Kakimoto & Nagashima LLP

Certified Public Accountants

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NEWSLETTER

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Summary of Articles

Private Company Financial Reporting

Many have expressed concerns about the financial reporting for private companies. Issues regarding the complexity of accounting standards, resources being used in their application and the relevance of the resulting financial information have become major concerns for the private company. In our current article we provide an overview of two recent developments in this area: (1) FASB/U.S. GAAP – the creation of the Private Company Council and (2) AICPA – the development of a financial reporting framework (an OCBOA) for small- and medium-sized entities.

Withholding Requirements for Certain Payments to Non-Resident Payees:

Does your company make any payments to foreign corporations or foreign individuals? If it does, your company may have an obligation as an agent for the IRS to collect withholding tax at the appropriate rate, deposit it with the IRS, and comply with reporting requirements.

In recent years, the IRS and U.S. Treasury have been focusing more and more on stricter enforcement of proper treatment and reporting of cross border transactions. Some of the rules are complicated, and inadvertent errors could occur resulting in the potentially large penalties. This issue summarizes some of the basic rules associated with certain payments made to foreign corporations and foreign individuals.

Preparation for Outsourcing------Creating Detailed Procedural Instructions

In our July newsletter, it was strongly suggested that companies should create detailed instructions or guidelines in preparation for outsourcing. In this issue, we will explain the basic steps of how to create strong detailed procedural instructions.

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We look forward to providing you with up-to-date accounting and tax information through our website.

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:

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Private Company Financial Reporting: Will It Suit Your Needs?

For several years there has been a growing concern, driven by changes made in the accounting and financial reporting landscape, that current U.S. GAAP standards do not properly address the needs of private company financial statements users. Of significant concern are:

- Increased complexity of accounting and disclosure requirements
- Resources used in applying and maintaining certain accounting standards versus benefits received
- Financial statements losing relevance and becoming less useful

Two current developments of note in this area are summarized below: (1) FASB/U.S. GAAP – the creation of the Private Company Council and (2) AICPA – the development of a financial reporting framework for small- and medium-sized entities.

Recent Background

In 2009, the Financial Accounting Foundation ("FAF", overseer of the FASB), AICPA and National Association of State Boards of Accountancy created the Blue-Ribbon Panel to address the needs of the users of U.S. private company financial statements. In January 2011, the Panel issued its report to the FAF trustees which contained recommendations for improving private company standard-setting. The report moved forward the message that "one size fits all" U.S. GAAP does not meet the needs of private company financial statement users and recommended a new and separate standard-setting board which would not be subject to FASB approval. The FAF created a working group to further consider standard-setting for the private company in addition to evaluating the Blue-Ribbon Panel's report.

As a result, in October 2011, the FAF issued its initial proposal which included the formation of a new standard-setting body which would focus on private companies and the needs of their financial reporting users. However, any changes proposed would continue to be subject to FASB ratification. This FAF proposal was exposed for comment; in May 2012, their plan was approved with certain modifications.

FAF/FASB/U.S. GAAP

On May 23, 2012, the FAF's trustees approved the formation of the Private Company Council ("PCC") which will have two principal responsibilities:

1) Identifying exceptions or modifications to address user needs of private company financial statements, and
2) Serving as an advisory body for the appropriate treatment for private companies on the FASB's technical agenda

The PCC will be composed of 9 to 12 members. Proposed private company exceptions and modifications by the PCC must be approved by a two-thirds majority of PCC members and subject to FASB endorsement. Proposals will be exposed for public comment, the PPC will redeliberate and submit final proposals to the FASB for final endorsement.

Issues that are anticipated to be first addressed by the PCC include: FIN 48 (Accounting for Uncertainty in Income Taxes), fair value, consolidation of VIEs, complexity of derivative accounting, and certain accounting aspects of business combinations.

At this point, the term "private company" is not consistently defined in U.S. GAAP. In a separate but related project, the FASB is in deliberations regarding the types of companies which would be included in the scope of the PCC decision-making framework.

AICPA/Financial Reporting Framework for Small- and Medium-Sized Entities ("FRF-SME")

In May 2012, the AICPA also announced its plans to develop a financial reporting framework for small- and medium-sized private companies ("FRF-SME"). FRF-SME, as an "other comprehensive basis of accounting" ("OCBOA"), is an alternative for private companies who do not need U.S. GAAP financial statements. Currently, there is no standard definition of a small- or medium-sized entity in the U.S. and the AICPA does not define the term either. OCBOA's are non-authoritative and use of FRF-SME is voluntary; the AICPA cannot require its use. (Note: with the clarified auditing standards taking effect at the end of 2012, OCBOA's will be referred to as "special purpose frameworks".) The FRF-SME will be based upon traditional accounting methods which will likely include the following:

- Be based on historical cost principals; fair value applications will be limited
- Eliminate VIE's/revert back to subsidiaries/investee accounting
- Goodwill amortization
- Not require complex accounting for derivatives and hedging activities
- Disclosure requirements will be reduced

Disadvantages of using FRF-SME could include: third-party acceptance and lack of guidance.

FRF-SME is expected to be exposed by the AICPA in October 2012 and finalized in early 2013.

We are committed to assisting our clients in understanding new accounting standards and the potential effects on your financial reporting. If you should have any questions regarding the contents of this article, please do not hesitate to contact us.♦

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

newsletter@knllp.com

Withholding Requirement for Certain Payments to Non-Resident Payees

Does your company make any payments to foreign corporations or foreign individuals? If it does, your company may have an obligation as an agent for the IRS ("a withholding agent") to collect withholding tax at the appropriate rate, deposit it with the IRS, and comply with reporting requirements.

In general, foreign individuals and corporations are subject to federal withholding tax at the rate of 30% (or lower Treaty rates as discussed later in this article) of the gross amount of US sourced fixed, determinable, annual, periodic (FDAP) income unless otherwise specified. Under the current regulation, FDAP income is all income except for certain items excluded by the regulations.

FDAP income includes (but not limited to) the following income:

- Interest (other than original issue discount)
- Dividends
- Rent/ Royalties
- Premiums/ Annuities
- Salaries, wages, compensation
- Gain from the disposition of patents, copyrights, goodwill, trademarks, franchises, and other like property
- Others

Withholding obligation of the payer:

When the amounts subject to withholding tax is paid, a withholding agent is required to withhold the proper amounts of withholding taxes and remit it to the IRS in a timely manner. A 'withholding agent' is any person, US or foreign, that has the control, receipt, custody, disposal or payment of an item of income of a foreign person subject to withholding; therefore, a payer is generally a withholding agent. For example, when a US subsidiary pays dividends to its Japanese parent, a US subsidiary is a withholding agent and is required to withhold tax at the appropriate rate. The amount of payments remitted to the Japanese parent would be net of withholding tax. A US subsidiary must then turn over the amounts collected to IRS.

Deposit requirements:

The taxes collected must be deposited with the IRS by electronic funds transfer by the due dates. Electronic funds transfers are mostly made using Electronic Federal Tax Payment System (" EFTPS"). If you do not wish to use EFTPS, you may arrange with other 3rd party to make deposits on your behalf. Penalty may be imposed for the failure to deposit through electric funds transfer (e.g. mailing a check). In order for deposits by EFTPS to be timely, the payment must be initiated by 8:00pm Eastern time the day before the due date. If you use a third party to deposit on your behalf, instead of using EFTPS, you should confirm the cutoff time for making deposit to IRS timely.

The frequency of your deposits to the IRS is determined by the amount of tax you are required to withhold. Please refer to the following chart to determine the frequency of your deposits:

Reduced Treaty Rates:

Based on the US domestic rule, withholding rate on FDAP income is flat 30% of the gross amount. The 30% withholding rate, however, may be reduced under the terms of the Treaty if the foreign payee is a qualified resident of the treaty jurisdiction. A withholding agent is required to obtain valid and reliable documentation that asserts the type (i.e. individual, corporation, etc.) and status (i.e. US or foreign) of the recipient prior to making the payment. In addition, a withholding agent must obtain a valid "withholding certificate" such as Form W-8BEN prior to applying the reduced Treaty rates to the amounts subject to withholding.

Example: Withholding Tax Rate on Dividends under U.S. Japan Tax Treaty:

Under the U.S. - Japan Tax Treaty, the withholding tax on dividend is 10%. The rate is reduced to 5% if at least 10% of the voting shares of the company paying the dividend are held by the company receiving the dividend. The withholding tax is completely eliminated if the beneficial owner of the dividends has owned, directly and indirectly, more than 50% of voting shares for the period of 12-months ending the date on which entitlement to the dividends is determined. In such case, the beneficial owner must also meet one of three tests under Article 22 of the U.S. Japan Tax Treaty ("limitation on benefits") . The "limitation on benefits" clause are intended to prevent "treaty-shopping," the scheme by which a multinational business tries to obtain more favorable treaty benefits available in certain jurisdictions. As the conditions set forth in the Treaty, including "limitation on benefits" clause, can be complex, we suggest that you consult with Kakimoto & Nagashima LLP or other tax professionals regarding the applicability of the treaty rates.

Compliance Matters - Form 1042/ Form W-8BEN/ Form 8833:

1) Form W-8BEN:

   Before applying the reduced treaty rate and prior to making a payment, a withholding agent must obtain Form W-8BEN from a beneficial owner of income. Form W-8BEN is valid only if its validity period has not expired, it is signed under penalties of perjury by the beneficial owner, and it contains all of the information required on the form. Form W-8BEN with a U.S. TIN does not need to be renewed provided that there is at least one payment annually which is reported on Form 1042-S and that there are no changes to cause information on the form incorrect. Form W-8BEN without TIN of the beneficial owner will remain in effect until the last day of the third succeeding calendar year after the signature date, unless a change in circumstances cause information on the form incorrect. For certain payments, TIN are required on Form W-8BEN in order to claim treaty benefits. Considering these factors, it may generally be recommended for a foreign payee of the amount subject to the U.S. withholding tax to obtain a TIN. When Form W-8 BEN is not provided, a withholding agent should consider withholding at the 30% rate.

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	Undeposited Tax Amount	*Due Date of Deposit*
Rule 1	$2,000 or more at the end of any quarter-monthly period**	Within 3 business days after the end of the quarter-monthly period
Rule 2	At least $200 but less than $2,000 at the end of any month	Within 15 days after the end of the month (If making a deposit of $2,000 or more under Rule 1, any end-of-the-month balance of less than $2,000 may be carried over to the next month. If a deposit of $2,000 or more is made during December under Rule 1, the end-of-December balance of less than $2,000 should be remitted with Form 1042 by March 15 of the following year).
Rule 3	Less than $200 at the end of a calendar year	Pay with Form 1042 or deposit the entire amount by March 15 of the following year

** Quarter-monthly period ends on the 7th, 15th, 22nd, and last day of the month.

Preparation for Outsourcing------Creating Detailed Procedural Instructions

In our July newsletter, it was strongly suggested that companies should create detailed instructions or guidelines in preparation for outsourcing. In this issue, we will explain the basic steps of how to create detailed procedural instructions.

Developing detailed procedural instructions will not only help the flow of the whole operation, it also helps other people to clearly understand company operations. Instructions also serve as a good opportunity to reevaluate the operation and to clarify those aspects of work such as personal preferences of processing and judgment of the person in charge. Instructions will also serve as a guide in unclear situations.

Analyzing the Existing Situation

It is important to make an analysis of the current situation first. Listening to the person in charge and asking him/her questions would be one of the many ways to make such an analysis. The analysis should include:

- The flow of operations (acquisition of raw data, data entry, verification, approval, submission of data or reports including those prepared for other departments, and filing)
- Operational rules and methodology
- Where decision making is needed, who in the organization should the employees consult with?
- Are there any situations where the person in charge should make decisions based solely on his/her experience?

Documentation of Procedural Instructions

After analyzing the current situation, the company should document the procedures in a flowchart or step by step instructions.

- The work flow should be in a time series format, and flowing only in one direction.
- The work flow (acquisition of raw data, data entry, verification, approval, submission of data or reports including those prepared for other departments, and filing) should be distinguished and described as one procedural instruction.
- If the process stage is different for a similar operation, they should be documented separately. For example as: monthly, quarterly, annually.
- Explanations should be presented in visual form rather than in words or paragraphs.
- The explanation should be summarized to simplify what is said on the documents.

Walk-through

Once the flowchart and step by step guidelines are created and completed, the next step is a walk through. Then the written information should be checked to see if it follows the flow chart or the created guidelines. By using the flowchart and the instructions as the sample base, you can see if the work process is flowing according to what is documented, see if there are any errors during the process, determine what to do when irregular situations occur, and what to expect. A walk-through will improve the quality of the detailed procedural instructions being created.

Finalizing of the Detailed Procedural Instructions including Improvements to be Made

After updating and revising the flowchart and instructions by the walkthrough method, the instructions should be verified and revised by the person(s) in charge, if necessary.

- The purpose and the nature of the operation should be checked again.
- The procedures should be checked to see if they are accurate.
- Unnecessary procedures should be identified and eliminated (to make the operation more efficient).
- Transactions that have not been treated consistently should be standardized.
- Decision making and resolution methods should be made clear.

Periodic Review of the Detailed Procedural Instructions

The way companies are run changes daily. Procedures and instructions must be reviewed frequently. Having up to date detailed procedural instructions is necessary to avoid conflicts. Periodically reviewing the instructions will benefit the company in the long run.

By creating a strong set of procedural instructions, a company can see how it is evolving, see what policies are in effect, and have visibility to up to date information. Having well developed instructions will increase staff communication skills, assist in reassignments, and help create effective employee training. Please take our method into account to build a strong ideal detailed procedural instruction for your employees.

Please feel free to contact us with any questions or concerns regarding outsourcing services.♦

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2) Form 1042:

A withholding agent must file Form 1042 for the preceding calendar year to report amounts paid that are subject to withholding and the amount of withholding tax collected[1]. Also, a Form 1042-S must be filed with the IRS for each income type (e.g. Interest, dividend) and for each recipient. A copy of Form 1042-S must be provided to a recipient of income. Due date for all above in this section is March 15th of a year after the report year. Close attention should be paid so that codes required on the form (e.g. income code, recipient code, exemption code, etc.) disclosed on the form are accurate.

3) Form 8833:

Form 8833 is a form with which a foreign recipient of income reports the treaty-based return position. The filing of Form 1042S may exempt the recipient of income from filing Form 8833 in some situations. If, however, the amount of payments received exceeds $500,000, timely filing of Form 8833 may be required even when Form 1042S has been filed. As the failure to file Form 8833 could result in a sizable penalty (e.g. $10,000 for a corporation, $1,000 for an individual), you should practice extra caution in determining whether Form 8833 filing is required.

Above discusses some of the rules relating to the federal withholding tax on FDAP income. The rules for withholding tax could be complex and require careful analysis of how such rules apply to each case. We strongly recommend obtaining advice from the tax specialists. For more details, please contact Kakimoto and Nagashima LLP and we would be happy to assist you.♦

[1] Form 1042 must be filed to report payments that are subject to withholding, regardless whether withholding taxes have been collected.