KAKIMOTO AND CO.
CERTIFIED PUBLIC ACCOUNTANTS

1996 STANDARD MILEAGE RATE

The IRS has provided the optional standard mileage rates to use in computing the deductible costs paid after 1995 in connection with the operation of passenger automobiles for business purposes. The standard mileage rate for business use of autos during 1996 will be 31 cents per mile. Taxpayers may base their deduction on either the standard mileage rate (plus business-associated parking fees, tolls, and, to the extent allowable, interest, and taxes) or the actual expenses that they incurred for the business use of an auto.

Employers may use the standard mileage rate when computing payments for employee's auto expenses incurred under a reimbursement or expense allowance arrangement and, thereby, substantiate the amount of such expenses, if the accountable plan requirements are satisfied. Accountable plan requirements are met when (1) the plan provides for reimbursements, advances, or allowances for business expenses that are allowable as deductions for expenses paid or incurred by an employee in connection with his performance of services as an employee; (2) employees are required to substantiate to the employer the expenses covered by the arrangement; and (3) employees are required to return any amount in excess of the substantiated expenses covered under the plan.

RECORD RETENTION PERIOD

The IRS has the right to adjust a taxpayer's tax liability when the taxpayer does not provide adequate substantiation for amounts reported on the tax return. Although determining what is adequate substantiation is difficult, taxpayers are required to keep copies of all returns, schedules, records, and details that may relate to any claim for refund, credit, or abatement. Books or records must be maintained which enable the IRS to establish correct income, deductions, credits, or other matters affecting tax or information returns. These books or records must be available for review or inspection by revenue officers for so long as they may be material. Whether records are material depends on the item for which the record is kept and the time period available for the IRS to assess additional tax. The statute of limitations for the IRS to assess additional tax is generally three years.

Following is a list of records and the periods that taxpayers must retain these records:

1 Year:	Receiving sheets
2 Years:	Bank reconciliations Correspondence (general)
3 Years:	Bank statements Employment applications Insurance policies (expired)

Sales commission reports

7 Years:
- Accounts payable ledgers and schedules
- Accounts receivable ledgers and schedules
- Cash books
- Checks (canceled)
- Contracts, mortgages, notes, and leases (expired)
- Invoices
- Notes receivable ledgers and schedules
- Payroll records and summaries
- Personnel files (terminated)
- Purchase orders (purchasing department copy)
- Sales records
- Stock and bond certificates (canceled)
- Subsidiary ledgers
- Time books/cards
- Withholding tax statements

Permanently:
- Audit reports
- Capital stock and bond records (ledgers, transfer registers, stubs showing issues, record of interest coupons, options)
- Checks (canceled for important payments, i.e. taxes, purchases of property, special contracts, etc.)
- Contracts, mortgages, notes, and leases (still in effect)
- Correspondence (legal and important matters only)
- Deeds, mortgages, and bills of sale
- Depreciation schedules
- Minute books of directors, stockholders, by laws, and charter
- Property appraisals by outside appraisers
- Property records, including costs, depreciation reserves, year-end trial balances, depreciation schedules, blueprints, and plans

We recommend that all records be maintained at least three years to correspond with the statute of limitations.

With the increased emphasis on verifying reported tax liabilities, recordkeeping is becoming an expensive and monumental task. However, adequate care in retention of substantiating evidence is key to defending against an adverse redetermination of tax liability.

PLANNING MAXIMIZES DEDUCTION FOR TRAVEL EXPENSES

The rules and regulations governing the deductibility of travel expenses are complex and often controversial. As a prerequisite, an expense must be an ordinary and necessary cost of business and not a personal expense. Since many business-related expenses provide the taxpayer with

personal enjoyment and social benefits, deductibility will often hinge on the circumstances in which the expense was incurred.

Travel Expenses

Ordinary and necessary expenses of foreign and domestic travel while away from home in pursuit of a trade or business are deductible under IRC §162(a)(2). These travel costs include meals and lodging, and related expenditures, such as:

- Cost of getting to and from airports, stations, and hotels; and traveling between customers or business locations.
- Baggage charges.
- Reasonable laundry and cleaning charges.
- Telephone charges.
- Reasonable tips incident to any allowable expenses.
- Other similar expense incident to qualifying travel.

The Supreme Court has set out three prerequisites for the deduction. The expense must be:

1. Reasonable and necessary.

2. Incurred "while away from home."

3. Incurred in pursuit of business.

In addition, IRC §162 denies a deduction for travel expenses that are lavish or extravagant under the circumstances. For the expenses to be deductible, the taxpayer must be "away from home" which means a taxpayer to be away overnight.

<u>Travel Within the U.S.</u>

If travel is entirely for business purposes, all reasonable and necessary travel expenses(subject to the 50% limitation for meals and the 2%-of-AGI limitation for miscellaneous itemized deductions) can be deducted. If a taxpayer engages in both business and personal activities while at a travel destination, the taxpayer must determine the primary purpose of the trip and must identify which expenses are business and which are personal. The cost of travel to or from a destination within the U.S. only is deductible if the trip is primarily for business. The time spent on personal activities compared to the time spent on business activities is an important factor in determining the primary purpose of a trip. Regardless of whether the primary purpose of the trip is business or personal, business-related costs at the destination are deductible.

<u>Travel Outside the U.S.</u>

If a taxpayer travels outside the U.S. and the trip is primarily personal, no round-trip transportation expenses are deductible. If the entire time is spent on business, travel costs are deductible. When less than the entire time is spent on business, however, a special rule may limit the deduction for the round-trip transportation outside the U.S. to the portion of the trip that is business oriented. (The rules on deducting the costs of meals, lodging, etc., at the location are the

same for U.S. and foreign travel.) However, under Reg. §1.274-4, if any of the following tests is met, the disallowance rule does not apply for the transportation costs:

1. Travel outside the U.S. did not exceed one week.

2. Less than 25% of the time outside the U.S. was spent on non-business activities.

3. The individual did not have substantial control over arranging the trip. A self-employed individual is considered to have substantial control. An employee who travels under a reimbursement or expense arrangement is not considered to have substantial control.

4. The taxpayer can establish that taking a vacation was not a major consideration in making the trip.

If any of the four is met (and the trip is primarily for business), the taxpayer can deduct the full cost of the round-trip transportation in addition to other business-related expenses, including meals (50%) and lodging.

Travel expenses incurred for conventions, seminars, and similar business meetings are deductible if attendance will benefit or advance the interests of the taxpayer's trade or business. The deductibility of travel costs for spouses, dependents, and other companions accompanying the taxpayer on a business trip was virtually eliminated by the RRA '93. Travel expenses for spouses or other companions on the trip are not deductible unless all the following criteria are met:

1 The accompanying individual is an employee of the person paying or reimbursing the expenses.

2. The travel is for a bona fide business purpose.

3. The expenses would otherwise be deductible.

Conclusion

The rules for deducting travel costs are detailed and complex. Furthermore, since taxpayer abuse has been so prevalent, strict substantiation rules apply, and the IRS actively audits these deductions. Taxpayers who understand the requirements, however, can reap substantial tax savings through these deductions.

MOVING EXPENSES REIMBURSED OR PAID BY EMPLOYERS

Effective 1994, qualified moving expenses reimbursement by an employer (including payments made directly to a moving company) are treated as excludable fringe benefits. It is under the condition that the expenses would have been deductible by the employee if the employee paid them without reimbursements, and the employee did not deduct the expenses in a prior year.

These reimbursements are excludable from wages on form W-2 and are not subject to withhold income tax, Social security, or Medicare taxes. Such amounts must be reported as a separate item on form W-2 in box 13 using Code P. Any unqualified moving expenses reimbursed are included in wages and subject to withhold income tax, Social security, and Medicare tax. The employer is also required to issue the employee a statement showing the detailed breakdown of reimbursements using form 4782.

The qualified moving expenses include any expenditure or cost resulting from the following in connection with a change of residence:

- transportation of household goods personal property
- travel, including lodging during the period of travel from the former residence to the new place of residence

The following are not qualified moving expenses:

- Meals in connection with a move
- Traveling and lodging expenses incurred in searching for a new residence and while residing in temporary quarters in general location of the new principal place of work during the 30-day period after obtaining employment
- Expenses surrounding the purchase, sales or lease of a residence in connection with a move

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