# Ready Set Retire

# Farming: Social Security Issues

Social security is a unique system primarily for the purpose of providing supplemental income for individuals in retirement years. Workers and self-employed individuals pay a social security tax throughout their productive years, then draw a monthly payment after retirement until death. Retirement benefits are indexed to the Consumer Price Index; a rise in the CPI during a given period of time may trigger a rise in benefits. In addition to retirement benefits for workers, social security provides five other kinds of benefits: (1) benefits to dependents when the retired worker is receiving benefits; (2) disability benefits to disabled workers and their dependents, regardless of the age of the disabled individual; (3) survivor benefits to the surviving dependents of a deceased worker; (4) lump sum death benefits to a surviving spouse; and (5) Medicare insurance. Of primary interest in retirement planning are the conditions under which contributions are made before retirement, and conditions under which social security payments may be drawn in retirement.

## Issues Prior to Retirement

As a self-employed individual, a farm operator is covered by social security. A farm operator is defined by the Social Security Administration as a person who farms for profit. The individual may be an owner/operator, partner, renter, or share farmer. Usually when a couple operates the farm together, the husband is considered to be self-employed and the income from the farm is credited to him.

An exception to this rule occurs when there is a family partnership between husband and wife. The partnership agreement is usually written, but it can be oral. Signs that a partnership exists include:

- The intent of the parties to form a partnership;
- The contribution by all parties of land, money, or services;
- Participation in management by all parties;
- The sharing of profits and losses;
- Mutual agency, in which each partner can act for the other; and
- Joint liability.

For social security purposes, each partner reports his or her share of the profits on separate schedules. This procedure holds even if the partners are husband and wife and they file their income tax returns jointly.

Many farm families now have off-farm income, generally in the form of wages or salaries. Social security taxes must be paid on a set amount of an individual's earnings. If the individual has wages as well as self-employment earnings, the wages count first for social security. If wages are less than the social security maximum ($45,000 for 1988), the self-employment tax is paid only on the difference between the wages and the maximum, or on net earnings, if the net earnings are less than the difference. In general, the amount of social security tax paid by a self-employed individual (an effective rate of 13.02 percent in 1988) is more than the tax paid by an employed individual (7.51 percent in 1988) but less than the total amount contributed on behalf of the employed individual, whose own social security contribution is, by law, matched by his or her employer.

If the farm business has been incorporated and the former operator became an employee of the corporation, social security taxes are paid at the rate established for employees and employers. The employees' contributions must be matched by the employer, in this case, the farm corporation.

In general, the self-employed social security tax, paid at the same time as federal income taxes are paid, is figured on net farm earnings. Net farm earnings are figured by subtracting allowable farm business expenses, including depreciation, from gross farm income. Federal agricultural program payments must be included

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in gross income for social security purposes. Capital gains income from the sale of raised breeding livestock or other capital assets, however, is not included in gross income. If the actual farm profit is less than $400 for the year, or if there was a net loss, income can be reported under an optional method that permits a social security earnings credit for that year.

The rental of farm land, either for cash or under a crop sharing plan, can be counted as income for social security purposes if the land owner has an active role in the production or management of the crop or livestock. Such activities are termed "material participation." There are four tests for material participation. Meeting any one of the four tests qualifies as material participation. The four tests follow.

1. Performing any three of these four activities—inspecting production activities; consulting with the tenant; furnishing tools, equipment, and livestock; or sharing production expenses.

2. Making decisions on a regular basis about the farm operation.

3. Performing physical work in the production or management of the crops raised.

4. Some combination of tests 1, 2, and 3.

In order to qualify for social security benefits at retirement, the retired person who was born after 1930 must have at least 40 quarters of coverage, or 10 years in farming or other jobs before retirement. Being able to count income from the rental of farm land may be advantageous to ensure enough quarters of coverage.

Another preretirement social security issue involves a husband who is a self-employed farmer paying his wife a salary for her work in the farm business. Her social security tax as an employee will be deducted from her paycheck, and her husband, as her employer, will be required to match her contribution. Although this arrangement decreases the income available for current consumption, it may be advantageous in the long run. A woman who has not earned social security credits for her own work is eligible for social security payments based on her husband's contribution. When she begins to draw social security, her benefits will be tied to her husband's benefits, and will be equal to half of his benefits. At his death, she will be eligible to draw his full benefit for the remainder of her life.

Typically, benefits to a noncontributing spouse are lower than benefits that would be received by an individual whose benefits are based on his or her own contributions rather than on the contributions of a spouse. Therefore, paying the spouse a salary, and paying both the employee's and the employer's contributions may result in higher retirement benefits for the couple than if the retirement benefits are based solely on the earnings of the self-employed farmer.

A final point to consider before retirement is that people who delay retirement past the age of 65 will receive delayed retirement credits for each month that they continue working. Presently, these credits increase the amount of the social security benefits, when they are finally received, by 3 percent per year until the worker reaches age 70. The percentage credited will gradually increase starting in 1990 until it reaches 8 percent annually by the year 2009.

### Issues After Retirement

The amount of monthly benefits that will be received after retirement is based on the earnings of the individual prior to retirement. The amount credited as well as projected benefits can be checked at any time by filling out form SA-7004 available at any Social Security Office. When planning for retirement, it is a good idea to submit this form well ahead of time to make sure that everything is in order: the quarters of credit as well as the income reported.

Benefits can start as early as age 62. Benefits taken before the age at which full benefits can be received will be paid at a reduced amount. The age at which full benefits can be received is being increased gradually from the current age of 65 to age 67 early in the next century. Payments as early as age 62 will still be possible, but the reduction will be greater than it is now.

The retiree will receive full benefits each month until death **unless** the individual receives more earned income than is permitted. In 1988, an individual who is less than 70 can receive $8,400 annual income ($700 monthly) with no reduction in benefits. Earnings of more than that amount will result in a reduction of $1 in social security benefits for every $2 over the limit. After age 70, there is no restriction on the amount of income one can earn.

The goal, then, is to limit one's **earned** income after retirement. Income from a regular partnership counts as earned income; income from a limited partnership (in which an operating heir is the general partner and the retiree is the limited partner) will not count as earned income. Income in the form of a salary from a farm corporation will count as earned income; income from corporation dividends will not count as earned income. Income from cash or share rental of farm land will count as earned income if the land owner "materially participates," as defined in the previous section; that income will not count if the land owner does not materially participate in the farm operation.

Before retirement, the goal for some farmers is to receive the maximum amount of credit possible, since social security benefits are based on preretirement income levels. Other farmers try to minimize social security taxes paid prior to retirement so that there is more after-tax income left to be invested in a private retirement plan.

After retirement, the goal is to reduce earned income, at least until the age of 70, so that maximum benefits can be received. This goal can be accomplished by planning the sources and types of income that will be received in retirement.

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