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SOCIAL SECURITY TAX AND BENEFIT ISSUES,
QUESTIONS AND ANSWERS
FOR FARMERS AND WORKERS

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ABSTRACT

Social Security taxes are a major and growing expense of operating a farm business. Self-employed farmers and family farm workers have some flexibility in managing cash income subject to Social Security. A basic understanding of Social Security benefits as well as costs is required to make a rational decision about optimum coverage.

SOCIAL SECURITY - WHAT FARM FAMILIES NEED TO KNOW

Many farm families have some choices about distribution of income which will affect taxes paid and thus benefits received in the event of severe disability, death or retirement. Often these choices are made only with the objective of paying the least possible FICA and self-employment tax. Farm families should also consider which family members should be and are eligible to receive benefits and how the distribution of income affects the amount of benefits.

For example, during transfer of farm ownership from the older to the younger generation, interest, principal, rent and wage payments are often made to members of the older generation. Often some break is given on one or more of these payments in order to successfully accomplish the transfer. If it is labor that is discounted in value, FICA taxes will be saved, but that may result in future retirement benefits being lower than as if full value was paid for the work done.

Disability

A farm couple with young children should seriously consider qualifying both parents for Social Security disability benefits. If either parent is disabled, the cost to replace the farmwork, house work, and/or child care plus care for the disabled person can be devastating. If both spouses work only on the farm and the business is organized as a sole proprietorship owned by one spouse, it will be necessary to pay the other spouse at least $2,080 in 1990 (increases each year) for work on the farm for a full year's credit toward Social Security coverage. If net farm profits are very low or negative, an optional method of figuring net earnings may be used by the farm operator to get a full year's credit toward coverage.

The number of quarters of work credits needed for disability benefits depends on your age, and when you become disabled. If you are age 24 through 31, you need credit for having worked half the time between 21 and the time you become disabled. In other words, if you are disabled at age 31, you need 20 quarters or five years of coverage. If disabled after age 31, you need five years of credit out of the most recent 10 year period. You also need to have as many total work credits as you would need for retirement.

The amount of disability benefit depends on the workers' earnings record and composition of family. Also, medicare coverage is available to people who have been entitled to disability benefits for 24 months.

Survivors Benefits

Monthly benefits can be paid to various members of your family should you die while currently insured by Social Security. To be currently insured you must have six quarters of coverage during the 13-quarter period ending with death. For example, the estimated monthly payment in 1990 for the family of a deceased worker whose earnings subject to Social Security averaged $10,000 during his base period was approximately $1,000 per month. His family included a widow and two children under age 16. For more information on Survivors Benefits, contact the S.S.A.

Retirement

Retirement benefits are not based just on your last three or five years of earnings as many farmers seem to believe. The formula for computing Social Security retirement benefits is quite complex. Ask your Social Security office for SSA Pub. 05-10070 which provides a more complete description on how benefits are calculated.

Step 1. The number of years to be used in calculating average earnings is determined. Individuals reaching age 65 in 1990 will use 31 years of earnings. Those reaching 65 in 1991 will use 32 years. Persons born in 1929 or later will use 35 years of earnings in their averaging.

Step 2. Earnings prior to age 60 are adjusted for inflation. Earnings after 60 are used as is. The highest earning years are used when the total number of earning years are greater than the number of years required for averaging. Years in which there are no earnings are added in as zeroes.

Step 3. The earnings are then averaged. The average is divided by 12 to determine an "averaged indexed monthly earnings" (AIME).

Step 4. The benefit formula is then applied to the AIME.

In 1990 the formula is: 90 percent of the first $356 of AIME, 32 percent of the next $1,790, and 15 percent of any amount over $2,145 of AIME. For example, a person with AIME of $2,000 would receive:

$356 x .90 = $320.40
$1,644 x .32 = 526.08
$0 x .15 = 0
Total of $846.48 (without cost of living adjustment)

Step 5. The basic benefit is adjusted for early or later retirement (if appropriate). If a person retires at 65, the preliminary benefit is adjusted by "cost-of-living" after 62.

The benefit for your wife or husband at 65 is one-half of your 65 benefit. If you are primarily interested in receiving an estimate of your Social Security retirement benefits rather than how they are calculated, ask your Social Security office for a Request for Earnings and Benefit Estimate Statement, Form SSA-7004-PC-OPI. If you are nearing retirement and can accurately estimate future earnings, filling out and sending in this form will provide you with a free statement of your earnings covered by Social Security and your estimated future benefits.

Trying to raise retirement benefits by increasing earnings during the last years before retirement is not very effective because AIME is based on so many years. Also, if your AIME is already more than $2,145, an increase of $100 AIME would mean only $15 more retirement benefit per month. However, if AIME is under $356, increasing it would result in significantly higher retirement benefits.

Social Security is designed to replace part of the income you and your family lose when you retire, become severely disabled, or die. Many people need additional retirement income, disability insurance, and life insurance during some stages of their lives.

Increases in Social Security (FICA) and self-employment rates, and increases in earnings subject to the tax have placed a higher priority on exploring opportunities to reduce the burden of these taxes. Farmers now pay at a rate of 15.3 percent on the first $51,300 of earnings subject to Social Security. The net farm profit from the bottom of Schedule F or self-employment income is reduced by 7.65 percent in calculating earnings subject to Social Security. In addition, self-employed taxpayers may take a deduction from taxable income for one-half the Social Security taxes paid on self-employment.

In summary, you need to know where you stand now before deciding whether it is to your advantage or disadvantage to try to lower taxes paid. Tax dollars saved and invested for the future could for some persons, result in higher income during retirement. Tax dollars kept from IRS but spent now could mean lower income during retirement.

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QUESTIONS AND ANSWERS ABOUT SOCIAL SECURITY

1. Who is eligible to receive Social Security benefits?

   answer: Benefits are granted to those that are insured. Here are the four different categories of insured status:

   A. Currently insured -- provides limited survivor benefits; requires six quarters of coverage in last 13 quarters for period ending with disability, retirement or death.

   B. Fully insured -- provides retirement and survivor benefits; requires 40 quarters of coverage since 1950 or age 21 if later, in 1991 (39 in 1990).

   C. Disability insured -- provides disability in addition to retirement and survivor benefits; must be fully insured plus 20 quarters of coverage in last 10 years, or one-half the quarters (minimum of six) after reaching age 21 if disabled before reaching age 31. Disability benefits are also paid to a qualified spouse and dependent children.

   D. Transitionally insured -- provides some benefits for those reaching age 72 that have too few quarters to qualify as fully insured.

   In summary, retirement and disability benefits are paid to insured workers, dependents of retired or disabled workers and surviving family members of deceased workers.

2. What coverage is needed to enable the dependent or surviving spouse to receive survivor benefits?

   answer: A widow or widower caring for a dependent child under age 16 or disabled, is eligible for survivor benefits if the worker is currently or fully insured. If there are no dependent children, the surviving spouse must be age 60 or over and the worker must be fully insured. Dependent, unmarried children under age 18 or full-time students receive survivor benefits when the deceased is currently or fully insured.

3. How much must be earned to receive one quarter of coverage?

   answer: In 1990 annual earnings divided by $520 equal the number of quarters (up to four) earned by an individual this year. The dollar amount needed to equal one quarter has increased annually from $250 in 1978. A self-employed person needs at least $400 in annual net earnings to be credited with any quarters of coverage for that year. Different coverage rules and amounts were in effect before 1978. In general, one quarter was credited when $100 or more was earned in a calendar quarter.

4. How are retirement benefits computed?

answer: Most Social Security benefits are based on the insured individual's primary insurance amount (PIA) which is currently based on the average indexed monthly earnings (AIME). PIA is equivalent to the basic monthly benefit computed by a formula that is tied to changes in cost of living and changes in national wage rates. AIME represents the insured individual's average monthly earnings over most of his or her working career, indexed for inflation. Computing AIME involves counting the worker's <u>elapsed years, determining base years</u> and <u>selecting benefit computation years</u>.

5. What are elapsed years, base years, and computation years?

answer: <u>Elapsed years</u> are the number of calendar years after 1950 up to but not including the year the worker reaches age 62. If the worker was age 20 or less in 1950, start with the year after reaching age 21.

<u>Base years</u> are the years after 1950 up to but not including the year the worker becomes eligible for full benefits (age 65) or through the year following the worker's death, whichever is shorter.

<u>Benefit computation years</u> are the base years with the highest earnings. In most cases the number of elapsed years minus five are the number of computation years to use.

Example:

> Mac A. was 65 in August 1990. He applied and became eligible for retirement benefits. Since he reached age 62 in 1987 he has 36 elapsed years (1951 through 1986). His base years begin with 1951 and end with 1989, a 39 year period. His benefit computation years are the 31 (36-5) highest earning years from the base year period. Mac can eliminate the eight lowest earning years from his 39 base year period.

6. Can I calculate my AIME and PIA?

answer: It is possible but not easy. You would have to know how to index most of your prior years' earnings to reflect the increase in average U.S. wages to compute your AIME. The formula used to compute PIA changes each year. For workers eligible for benefits in 1990, PIA equals:

 90% of the first $356 or less of AIME
+32% of AIME between $356 and $2,146
+15% of AIME $2,146 and above

Rounding procedures used by the Social Security administration and cost of living adjustments make it difficult to duplicate official PIA's. It is best to have Social Security calculate your AIME, PIA, and estimate benefits for you! Ask for Form SSA-7004-7004-PC-OPI.

7. What are the maximum retirement benefits?

answer: In 1990 they are $975.00 per month for a fully insured individual retiring at age 65. Reduced benefits (approximately 80 percent of full) are available at age 62. In addition, the retiree's spouse may be eligible for benefits.

8. What are the retiree's spouse's benefits?

answer: When a worker or fully insured individual retires at 65, his or her spouse age 65 or more may receive 50 percent of benefits. If the spouse is age 62, he or she is eligible for 37.5 percent of the insured spouse's benefits. The spouse of an insured retiree cannot draw Social Security benefits from his or her own earnings plus those of the retired spouse. A spouse caring for the retired worker's child is eligible to draw if less than age 62. Use the Sample Benefits table at the end of this publication to find the relationship.

9. What are the benefits paid to a surviving spouse?

answer: Full benefits, if the deceased was fully insured. Qualifications vary if the surviving spouse is caring for a child and if the spouse remarries. Reduced benefits may be drawn at age 60. A surviving spouse caring for a child will receive benefits if the deceased was currently or fully insured. The dependent child is also eligible.

10. How much are disability payments?

answer: Disability payments are equal to the retirement benefit that would be paid at normal retirement age or the worker's PIA. Dependent children are eligible for 50 percent benefits.

11. Are there maximum benefits a family may draw?

answer: Yes, there is a cap on total family benefits. It is computed using 85 percent of the worker's average wages or 150 percent of the PIA. Total family benefits include workers compensation insurance and other federal and state disability payments. Refer to the Sample Benefits table attached to see the relationship between AIME, PIA, and maximum family benefits.

12. Will retirement age remain at age 65?

answer: Normal retirement age is scheduled to increase to age 67 after the turn of the century. It will be phased in starting in the year 2000 with an addition of two months per year for six years for individuals reaching age 62. For example, normal retirement age will be 66 for those reaching 62 in 2005. A second six year phase-in starts in the year 2017. Early retirement benefits will be reduced to 75 and 70 percent of full benefits when normal retirement age reaches 66 and 67 respectively.

Sample Benefits for Worker Reaching Age 65 in 1990

		Spouse		Survivors		Maximum
AIME[1]	PIA[2]	Age 65	Age 62	Spouse 62	Child	per Family
$ 100	$101.90	$ 50.90	$ 38.10	$ 84.40	$ 76.40	$ 153.00
200	204.10	102.00	76.50	169.10	153.00	306.00
300	306.20	153.10	114.80	253.80	229.60	459.40
400	349.10	174.50	130.80	289.40	261.80	523.70
500	385.40	192.70	144.50	319.40	289.00	578.20
600	421.70	210.80	158.10	349.50	316.20	632.70
700	458.00	229.00	171.70	379.60	343.50	697.90
800	494.30	247.10	185.30	409.70	370.70	796.50
900	530.60	265.30	198.90	439.80	397.90	895.20
1,000	566.90	283.40	212.50	469.90	425.10	994.20
1,100	603.20	301.60	226.20	500.00	452.40	1,092.80
1,200	639.50	319.70	239.70	530.10	479.60	1,191.60
1,300	675.90	337.90	253.40	560.30	506.90	1,251.50
1,400	712.10	356.00	267.00	590.30	534.00	1,300.20
1,500	748.60	374.30	280.70	620.50	561.40	1,348.80
1,600	784.80	392.40	294.30	650.50	588.60	1,397.50
1,700	821.00	410.50	307.80	680.60	615.70	1,446.20
1,800	857.40	428.70	321.50	710.70	643.00	1,499.90
1,900	887.10	443.50	332.60	735.40	665.30	1,551.90
2,000	904.10	452.00	339.00	749.40	678.00	1,581.70
2,100	921.20	460.60	345.40	763.60	690.90	1,611.50
2,200	938.20	469.10	351.80	777.70	703.60	1,641.70
2,300	955.10	477.50	358.10	791.70	716.30	1,671.00
2,417[3]	975.00	487.50	365.60	808.20	731.20	1,705.70

[1]Averaged Indexed Monthly Earnings.
[2]Primary Insurance Amount. Monthly benefits for fully insured workers age 65, subject to rounding. Disability benefit usually same.
[3]Maximum for most workers reaching age 65 in 1990.

Source: 1990 Social Security Explained, Commerce Clearing House, Inc.

LETTERS FROM FARMERS

Dear Tax Advisor:

I am a 60 year old self-employed farmer, my wife is 61. I am going to retire at age 65 and sell the farm. I have received my Earnings and Benefit Estimate from Social Security. They say my estimated retirement benefits are only $400 per month because I had several years of zero earnings from 1951 to 1965. I have estimated my average earnings for the next four years at $15,000 but can raise it to $20,000 if added Social Security benefits would make it pay. Please advise.

Sincerely,
M.M. Atlast

Dear Atlast:

Increasing your future earnings by $5,000 per year for the next four years will add approximately $571 to your 35 year annual average earnings and about $48 to your AIME. This will increase your retirement benefits approximately $15 per month. If your wife is eligible to receive spousal benefits your combined benefits will increase approximately $22.50 per month.

Additional Social Security taxes will cost you at least $650 per year or $2,600 ($2,060 present value at 10 percent). You may have additional income taxes as well. You and your wife must draw benefits for 10 or more years before you break even with Social Security taxes in present value terms. If you and your wife live beyond age 80, the added Social Security benefits may exceed what you paid for them.

My advice: manage your business over the next four years to maximize after-tax profits rather than to increase Social Security benefits.

Sincerely,
Tax Advisor

Dear Farm Tax Specialist:

My husband and I own and operate a small farm business. We have four dependent children, pay little income tax, but my husband's self-employment income may exceed $20,000 in 1990. We are 28 years old and have operated the farm for three years. I paid Social Security taxes for eight years prior to 1988. My husband has been covered since 1983. Should I renew my Social Security insurance coverage by taking a wage for the work and responsibilities I have in this business?

Sincerely,
Liberated Farmer's Wife

Dear Liberated:

If you die or are disabled it may be a major financial loss to the family and business. Becoming insured for disability benefits may help. To be disability insured, you will need Social Security coverage for at least one-half the quarters beginning with the quarter after your 21st birthday, and ending with the quarter before your 31st birthday or the quarter in which you become disabled. If you were 21 years old during the first quarter of 1983, you may have 19 quarters of coverage which is more than one-half of the 31 quarters that have passed to-date. If you continue with no coverage for six more quarters, you will lose disability insurance coverage. Drawing a wage as an employee of the business and paying 15.3 percent Social Security tax may be worth more than the cost.

Your potential disability benefits depend on your primary insurance amount (PIA) which is based on your AIME. If your annual earnings averaged $15,000 from 1983 through 1987, your AIME will be more than $1,250 per month and your PIA would exceed $650 per month. Since your dependent children are also eligible to receive one-half of the PIA, your family would be eligible for maximum benefits that could exceed $1,200 per month. Part-time farm employment may reduce your PIA in future years.

You will need to take $2,080 in 1990 farm wages to earn four quarters of additional coverage. This minimum will increase in 1991.

The cost of you taking a wage from the farm business will be the potential loss of future Social Security benefits to your self-employed husband. There should be no or very little difference in the total Social Security taxes paid by you and your husband. The potential loss of your husband's future benefits is small if his average indexed monthly earnings (AIME) are maintained at approximately $360. This AIME is equivalent to $4,320 of net farm profit from Schedule F.

Sincerely,
Farm Tax Specialist

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