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SEPTEMBER TAX ALERTS

WHO PAYS TAXES? (from August 2009 Kiplinger Tax Letter)

Upper incomers continue to bear a record share of the income tax burden. The top 1% of filers paid 40.4% of all federal income taxes, up from 39.9% in the previous year, according to IRS data for 2007, the most recent year available. Yet those taxpayers made just 22.8% of the total reported adjusted gross income. The minimum level of AGI needed to be in the top 1% hit a new high...\$410,100.

The highest 5% paid 60.6% of total income tax and made 37.4% of all AGI. They each had adjusted gross incomes of at least \$160,000. The top 10% of filers, those who had AGIs of \$113,000 or higher, bore 71.2% of the overall tax burden, while garnering slightly more than 48% of the total of adjusted gross income.

The bottom 50% of all filers paid just 2.9% of the total income tax bill. Their share is so low because Social Security taxes are not included in the figures and because many of them get substantial tax relief from the earned income credit.

Business and Nonbusiness Bad Debts

It is virtually inevitable that all of us will at one time or another incur financial losses in our business and personal lives. One frequently occurring type of loss is a bad debt. Whether made in the course of business, or to a friend or relative, sometimes a loan simply cannot be repaid despite the best intentions of the debtor, and if there is little or no prospect that repayment can be made in the future you may have a bad debt. From a tax standpoint, the question is how to handle bad debts, and what steps to take to at least derive the maximum tax benefits available from them. Although this subject is fraught with complexities, we will outline the basic principles here to give you an idea as to whether the bad debt rules may apply to you.

The first step is ascertaining that a real debt exists. There must be a valid and legally enforceable obligation to pay you a fixed or "determinable" sum of money. Loans between family members, or other related parties such as corporations and their shareholders, are particularly scrutinized to make sure that they are really debts rather than disguised gifts, dividends, or contributions to the corporation's capital. Therefore, if you are contemplating a loan to a related party, you must ensure that you treat the transaction as a true loan by taking the steps that an arm's-length lender would take, such as putting it in writing and charging a reasonable rate of interest.

It then must be determined if, and when, the debt has become totally or partially worthless, i.e., a bad debt. The problem here is that the IRS often requires taxpayers to play a guessing game. If a taxpayer claims a bad debt loss when nonpayment is only probable, rather than a virtual certainty, the IRS may disallow the loss as premature because there is some possibility of repayment in a later year. On the other hand, if the taxpayer waits until repayment is clearly hopeless, the IRS may maintain that the debt was really worthless in an earlier year and the loss should have been taken then. Because of potential statute of limitations problems, we generally recommend that the loss be claimed in the earliest possible year that it can reasonably be argued to be worthless. There are a number of facts which might indicate worthlessness, including the debtor's bankruptcy, but no one of them is decisive; it is the totality of circumstances that is determinative.

Once it is established that a bad debt exists, the business or nonbusiness nature of the debt decides the outcome. As you might expect, a business bad debt must be created or acquired, or become worthless, in the course of your trade or business. If you conduct a business in the form of a corporation, generally any debt held by the corporation is a business debt. Any debt not falling into the business category is a nonbusiness debt. A nonbusiness debt must be completely worthless before a loss can be taken, whereas a loss on a business bad debt can be taken when partial worthlessness can be established. Furthermore, nonbusiness bad debts are subject to the limitations on capital losses. Business bad debts, on the other hand, are deductible as ordinary losses in full against your other income.

As we said above, this is a complex topic and the preceding discussion can give only a rudimentary overview of all of the tax rules involved. If you are, or may be in a situation where these rules could affect you, please do not hesitate to contact us.

2009 Planning: Vehicle Depreciation and Deductions

As part of your ongoing tax planning, you should consider the tax benefits available from the use of your car for business purposes. In general, taxpayers, including employees, who use their vehicles, including passenger cars, in pursuit of a trade or business are allowed deductions for ordinary and necessary business expenses of operating those vehicles and may also be entitled to depreciation. However, no deductions are allowed for personal expenses or personal use of the vehicle, including commuting; deductions are allowed only for the part of the expenses attributable to business use. For purposes of these deductions, "car" includes a van, pickup or panel truck.

Business use of your car can include traveling from one work location to another work location within your tax home area; visiting customers; attending a business meeting away from the regular workplace; and traveling from home to a temporary workplace if you have one or more regular places of work. The costs of travel between home and a regular place of work, however, are nondeductible commuting expenses.

There are two basic methods for computing vehicle expenses, the standard mileage rate or the actual expense method. There are restrictions and benefits to the use of each method. The 2009 standard mileage rate is 55 cents per mile. You may not depreciate your car or deduct lease payments if you use the standard mileage rate method. If you use the actual cost method, you may take deductions for depreciation, lease payments, registration fees, licenses, gas, insurance, oil, repairs, garage rent, tolls, tires and parking fees. Regardless of the method you use, if your vehicle is used for personal as well as business purposes, only expenses or mileage attributable to the percentage of business use are deductible. There are separate considerations involved in leasing a car for business.

If you are using your car for business purposes, whether owned or leased, proper recordkeeping is critical. The recordkeeping requirements vary depending upon which method you use. If you use the standard mileage rate, you should keep a daily log showing the miles traveled, destination and business purpose. Recordkeeping under the actual cost method is somewhat more onerous. You should also keep a mileage log if you use the actual cost method in order to establish business use percentage. In addition, you must keep receipts, invoices and other documentation to verify expenses. Finally, you must be able to prove the original cost of the vehicle and the date it was placed in service for business use in order to claim depreciation.

The restrictions and limitations involved in determining whether and the extent to which you are entitled to deductions and depreciation for the business use of your vehicle are complex and detailed. Please call us at your earliest opportunity so that we may help you evaluate your entitlement to these deductions and the detail involved in recordkeeping for the method you use.

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.

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