

Taxation Tidbits: What's Your Social Security Strategy?

Farmers who report income on a cash-basis have a tremendous amount of planning flexibility with regard to managing their Social Security costs and benefits. Ironically, given the significance of self-employment tax to the overall tax bill, few farmers take advantage of pro-active strategies for optimizing their self-employment/Social Security costs and returns.

Different strategies should be utilized during different phases of one's career. Early on, just meeting and maintaining eligibility requirements for Social Security retirement, disability, and survivor benefits will be of extreme importance. However, in the later phase of one's career, you may want to focus on maximizing the returns on retirement dollars, while maintaining your eligibility for Social Security benefits.

For farmers in this latter category, lumping income and/or expenses so earned income is relatively high every other year can yield substantially greater retirement benefits than utilizing the more typical scenario of trying to level-out taxable income each year. Advantages of this lumping strategy spring from the following factors:

Only the highest 35 years of indexed earnings are utilized to calculate Social Security retirement benefits.

There is a maximum annual earnings subject to the Social Security retirement tax.

The Social Security retirement calculation has a regressive benefit rate schedule based on your indexed earnings.

To demonstrate this point, Farmer A and Farmer B both age 66, retired in 2004 and started drawing Social Security benefits. Farmer A and Farmer B have identical farming operations and farm income. Farmer A had reported the maximum self-employment earnings from 1955 to 2003. Farmer B also reported the maximum self-employment earnings 1955 to 2003, except for two years 2000 and 2002. For 2000 and 2002 Farmer B shifted his farm income and expenses to artificially report zero earnings for those years, shifting that net income to 2001 and 2003.

Farmer A's monthly Social Security benefit was calculated at \$1,836. Farmer B, who avoided paying SE tax for 2000 and 2002, had an estimated monthly Social Security benefit of \$1,801. While Farmer B will receive approximately \$35 less Social Security per month, he saved approximately \$15,143 in total taxes for the tax years of 2000 and 2002. The \$19,976 of SE tax savings were offset by an estimated \$4,833 of additional federal income tax.

Given the amount of dollars involved and the long-term consequences, you are encouraged to investigate and analyze whatever strategy you're considering with your financial and tax consultants. This is one of those situations where doing nothing is doing something -- be proactive!

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