Kakimoto & Nagashima LLP
Certified Public Accountants
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NEWSLETTER

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Summary of Articles

New Revenue Recognition Standard Issued

In May 2014, the U.S Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2014-09, "Revenue from Contracts with Customers", the result of a joint project with the International Accounting Standards Board. This comprehensive new revenue recognition standard could result in considerable changes for certain companies to their accounting and financial reporting. Accordingly, all companies should begin to assess the impact to enable them to determine what changes to systems, processes, and policies would be needed to implement the new accounting standard.

Partial Sales and Use Tax Exemption for Manufacturing and Research and Development Property

Effective July 1, 2014, taxpayers may be eligible to take advantage of a partial exemption of sales and use tax on certain purchases and leases of manufacturing and research and development equipment. Please see this article for a discussion of the exemption.

Is the Surface Pro 3 the Tablet That Can Replace Your Laptop?

This is the statement that Microsoft is touting for its newly released Surface Pro 3, a bold statement considering the popularity of other tablets out there in the market today. Microsoft's market share for tablets is currently in 3rd place, behind the ever popular Apple iPad line and Android, the latter being the industry leader. Let's just see if Microsoft can back up its words.

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

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Revenue Recognition – Top Line Changes: A FASB/IASB Joint Project

In May 2014, the U.S Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2014-09, "Revenue from Contracts with Customers" ("ASU 2014-09"), the result of a joint project with the International Accounting Standards Board. This comprehensive new revenue recognition standard will result in significant changes to accounting and financial reporting. The standard will also eliminate most industry specific revenue recognition guidance. Many companies will need to use more judgment in the application of the new standard than what is required under current U.S. GAAP.

The objective of the new standard is to establish the principles to report useful information to users of financial statements about the nature, timing, and uncertainty of revenue relating to customer contracts. ASU 2014-09 establishes a principle-based revenue recognition framework which includes: a five-step revenue recognition model, improvement of the comparability of revenue recognition practices over industries/entities, and expansion/improvement revenue disclosures.

Revenue Recognition Model

The core principle of the new standard is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

ASU 2014-09 establishes a five-step model to recognize revenue as follows:

- Identify the contract with a customer
- Identify the performance obligations in the contract
- Determine the transaction price
- Allocate the transaction price to the performance obligations in the contract
- Recognize revenue when (or as) the entity satisfies a performance obligation

The new standard generally does not apply to: lease contracts, insurance contracts, certain financial instruments/other contractual rights or obligations, guarantees (other than product or service warranties), and certain nonmonetary exchanges.

Disclosure Requirements

The goal of the new disclosure requirements is to enable an entity to disclose an adequate amount of information for users to understand the nature, timing, and uncertainty of revenue and cash flows arising from customer contracts. New disclosure requirements are more comprehensive than those required by current U.S. GAAP and include qualitative and quantitative information regarding the following:

- Contracts with customers
- Significant judgments/changes in judgments made in applying the guidance to those contracts
- Assets recognized from costs to obtain/fulfill a contract

There are certain exceptions for nonpublic entities.

When Will ASU 2014-09 Be Effective?

Public Entities

Public entities are required to apply ASU 2014-09 for annual reporting periods beginning after December 15, 2016, including interim reporting periods therein; early application is not permitted.

Nonpublic Entities

Nonpublic entities are required to adopt ASU 2014-09 for annual reporting periods beginning after December 15, 2017 and interim periods within annual periods beginning after December 15, 2018; early application is permitted.

Transition Methods

ASU 2014-09 allows for two transition methods: full retrospective and modified retrospective methods.

Full Retrospective Method

This approach requires full retrospective application of the new guidance to all periods presented; certain optional practical expedients will be available.

Modified Retrospective Method

The modified retrospective method would allow entities to apply the new standard to all existing contracts as of the effective date with a cumulative adjustment to the opening balance of retained earnings and to all new contracts.

Looking Forward

Virtually all companies will be affected by this standard. Companies should start giving thought to developing an implementation plan. Potential items to consider:

- Assessment of major revenue streams
- Updating accounting policies
- I/T systems/processes
- Legal considerations
- Financial reporting requirements
- Investor obligations – financial information user/Parent Company expectations
- Education/staff requirement
- Tax implications

We're Here to Help

We encourage our clients to begin planning for the effect of these changes, which would also likely have an impact on: controls/processes, information systems, operations/performance measurements and personnel. Please consult us for further information or to discuss the impact that this may have on your Company's future accounting and financial reporting needs. ♦

Partial Sales and Use Tax Exemption for Manufacturing and Research and Development Property

Effective July 1, 2014, taxpayers may be eligible to take advantage of a partial exemption of sales and use tax on certain purchases and leases of manufacturing and research and development equipment which was signed into law by Governor Brown on July 11, 2013. The California Board of Equalization has approved a final draft of a proposed regulation which implements and explains the partial sales and use tax exemption. It is anticipated that the proposed regulation will receive final approval in September 2014 and when approved, will be effective retroactive to July 1, 2014. This article includes discussion of the provisions of the proposed regulation. The provisions of the proposed regulation are subject to change until final approval is received.

To be eligible for the partial exemption, the taxpayer must be a "qualified purchaser" (engaged in certain types of businesses) that purchases "qualified property". If eligible, the California sales tax rate will be reduced by 4.1875% (to 3.3125% based on the current state rate of 7.5%) for qualifying purchases and leases made from July 1, 2014 through December 31, 2016, and will be reduced by 3.9375% (to 3.5625%) for qualifying purchases made from January 1, 2017 through June 30, 2022. The exemption does not apply to local city, county or district taxes. For example, in Los Angeles the current combined state and local rate is 9%; therefore, after the exemption, the combined state and local rate for qualified property will be 4.8125% (9% less the exemption of 4.1875%). Qualified persons can purchase a maximum of $200 million of qualified property at the reduced sales tax rate each calendar year.

Qualified Purchaser

A purchaser who qualifies for the partial exemption is one that is "primarily engaged" in a manufacturing business activity described within Codes 3111 through 3399 of the North American Industry Classification System (NAICS), or in research and development activities described in NAICS Codes 541711 or 541712. NAICS Codes 3111 through 3399 include most manufacturing activity. NAICS Code 541711 encompasses research and development in biotechnology, while NAICS Code 541712 encompasses research and development in physical, engineering, and life sciences.

A qualified purchaser may be "primarily engaged" either as a legal entity or as an establishment within a legal entity. A purchaser is "primarily engaged", and therefore qualifies for the partial sales and use tax exemption as an entity, if the entity derived 50% or more of its gross revenue from, or expensed 50% or more of its operating expenses in, a business activity that falls under one of the business activity codes described above during the prior financial year. If the purchaser did not meet this 50% test in the financial year preceding the purchase of the property, the one-year period following the date of purchase of the property will be used instead.

In the case where the entity as a whole does not meet the 50% revenue or operating expense test described above, separate subdivisions of the entity referred to as "establishments" may individually meet one of the 50% tests and therefore qualify for the partial exemption. An establishment may also qualify for the exemption if, in the prior financial year, it allocates, assigns, or derives 50% or more of any of the following to a qualifying line of business: 1) employee salaries and wages, 2) value of production, or 3) number of employees.

An "establishment" is a location or combination of locations designated as a "cost center" or an "economic unit" by the taxpayer where a qualified activity is performed and for which the taxpayer maintains separate books and records that reflect financial data pertaining to the qualified activity. There may be more than one qualifying establishment within a legal entity.

Qualified Property

In general, the partial exemption applies to the sale of, and the storage, use, or other consumption in California of qualified tangible personal property purchased for use by a qualified purchaser to be used primarily in:

- Any stage of the manufacturing, processing, refining, fabricating, or recycling process, beginning at the point any raw materials are received by the qualifying purchaser and introduced into the process and ending at the point at which the manufacturing process has altered the tangible personal property to its completed form, including packaging, if required;
- Research and development; or
- Maintenance, repair, measuring, or testing of any property described above.

Qualified tangible personal property includes:

- Machinery and equipment;
- Devices used to operate or control the machinery, such as computers, data-processing equipment, and computer software;
- Repair and replacement parts with a useful life of one or more years;
- Tangible personal property used in pollution control; and
- Special purpose buildings and foundations used as an integral part of the manufacturing process, or that constitute a research or storage facility used during those processes.

Tangible personal property that does not qualify for the reduced sales and use tax rate includes:

- Consumables with a useful life of less than one year;
- Furniture, inventory, and equipment used in the extraction process, or equipment used to store finished products that have completed the manufacturing process; or
- Tangible personal property used primarily in administration, general management, or marketing.

In addition to the $200 million limit described above, the reduced sales and use tax rate also does not apply to the sale or storage, use, or other consumption of property that, within one year from the date of purchase, is removed from California, converted from an exempt use to some other use not qualifying for exemption, or not used in a manner qualifying for exemption.

Partial Exemption Certificate

Qualified purchasers that purchase or lease qualified tangible personal property from an in-state retailer, or an out-of-state retailer obligated to collect California use tax must provide the retailer with a partial exemption certificate in order for the retailer to claim the partial exemption. A retailer that takes a timely partial exemption in the proper form and in good faith is relieved from the liability for the exempted portion of the sales or use tax. A certificate is considered to be timely if taken by the retailer at any time before billing the purchaser for the property, within the retailer's normal billing or payment cycle, or at or prior to delivery of the property to the purchaser. The retailer must retain each partial exemption certificate received from a qualified purchaser for no less than four years from the date on which the retailer claims a partial exemption per the certificate.

California has issued exemption certificate forms that may be used as partial exemption certificates; however, any document, such as a letter or purchase order, that is timely provided by the purchaser to the seller will be regarded as a partial exemption certificate for the sale or purchase of qualified property as long as it contains the same information required on the partial exemption certificate provided by the state.

Instead of issuing a partial exemption certificate for each individual transaction, a qualified purchaser may issue a "blanket" partial exemption certificate for future purposes. In absence of evidence to the contrary, a retailer may accept an otherwise valid blanket partial exemption certificate in good faith if the certificate complies with all requirements.

Under normal circumstances, the retailer is liable for payment of sales tax to the state of California. However, the purchaser becomes liable for the tax, with applicable interest, in the following cases:

- The purchaser issued a partial exemption certificate at the time of the purchase based on the expectation that the purchaser will meet the requirements of the regulation, but ultimately did not; or
- The purchaser certifies in writing to the seller that property purchased

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Is the Surface Pro 3 the Tablet That Can Replace Your Laptop?

If you're currently in the market for a new laptop, then perhaps the Surface Pro 3 should be on your list to review.

Microsoft's third entry into the crowded tablet market represents a huge improvement over its earlier efforts. This time around, their attempt in creating a tablet that replaces a laptop has come even closer to fruition.

Last fall's Surface Pro 2, released in concurrence with its Windows 8.1 update, was just a minor upgrade that added a Haswell processor which improved battery life. They also updated the trademark Surface kickstand a second angle.

The Surface Pro 3, on the other hand, is a complete redesign. It takes what was learned from the prior two iterations and fixes some of its flaws to create an almost brand new product while still retaining the same vision Microsoft had for its signature tablet.

Like its predecessors, the Surface Pro 3 has its quirks. How would you describe this device? Is it a tablet striving to be laptop? Or, vice versa, a laptop striving to be a tablet? It's so hard to categorize that it eventually will be compared to both tablets and laptops alike. By doing so, reviews will focus more on what kind of product it isn't, rather than what it is.

New Features of the Surface Pro 3
For the most part, the new model continues with key design features as seen in previous Surface Pro versions. First and foremost, it's a tablet, but it has the same components of a premium Windows 8.1 Ultrabook. It features a fourth-generation (Haswell) Intel Core i3/i5/i7 processor, a choice of 4 or 8 GB of LPDDR3 memory, and up to 512 GB of flash storage.

The Surface Pro 3's physical dimensions are now dramatically different from its predecessors. At 9.1mm, it's just as slim as most current smartphones and 4.4mm thinner than the Surface Pro 2. The Surface Pro 3 increases to a 12-inch screen with a 3:2 aspect ratio and a resolution of 2160x1440. That gives you a screen that is about 40 percent larger than its predecessor. Amazingly, despite its much larger screen, the Surface Pro 3 is actually 120g lighter than the Surface Pro 2. The combination of lighter weight, a thinner profile, and a well-balanced shape means the Surface Pro 3 is considerably more transportable than older models.

It contains the same single USB 3.0 port, mini-DisplayPort adapter, and Micro-SDXC card slot. The wireless adapter has been upgraded to 802.11ac. Other upgrades are the front and rear 5MP cameras and the digital compass. The TPM 2.0 chip is upgraded from the TPM 1.3 chip in prior models. The power connector has been redesigned, which is supposed to make it easier to attach as compared to the previous design.

The Surface Pro's trademark hinge can now be placed in a full range of positions rather than the one or two from before. A redesign of the included pen has also been made. It's an active battery-powered device with a top button that you can click to wake the device and open the OneNote app, this is a very convenient feature, should you be a user that utilizes this application.

The Surface Pro 3 contains a 42Wh battery which Microsoft claims will last up to nine hours while performing general functions. They also say it will last 20 percent longer than the Surface Pro 2 while performing similar tasks. Under normal usage scenarios, the Surface Pro 3 could easily last all day.

Using the Surface Pro 3 as a tablet
At 1.76 pounds, the Surface Pro 3 is just slightly higher in weight than the original iPad, and only about four ounces heavier than the current generation iPads. The weight difference from the Surface Pro 2 enables it to be more comfortable in the hand and much easier to use as a tablet. The larger screen used in portrait mode also helps in its readability when being used as an e-book reader. This is an improvement from before and places it on par with other tablets of its size.

Using the Surface Pro 3 as a laptop
In its television advertisements, Microsoft touts the Surface Pro 3 as "the tablet that can replace your laptop."

A laptop has the name "laptop" because its original intention was to be used on your lap. A conventional laptop has a rigid base and a hinge that allows you to easily balance the device on your lap while working. Due to the unconventional shape of the Surface Pro 3, while it is possible to use on your lap, it might take some maneuvering to maintain a comfortable position to do so. For most users, this is not a deal breaker, as it will be used on a hard surface or tabletop, anyway. Other than this issue, when combined with the optional keyboard cover, it works quite well as a laptop.

Using the Surface Pro 3 as a desktop replacement
This is the biggest question most mobile users will ask. The answer is: only if you were to purchase the $199 docking station along with it. The docking station includes its own power supply, 2 USB 2.0 ports, 3 USB 3.0 ports, a wired Gigabit Ethernet port, and a mini-DisplayPort adaptor. Using the Surface Pro 3 in conjunction with the docking station enables the use of a full keyboard, mouse, large monitor, and external peripherals. For these reasons, the docking station is a must-have accessory for mobile professionals.

Final thoughts:
The changes that Microsoft has implemented in the Surface Pro 3 are a major improvement over its previous two iterations, so much so, that we here at Kakimoto & Nagashima LLP are in the process of procuring it for our future use. Our tests of using the Surface Pro 2 in our work environment were pleasurable and we look forward to implementing the Surface Pro 3. If our readers are interested in implementing it into their own workplace, please contact us and we will be happy to help.♦

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qualifies for the partial exemption, and the purchaser then exceeds the $200 million limitation or within one year from the date of purchase, the purchaser removes that property from California, converts that property for use in a manner not qualifying for the exemption, or uses that property in a manner not qualifying for the exemption.

If the purchaser pays the full amount of tax at the time of purchase and later becomes aware that the requirements to claim the partial exemption are met, the purchaser may issue a partial exemption certificate to the retailer, who may then file a claim for refund.

Please note that this article does not include all of the provisions related to