



**KAKIMOTO AND CO.**  
CERTIFIED PUBLIC ACCOUNTANTS

---

**KAKIMOTO AND CO. NEWSLETTER**

July 1994

**Federal Income Tax**

**Business Meals and Entertainment**

From the first day of your new tax year beginning in 1994, your tax deduction for most meals and entertainment expenses will be limited to 50% (formerly 80%) of the cost. There are several exceptions to this 50% limitation. Therefore, it is important to identify and segregate the meal and entertainment expenses which are not subject to the 50% limitation.

The expenses which are not subject to the 50% limitation include the following items:

1. Traditional recreational expenses: This includes year end parties, annual recreational events, etc. which are provided to employees.
2. De minimus expenses for employees: These are fringe benefits provided to employees which are both low in value and infrequent. This includes occasional recreational expenses for employees such as picnics or parties, coffee and donuts, or occasional meals provided to employees due to overtime.
3. Expenses treated as compensation to an employee: For example, fringe benefits provided to an employee such as a golf club membership must be treated as compensation to the employee rather than meals and entertainment.
4. Meals and entertainment made available to the general public. This includes expenses such as samples, food, or entertainment made available to the public for promotional purposes.
5. Tickets to attend certain charitable sporting events: To qualify, the event must be organized primarily for the benefit of a tax-exempt charity, 100% of the net proceeds must be contributed to the charity, and the event must use volunteers for substantially all work performed in carrying out the event.

We recommend that you segregate the above expenses in a separate account, so that these expenses will not be subject to the 50% limitation on your tax returns.

### Substantiation of Entertainment Expenses

The IRS will not allow a deduction for entertainment expenses if adequate records are not maintained. Similar recordkeeping is also required for business gifts. In order to meet the adequate records requirement, the following evidence must be maintained:

1. Receipts or bills and cancelled checks supporting the expense.
2. An account book, log, diary, or other statement of the entertainment expense. These records must include the following information (if not shown on the receipts or bills):
  - a) The amount of each separate expenditure, or reference to the appropriate receipts.
  - b) The date the entertainment took place.
  - c) The name and location where the entertainment took place.
  - d) The business reason for the entertainment, or the nature of the business benefit expected to be derived.
  - e) The nature of any business discussion or activity that took place.
  - f) The name, occupation or title, and relationship of the person or persons being entertained.

The IRS can deny a deduction if any of the above items are not documented or proven. For example, the IRS will disallow an entertainment deduction if you do not provide a business reason for the expense. To avoid any denial of deductions in the event of an audit, we suggest that you consistently record the above information for your entertainment and business gift expenses.

### California Income Tax

#### CA Unitary Tax

On June 20, 1994, the Supreme Court upheld California's worldwide combined taxing method and rejected the request for a state tax refund sought by Barclays Bank and other multinational corporations. This has put an end to the court battle in favor of the Franchise Tax Board. However, the decision probably won't have much immediate impact because California has already repealed the water's-edge fee last October due to the pressure from British government. Rather, California is at disadvantage under the current law because since the alternative water's-edge election method has been enacted in 1988, multinational corporations use the worldwide combined method only when it is beneficial for them. According to the Wall Street Journal, California is losing as much as \$125 million a year.

The states currently imposing worldwide unitary method similar to that of California are Alaska, Idaho, Montana and North Dakota.

## Independent Contractors

Although the laws regarding independent contractors have not changed much in recent years, different definitions of what an independent contractor is still remain. The major cause of these differences is that the rules regarding independent contractors are very ambiguous. To make the independent contractor issue more confusing, federal and California laws are similar in certain cases, slightly different in other cases, and in some instances there are no similarities at all.

The IRS bases its classification of independent contractors on a list of twenty questions on the relationship between the employer and the contractor/employee. California has additional factors which it considers in determining the independent contractor classification. Laws are being proposed for both federal and California which would attempt to make more employees out of possible independent contractor situations.

Both the IRS and EDD are conducting payroll audits. According to the Wall Street Journal, IRS agents have assessed more than \$500 million in back taxes and penalties since 1988. According to the Los Angeles Times, the EDD has more than doubled the number of payroll tax audits in recent years.

Important actions that can be taken when hiring an independent contractor are as follows:

1. If possible, make sure that the independent contractor is incorporated and make all payments to the corporation.
2. Have a written agreement between the employer and contractor supporting an independent contractor relationship. The agreement should have enough factors to support the independent contractor relationship and the agreement should be followed.
3. Perform self-audits of independent contractor situations and make adjustments whenever necessary to support the independent contractor relationship.

**Kakimoto and Co.**  
1515 W. 190th St.  
Suite 208  
Gardena, CA 90248  
Tel (310) 715-9100  
Fax (310) 715-9830