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. Most often 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 warnings, the wages count first for social security. If wages are less than the social security maximum, 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. The amount of social security tax paid by a self-employed individual is twice that of the tax paid by a wage or salary earner, whose own contribution is—by law—matched by his or her employer.

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However, an amount equal to one-half of the self-employment tax may be deducted from a self-employed individual's income when calculating federal income taxes. This results in a social security tax that is effectively one or two percentage points less.

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 92.35 percent 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 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 you meet certain income tests, 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 at least half the 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 amounting to 100 hours or more spread over at least 5 weeks.

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 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 the common situation of 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. The wife may be eligible for retirement benefits on her own record, for survivor benefits for her young children if she should die, and for disability benefits if her disability occurs while or shortly after she is employed. A minimum number of credits are needed for disability coverage as well as for retirement eligibility. A woman who has not earned social security credits for her own work is eligible for social security retirement benefits 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 approximately half of his benefits. This benefit is reduced if drawn prior to age 65. At his death, she will be eligible to draw a full benefit for the remainder of her life.

Wages paid “in kind” for agricultural labor—for example, in the form of grain—are not subject to social security tax.

Typically, benefits to a non-contributing 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 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. Workers who reached age 62 in 1989 or 1990 will receive credits that will increase the amount of the social security benefits, when they are finally received, by 4 percent per year until the worker reaches age 70. The percentage credited will gradually increase in subsequent years until it reaches 8 percent annually for those reaching age 62 in 2005 or later.

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. The form may be obtained by calling 1-800-234-5772. This nationwide toll-free number is answered 24 hours per day. 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.

Retirement 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 by 2003. 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 by the social security “retirement test.” For individuals under age 65, earnings of more than the permitted amount ($11,280 in 2002) will result in a reduction of $1 in social security benefits for every $2 over the limit. After age 65, there is no restriction on the amount of income one can earn.

The retiree’s goal, then, is to limit one’s earned income before age 65. 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 “maternally 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.

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