

Office of Parish Finance Parish Bulletin

TOPIC

Income and Payroll Taxes for Priests¹

INTRODUCTION

A priest is taxed differently on his earnings than a lay employee if he is a minister for tax purposes.²

Per the US tax code and associated regulations, ministers are individuals who are duly ordained, commissioned, or licensed by a religious body constituting a church. Ministers have the authority to conduct religious worship, perform pastoral functions, and administer ordinances or sacraments according to the prescribed tenets and practices of that church.

If a minister performs ministerial services, all his ministerial earnings are subject to income tax, including wages earned per his parish assignment and other fees (honoraria) received for his ministry services.³ **Further**, a priest:

- is **always self-employed for Social Security and Medicare purposes** with regard to ministerial income;
- is (technically) **exempt from automatic federal income tax withholding by his employer** (this does not mean that the priest is not subject to income tax; he is).

This Bulletin highlights some of the facts surrounding the income and payroll taxation method applicable to priests, and the underlying federal programming funded by the Payroll Tax: Social Security and Medicare.

¹ This Bulletin assumes a general understanding/knowledge of the following: the taxes that comprise the US federal income and payroll taxes; the concept of “withholding”; and knowledge of the major tax forms referenced (IRS Forms W-2, W-4, and Schedule SE (IRS 1040)).

Bulletin content is not intended to be nor should be treated as tax advice; priests are advised to work with their tax/accounting expert to ensure understanding of tax compliance requirements specific to priests, of tax planning needs, and of tax filing status under the US tax code and per the federal entitlement programs known as Social Security and Medicare. See also: (i) Section 10.22.5, Archdiocese of Denver Pastoral Handbook; and (ii) IRS Publication 517.

² For purposes of this Bulletin, it is assumed that all archdiocesan priests are ministers for tax purposes.

³ It is highly advised that a priest grasp what *must be*, versus what *may be*, input as part of the “net profit or loss” calculations behind line 2 of Schedule SE (IRS Form 1040). See footnote 10, below.

Who is this Parish Bulletin intended to assist?

Bulletin content is intended to assist both business managers and priests.

The Bulletin content is primarily applicable to diocesan priests receiving wages, offerings, and fees for and/or as part of performing ministerial services.

Given that members of a religious order who take a vow of poverty do not receive reportable income nor report any self-employment income,⁴ Bulletin content may be of interest, but cannot comprehensively inform as to religious order/religious order member taxation obligations (if any), nor inform regarding religious order member access to the two federal entitlement programs funded by the payroll tax: Social Security and Medicare. Religious order members are therefore asked and advised to consult with and work directly with religious order leadership and tax/accounting experts regarding taxation matters and member access to Social Security and Medicare.⁵

What is a “withholding” in the context of individual taxation?

Generally, a “withholding” is the portion of an employee's wages that is not included in his/her paycheck because it is sent directly by the employer to federal, state and local tax authorities.

Income Taxes . . . what are they and how are they paid?

Income taxes are taxes collected by federal, state and local governments on the income of individuals and businesses. These taxes are typically a percentage of the income subject to income tax, but the rate of taxation may vary based on the type of income, amount of income and/or the type of taxpayer.

Employers are generally required to be part of the income tax and remittance process for their employees (i.e., the process of withholding) . . . **EXCEPT** in the case of priests.

When it comes to a priest in ministry, a priest is exempt from *automatic* federal income tax withholding.

⁴ This assumes that ministry services are being provided by the religious order member, that ‘salary equivalents’ are being paid directly to the religious order under the order’s federal Employer Identification Number, and that all other ministry activity is otherwise consistent with applicable tax law and associated IRS regulations.

⁵ Discussion of payments to religious orders/religious order members (foreign and non-foreign) can get complicated and is beyond the scope of this Bulletin. If a religious order priest is being paid directly by a church employer, research with Parish Finance should occur to confirm this is appropriate and the religious order priest is advised to consult his tax advisor. If there are church employer questions regarding proper “payroll” treatment of religious order/religious order priests serving within the parishes, please contact the Office of Parish Finance.

This does NOT mean that the priest is not subject to income tax (he is!); it only means that his church employer is not required to withhold income tax (as is otherwise required for lay employees) UNLESS the priest has submitted his completed Form W-4 to his employer detailing his withholding preferences.

If a priest processes a Form W-4, then the employer MUST withhold consistent with the priest's Form W-4 choices.

Payroll Taxes . . . what are they and how are they paid?

“Payroll taxes” are federal taxes paid to the US government by both an employer and its employees with the purpose of funding the US entitlement programs commonly known as Social Security and Medicare.⁶

Payroll taxes are paid under one of two methods, depending on whether a person is self-employed or whether a person is an employee:

- Under the **Self-Employment Contributions Act**, or **SECA**, the self-employed person pays all the taxes due under SECA.
- Under the **Federal Insurance Contributions Act**, or **FICA**, the employer and the employee each pay half of the Social Security and Medicare taxes due under FICA, with the employee's portion typically processed through the employer payroll process.⁷

As stated previously, a priest is always self-employed for Social Security and Medicare purposes with regard to ministerial income per SECA.

⁶ For a description of the Social Security program, please see the information found at the following link: <https://www.ssa.gov/pubs/EN-05-10024.pdf>. For a description of Medicare, please see the information found at the following link: <https://www.medicare.gov/what-medicare-covers/your-medicare-coverage-choices/whats-medicare>.

⁷ Worker earnings cannot be subject to both the SECA and FICA regimes.

PRIESTS AND DUAL TAX STATUS

Why are payroll tax obligations of particular importance for priests to track?

Under US tax law, a priest who is a minister for tax purposes has *dual tax status*.⁸

This means:

- The priest is as an **employee** for income tax purposes.
- AND
- The priest is **self-employed** for both Social Security and Medicare purposes (meaning SECA applies, not FICA).

This fact translates into additional filing and payment obligations on the part of a priest.

What is the impact of a priest's dual tax status on his tax filings/reporting?

Unlike a lay employee, being subject to SECA means that a priest will not have FICA⁹ taxes withheld by his employer.

Applicable tax filings are as follows:

- An employer **DOES** report a priest's earnings on the priest's year-end IRS Form W-2.
 - The employer cannot withhold from priest wages **UNLESS** the employer is specifically directed to do so by a priest who files with his employer his completed Form W-4 wherein the priest clearly indicates his withholding choices.
- An employer **DOES NOT** withhold Payroll Taxes (Social Security and Medicare taxes) from a priest's wages, nor report such taxes on Form W-2.
 - The boxes available on Form W-2 for reporting of Social Security and Medicare withholding should be marked "\$0.00".

⁸ This dual tax status of ministers evolved from the original Social Security Act of 1935 (initially Congress specifically excluded many professions and vocations from the program, including clergy). In the 1950s, and then again in the late 1960s, Congress eased this restriction and allowed ministers to participate in Social Security, but only as self-employed workers that had to pay in separately.

⁹ A parish may not pay the FICA "employer" portion on a priest's salary. That said, know that incorporated into the salary scale for Archdiocese of Denver priests is an amount intended to assist with offsetting SECA related taxes.

- When a priest files his own individual federal tax return (Form 1040), the priest will prepare and include a completed Schedule SE. In that Schedule SE, the priest reports his self-employment income¹⁰ and any taxes he himself has paid toward his tax obligations (e.g., quarterly estimated payments), or which may have been paid on his behalf (e.g., through employer withholding per his submitted Form W-4 specifying extra withholding to occur).
- Though an employer does not specifically withhold Payroll Tax from a priest's wages, a priest's planned use of Form W-4 can result in periodic withholding each pay period that meets annual withholding requirements (see below).

Through paying the SECA self-employment tax (the SET) each year, a priest earns credits to become eligible to collect Social Security when he retires, subject to Social Security Administration policies. In addition, when a priest becomes eligible for Social Security, he also becomes eligible for Medicare.

Though a topic best addressed between a priest and his tax advisor, generally the payment of the SECA self-employment tax can be addressed by a priest in a few different ways:

- It may be left to year end annual Schedule SE/Form 1040 preparation (which has the potential to result in a surprise tax obligation if any potential tax liability calculations are left to tax filing season).
- It may be addressed by the priest through quarterly estimated payments to the US Treasury.
- It may be addressed through a priest's utilization of Form W-4 and periodic withholding by the employer - see Form W-4 line 4c entitled "*Extra withholding. Enter any additional tax you want withheld each pay period.*"
 - **The additional amount specified by the priest to be withheld by his employer can in turn be applied to the priest's total tax responsibility (including income and SET taxes) as calculated when he files his annual 1040 tax return with Schedule SE.**

¹⁰ It is highly advised that a priest grasp what *must be*, versus what *may be*, input as part of the "net profit or loss" calculations behind line 2 of Schedule SE (IRS Form 1040). Meaning, a priest is best served by clearly understanding the scope of his ministerial income that *must be* reported for services performed (W-2 wages, honoraria fees, other fees, etc.) less his allowable business expenses that may be deducted from his income (the cost of vestments, books, the value of his room, etc.). For instructions on Schedule SE (IRS Form 1040), refer to the IRS instructions at <https://www.irs.gov/instructions/i1040sse>. Additionally, do not hesitate to reach out to the Office of Vicar for Clergy for additional input.

CONCLUDING REMARKS

Planning for the Income and SECA Self-Employment Tax (SET) Obligations

Navigating priest income and self-employment tax requirements can be challenging. Here are some old and new points:

- A priest's annual salary, in combination with SECA being run outside of employer withholding, suggest that a priest is advised to carefully engage tax planning assistance to assess and determine well ahead of time a reasoned amount he should expect to remit to (pay into) the federal government for both income and SECA tax obligations.
- Because of a priest's dual tax status, considered in combination with additional earnings that may come through ministry services provided apart from priest wages, reliance on IRS wage-based tax tables has the potential to be misleading and to understate a priest's tax liability.
- To assist with SET timing and amount due for Payroll Taxes, one possible strategy a priest may engage is use of the IRS Form W-4 (see previous section).

Business Manager Best Practices

- Recognize that priests are treated differently for payroll withholding purposes.
- FICA does not apply to priest payroll; NEVER withhold FICA taxes from a priest's salary.
- ONLY withhold the amount specified by the priest on his W-4. Ask each priest annually if he is choosing to complete a W-4. Encourage him to seek the advice of a tax professional to estimate the amount of his tax liability.
- When preparing a priest's W-2, the boxes for Social Security & Medicare should be "\$0.00"

Best Practices for Priests

- Talk to your personal tax advisor to better understand priest taxation and work with that person to estimate the amount of all taxes (federal and state income taxes as well as self-employment taxes) that will be owed – your total tax liability.
- Review and, if necessary, complete a new Form W-4 annually and give it to your employer's business manager/bookkeeper to specify the amount the employer is to withhold from your paycheck for federal and state income taxes.

Social Security and Medicare: Conscientious Objection to Paying Taxes

Payroll Taxes fund Social Security and Medicare. As a concluding observation, there may be misunderstanding as to the value of Social Security, resulting in a thought/preference for “opting out” of Social Security.

First, follow up Bulletins and/or presentations to clergy will more comprehensively address priest retirement considerations and the value of paying in to Social Security and other federal entitlement programs.

With regard to opting out of Social Security, a review of IRS Form 4361 content and accompanying instructions may suggest that a priest *could* opt out of Social Security, but that content is to be carefully assessed within the context of the following considerations:

- As a matter of Archdiocese of Denver policy, incardinated priests are expected and required to participate in Social Security, Medicare, and all other programs that could provide a priest assistance during his retirement.
- The Catholic Church **does not** maintain a conscientious objection to public insurance such as Social Security, Medicare, etc.
- Opting out of Social Security means that a minister will not be eligible for and will not receive Social Security, Medicare, or disability benefits. **Further, he cannot opt back in once he has opted out.**
 - Though Congress has on two occasions provided a window to opt back in (the most recent occurrence ending in 2002), there is no guarantee of any future window opening up.

Thank you. If Parish personnel have any questions or require further clarification, please reach out to the Archdiocese of Denver’s Office of Parish Finance at aodparishfinance@archden.org.

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