KAKIMOTO AND CO.

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Federal

Transfer Pricine - Final Rei!ulations

The transfer pricing tax law (Internal Revenue Code section 482) was enacted to prevent the shifting of income and deductions between related parties or controlled parties for the purpose of avoiding or reducing U.S. income taxes. The pricing of inventory is one way in which a U.S. corporation could shift income out of the U.S.

The primary purpose of the transfer pricing tax law is to develop a transfer pricing methodology in order to detemi'me the proper "ann's length price" for inventory transferred between controlled parties (meeting the ann's length standard). A secondary purpose of the law is to produce adequate documentation to prevent any potential valuation penalties as a result of any Internal Revenue Service adjustments made under a transfer pricing audit (meeting the documentation requirements).

The artn's length standard is used to determine the appropriate price for goods transferred between controlled taxpayers. This standard is met if the price is consistent with the amount that would be charged between uncontrolled parties in comparable transactions under comparable circumstances.

The term "controlled" includes any kind of control whether direct or indirect legally enforceable, and however exercised. Where two parties have a common interest in shifting income/deductions, control is considered to exist. Although the terms "controlled party" and "related party" are often used interchangeably in regards to transfer pricing, the broad definition of control can include parties that may not be related by ownership.

An uncontrolled party is one that is acting in its own self interest.

The Income Tax Regulations provide that in order to meet the arm's length standard all factors of the controlled and uncontrolled sale must be comparable. The factors which must be comparable include the following:

1) Physical products
2) Economic and market conditions of the transaction
1) The contractual terms of the transaction
2) The functions performed by each party
3) The risks assumed by each party

The regulations provide for the following methods to determine the arm's length price of inventory:

1) Comparable Uncontrolled Price (CUP)

2) Resale Price Method (RPM)

3) Cost Plus Method (C+M)

4) Comparable Profits Method (CPI)

5) Profit Split Method (PSM)

6) Other Method

The method to use is the method that provides the most reliable rather than accurate result. A method will be considered the best method if that method provides the following:

1) The transactions used to apply the method have a higher degree of comparability than the other methods.

2) The data is more complete and accurate than the data available under the other methods, and the assumptions under the, method have greater soundness and reliability.

The new regulations offer more flexibility in using the various methods. However, using a particular method does not guarantee that the IRS will accept the method in determining a valid arm's length price. For greater assurance, a taxpayer may want to determine the arm's length price under two or more methods to determine if consistent results are achieved.

The CUP method generally provides the most accurate arm's length price. However, close comparable transactions are often difficult to find. The CUP method will be used when the controlled party either buys or sells the same or similar products to both controlled and uncontrolled parties

The RPM method is used when the controlled taxpayer (reseller) does not add substantially to the value of the product by physical alteration. Packaging, repackaging, labeling, or minor assembly does not constitute physical alteration. The reseller must purchase and sell products in an uncontrolled transaction.

The C+M method is used when the controlled party manufactures the goods sold and sells to both controlled and uncontrolled parties.

The CPM method evaluates whether the amount charged in a controlled transaction is arm's length based on objective measures of profitability derived from uncontrolled taxpayers that engage in similar business activities under similar circumstances.

The arm's length range method determines a pricing range for which the transfer price should fall within. An arm's length range is determined by first selecting an appropriate method (CUP, RPM, etc.). Two or more uncontrolled parties are selected. An arm's length price is determined for each uncontrolled party. These prices determine the range for the transfer pricing.

California

Amendment on Water's - Edge

As you may already know, the water's-edge election fee has been eliminated effective for tax years beginning in 1994 due to the recent amendment on water's-edge regulation. Also, the water's - edge contract term has been extended from five years to seven years, and reelection of water's-edge is necessary to be in compliance with this new regulation. Should you have any questions, please do not hesitate to contact us.

Other

Our Services

Kakimoto and Co. provides excellent accounting, tax and management consulting services. Our professional staff possess the technical experience, knowledge and resources to tackle complex international tax issues and difficult accounting areas, in addition to providing a wide range of other diversified services. Our commitment to quality and personal approach to services has resulted in the growth of our client base to include small companies as well as multinational corporations in a broad range of industries.

The season for individual tax returns is drawing near. For the individual and corporate tax compliance requirements, our entire staff, consisting of approximately 20 professionals, participates in the preparation of the tax returns. We have the capability o preparing tax returns for any state; tax returns are processed in our office using the same advanced software used by many of the Big 6 accounting firms.

We specialize in the preparation of individual income tax returns for Japanese foreign nationals who are assigned to U.S. offices for short- or long-term durations. We are also available to consult with you as to your tax requirements and planning; each return is prepared on an individual basis with consideration given to any tax benefits from the U.S. - Japan tax treaty, as well as U.S. income tax laws and regulations. Of our current clients, several are former Big 6 clients who are taking advantage of our competitive fees which are generally 30 to 40% less than those charged by most Big 6 accounting firms
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Should you have any questions or are interested in the services provided by our company, please do not hesitate to contact Mr. Gerald Kakimoto or Ms. Yuko Okuda.

Kakimoto and Co.

Certified Public Accountants

1515 West 190th Street, Suite 208
Gardena, California 90248-4308
Phone (310)715-9100
Fax (310)715-9830

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