

Tax Guidance for Priests
October 23, 2013 Priest Retirement Meeting

Judith M. Stegman, CPA
judithstegman@gmail.com

I. Overview

- A. Review of Basics: Priests are “Dual Status” Employees. How this affects taxation before and after retirement.**
- B. Taxation of Typical Retirement Income Sources**
- C. Tax Planning**

II. “Dual Status” Employees – paying into the Social Security system

A. Ordained clergy are considered to be “Dual Status Employees:”

- 1. Favorable status in comparison to most employees; unfavorable compared to most self-employed.
- 2. Applicable to ordained clergy working in ministerial positions.
- 3. Treated as “employees” for INCOME tax purposes.
- 4. Treated as “self-employed” for SOCIAL SECURITY tax purposes.
- 5. So, for regular work, a priest should receive a W-2 from his parish that shows taxable wages, but shows no social security or medicare wages or withholding.
- 6. For irregular work, a priest may have his income reported on form 1099-MISC.

B. Income subject to social security / self-employment taxes:

- 1. All “earned” income is subject to social security or self-employment taxes. Unearned income is not subject to social security taxes.
- 2. Taxable income may not be reported on 1099 or W-2: examples are housing allowance and stipends / stole fees.
- 3. See list for examples of income types and their taxation.

C. Mechanics of paying income taxes and self-employment taxes:

- 1. Generally must pay at least 90% of tax in advance of April 15 in order to avoid underpayment penalty. Must pay evenly during year:
 - a. Pay by federal withholding from payroll at parish (if W-2 employee) OR
 - b. Pay with quarterly estimated tax vouchers. OR
 - c. a combination of withholding and estimated payments.
- 2. In either case, be sure to set the amount of withholding or of estimates high enough to cover the combined income tax and self-employment tax liability.

III. Tax Planning

A. Tax planning related to income for priests:

1. Where possible and appropriate, receive reimbursement for mileage and other expenses. Reimbursements under “accountable plans” are tax-free. It’s a better way to go, tax-wise, than taking a deduction.
2. Put as much as possible into a 403 (b) plan or other tax sheltered annuity.
 - a. These must be arranged through the employer and withheld from your income.
 - b. Not subject to S/E nor to income tax – the amount reduces taxable income and does not even appear on W-2.
 - c. 403(B) is more favorable than the tax advantage available in a 401(k) plan.
 - d. Increase amounts going into the 403(B) plan when nearing retirement - there are generous “catch-up” contribution provisions.
 - e. The 403(B) may also be a good option for sheltering income received from work after retirement.
3. In addition, consider contributions to IRA and Roth IRA accounts.
4. Be aware of taxation on housing allowances and attentive to outside sources of income such as investment income and rental income – there are too many variables to consider in a general presentation.

B. Tax planning related to deductions for priests:

1. Itemized deductions: Personal deductions, such as mortgage interest and real estate taxes, charitable contributions, investment expenses, and medical expenses, are deducted in the same way on Schedule A as any taxpayer.
2. As noted above, reimbursed expenses result in no deduction and in no taxable income.
3. Unreimbursed expenses related to W-2 ministerial income, if the employer’s policy is to not reimburse for the expenses:
 - a. Examples: business use of automobile, specifically clerical clothing and cleaning, vestments, dues and subscriptions, meals and entertainment related to ministry, continuing education, travel, library additions, homily aids, computer expenses, office furniture.
 - b. Deduct as itemized deductions subject to a 2% of AGI floor. (There is no benefit if a standard deduction is taken). Complete Form 2106.
 - c. Be aware of reducing the allowable deduction due to the Deason rule, if there is a tax-free housing allowance.

- d. No deduction for commuting miles. Mileage rate for 2013 for miles not able to be reimbursed by employer is 56.5 cents per mile.
 - e. 50% of meals and entertainment for business may be deducted.
 - f. The deductions are applicable to Self-Employment tax, too, but not subject to the 2% floor.
 - g. Deductions do not affect the Michigan tax computations.
4. Unreimbursed expenses related to Schedule C income (not reported on W-2):
- a. All the same as those related to W-2 income, except:
 - b. Expenses are deducted in full on Schedule C, with no 2% of AGI limitation.
 - c. Deductions are fully allowed in computation of the Self-Employment tax.
 - d. Deductions carry through to the Michigan return.
5. Notes on charitable deductions:
- a. Deductible if given to a U.S. based charity or church.
 - b. Not deductible as a business deduction.
 - c. Some business deductions could perhaps instead be taken as charitable contribution deductions.

IV. Questions

Taxation of Various Income Sources for Priests

<u>Type of Income</u>	<u>Subject to Federal Income Tax?</u>	<u>Subject to Self-employment Tax?</u>
Earned income on W-2 or 1099:	Yes	Yes
Stipends / Stole fees	Yes	Yes
Cash gifts from parishioners	Yes	Yes
Expense reimbursements –		
Accountable plan	No	No
Non-accountable plan	Yes (deduct expenses)	Yes (deduct expenses)
Housing allowance –		
Before retirement	No	Yes (note Deason rule)
After retirement	No	No
Retirement pay –		
Pension	Yes	No
IRA withdrawal	Yes	No
Roth IRA withdrawal	No (generally)	No
403(b) withdrawal	Yes	No
Social security income	Yes or No - varies with income	No
Rental income	Yes	No
Farm income	Yes	Yes

2013 Tax Rates and Deductions

Self-Employment tax rate:	15.3%
Federal income tax on taxable income (single person):	
Under \$2,200	0.0%
\$ 2,201 - \$ 11,125	10.0%
\$ 11,126 - \$ 38,450	15.0%
\$ 38,451 - \$ 90,050	25.0%
Standard deduction for single person:	\$6,100
Plus, if 65	\$1,300
Personal exemption:	\$3,900

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