



Taxation for Clergy


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Taxation for Clergy

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- Overview

 - Income: stipend, housing, other income


 - Expenses: professional expenses
 - Transportation and travel
 - Computers, cell phones
 - Supplies: books, vestments, etc.

 - Self-employment tax versus income tax

 - Estimated taxes

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Taxation for Clergy

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- Income


 - Stipend: set by vestry before first payment made
 - Subject to both income tax and self-employment tax
 - Amount on W-2 as taxable wages, Block 1

 - Other income: wedding fees, funerals, etc.
 - On Schedule C or C-EZ, with offsetting expenses, if any
 - Also subject to both income and self-employment tax

 - Reimbursements not accounted for to employer
 - Subject to both income tax and self-employment tax
 - Amount on W-2 as taxable wages


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- Income
 - Business expenses, accounted for
 - Better to account for them to employer and get reimbursed
 - Then can ignore at tax time: no reporting on return
 - Examples: auto expense, continuing education
 - Unaccounted for:
 - Flat allowances are fully reportable as income
 - Related expense is limited in deductibility to amount that exceeds 2% of adjusted gross income [2106 & Sch A]
 - Reimbursement for self-employment tax is fully reportable as taxable wages for income & SE tax


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- Income
 - Discretionary funds
 - Best kept in totally separate church checking account
 - If wedding and funeral receipts are consistently put here, one can reasonably argue that such amounts are not income
 - Make at least one annual report to vestry of use of funds, by category (for example, aid to individuals, purchase of necessary church items not provided for by budget, etc.)
 - If no reporting done on use, IRS can argue that all such amounts are includible in income of priest
 - Retain detailed records of use for 4 years, in case one is audited

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- Income

 - Housing allowance – set by vestry in advance
 - Subject to self-employment tax only
 - Can put on Box 14 of W-2 for reporting purposes
 - Cash allowance is *the lowest of*:
 - **Reasonable compensation**
 - **Actual housing expense**
 - **Amount prospectively and officially designated**
 - **Fair rental value of home including utilities and furnishings**
 - Ideally, amount should be as close to actual housing expense as possible

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- Income – Housing Allowance

 - Mortgage payments (including the interest expense)
 - Real estate taxes [if a renter, then rents paid]
 - Homeowner's insurance
 - Maintenance and repair expenses
 - Utilities: gas, electricity, water, sewer, trash collection
 - Furnishings: purchase and repair of internal furnishings
 - Telephone expense: monthly base charge
 - If one anticipates a big change during the year, get vestry to change allowance, to be able to exclude more from that point on
 - Big Benefit: mortgage interest and R.E. taxes not includible in income, but can deduct the same expense: **Double Deduction**

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■ Income – Housing Allowance

- If housing allowance somehow exceeds the excludible expenses, the excess allowance is taxable as “Other Income” on the front page of Form 1040, Line 21
- If the housing allowance is less than the actual housing expense, there is no tax benefit in the difference; one can only exclude what has been designated by the vestry
- Only expenses deductible for income tax purposes are mortgage interest and real estate taxes

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■ Expenses

- Professional expenses are deductible if:
 - They are *ordinary* and *necessary* expenses incurred in that trade or business
 - “Ordinary” means what is customarily done in that profession
 - “Necessary” has been defined by the courts as useful or helpful (and implies reasonable)


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- Expenses
 - Substantiation of business expenses:
 - Timely record of
 - Why (business purpose)
 - What it was and amount
 - When (date)
 - Where (location of business event)
 - Who (names of persons involved and business relation)
 - Keep a business diary, log, or calendar with notes; fill out on the day of event to keep current


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- Expenses
 - Travel away from home overnight (conventions, conferences, meetings)
 - Hotel or motel receipts from place of lodging
 - Meals and incidentals:
 - Actual receipts, or
 - Per diem allowances of Federal government (varies by locale) -- prorate if a partial day away from home
 - Timely notations of meal expense on diary, log, calendar
 - NOTE: But only 50% of these amounts are deductible


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- Expenses
 - Maximum amount that can be considered substantiated for a day without receipts, except for lodging, is \$75
 - Examples of Meals/Incidentals per diem allowances for 2008 (and most of 2009):
 - Monterey: \$64
 - San Francisco: \$64
 - Salinas \$45
 - Santa Cruz: \$54
 - Parking, tolls, local transportation can be verified by actual receipts or timely record on log, diary, etc.


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- Expenses
 - Most up to date information on per diem rates is published annually in IRS Pub. 1542 (usually in October, when fiscal year changes)
 - Travel expenses first are reported on Form 2106 or Form 2106-EZ and then totals transferred to Schedule A, Itemized Deductions


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- Expenses
 - Transportation (auto expense)
 - For use of car going to professional events: church meetings, hospitals, parishioners' homes
 - Driving from home to normal place of work is not a business expense (home to church, home to hospital, e.g.)
 - Driving from home to temporary place of work can be a business expense (home to parishioner's home, home to a meeting place not at own parish)


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- Expenses
 - Transportation (auto expense)
 - Substantiation:
 - Log of miles driven (diary, log, calendar, etc.) with note of business purpose or person seen, etc.)
 - Simplest method to calculate expense:
 - 50.5¢ per mile from 1/1/2008 to 6/30/2008
 - 58.5¢ per mile from 7/1/2008 to 12/31/2008
 - 55¢ per mile from 1/1/2009 (*until further notice*)
 - Can also deduct parking fees, tolls, interest and taxes related to automobile


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- Expenses
 - Transportation (auto expense)
 - Actual method (using actual receipts):
 - Depreciation
 - Gas and oil
 - Maintenance
 - Batteries and tires
 - Interest and taxes
 - Parking fees and tolls
 - But must total *all* miles (personal & business), business miles; divide business miles by all miles; get percentage of expenses that can be deductible


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- Expenses
 - Professional supplies:
 - Books and subscriptions: ones bought annually and not a long term resource can be deducted currently
 - Books: ones that are part of long term library (commentaries, dictionaries, histories, etc) should be depreciated over 5 years (60 month straight line depreciation is the simplest method):
 - \$100 book bought in July = $100/60 = 1.667/\text{mo} \times 6 = \10 for a half year's depreciation
 - Books: if an asset, can still be deducted in full as a "Section 179" expense; make election to write off on Form 4562
 - If have older books never depreciated, begin to depreciate now: "cost" is lower of actual cost or fair market value now

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- Expenses

 - Professional supplies:
 - Vestments:
 - Definitely are assets, as last many years
 - Cassocks, albs, stoles, chasubles, surplices, copes
 - (Cannot deduct or depreciate suits, shirts, or collars)
 - Depreciate over 5 years, or 60 months, similar to books
 - Or can make Section 179 election to expense in one year
 - Again, if have not deducted or depreciated before, can begin to do so now ("cost" is lower of actual cost or fair market value now)

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- Expenses

 - Professional supplies:
 - Cell phones:
 - If used in business, can be depreciated over 5 years, or 60 months straight line depreciation
 - If use is more than 50% business use, can also elect to deduct business portion of cost (e.g., if 70% of use is business related, 70% of cost can be deducted)
 - Monthly fees are deductible (business portion)
 - Must keep records of business vs. personal use to make allocation between the two
 - Keep monthly bills and notate what each call is for

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- Expenses

- Professional supplies:

- Computers:

- Can be depreciated over 5 years (60 months)
- Business portion of cost is amount to be depreciated
- If over 50% of use is business, then can also elect under Sec. 179 to deduct in full the business portion of cost
- Records of use must be kept, to support business versus personal use (hours spent doing each kind of activity)
- Some kind of log would have to be kept

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Taxation for Clergy




- Expenses

- Entertainment

- Ordinary and necessary to produce income?
- Church social events you pay for at home could be "business related"
- Lunch with prospective new member could be "business"
- Lunch with parishioner to discuss personal counseling matter could be "business"
- Meals with colleagues are questionable
- Keep record of time, place, who, business purpose, and amount (receipts are recommended)
- Only 50% of cost is deductible


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- Expenses
 - Other professional expenses:
 - Continuing education: fees, books
 - Gifts: limited to \$25 per year per donee
 - Business related organizations: e.g., Kiwanis, Rotary, but not social clubs: annual dues


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- Expenses
 - Once all business expenses are added up, how much is deductible?
 - If only 60% of compensation is taxable for income tax purposes, only 60% of expenses are deductible for income tax purposes
 - For Self-employment tax, it is logical to think that 100% of these expenses are deductible (as ALL compensation is includible for SE tax)—but IRS may disagree

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- Medical Insurance - Out of Pocket
 - Especially for retired clergy -- if they are paying for medical/dental insurance premiums, they may be deductible from gross income
 - Deductible *up to the amount of net earnings* from self-employment (e.g., weddings, funerals, supply work, etc.)
 - Can deduct on Line 29, Form 1040
 - Reduces gross income, but not net income from self-employment
 - Amount not deductible because of limitation above can be deducted on Schedule A, Medical Expenses

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Income Tax and Self-Employment Tax

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- Income and related expenses go to Form 1040, Schedule C (Net profit), Form 2106 (business expenses), and Schedule A (Itemized deductions) – for income tax purposes
 - Income and related business expenses go to a self-created schedule to compute net income from profession; net amount goes to Schedule SE to calculate self-employment tax (at 15.3%)
 - 50% of SE tax is deductible from gross income on front page of Form 1040
 - 50% of SE tax on tentative net income is deductible from net income for calculating net income subject to SE tax

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Estimated Tax Payments

- Required to make quarterly estimated tax payments—if no withholding—in order to avoid Underpayment of Estimated Tax Penalty
- Penalty rate varies quarterly (7%, 6%, 5%, 6%)
- Avoid penalty by paying:
 - At least 90% of current year's 2008 tax, or
 - 100% of 2007 tax (but 110% if adjusted gross income is over \$150,000), or
 - Installments based on an annualized income method
- Penalty is still a penalty, even though based on an interest rate; applies if \$1,000 or more is owed

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Estimated Tax Payments

- Make payments using Form 1040ES – four parts
- For Federal: 4 equal payments of 25% each
- Payments are due:
 - April 15
 - June 15
 - September 15
 - January 15
 - Can skip January 15 payment if return is filed and tax owed is paid by February 2

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Estimated Tax Payments

- California law is similar, but:
 - 4 payments, using Form 540-ES, on same dates as required by Federal law
 - For 2008 taxes, penalty can apply if \$200 or more is owed; changes to \$500 for 2009 taxes
 - For 2009 payments, 30% for 1st and 2nd payments; then 20% for 3rd and 4th payments
 - Penalty rate adjusted semi-annually, not quarterly; blended rate for 2008 underpayment is 4.15538%

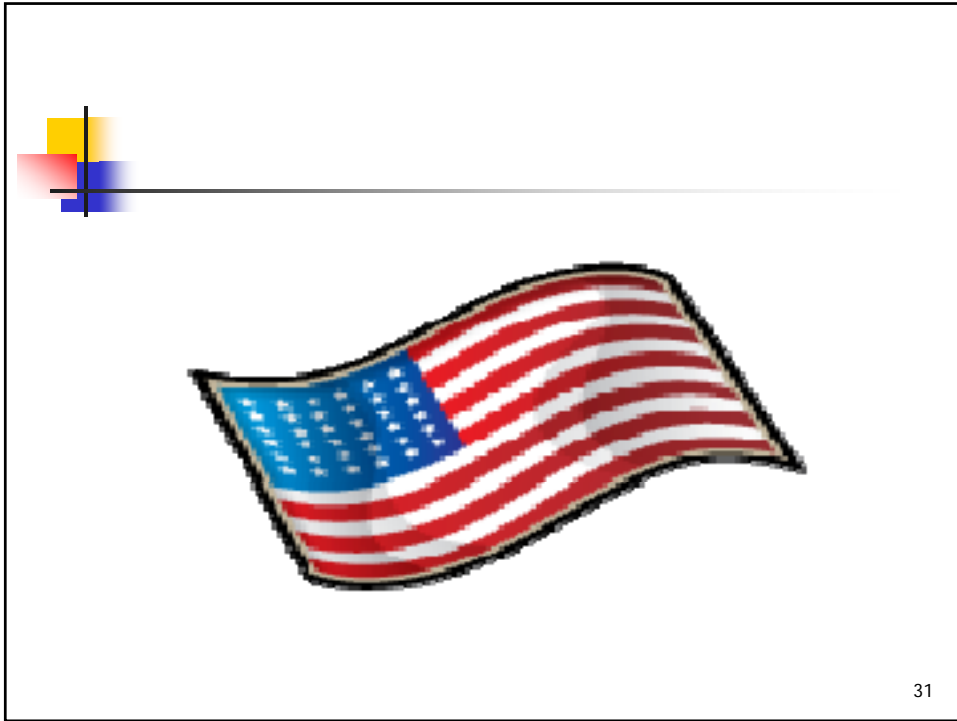
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Where to find information:

- IRS web site: www.irs.gov
 - Forms and instructions and publications
 - Publication 517, Social Security and Other Information for Members of the Clergy
 - Publication 1542, Per Diem Rates
 - Publication 17, Your Federal Income Tax – for Individuals
- Franchise Tax Board of California web site:
 - www.ftb.ca.gov
 - Forms and instructions and general information
- Simple question: rlrible@aol.com

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