

TAX PLANNING FOR CHURCH MUSICIANS

BY MICHAEL MARTIN



This article will discuss the federal income tax deductions available to church musicians, explain the differences between an employee and an independent contractor, and examine how your classification affects the way you deduct business expenses.

THE INTERNAL REVENUE CODE (IRC) states that you may deduct any cost that is ordinary and necessary to your business. When Congress wrote this law in 1954, it did not want to specify individual types of deductible expenses, but instead left it up to the IRS to make rulings as to what is or is not deductible. With that in mind, let's look at some of the most common areas of deductible expenses.

COMMUNICATION • In order for you to communicate with a potential employer, customers, and others, you have to have technology to do so. This technology may include cell phones, tablets, computers, or other devices. Therefore, your wireless fees, Internet fees, the cost of your device, and land line would be at least partially deductible. Until recently, the IRS took the position (unreasonable) that you needed to keep a log of cell phone usage (business vs. nonbusiness). In 2010, they abandoned that position and allowed employers who furnished

a cell phone to their employee to deduct the entire cost without ascribing some to personal use. This ruling could be interpreted to mean that any cell phone that is used primarily for business use would be 100% deductible no matter who paid for the service.

CONTINUING EDUCATION • Those expenses you incur to maintain or improve your qualifications as a musician would be allowable. This would include attendance at professional society meetings as well as workshops

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and lessons. The only restriction is that the education cannot qualify you for a new business or profession. The items that would be deductible include the fees paid for the education, supplies purchased for the education, travel to the site, meals (see below for restrictions) and the cost of lodging if you are away from home.

DUES • Dues paid to professional organizations, such as the AGO, who promote your business, provide education, etc. would be a business expense. However, dues paid to organizations that are not related directly to your profession—such as American Express

or AAA (the American Automobile Association)—would not be deductible under this category. However, they may be deductible elsewhere, such as car expenses.

HOME OFFICE • The IRC allows that you may deduct the costs of maintaining an office in your home under the following conditions. First, it is your primary or only place of business, it is an identifiable space (not necessarily a room), and it is used exclusively as an office. If you are an employee, it must also be a requirement of your employment. Home-office deductions can include a percentage of your rent, mortgage interest, real estate taxes, utilities, and even repairs. Costs directly related to maintaining the office, such as painting or other repairs, would be fully deductible.

The IRS has recently issued new regulations that allow a simplified method by allowing a deduction of \$50 per square foot, with a maximum of 250 square feet allowed.

MEALS • If the cost of meals is otherwise relative to your business, 50% of the cost is deductible. The IRC defines allowable entertainment expenses as those where you have a reasonable expectation of deriving income from the person entertained. Meals while you are away from home, such as those at a conference, are always deductible, but again are reduced by 50%.

OFFICE SUPPLIES • This would include paper, pens, and flash drives, and could include furniture used in your office at church or at your home office. The cost of a computer, laptop, or tablet (although required to be depreciated over a useful life) is, in fact, usually expensed under a provision of the IRC.

PROFESSIONAL SUPPLIES • This would include copies of music you plan to perform as well as music you may perform at a later date, supplies you purchase for your program if you are not reimbursed, shoes, performance attire, and CDs. Here the restriction on performance attire is that it has to be something that you would not wear during nonworking hours. The purchase of CDs, like music, that are relevant to your program would be clearly deductible. It is less clear when these are CDs of a general nature. Do they provide an educational function? One IRS ruling concerning a music critic who purchased several hundred CDs a year allowed that it was a deductible expense, but that he had to amortize their cost over five years.

TRAVEL • Travel expenses fall into two distinct categories: local travel and travel away from your tax home. Travel away from home can be by car or public transportation. If you are driving to a conference, your car expenses would be the larger of the actual costs or a per-mile allowance established by the IRS and updated annually to reflect current conditions. Local travel is defined as any travel from one job site to another business location. Thus, if you drive from the church to the music store, that would be deductible miles. If you drive from one job site to the site of a second job, that would constitute deductible miles.

Car expenses are calculated by either of two methods, whichever gives you the higher deduction. Under the actual expenses method, you add together all of the costs of operating your car during the year, plus an allowance for depreciation, and multiply that total by your business-use percentage. The alternative is to multiply the business miles times the allowable per-mile rate provided by the IRS. In most cases, the



allowance will produce the higher deduction with less record keeping.

Record keeping is required, as the return poses two questions related to car use: Are there records? and Are they written?

FOREIGN TRAVEL • Travel outside of the United States is deductible as long as it is for a legitimate business purpose, such as attending a conference or performing. If the travel is less than one week (seven consecutive days), all of your expenses would be deductible—including airfare, hotel,

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food (meal limitations still apply), local travel and, of course, your registration fee. If the trip is more than seven days, and more than 25% of the time was spent for personal rather than business activities, the deduction would be limited to that amount spent on your business days, and none of your airfare would be deductible.

EMPLOYEE VS. INDEPENDENT CONTRACTOR

• The IRC does not define who is an employee or who is an independent contractor. But there are several IRS publications that deal with the issue. There is, in fact, a list of a dozen questions, which, if answered, will help make that determination. Most of these questions deal with “control.” Where do you work?

Whose equipment do you use at work? Who sets the hours of work? For church musicians, the answer to most of these questions comes down on the side of being an employee. You work at the church. You play on an instrument provided by the church.

You work on Sundays or whenever church services and rehearsals are scheduled. Perhaps you can control when rehearsals occur, and, of course, your own practice time is yours to decide; but the major factors fall on the side of you being an employee. That said, many churches offer employment as an independent contractor because they do not want the expenses of having you as an employee. So, if you are offered a position, and the employer insists that you be an independent contractor, your choice is to take the job or not. Before you decide to take the job as an independent contractor, you need to know the ramifications.

As an employee, your employer withholds taxes from your paycheck, including Social Security and Medicare tax (social taxes). The employer then is required to match that amount, and it is sent to the government.

As an independent contractor, you are paid a flat fee and are required to pay your own taxes, including both halves of the social taxes. As an example: if you earned \$10,000 as an employee, you would have \$765 withheld for Social Security/Medicare taxes, and your employer would match that \$765. As an independent contractor, you would be liable for the entire \$1,530.

Except:

As a self-employed person, you are allowed to deduct all of those ordinary and necessary business expenses listed earlier from your gross income, to arrive at your net income from self-employment. That amount is subject to the self-employment social taxes—and also adds in to whatever other income you may have to determine your income tax.

As a self-employed person, you can establish a home office/studio as the site of your business (especially if you teach at home or have practice facilities). This means that all of your trips from home to church are no longer commuting but travel expenses between work sites.

In the above example, you have \$10,000 of fees from the church. But now you have \$3,000 in expenses for

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dues, supplies, home office, and travel. Your net income is \$7,000, and your combined social taxes are \$1,085.

If you are treated as an employee, all of those expenses are referred to as employee business expenses. That means they go to the “miscellaneous deductions” section of your tax return. Normally, employee business expenses are reduced by 2% of gross income and then added to all of your other deductions to determine if you itemize or take the standard deduction. Both you and the church are paying social taxes on the full salary.

There is a special provision for “performing artists” who have two or more employers and earn less than \$16,000 per year to deduct their employee business expenses as an adjustment to income rather than as an itemized deduction.

The best of both worlds is to have your employer reimburse or directly pay for your expenses in addition to your salary as an employee. The next best option is to have the employer pay directly or reimburse you for your expenses as part of your compensation package. Thus, you have a lower salary but your expenses are paid for you, and never figure into your tax calculations. Taking our hypothetical \$10,000, you request that the church pay your dues, education expenses, and maybe some travel costs, totaling the same \$3,000.

If the church pays these expenses directly, you now have a salary of \$7,000 and \$3,000 of expenses that have been paid on your behalf. If you pay the expenses and the church reimburses you, you have what is called an accountable plan, where the church is

responsible for maintaining the records of your expenses. In either case, you and the church save the social taxes on \$3,000—a savings of \$459.

THOSE WHO ARE BOTH • For those individuals who are both an employee and have independent income, current IRS rules require that those expenses directly attributable to each activity be deducted against that activity. Those expenses not directly allocated are to be allocated on the basis of the income earned from that activity. Thus, if you had driven 500 miles for activities that were related to independent income, that mileage would be reported on Schedule C (independent income). Your general expenses such as dues, office supplies, and computer would then be allocated between independent income (Schedule C) and employee business expenses (Schedule A).

STATE TAXES • Most state income taxes follow the federal rules on classification of income and deductions. Therefore, reducing your federal taxes will generally result in reduction in your state income tax as well. However, there are states that have special taxes on self-employed income, and many have a personal property tax on business equipment.

CONCLUSION • The bottom line is, if you know the consequences of how business expenses are deducted, you will be in a better position to negotiate a contract that is more beneficial to you, providing you with the larger net income after taxes.

DISCLAIMER: None of the above can be considered tax advice but is for general guidance only. Please consult with your own tax adviser to determine how any of these items relate to your tax return.

Michael Martin is enrolled to represent taxpayers before the IRS. He has a tax compliance practice in Washington, D.C., and is a frequent author and lecturer on tax and procedure. He is married to Carol Feather Martin, who is director of music and arts at Trinity Presbyterian Church in Arlington, Va.