Welcome! As 2012 came to a close, Americans wondered whether Congress would act in time to avoid the so-called "fiscal cliff." Just hours into the new year, Congress enacted the American Taxpayer Relief Act of 2012, a 157-page document that details the extension—and expiration—of several tax benefits. I pored over the Act and created a comprehensive analysis of the tax law changes most relevant to churches and church employees. This supplement is included in the newly published 2013 Church & Clergy Tax Guide.

In this edition of Church Finance Today, I highlight the major benefits from the Act, which you'll need to know about before filing your 2012 returns, and the effect some of the new provisions may have on your church and staff. The expiration of the payroll tax holiday alone will result in a tax hike for 77 percent of all Americans.

As tax-filing season nears, remember, we've created lots of resources to assist you, including an article in this issue on the new "Prepare1099" electronic form by the IRS.

The Tax Calendar on page 4 is designed to help you stay up-to-date on key deadlines.

Blessings as you serve—
Richard R. Hammar

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WILL CHURCHES FIND RELIEF FROM TAXES?

Highlights from the American Taxpayer Relief Act of 2012.  
By Richard R. Hammar

In the early hours of 2013, Congress enacted the American Taxpayer Relief Act of 2012 (ATRA or the "Act") in order to avoid the so-called "fiscal cliff." The 157-page Act has two major features—an increase in the tax rates paid by the wealthiest Americans, and an extension of several tax benefits that were scheduled to expire at the end of 2011 or 2012.

Here are some tax benefits that have been extended through 2012 (and in some cases longer):

- The lower income tax rates for most Americans that were enacted by Congress in 2001.
- The lower capital gains and dividends rates for most Americans.
- The enhanced child tax credit.
- Marriage penalty relief.
- Enhancements in the dependent care credit and earned income tax credit.
- Enhancements in Coverdell Education Savings Accounts.
- Expansion of the credit for employer-provided educational assistance.
- Extension of the American Opportunity Tax Credit.
- Increased exemption amounts in computing the alternative minimum tax.
- An extension of the $250 above-the-line tax deduction for teachers and other school professionals for expenses paid or incurred for books and equipment used in the classroom.
- The deduction of state and local general sales taxes.
- Extension of tax-free distributions from individual retirement plans for charitable purposes.

Some expiring tax benefits were not extended. Most notably, Congress chose not to extend the so-called payroll tax "holiday" that reduced the Social Security taxes for both employees and the self-employed for the past two years. Prior to 2011 employees paid a 6.2 percent Social Security tax on all wages earned up to the annual "wage base" and self-employed individuals paid a 12.4 percent Social Security self-employment tax on all their self-employment income up to the same threshold.

Congress enacted legislation in 2010 providing for a payroll tax and self-employment tax "holiday" during 2011 of two percentage points off the employee share of Social Security tax, and the Social Security component of self-employment taxes. This meant that the employee share of Social Security taxes dropped from 6.2 to 4.2 percent of wages, and the Social Security component of self-employment taxes dropped from 12.4 to 10.4 percent of self-employment earnings. This reduction in taxes was enacted to stimulate the economy by increasing the take-home pay of millions of workers.

Congress enacted legislation early in 2012 temporarily extending the two percentage point payroll tax cut for employees and self-employed persons through 2012.

The American Taxpayer Relief Act of 2012 does not extend the reduction in Social Security taxes after 2012. This has the following consequences:

- Employees and self-employed workers will have a tax increase of 2 percent of
their earned income under $13,700.
• This tax increase will impact an estimated 77 percent of all workers.
• To illustrate, for a church employee earning $40,000 in 2013, the additional tax will be $800.
• Churches, like any employer, must take into account the elimination of the reduction in Social Security taxes when withholding Social Security taxes from nonminister employees.
• Ministers are self-employed for Social Security, and pay the self-employment tax rather than Social Security and Medicare taxes. Their self-employment taxes will increase 2 percent beginning in 2013. To illustrate, a minister earning $60,000 in 2013 in the exercise of ministry will pay an additional $1,000 in self-employment taxes.
• The housing allowance exclusion applies only to income taxes, and not self-employment taxes. As a result, the 2 percent hike in self-employment taxes will apply not only to a minister’s salary, but also to any church designated housing allowance.
• Ministers should take into account the hike in self-employment taxes when computing their quarterly estimated tax payments for 2013 and future years.

KEY POINT. **The Affordable Care Act (the new healthcare law) contains an additional hike in Social Security and self-employment taxes for higher-income taxpayers. It increases the Medicare tax paid by both employees and self-employed persons by an additional 0.9 percent on wages in excess of a threshold amount beginning in 2013. However, unlike the general 1.45 percent Medicare tax on employee wages, or the 2.9 percent Medicare tax on self-employed workers, this additional tax is on the combined wages of the employee and the employee’s spouse, in the case of a joint return. The threshold amount is $250,000 in the case of a joint return or surviving spouse, $125,000 in the case of a married individual filing a separate return, and $200,000 in any other case.**

Impact on charitable contributions.
Some analysts are predicting that charitable contributions will decline as a result of the American Taxpayer Relief Act, for three reasons:

The elimination of the reduction in the employees’ share of Social Security taxes will result in a tax hike for an estimated 77 percent of all taxpayers.

First, charitable contributions are discretionary outlays and many high income taxpayers may cut back on their contributions to offset the impact of higher taxes. According to the latest IRS statistics, higher-income taxpayers pay a larger percentage of their household income to charity than lower-income taxpayers. Will higher taxes cause the rich to cut back on their contributions? It’s too soon to tell, but the possibility exists.

Second, the reinstatement of the “Pease limitation” (addressed below), which caps charitable contributions for the wealthy at 20 percent of the amount of their contributions, may cause higher-income taxpayers to cut back on their giving. Note that the Pease limit impacts taxpayers at a lower level ($300,000 for joint filers) than the higher income tax rates ($450,000 for joint filers), which may disincentivize charitable giving for a larger group of taxpayers.

Third, many taxpayers make some or all of their contributions by payroll deductions at work. Many of these taxpayers were stunned to see smaller paychecks in the early weeks of 2013 following the expiration of the 2 percent reduction in Social Security taxes that prevailed for the previous two years. Some undoubtedly will seek to offset the financial impact of higher Social Security withholdings by reducing or canceling contributions made by payroll deduction.

KEY POINT. **Several studies on the impact of charitable contribution limits on charitable giving have produced conflicting results. Some studies suggest that charitable giving is adversely affected by less favorable deduction rules, while other studies indicate that the effect is minimal.**

Tax-free distributions from individual retirement plans for charitable purposes. Congress enacted legislation in 2006 allowing tax-free qualified charitable distributions of up to $100,000 from an IRA to a church or other charity. Note the following rules and conditions:

• A qualified charitable distribution is any distribution from an IRA directly by the IRA trustee to a charitable organization, including a church, that is made on or after the date the IRA owner attains age 70½.
• A distribution will be treated as a qualified charitable distribution only to the extent that it would be includible in taxable income without regard to this provision.
• This provision applies only if a charitable contribution deduction for the entire distribution would be allowable under present law, determined without regard to the generally applicable percentage limitations. For example, if the deductible amount is reduced because the donor receives a benefit in exchange for the contribution of some or all of his or her IRA account, or if a deduction is not allowable because the donor did not have sufficient substantiation, the exclusion is not available with respect to any part of the IRA distribution.

This provision, which was scheduled to expire at the end of 2011, is extended for two more years (through 2013) by the American Taxpayer Relief Act of 2012.

The Act also contains a transition rule under which an individual can make a rollover during January of 2013 and have it count as a 2012 rollover. Also, individuals who took a distribution in December of 2012 will be able to contribute that amount to a charity and count it as an eligible charitable rollover to the extent it otherwise meets the requirements for an eligible charitable rollover.

Richard Hammar’s complete analysis of the American Taxpayer Relief Act of 2012 is included in the 2013 Church & Clergy Tax Guide, available on YourChurchResources.com.
FINANCIAL Q&A

FOREGOING A FULL SALARY
How is a pastor taxed if he declines his full, agreed-upon pay?

By Richard R. Hammar

Q: Our church agreed to pay our pastor a salary of $60,000 for 2013. Because of financial pressures our church is experiencing, our pastor is only accepting half of the agreed-upon salary. Is he taxed on the full salary of $60,000 even though he has declined to accept it, or is he taxed only on the salary that he actually receives?

A: The constructive receipt doctrine specifies:

Income although not actually reduced to a taxpayer’s possession is constructively received by him in the taxable year during which it is credited to his account, set apart for him, or otherwise made available so that he may draw upon it at any time, or so that he could have drawn upon it during the taxable year if notice of intention to withdraw had been given. Treas. Reg. 1.451-2(a).

A number of courts have ruled that this principle requires employees to include in their taxable income any portion of their stated salary that they refuse to accept. On the other hand, some courts have reached the opposite conclusion.

Perhaps the most notable case is Giannini v. Commissioner, 129 F. 2d 638 (9th Cir. 1942). This case involved a corporate president whose annual compensation was 5 percent of the company’s profits. In the middle of one year, the president informed members of his company’s board of directors that he would not accept any further compensation for the year and suggested that the company “do something worthwhile” with the money. The company never credited the president any further compensation for the year, nor did it set any part of it aside for his use. The amount of salary refused by the president was nearly $1.5 million, and no part of this amount was reported by the president as taxable income in the year in question.

The IRS audited the president and insisted that the $1.5 million should have been reported as taxable income. The taxpayer appealed, and a federal appeals court rejected the IRS position:

The taxpayer did not receive the money, and . . . did not direct its disposition. What he did was unqualifiedly refuse to accept any further compensation for his services with the suggestion that the money be used for some worthwhile purpose. So far as the taxpayer was concerned, the corporation could have kept the money . . . . In these circumstances we cannot say as a matter of law that the money was beneficially received by the taxpayer and therefore subject to the income tax provisions.

The court acknowledged that the United States Supreme Court has observed that “one who is entitled to receive, at a future date, interest or compensation for services and who makes a gift of it by an anticipatory assignment, realizes taxable income quite as much as if he had collected the income and paid it over to the object of his bounty.” Hefver v. Schaffner, 312 U. S. 579 (1941). However, the court distinguished this language by observing that “the dominance over the fund and taxpayer’s direction show that he beneficially received the money by exercising his right to divert it to a use.” This was not true of the corporate president in the present case, the court concluded.

In summary, there is some basis for treating as taxable income the portion of an employee’s stated salary that is refused, particularly if the employee does not assign the income to a specified use but is content to leave the unpaid salary with the employer. But the IRS has cautioned that the correct treatment of salary refusals “depends on the facts and circumstances of each case,” and that depending on the circumstances a different result may prevail. IRS Notice 2001-69. A tax professional should be consulted in such cases to render an opinion based on all the facts and circumstances.

To submit a question for consideration in a future Q&A, email: 676editor@ChristianityToday.com.

“IT IS FINISHED.”
John’s gospel records Jesus crying “telelestai” from the cross, which is usually translated “it is finished.” The word telelestai was a word commonly used in commerce to mean that a debt had been paid in full. The word was often written across debt instruments when a debtor repaid a debt. Some theologians assert that Jesus’ use of this word signifies a complete atonement for the sins of mankind. By his death, the debt of sin was paid in full. If correct, this represents a way of thinking that is foreign to the tax code.

USING “PREPARE1099” TO ISSUE FORM 1099
New IRS electronic form simplifies filing.

The IRS receives more than 30 million 1099-MISC paper forms each year. As part of its transition to electronic filing for most tax returns, the IRS has approved the electronic filing of Form 1099-MISC using “Prepare1099.” You can obtain information about this new service, and sign up, at Prepare1099.com. There are several advantages to this service, including the following:

- The cost is as low as 60 cents per form.
- Elimination of paper waste.
- No need to file Form 1096.
- Prepare1099 is an IRS-approved E-file provider.
- Prepare1099 refiles rejected 1099-MISC forms at no additional cost.
- Bank-level security features to protect confidential information.
- Free customer support.
Tax Calendar
Important Tax Deadlines in April 2013

In addition to the regular semiweekly and monthly withholding requirements, churches should note the following dates for this month. If the regular due date falls on a Saturday, Sunday, or legal holiday, file by the next business day.

April 15
• Federal income tax and self-employment tax returns by individuals for calendar year 2012 are due by this date.
• Last day to file an amended federal income tax return (Form 1040X) for calendar year 2009 (unless you received an extension of time to file your 2009 return).
• Ministers who have not elected voluntary withholding and self-employed workers must file their first quarterly estimated federal tax payment for 2013 by this date (a similar rule applies in many states to payments of estimated state taxes).

April 29
• Churches hiring their first nonminister employee between January 1 and March 31, 2013, may exempt themselves from the employer's share of FICA (Social Security) taxes by filing Form 8274 by this date. Nonminister employees are therefor treated as self-employed for Social Security purposes. The exemption is only available to churches that are opposed on the basis of religious principles to paying the employer's share of FICA taxes.

April 30
• Churches having nonminister employees (or one or more ministers who report their federal income taxes as employees and who have elected voluntary withholding) must file an employer's quarterly federal tax return (Form 941) for the first calendar quarter of 2013 by this date.

WE NEED YOUR HELP!
Take the new compensation survey.

We're gathering compensation information from pastors and church leaders around the country. Data from the survey will become the basis for our upcoming 2014-2015 Compensation Handbook for Church Staff. You can participate in this biannual survey until March 31, 2013, by going to ChurchLawAndTax.com/Survey.

Your data will help us provide the most comprehensive, trustworthy guide for compensation planning for the church. You'll receive $15 toward downloadable church management resources just by taking the survey!

Thank you in advance for being part of this critical research.

—Richard R. Hammar

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at ChurchLawAndTax.com

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To sign up, complete the following three steps:
2. Select the Group Plan. For the Group ID enter cft1303.
3. Complete the rest of the form.

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