
## NEWSLETTER

Volume 3, Issue 2

June 2005

### Inside this issue:

Summary of Articles	1
Mergers and Acquisitions: Do What's Right for Your Company	2
Deduction Related to In- come Attributable to U.S. Production Activities	3,4
Spam: Legal Issues	4



### 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. Our company profile is available on the internet at:

<http://www.knllp.com>

Los Angeles Office:  
Tel: (213) 439-6800  
E-mail: [laoffice@knllp.com](mailto:laoffice@knllp.com)

South Bay Office:  
Tel: (310) 715-9100  
E-mail: [sboffice@knllp.com](mailto:sboffice@knllp.com)

## Summary of Articles

### Mergers and Acquisitions

As the economy moves in a positive direction, merger and acquisition (M&A) activity is expected to continue its upward trend according to some experts. Part of a company's growth strategy may involve the merger or acquisition of another business. Is your company considering such an undertaking? Each M&A transaction encompasses a unique set of due diligence, planning and structuring needs. Early and detailed planning, as well as having the right team in place, are essential for a successful M&A transaction. In this issue, we offer an overview of the M&A life cycle and the possible support a CPA can provide throughout the entire process.

### Deduction Related to Income Attributable to U.S. Production Activities

In January 2005, the Internal Revenue Service published interim guidance regarding the deduction related to U.S. production activities. This tax law change offers major advantages to taxpayers performing production activities in the U.S. What are considered production activities and how much of a deduction is available for taxpayers performing production activities? Our current article will touch upon some of the definitions and guidance related to this topic.

### Fight Against Spam

Are you tired of seeing ads for Viagra and low mortgage rates litter your inbox? Ever since the introduction of the CAN-SPAM Act in 2004, Microsoft and law enforcement have joined forces to crack down on illegal e-mail activities. Spammers around the world better run and hide. Someone is out to get you.

## Mergers and Acquisitions: Do What's Right for Your Company

The recent surge of merger and acquisition ("M&A") activity observed in 2004 should persist through 2005. The standard indicators - better economic outlooks, an improved financing environment and expansion demands - are more evident. However, the concerns related to corporate governance and the \*Sarbanes Oxley Act will undoubtedly have a dampening effect on M&A efforts. Has your company ever contemplated a merger or acquisition as part of your growth strategy? With so many things to consider, it is imperative to have the right team in place to achieve a successful acquisition. Among the professionals that get involved, a CPA is a tremendous asset to bridge the needs of both buyers and sellers.

\* The Sarbanes-Oxley Act was signed into law on July 30, 2002, and introduced significant legislative changes to financial practice and corporate governance regulation. It introduced stringent new rules with the stated objective: "to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws".

M&A transactions traditionally have a life cycle that follows:

<b>Phases of the M&amp;A Transaction Life Cycle</b>		
<b><u>Pre-Deal</u></b>	<b><u>Deal</u></b>	<b><u>Post-Deal</u></b>
<ul style="list-style-type: none"> <li>• Strategy Definition</li> <li>• Identification of acquisition target (s)</li> <li>• Establish contact/determine interest levels</li> </ul>	<ul style="list-style-type: none"> <li>• Development of price proposals</li> <li>• Due diligence review and analysis</li> <li>• Structure of the transaction</li> <li>• Arrange for financing</li> <li>• Negotiate terms</li> <li>• Closing the deal</li> </ul>	<ul style="list-style-type: none"> <li>• Restructuring</li> <li>• Integration process</li> <li>• Review</li> </ul>

### Pre-Deal Process

A company should clearly define its purpose for M&A activities. M&A activities should be aligned with overall business strategies, risk assessment and company goals. In the target selection process, a CPA can assist by providing the client with strategic information, staffing, independence from internal conflicts and anonymity in the initial approach of the target.

### The Deal

The development of the purchase price is primarily dependent on value; therefore, concentrated efforts are geared towards the determination of the value of the target. An investigation ("due diligence") is conducted regarding the status of a business. Due diligence is usually performed in the following areas: financial, operational and legal. Due diligence should be thorough; proper due diligence is a key ingredient in assessing whether to proceed with a deal, and if the deal proceeds, how to maximize the benefits achieved. Generally, a CPA's role in the due diligence process includes the identification of hidden liabilities, verification of the accuracy of the seller's information and achieving a comprehensive understanding of the target's business. The CPA can also perform a valuation of the target which assists the buyer in its pricing negotiations.

### Post-Deal

Upon completion of the transaction, the integration process begins. Integration planning should be developed before the deal actually occurs; several post deal failures are due to poor post-deal implementation planning. The CPA can provide assistance as to recommendations and advice for the successful planning and integration of systems.

Successful M&A transactions depend on well-thought out planning throughout the entire process and having the right team in place. If you are contemplating an M&A transaction or seeking advice in potential avenues in the future expansion of your business, we would be happy to assist your company in tailoring a services package suitable for your needs. ♦

## Deduction Related to Income Attributable to U.S. Production Activities

As part of the American Jobs Creation Act of 2004, the extraterritorial income exclusion has been repealed and replaced by the deduction related to income attributable to U.S. production activities.

The deduction is available for income attributable to U.S. production activities and is limited to the lesser of a percentage of taxable income or "qualified production activities income" (QPAI.) The maximum deduction percentage is phased in over five years, starting with 3% in 2005 and 2006, increasing to 6% in 2007 to 2009, and 9% thereafter. The details regarding the calculation of these deductions are not yet established at this time; however, proposed regulations are expected to be available during the summer of 2005 and the final regulations are expected in April 2006. The interim guidance that the taxpayers can rely on until the regulations are issued, as outlined in Internal Revenue Service Notice 2005-14 published on January 19, 2005, will be discussed below:

### **Qualified Production Activities Income (QPAI)**

The income used in calculating the deduction is called QPAI, and is the net income calculated as a result of the "domestic production gross receipts" (DPGR) reduced by the following:

- 1) The cost of goods sold related to such gross receipts;
- 2) Other deductions, expenses, or losses directly related to such gross receipts; and
- 3) A pro rata portion of other deductions, expenses, or losses that are not directly allocable to such gross receipts.

### **Domestic Production Gross Receipts (DPGR)**

Examples of domestic production gross receipts used in calculating the QPAI is as follows:

1. Gross receipts from the sale of "qualifying production property" (QPP) (e.g., tangible personal property, computer software, and sound recordings) that are "manufactured, produced, grown, or extracted" (MPGE) in whole or in significant part by the taxpayer within the United States and derived from the lease, rental, license, sale, exchange, or other disposition of QPP. Currently, the term in whole or in significant part is not a defined term. However, the in whole or in significant part requirement is satisfied if the MPGE activity within the United States with respect to the QPP is "substantial in nature." Whether or not a taxpayer's activity is substantial in nature is determined based on the facts and circumstances, including the relative value added, the relative cost, nature of the property, and the nature of the activity performed by the taxpayer in the United States. For example, if a taxpayer imports a QPP that is partially manufactured abroad, the taxpayer may still satisfy the in whole or in significant part requirement depending on the activity in the United States. Certain activities such

as packaging, repackaging, and labeling which are considered to be minor in nature are disregarded in applying the general substantial in nature test;

2. Gross receipts derived from the lease, rental, or license of "qualified film" if at least 50% of the total compensation relating to the production is for compensation for services performed in the United States by actors, production personnel, directors, and producers;
3. Gross receipts derived from any lease, license, or sale of electricity, natural gas, and drinking water produced by the taxpayer within the United States. For producers who produce and distribute the above, the gross receipts from the distribution is excluded from the DPGR;
4. Gross receipts derived from the construction of real property performed in the United States. However, lease and rental income is excluded from the DPGR; and
5. Gross receipts derived from engineering and architectural services performed in the United States for real estate construction projects in the United States.

A taxpayer must calculate the portion of its gross receipts that qualifies for the DPGR and the portion that does not qualify. However, if the non-DPGR portion represents less than five-percent of the taxpayer's gross receipts, all of the taxpayer's gross receipts are treated as DPGR.

### **Calculation and Limitation of the Deduction**

The deduction related to income attributable to U.S. production activities is limited to the lesser of 3% (6% for 2007 to 2009; 9% thereafter) of QPAI or taxable income. In addition, the amount of deduction allowed is limited to 50% of the W-2 wages of the taxpayer. For taxpayers not using the calendar year as their taxable year, the W-2 wages are those issued for the calendar year ending during its taxable year. For example, if a taxable year ends in March 2006, the W-2 wages to be used will be the amount paid during the 2005 calendar year. If the wages were paid to employees of the taxpayer for employment by the taxpayer, the wages are considered to be taxpayer's W-2 wages even if another entity is shown as the employer on the W-2. Under the same token, if the taxpayer is paying wages as an agent of another entity, those wages will not qualify as the taxpayer's W-2 wages.

### **Exception for Income Eligible for the Deduction**

Sale of food and beverages prepared by the taxpayer at a retail facility does not qualify for DPGR. Wholesale sale of food and beverages qualify as DPGR.

*(Continued on page 4)*

(Continued from page 3)

### **Application of the Deduction to Partnerships, S Corporations and Other Pass-thru Entities**

The deduction for each pass-through entity is allocated to each partner and/or shareholder based on its distributive or proportionate share of the items allocated.

### **Application of the Deduction to the Affiliated Group**

All members of the "expanded affiliated group" (EAG) are treated as a single corporation for purposes of the deduction. EAG means one or more chains of corporations connected through stock ownership with a common parent corporation owning at least 50% of the voting power and value of the stock of such corporation. A single deduction is computed for the EAG utilizing the combined members' taxable income or loss, QPAI, and W-2 wages. The deduction is allocated among the members of the EAG in proportion to each member's QPAI, if any. For this calculation, the members of a consolidated group should be treated as a single member of the EAG.

In determining whether or not the gross receipts are DPGR, each member of the EAG should be treated as conducting the activities of each other member of the EAG.

### **Availability of the Deduction**

The above deduction related to income attributable to U.S. production activities will be effective for taxable years beginning after December 31, 2004.

For more details, consultation with a professional is recommended. If you should have any questions or concerns, we would be happy to discuss them with you.♦

---

## **Spam: Legal Issues**

"Cheap meds, wholesale prices." "Your application approved." "Get an online degree." Any of these look familiar? Each and every day the entire population is deleting millions of e-mails with subject headings similar to these. Precious time wasted doing trivial work.

According to recent surveys, approximately 80% of all e-mail received is considered to be unsolicited e-mail or more commonly referred to as spam. So that means one out of every five e-mail messages are actually legitimate. The same survey suggests that employees are spending upwards of an hour or more each day filtering through their inboxes for genuine e-mail. It's a wonder how any work is accomplished considering how embedded e-mail is in today's business practice.

Beginning in January of 2004 the Controlling the Assault of Non-Solicited Pornography and Marketing Act, or CAN-SPAM, went into effect. Its primary purpose is to curtail those individuals responsible for the massive outbreak of spam. What this law can do is enforce certain etiquette (e-mailers

must be truthful in subject lines and honor remove requests) and lay the groundwork for the creation of a Do Not Spam list similar to the Do Not Call list. It would also allow ISPs, states and the Federal Trade Commission (but not individuals) to sue spammers.

This past May, a Massachusetts judge ordered what authorities are calling one of the world's largest "spam gangs" to shut down. The move followed a lawsuit filed by the Massachusetts Attorney General's Office, which alleges the operation broke the federal anti-spam law, "CAN-SPAM". The nine-month investigation, which was assisted by Microsoft, uncovered a worldwide operation that sends out hundreds of millions of illegal spam pitches a month, as well as advertising for fraudulent products. Nine individuals are being charged with engaging in deceptive acts, including sending unsolicited e-mail, operating online businesses that sell counterfeit prescription drugs, such as Viagra knockoffs, bootleg software and porn, as well as operating unlicensed online mortgage brokerage services.

It was another example of Microsoft teaming up with law enforcement to crack down on illegal e-mail activities, which Microsoft sees as a threat to consumer confidence in its products. Microsoft's campaign against spammers is now considered a main part of the company's business strategy.

The Massachusetts group, considered to be one of the largest and most sophisticated operations known, used domain names registered in Monaco, Australia and France, and servers in China, South Korea, Brazil and Taiwan.

"They really used the Internet to build a global, virtual business," Microsoft General Counsel Brad Smith said. "They hired affiliates to send e-mail on their behalf and put in place fulfillment houses. If you bought Viagra from them, they would have it shipped to you from someone in India."

It remains to be seen as to what the outcome of the lawsuit will be, as it is still pending. Hopefully they will be punished to the fullest extent of the law, in order to thwart any would-be wrongdoers in the foreseeable future.♦

Questions or comments about  
this issue or inquiries about our  
newsletter by e-mail subscription  
service can be sent to:

[newsletter@knllp.com](mailto:newsletter@knllp.com)