



Kakimoto & Nagashima LLP

Certified Public Accountants Consultants

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Any Questions?

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Summary of Articles

Tangible Property/Repair Final Regulations

On September 13, 2013, the Treasury Department and the IRS issued final regulations pertaining to the tax treatment of expenditures made to acquire, produce, maintain and improve tangible property. Along with several changes and additions, the final regulations intend to clarify and simplify the standards set forth in the temporary regulations issued in 2011 (for example, the de minimis safe harbor rule to follow the book minimum capitalization policy). These regulations affect virtually all taxpayers; therefore, it is essential to understand the impact of these rules on your tangible property expenditures.

AICPA Compilation and Review Standards - Clarity Project

In 2011, the AICPA's Auditing Standards Board had completed its clarification on U.S. generally accepted auditing standards which involved the redrafting and reformatting of the auditing standards for easier comprehension and use. A similar project is currently under way to clarify the existing AICPA's Statements on Standards for Accounting and Review Services; our current article provides an overview of the project.

Cloud Computing

When you store your photos online instead of on your home computer, or use webmail or a social networking site, you are using a "cloud computing" service. If you are an organization, and you want to use, for example, an online invoicing service instead of updating the in-house one you have been using for many years, that online invoicing service is a "cloud computing" service. Cloud computing refers to the many different types of services and applications being delivered in the internet cloud, and the fact that, in many cases, the devices used to access these services and applications do not require any special applications. We will introduce to you the growing trend that is called cloud computing.

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

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Tangible Property/Repair Final Regulations

Overview

On September 13, 2013, the Treasury Department and the IRS released the long-awaited final tangible property/repair regulations which provide guidance on the treatment of payments pertaining to acquiring, producing, maintaining or improving tangible property. These regulations intend to clarify, simplify and refine the standards set forth in the temporary regulations (issued on December 23, 2011), provide several new safe harbor rules, provide guidance on the accounting for property subject to depreciation, and clarify which costs are deductible and which ones are capital expenditures.

The final regulations are mandatory for tax years beginning on or after January 1, 2014, but taxpayers have the option to apply the final regulations retroactively to the 2012 and 2013 tax years.

On the same day the final regulations were issued, the Treasury and the IRS also issued proposed regulations which address dispositions of property depreciable under the Modified Accelerated Cost Recovery System ("MACRS").

Some of the major provisions are outlined below.

Acquisition and Production of Tangible Property [Reg. §1.263(a)-1(f) and -2]

Taxpayers are generally required to capitalize amounts paid to acquire or produce a unit of tangible property (see Unit of Property section below) except for certain costs determined to be nominal or amounts determined to be deductible as materials and supplies (see Materials and Supplies section below). Units of tangible property include leasehold improvement property, land and land improvements, buildings, machinery and equipment, and furniture and fixtures. Among other things, the final regulations require the capitalization of amounts paid to defend or perfect title to real or personal property, provide rules for determining the extent to which taxpayers must capitalize transaction costs related to the acquisition of property, provide a de minimis rule for amounts paid for the acquisition or production of property, and address the treatment of capital expenditures.

With respect to the de minimis rule, taxpayers that have a written policy at the beginning of the taxable year to expense, for non-tax purposes, amounts paid for property costing less than a specified dollar amount or having an economic useful life of 12 months or less may take the same deductions for tax purposes. The de minimis safe harbor rule applies as long as the taxpayer consistently treats such amounts as expenses on its "applicable financial statement" and the book minimum capitalization policy does not exceed \$5,000 per invoice or item. If a taxpayer does not have an applicable financial statement, the threshold is reduced to \$500 per invoice or item. The de minimis safe harbor rule must be applied to all amounts expensed under the taxpayer's book policy, including materials and supplies (as mentioned below).

An "applicable financial statement" is defined by the regulations as either 1) a financial statement required to be filed with the Securities and Exchange Commission (SEC); 2) a certified audited financial statement, accompanied by the report of an independent certified public accountant, that is used for credit purposes, reporting to shareholders, or any other substantial non-tax purpose; or 3) a financial statement required to be provided to the federal or a state government, or any other federal or state agency (other than the SEC or IRS). The regulations allow taxpayers that are members of consolidated groups for financial statement purposes, but not for federal income tax purposes, to use the applicable financial statements and accounting procedures of their consolidated group to qualify for the de minimis rule.

The de minimis safe harbor is an irrevocable annual election made on a taxpayer's timely filed original federal tax return.

Materials and Supplies [Reg. §1.162-3]

The final regulations define materials and supplies as property that is used or consumed in a taxpayer's operations that is not inventory and is a component acquired to maintain, repair or improve a unit of tangible property that is owned, leased or serviced by the taxpayer. Furthermore, the definition includes items, such as water and fuel, that are expected to be consumed in 12 months or less and any unit of property that has a useful life of 12 months or

less. The definition is also expanded to include any unit of property that has a cost of \$200 or less. Materials and supplies are deductible at different times depending on how the items are categorized (incidental – deduct in the year purchased; non-incidental – deduct when used or consumed; rotatable, temporary or emergency standby spare parts – deduct when disposed). The regulations, however, provide for an optional election to capitalize and depreciate rotatable, temporary or emergency stand-by spare parts. Rotatable spare parts (for example, an aircraft engine) are acquired for installation on a unit of property (see Unit of Property section below), removable from that unit of property, generally repaired or improved, and either reinstalled on the same or other property or stored for later installation. If the de minimis safe harbor rule under Reg. §1.263(a)-1(f) is elected (see Acquisition and Production of Tangible Property section above), then the de minimis rule must be utilized for all materials and supplies that meet its requirements.

Improvements [Reg. §1.263(a)-3]

In general, any payment made related to a unit of property (see Unit of Property section below) is deductible if the purpose of the payment is to maintain the property in its useful order. However, the final regulations allow taxpayers to make an annual election to capitalize amounts paid during the taxable year for repairs and maintenance of tangible property that are capitalized on the taxpayer's books and records (see Repairs and Maintenance section below).

If the intent is to improve the property by extending its useful life and/or improving its quality or productivity, then costs for such improvements must be capitalized. A unit of property is considered "improved" if a payment results in the property's betterment, restoration or adaptation to a new or different use.

The regulations do, however, permit taxpayers with average annual gross receipts for the three preceding taxable years of \$10 million or less to elect not to capitalize improvements to an eligible building property if the total amount paid during the taxable year for repairs, maintenance, improvements and similar activities performed on the building does not exceed the lesser of \$10,000 or 2% of the unadjusted basis (generally cost) of the building. Under the Small Taxpayer Safe Harbor Election, an eligible building property is one that is owned or leased by a qualifying taxpayer and has an unadjusted basis of \$1 million or less.

The regulations also provide a routine maintenance safe harbor rule which holds that certain qualifying cyclical maintenance activities are not required to be capitalized. An activity qualifies for the safe harbor if, at the time a unit of property is placed in service, the taxpayer reasonably expects to perform the activity more than once during the property's Alternative Depreciation System (ADS) class life and the activity keeps the property in its ordinarily efficient operating condition. For building property, the taxpayer must reasonably expect to perform the activity more than once during a ten year period from the placed-in-service date. Routine maintenance activities include the inspection, cleaning and testing of a unit of property (including building structure or each building system) and the replacement of damaged or worn parts with comparable and commercially available replacement parts.

Unit of Property [Reg. §1.263(a)-3(e)]

One of the most significant changes made by the regulations (including temporary regulations) is providing a clearer definition of what constitutes a "unit of property." Understanding "unit of property" is extremely crucial since it is a fundamental concept in applying the capitalization standards.

In the case of a building, each building and its structural components will constitute a single unit of property; however, the regulations require taxpayers to apply the improvement standards separately to each component identified as a "building system". The regulations define building systems to include 1) the heating, ventilation and air conditioning (HVAC) systems; 2) the plumbing systems; 3) the electrical systems; 4) all escalators; 5) all elevators; 6) the fire protection and alarm systems; 7) the security systems; 8) the gas distribution systems; and 9) any other systems identified in future published guidance.

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The AICPA's SSARS Clarity Project: Focusing in on Review and Compilation Services

In 2011, the AICPA/ASB completed its clarification on U.S. generally accepted auditing standards ("U.S. GAAS"). This involved redrafting and reformatting the auditing standards for easier comprehension and use, in addition to the convergence of U.S. GAAS with International Standards on Auditing.

The AICPA/ARSC SSARS Clarity Project

In May 2010, the AICPA's Accounting and Review Services Committee ("AICPA/ARSC") approved a similar project to clarify the existing review and compilation standards included in the Statements on Standards for Accounting and Review Services ("SSARS"). The AICPA/ARSC's SSARS Clarity Project was undertaken in an effort to make review and compilation standards easier to read, understand and apply. In an effort for professional standards to be consistent with one another, the AICPA/ARSC will be using similar conventions used to reformat/redraft the auditing standards. One notable difference between the clarification of the review/compilation and auditing standards is that SSARS will not be converged with international standards. The AICPA/ARSC expects to complete the SSARS Clarity Project in the second half of 2014.

AICPA/ARSC SSARS Clarity Drafting Convention/Formatting

The reformatting/redrafting of review and compilation standards are anticipated to follow these guidelines:

- ◆ Establish objectives for each clarified AR section
- ◆ Include a definitions section, where appropriate, in each clarified AR section
- ◆ Separate requirements from application and other explanatory material
- ◆ Numbering application/other explanatory material paragraphs using an A-prefix which will follow the requirements section
- ◆ Use formatting techniques, such as bulleted lists, to facilitate understanding

Review Standards

At this point, two proposed SSARS, using the drafting provisions noted above, have been issued:

- Review of Financial Statements (AR section 90)
- Review of Financial Statements—Special Considerations (AR section 95)

Based on the exposure drafts issued by the AICPA/ARSC, changes are expected in the following areas:

- ◆ Will require the use of headings throughout the accountant's review report
- ◆ Emphasis-of-matter or other-matter paragraph will be required in certain situations
- ◆ Requirement to obtain a signed engagement letter
- ◆ Introduces the term "special purpose framework" (includes, cash, tax and other bases of accounting); new requirements with respect to reporting on financial statements prepared in accordance with a special purpose framework

Compilation Standards

An exposure draft on compilation standards had been previously issued in June, 2012, but after reviewing comment letters received, the AICPA/ARSC had voted to withdraw the draft in January, 2013. Addressing the concerns that were cited in the comment letters, the AICPA/ARSC will be exposing for comment the following three proposed SSARS:

- Association with Financial Statements
- Preparation of Financial Statements
- Compilation Engagements

The exposure drafts are expected to be issued in October/November 2013. Changes are anticipated in the following areas:

- ◆ Elimination of the submission requirement. Accountants will no longer be required, at a minimum, to "compile" financial statements; compilation standards would apply when an accountant is "engaged" to perform a compilation
- ◆ When engaged, a compilation report will be required in all circumstances; the "management use only" exception will be eliminated
- ◆ Changes to the language used in the compilation report
- ◆ Requirement to obtain a signed engagement letter

Effective Date

The effective date of the clarified review and compilation standards is anticipated to be for periods ending on or after December 15, 2015.

Kakimoto & Nagashima LLP is dedicated to our clients and their success. We are also committed to professional standards and assisting our clients to understand the new and significant changes in those standards. If you should have any questions or concerns, please do not hesitate to contact us.◆

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For example, an expenditure related to an HVAC system may not necessarily result in a betterment or restoration to the building as a whole; however, if the expenditures improve the HVAC system, the cost must be capitalized as though it were an improvement made to the entire building.

For tangible property other than buildings, components that are "functionally interdependent" comprise a single unit of property. Components are functionally interdependent if placing one component in service depends on placing another component in service. In the case of plant property, a unit of property is each component or group of components that performs a discrete and major function or operation within the functionally interdependent machinery or equipment.

Repairs and Maintenance [Reg. §1.162-4, Reg. §1.263(a)-3(n)]

The regulations specifically state that any payments made for repairs and maintenance to tangible property can be expensed if the payments are not otherwise required to be capitalized under the tax law.

However, as mentioned in the Improvement section above, a taxpayer may elect to capitalize otherwise deductible repairs that are capitalized on its books and records. It is important to note, however, that this election does not apply to amounts expensed for book purposes, including those expensed under the de minimis rule.

The election to capitalize repair and maintenance costs is an irrevocable annual election made on a taxpayer's timely filed original federal tax return.

Dispositions [Prop. Reg. §1.168(i)-8]

As noted in the Overview section above, on the same day the final regulations were issued, the Treasury and the IRS also issued proposed regulations which address dispositions of property depreciable under MACRS. The proposed regulations will affect all taxpayers that dispose of MACRS property (most property placed in service after December 31, 1986). Under the proposed regulations, the disposition rules apply to a partial disposition of an asset (for example, the disposition of a building's roof or a portion of the roof). Therefore, the rule allows taxpayers to recognize gain or loss upon the disposition of a structural component (or portion thereof) of a building or upon the disposition of a component (or portion thereof) of any other asset. In many cases, the partial disposition rules are elective; however, under certain cases (such as dispositions as a result of a casualty event, certain non-recognition transactions, or a sale of a portion of the asset), these rules are mandatory.

Conclusion

The final regulations will likely bring both relief and concern to the tax community. On one hand, the regulations attempt to reduce the administrative burden on taxpayers by allowing several areas in which the taxpayer can treat expenditures for tax purposes in the same way they treat expenditures on their

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Cloud Computing

In cloud computing, the word "cloud" (also phrased as "the cloud") is used as a metaphor for "the Internet," so the phrase cloud computing means a type of Internet-based computing, where different services (such as servers, storage and applications) are delivered to an organization's computers and devices through the Internet.

Cloud computing is an on-demand service that is gaining mass appeal in corporate data centers. The cloud enables the data center to operate like the Internet and computing resources to be accessed and shared as virtual resources in a secure and scalable manner. Like most technologies, trends start in the enterprise and shift to adoption by small business owners.

In its most simple description, cloud computing is taking services ("cloud services") and moving them outside an organization's firewall on shared systems. Applications and services are accessed via the Web, instead of your hard drive. In cloud computing, the services are delivered and used over the Internet and are paid for by cloud customer (your business), typically on an "as-needed, pay-per-use" business model. The cloud infrastructure is maintained by the cloud provider, not the individual cloud customer.

Cloud computing networks are large groups of servers and cloud service providers that usually take advantage of low-cost computing technology, with specialized connections to spread data-processing chores across them. This shared IT infrastructure contains large pools of systems that are linked together. Virtualization techniques are often used to maximize the power of cloud computing.

There's a good chance you've already used some form of cloud computing. If you have an e-mail account with a Web-based e-mail service like Hotmail, Yahoo! Mail or Gmail, then you've had some experience with cloud computing. Instead of running an e-mail program on your computer, you log in to a Web e-mail account remotely. The software and storage for your account doesn't exist on your computer -- it's on the service's computer cloud. While this example may describe cloud computing in its simplest form, just imagine what can be possible once your corporate applications are put into the "cloud".

Small Business Cloud Computing

For a small and medium size business (SMB), the benefits of cloud computing is currently driving adoption. In the SMB sector there is often a lack of time and financial resources to purchase, deploy and maintain an infrastructure (e.g. the software, server and storage). In cloud computing, small businesses can access these resources using an Internet connection and Web browser. You can expand (or shrink) services as your business needs change. The common pay-as-you-go subscription model is designed to let SMBs easily add or remove services and you typically will only pay for what you use.

From an emerging technology to a mainstream system – cloud computing has come a long way since it first appeared on the business tech scene. In fact, a recent report has revealed that the number of small firms running their back office services on a cloud-based system has more than doubled in the last two years – now hitting 20%. This means small and mid-sized businesses are rapidly equipping themselves with the tools they need to rapidly expand and compete with their larger counterparts.

The shift is no real surprise; the cloud offers reduced costs for business' IT infrastructure, as well as increased scalability, which can allow more straightforward expansion into new markets. Now that concerns over security and data compliance have been put to rest, we can expect more and more ambitious businesses to adopt cloud, increasingly the de facto platform for new businesses, replacing the traditional and now archaic on-premise environments of old.

Benefits of Cloud Computing

1. **Achieve economies of scale** – increase volume output or productivity with fewer people. Your cost per unit, project or product plummets.

2. **Reduce spending on technology infrastructure.** Maintain easy access to your information with minimal upfront spending. Pay as you go (weekly, quarterly or yearly), based on demand.
3. **Globalize your workforce on the cheap.** People worldwide can access the cloud, provided they have an Internet connection.
4. **Streamline processes.** Get more work done in less time with less people.
5. **Reduce capital costs.** There's no need to spend big money on hardware, software or licensing fees.
6. **Improve accessibility.** You have access anytime, anywhere, making your life so much easier!
7. **Monitor projects more effectively.** Stay within budget and ahead of completion cycle times.
8. **Less personnel training is needed.** It takes fewer people to do more work on a cloud, with a minimal learning curve on hardware and software issues.
9. **Minimize licensing new software.** Stretch and grow without the need to buy expensive software licenses or programs.
10. **Improve flexibility.** You can change direction without serious "people" or "financial" issues at stake.

We here at Kakimoto & Nagashima LLP have utilized cloud computing to become a more efficient workforce since 2008. Is cloud computing right for your business? Give us a call and we can help you determine the right solution.♦

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books (capitalize or deduct). The regulations also provide clarity regarding the treatment of certain expenditures as deductible repairs or capital improvements. On the other hand, although simplified, the regulations remain complex overall and can be construed as too burdensome to some companies, making compliance extremely difficult for such businesses.

As the January 1, 2014 effective date is fast approaching, the regulations will require taxpayers to quickly re-evaluate their procedures in determining how property expenditures will be treated for tax purposes. Among the items taxpayers will want to consider are the following: establishing a written book minimum capitalization policy by no later than the beginning of the 2014 tax year and obtaining an "applicable financial statement" in order to fully utilize the de minimis rule regarding amounts paid for the acquisition of property; determining whether any recurring restorations performed on particular units of property qualify to be expensed under the routine maintenance safe harbor rule; and electing to capitalize any repair and maintenance expenditures for tax purposes that the taxpayer capitalizes on its books and records. Taxpayers with average annual gross receipts of \$10 million or less may also wish to consider expensing building improvement costs if eligible under the Small Taxpayer Safe Harbor Election.

Please note that this article does not include all of the provisions included in the final tangible property/repair regulations. Should you have questions pertaining to these regulations, please contact the office of Kakimoto & Nagashima, LLP at (310) 320-2700.♦