

Lesson 6: Render to Caesar- Honoring God in Taxes and Stewarding Deductions

Big Idea: Taxes are a way that we can honor God's appointed authorities as they seek the good of God's people.

I am sure you have heard the phrase that there are 2 things in life that are certain: Death and Taxes. Seeing as how we have only made it through giving, budget, debt and insurance and we have another 2 weeks to go, it would be safe to surmise that we are not talking about death. Which leaves taxes. I am sure that if we took a poll, we find that taxes are American's favorite expense. We like taxes so much that fought a war because of taxes. And people in Bible times loved taxes just as much,

Then the Pharisees went and plotted against him in his talk. And they sent their disciples to him, along with the Herodians, saying, "Teacher, we know that you are true and teach the way of God truthfully, and you do not care about anyone's opinion, for you are not swayed by appearances. Tell us, then, what you think. Is it lawful to pay taxes to Caesar, or not?" But Jesus, aware of their malice, said, "Why put me to the test, you hypocrites? Show me the coin for the tax." And they brought him a denarius. And Jesus said to them, "Whose likeness and inscription is this?" "They said, "Caesar's." Then he said to them, "Therefore render to Caesar the things that are Caesar's, and to God the things that are God's."

Matthew 22:15-21

Let every person be subject to the governing authorities. For there is no authority except from God. And those that exist have been instituted by God. Therefore, whoever resists the authority resists what God has appointed, and those who resist incur judgement. For rulers are not a terror to good conduct, but to bad. Would you have no fear of the one who is in authority? Then do what is good, and you will receive his approval, for he is God's servant for your good... Therefore, one must be in subjection, not only to avoid God's wrath but also for the sake of conscience. For the same reason you also pay taxes, for the authorities are ministers of God, attending to this very thing. Pay to all what is owed to them: taxes to who taxes are owed, respect to who respect is owed, honor to who honor is owed. Romans 13:1-4, 6-7

Overarching picture regarding delegated authority

- God is our highest authority
- God has installed governments here on earth
 - Kings are in the hand of God

- *Blessed be the name of God forever and ever, to whom belong wisdom and might. He changes times and seasons; he removes kings and sets up kings. Daniel 2:20-21*
- Governments are established to create order, punish evil and promote good.
 - *For he is God's servant for your good. Romans 13:4*
 - *Be subject for the Lord's sake to every human institution, whether it be to the emperor supreme, or to governors as sent by him to praise those who do good. 2 Peter 2:13-14.*
- Taxes are the means by which governments on earth can conduct their business.
 - *For the same reason you also pay taxes, for the authorities are ministers of God, attending to this very thing. Romans 13:6*

It is right for us to pay taxes

While this is not designed to be Biblical exposition of optimal tax policy. There is certainly a lot of room, especially in our culture and way of government for citizens to be engaged and to try to affect tax policy. And there is a lot of room to discuss what is the proper purpose for taxes and amount of taxes to pay. But at the end of the day, while there is no biblical mandate for government to charge taxes, we as believers and citizens are to pay the taxes that are due.

1. Always pay your taxes, honestly
2. Deduction and credits are built into the tax code
 - a. You don't have to feel guilty about utilizing the structure of the tax code to maximize your tax efficiency.

The Tax Code

This is a daunting topic. And frankly until recently, when it came to taxes, I checked out and left tax preparation up to a CPA. While I still do have a CPA prepare my taxes, it is important to know a little about how the tax code works so that we can plan all aspects of our finances most efficiently.

Progressive Tax Code

The first thing that we need to know is that our tax code is a progressive tax code.

What is a progressive tax code?

- As your taxable income increases, the rate at which you get taxed increases as well
- Income is divided in to tiers (brackets) and each tier is taxed at a different rate
 - First tier taxed at 10%
 - 2nd tier taxed at 12%

- 3rd tier taxed at 22%
- 4th tier taxed at 24%
- 5th tier taxed at 32%
- 6th tier taxed at 35%
- 7th tier taxed at 37%
- Bucket analogy – you start filling buckets
- Income cutoffs are determined by your filing status

Filing Status: based on your marital/family situation on the last day of the tax year

- Single
- Married filing jointly
- Married filing separately
- Head of household
 - Unmarried on the last day of the year
 - Pay more than ½ of the cost of keeping up a home for the year and
 - Have had a qualifying dependent live with you for more than half the year
- Qualifying widow(er) with dependent child
 - If you were eligible to file a joint return with your spouse in the year of his/her death
 - You have not remarried
 - You have a dependent child or stepchild
 - The child lived in your home all year and
 - You paid more than half of the cost of keeping up the home over the course of the year
 - You may file this status for 2 years following the death of a spouse

So let's do an example of a married couple making \$100,000/year.

- $\$19,750 * 10\% = \$1,975$
- $\$60,500 * 12\% = \$7,260$
- $\$19,750 * 22\% = \$4,345$
- Total = \$13,580

Marginal Tax Rate – the rate you pay for the next dollar of income (i.e. top tax bracket you pay)

Effective Tax Rate – total tax divided by taxable income

What gets taxed

- So, that is the basic structure of the tax code. But the reality is that not every dollar you earn gets taxed, and not every source of income gets taxed the same way.
- There are certain adjustments to your income that you can make that change how much tax you owe and how much tax you pay. These adjustments come in 2 forms – deductions and credits.

- Deductions – reduce your taxable income. So if you make \$100,000, a deduction will decrease the proportion of that money that is subject to tax
- Credits – directly reduce your tax. That is, you calculate how much tax you owe, then deductions decrease that amount.

Deductions

- Deductions come in 2 forms. As you calculate your deductions, you are allowed to claim the sum of all of the deductions that you qualify for,
- 2 types of deductions
 - Adjustments to Income
 - Itemized Deductions (vs. standard deduction)

Adjustments to Income (Above the line deductions) (Schedule 1, Part II) – always apply to your total reported income.

- Common Adjustments to Income
 - Traditional IRA contributions
 - Deduction = the amount of the contribution (limit \$6,000)
 - Deduction phases out at higher incomes ***
 - HSA contributions
 - Deduction = amount of contribution (limit \$3,500 for single or \$7,000 for family)
 - Student Loan Interest
 - Deduction = cost of interest up to \$2,500/year
 - Loan must be taken solely for qualified higher education expenses
 - You (and spouse) must not be dependents of anybody else
 - If married – must file jointly
 - Deduction reduced after AGI \$70,000/\$140,000
 - Deduction eliminated after AGI \$85,000/\$170,000

Itemized Deductions – applies if the sum of all your itemized deductions is greater than your standard deduction. The standard deduction is \$12,200 for singles and \$24,400 for married filing jointly.

- Common Itemized Deductions
 - Charitable contributions
 - Qualifying items
 - Cash – equal to the value of the gift
 - Property (also stocks) – equal to the fair market value. If it would trigger short term gains, then deduction is limited to basis
 - Services – only expenses incurred in providing donated services
 - Need to provide documentation of the gift
 - Deduction is limited after contributions exceed 20% of AGI
 - State/Local Tax up to \$10,000

- Property Tax
- State/Local Income tax or state/local sales tax
- Home mortgage interest
 - Deduction = amount of interest paid
 - Debt must be secured by the home
 - Mortgage must have been used to purchase, build, substantially improve your primary home or qualifying second home.
 - Only interest on the first \$750,000 of the loan (MFJ) or \$375,000 of the loan (MFS)
- Medical/dental expenses
 - Applies to unreimbursed medical expenses
 - Applies if your medical expenses exceed 10% AGI
 - Qualified expenses = premiums, payments for cure, prevention, diagnosis, mitigation or treatment of disease, prescription drugs.

General Formula:

- Total Income – Adjustments to Income = Adjusted Gross Income
- Adjusted Gross Income – Itemized vs Standard Deduction = Taxable Income
- Apply tax tables to taxable income

Taxable Income & Gains

Not all income is taxed equally. What we described above is the basic formula for earned income. But what about interest, dividends, capital gains, passive income?

Income Tax

Sources of Income

- Wage Income
 - Money that you make as an employee
 - Reported on W2
 - Normal income tax rate
- Self-Employment Income
 - Money made when self-employed
 - Normal income tax rate
- Interest Income
 - Interest on most accounts
 - Normal income tax rate
 - Tax exempt interest
 - State & Municipal Bonds
- Dividend Income
 - Distribution of a corporation's profits to shareholders
 - Non-qualified dividends - Normal income tax rate

- Qualified dividends – dividend rates (0, 15%, 20%)
 - Dividends for stock held >60 days
- Passive Income
 - Income from trades or businesses in which you do not materially participate
 - Rental income
 - Normal income tax rate
 - Can be offset by losses from passive activities – i.e. expenses from rental business

Payroll tax vs Self Employment Tax

- Payroll Tax (FICA)
 - Paid on W2 income, not for interest, dividend, passive income
 - Payroll Tax (6.2% Social Security, 1.45% Medicare) Total = 7.65%
 - 6.2% Social Security, 1.45% Medicare also paid by employer
- Self-Employment Tax
 - Paid on self-employment income, not interest, dividend or passive income.
 - SE Tax – employee and employer portion of payroll tax = 15.3%

Type of Income	Federal Income Tax Rate	Social Security and Medicare Tax
Wages/Salary	Normal rate	Yes
Self-employment Income	Normal rate	SE tax
Interest Income	Normal rate	No
Dividend Income	Max of 20% if qualified dividends	No
Passive income	Normal rate	No

Capital Gains

- Definition The increase generated from the sale of an asset
 - $\text{Sale Price} = \text{Basis} + \text{Capital Gains}$
- Basis – the cost that you paid for the asset.
 - The price you paid for your stocks, mutual fund shares, etc.
 - The price you paid for your home.
- Capital Gain – the proceeds from the sale above the cost basis
- Notice that this applies only when the asset is sold – you are not taxed for as long as you own the asset.
- Classes of Capital Gains
 - Short term
 - Assets held for <1 year
 - Normal income tax rate
 - Long term
 - Assets held for >1 year
 - Taxed at capital gains rate (see table)

- Adjustable for losses
- Assets that Generate Capital Gains
 - Stocks – this is easy, you look at the price of the shares when you purchase and the price when you sell
 - Mutual Funds – this is a fund filled with individual stocks. The fund manager will be constantly buying and selling shares of different stocks in keeping with the fund plan. As such some of these sales will result in capital gains (net capital gains).
 - Home – If you sell your home for more than you purchased, you generate capital gains. You are allowed to exclude \$250,000/500,000 of the gains if.
 - From 2 years prior to the date of sale you did not exclude gain from the sale of another home.
 - During the five years prior to the date of sale, you owned the home for at least 2 years.
 - During the five years prior to the date of sale, you lived in the home as your main home for at least 2 year.
 - You are allowed to adjust your basis if you do certain improvements to your home/property.
- Capital Losses
 - Selling an asset for less than you paid for it.
 - Losses on the sale of an asset can be used to offset capital gains
 - Short term capital losses offset short term capital gains
 - Long term capital losses offset long term capital gains
 - You are allowed to claim up to \$3,000 of capital losses against your ordinary income. If you have losses >\$3,000/year, you can carry those losses forward to future years.
 - 2 important sources of capital losses
 - Stocks – Tax Loss Harvesting
 - Sale of stocks for a loss if
 - The money is not used to purchase a substantially similar asset 30 days before or after the date of sale.
 - Sale of home

Credits

Tax credits are applied after you calculate your tax and they directly reduce the amount of tax that you pay dollar for dollar.

Common Tax Credits

- Earned Income Tax Credit
 - Tax credit designed to benefit and help lower income taxpayers.
 - Depends on income and number of dependents.
 - Credit phases out as income increases.
- Child/Dependent Tax Credit

- \$2,000 per year for each qualifying child
 - Age <17 at the end of the year
 - Live with you for more than half the year
 - Not provide half of his/her own support
 - Be your child, stepchild, foster child, sibling, step sibling, half sibling or descendent of any of the above.
 - Tax credit reduce of MAGI > \$200,000/\$400,000
- Child/Dependent Care Credit
 - Applies if you pay someone to care for your child/dependent so that you and spouse (if married) can work.
 - You and spouse need to have earned income
 - Pay someone to care for your kids so you can work
 - That someone cannot be claimed as your dependent or parent of child
 - You need to identify the person
 - You need to file jointly with your spouse
 - Credit = 20-35% of expenses paid (varies based on income)
 - Limited to \$3,000 for 1 child or \$6,000 for 2 or more children
- Retirement Savings Contribution Credit
 - Applies if:
 - You an IRA or work retirement plan
 - Not a full-time student
 - Not somebody's dependent
 - Claim if income less than
 - \$64,000 – married filing joint
 - \$48,000 – head of household
 - \$32,000 – single or married filing separately
 - Credit is 10%, 20% or 50% of the first \$2,000 you contribute.
- Premium Tax Credit
 - For health insurance purchased on the ACA exchange.
 - Eligible if:
 - Household income between 100% - 400% of federal poverty level
 - If married – must file joint
 - Not someone else's dependent
 - Not eligible for “minimum essential coverage” through any other source (i.e. employer, Medicare, Medicaid)
 - Claimed in advance and settled up on your tax form
- Education Credits
 - Available for higher education expenses for you, spouse or dependents
 - For a given student you can claim either but not both
 - Credits
 - Lifetime Learning Credit
 - 20% of the first \$10,000 of qualified education expense

- Eligibility decreases from MAGI \$58,000/116,000 - \$68,000/136,000
- American Opportunity Credit
 - Sum of first \$2,000 of qualified education expenses plus 25% of next \$2,000 of qualified education expenses (total \$2,500)
 - Eligibility decreases from MAGI \$80,000/160,000 to \$90,000/180,000.

General Formula:

- Total Income – Adjustments to Income = Adjusted Gross Income
- Adjusted Gross Income – Itemized vs Standard Deduction = Taxable Income
- Apply tax tables to taxable income
- Tax Owed = (Taxed income + Capital Gains Tax) – Tax Credits

Alternative Minimum Tax

- This is a catch all – safety – tax for the government designed to make sure that high income tax earners can't take advantage of so many deductions and credits that they pay very little tax.
- Formula
 - Gross income – exemption x 26%.
- Compare with your calculated income tax and pay whichever tax is greater
- Calculating your gross income – start with adjusted gross income and add back income (certain forms of income are treated differently)

Discussion Questions:

- What is God's overall purpose for you paying taxes?
- How is paying taxes an important part of worshiping and honoring God?
- Is it right to pay taxes to the government when the government does things with which we don't agree? Why?
- Does maximizing tax deductions and credits honor the principle of Rendering to Caesar?

Homework:

- Review your 2019 tax filings and read through your 1040 tax form taking note of lines 1-11. This will help you work through your deductions and determine your taxable income.
 - Look at Schedule 1 and Schedule A and review applicable tax deductions.
 - Look at Form 1040 line 13 and Schedule C and review applicable tax credits.
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