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AUGUST TAX ALERTS

2009 Planning: Casualty Losses

If your home or other property is damaged as a result of a fire, earthquake, flood, hurricane, vandalism or similar event, you may be able to take a deduction for the loss. To be deductible as a casualty loss, the property must be damaged, lost or destroyed by a sudden, unexpected or unusual event. Therefore, using the term "tax planning" when referring to a casualty loss may seem inappropriate. However, if you have suffered a loss, there are several tax issues that you need to consider, such as determining the year in which to take the loss, the benefit of married individuals filing separately, valuation of the property, limitations and adjustments to the loss, and finally the tax consequences of any insurance reimbursements or recoveries.

A casualty loss is not allowed when the loss is gradual, such as insect damage to trees or water damage from a leaky roof. Therefore, damage or destruction resulting from progressive deterioration of property, such as beachfront erosion, would not qualify as a casualty loss. Loss of property through theft is deductible, but merely misplacing property is not.

The amount of a deduction is generally determined by the difference in the fair market value of the property before and after the loss, or by the cost of the necessary repairs to restore the property to its original condition. However, the amount of a loss cannot exceed your basis. Even with the destruction of a home or building, the loss is actually not a total loss since the land retains its value.

The amount of the loss is further reduced by any amounts covered by your insurance company, *regardless of whether or not you file a claim*. After the loss is determined and the insurance reimbursement is subtracted, the loss deduction is generally reduced by \$100 for each casualty, any casualty gains, and 10 percent of your adjusted gross income. If the loss occurred as a result of a federally declared disaster, these limitations may not apply and the loss may be included in your standard deduction if you do not itemize.

2009 Recovery Act: American Opportunity Education Credit

The American Recovery and Reinvestment Tax Act of 2009 (2009 Recovery Act), which provides billions of dollars of tax relief, includes a tax credit for individuals seeking a college education. This provision may benefit you as a parent of a child working toward a college degree.

There are many federal tax incentives available to help reduce the costs of higher education. Some of these incentives offer tax breaks for current educational expenses, such as the above-the-line deduction for qualified tuition and related expenses, and the Hope scholarship and lifetime learning credits. In lieu of claiming the Hope scholarship credit, the 2009 Recovery Act provides an "American Opportunity" tax credit for 2009 and 2010.

Eligible taxpayers may claim an American Opportunity tax credit up to \$2,500. The credit is determined as 100% of the first \$2,000, and 25% of the next \$2,000 of tuition and related expenses paid during the year. Forty percent of the credit is refundable.

Unlike the Hope credit, the American Opportunity credit is not limited to the first two years of post-secondary education. Also, the American Opportunity credit covers "course materials" such as books. This credit phases out for taxpayers with adjusted gross income in excess of \$80,000 (\$160,000 for married couples filing jointly).

Educational incentives can provide significant tax relief for families. The American Opportunity credit is one of several tax options related to saving and paying for higher education. Some may be more beneficial than others in your specific circumstances. Maximizing the benefits of the education tax breaks requires careful planning, particularly because of the interrelationship between the rules that apply to each provision.

2009 Planning: Misunderstood and Abused Deductions

Many business taxpayers fail to fully deduct qualifying business expenses. As a result, they may be paying too much in income tax. Alternatively, they may be deducting such expenses improperly, which could result in additional taxes, interest and penalties. Below is a list of commonly misunderstood deductions that you may not be fully utilizing.

- * *Home Office Deduction:* If you use part of your home as a home office, you may be entitled to deduct expenses related to the home office, including mortgage interest, property taxes, utilities, and repairs, etc.
- * *General Business Expenses:* If you use your personal funds for business expenses such as office supplies, these are qualifying business expenses, which you may deduct.
- * *Imputed Interest on Shareholder Loans:* If you have loaned money to your business, you are required to charge interest on the loan, or interest will be imputed to you. While you are required to report the interest as income on your personal return, your business is permitted a deduction for the interest paid. If any of the interest amount is improperly characterized as wage income to you, your business may be overstating its employment tax liability. By recharacterizing these amounts as interest expense, your business may be able to reduce its employment taxes and possibly obtain a refund.
- * *Meals and Entertainment Expenses:* If you have used your personal funds to pay for meals and entertainment expenses, these expenses may qualify as a business deduction, subject to limitations.
- * *Personal Assets Converted to Business Use:* If you have contributed personal assets, such as a computer, the fair market value of these assets may qualify as a business deduction, subject to depreciation limitations, beginning with the date of conversion.
- * *Communications Expenses:* Expenses related to the business use of your personal telephones, cellular phones, and internet connections may be deducted.
- * *Automobile Expenses:* Mileage and other related automobile expenses may be deducted when your personal vehicle is used for business purposes.

These are just some of the many federal tax developments so far this year. Please contact our office if you have any questions about these or other developments.