Social Security Retirement – How Much & When?
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When you retire and how you retire can have an impact on your Social Security retirement benefits and vice versa. Retirement planning for farmers poses some special challenges. We are all familiar with the statement "farmers live cash poor and die land rich". The large percent of capital tied-up in long term assets, the desire of many farm families to pass on the farm to the next generation, and the current tax laws all work together to complicate the financing of retirement from within the farming operation. These factors tend to make Social Security benefits a substantial component of the retirement plans for most farmers.

The basic philosophy behind Social Security is rather simple. During your working years you put funds into the “system” - and when you retire or become disabled, you and members of your family become eligible for monthly benefits. Further, your survivors may be eligible to receive benefits even after you die. However, it should be recognized, particularly in today's economic and political environment, the Social Security system was not designed nor intended to be your only or even your main source of retirement income or disability coverage.

Your age and most importantly your earning's history are factors which will affect the amount of your Social Security benefits. However, to be eligible, you must have paid taxes into the Social Security system for a minimum number of quarters. Most people need 40 quarters to qualify for benefits. The earnings required to receive a quarter varies year to year, however, the maximum quarters that can be earned per year are four. In 2004, a quarter is earned for each $900 of earnings; so you need $3,600 of earned income to receive credit for 4 quarters. Four quarters are the maximum that can be earned per year. Additionally, in computing quarters, the number of quarters are rounded down to a whole number, so $3,500 of earnings would result in 3 quarters.
The following are important issues for people nearing retirement age to consider. First, how are retirement benefits calculated; second, should you “beef-up” your earnings shortly before retirement; and third, should you file for benefits at age 62, full-benefit age, or later?

Since 1991, the calculation of retirement benefits is much easier to understand. First, your earnings which have been reported over the years are indexed to adjust for inflation. Second, the highest 35 years of indexed earnings are added together and divided by 420 months (the number of months in 35 years) to arrive at an "Average Indexed Monthly Earnings" (AIME). Finally, this average indexed monthly earnings is multiplied by a percentage to determine your retirement benefits. On average, for Social Security retirement beneficiaries, this formula results in benefits that replace about 42% of a person's earnings. The percentage is higher for people with low incomes (a marginal return of 90%); and lower for people with high incomes (a marginal return of 15%).

This percentage weighting of the benefit formula in favor of low-income earners, is one reason why people in higher income brackets are attempting to minimize their exposure to Social Security tax liability. It also provides insight into whether reporting additional earnings shortly prior to retirement will be financially rewarding. For example, $10,000 additional earnings reported the year prior to retirement would increase the AIME only $23.81 (assuming that year was one of the high 35 years and was $10,000 greater than the year it replaced). A person with a low history of earnings would receive monthly benefits equal to 90 percent of the $23.81 ($21.43); while a person with a high history of earnings would only receive 15 percent of the $23.81 ($3.57) per month for reporting the extra $10,000 of earnings. Given, self-employment taxes on the extra $10,000 would be in the neighborhood of $1,215; the payout (not figuring the present value of money) for historically low earners would be around 5 years, while the payout for historically high earners would be around 28 years.

The third question of when to start receiving retirement benefits is more subjective and difficult to answer. If you're at retirement age, but continuing to work, the Social Security benefit formula will only provide you with increased monthly retirement benefits if your current earnings are greater than any of the indexed earnings in your high 35-year earnings base. Additionally, your retirement benefits can be received as early as age 62. However, if you begin receiving your benefits early, the benefits are reduced a small percentage for each month before your "full" retirement
age (currently 65 years and 2 months). If you sign-up for benefits at age 64, (14 months early) you will receive 92.2 percent of your full benefit; while signing-up for benefits at age 62 (38 months early) would result in you receiving 79.2 percent of your full benefit amount. The disadvantage of starting your benefits early is that your monthly benefit is permanently reduced. The advantage, of course, is that you collect benefits for a longer period of time.

For the self-employed farmer electing early retirement, the selection of the "month of retirement and entitlement" can have significant consequences regarding the hold-over of inventory and the impact on the earnings exclusion. First, during the calendar year selected as the initial year of retirement, you are entitled to your full total monthly benefits regardless of the amount of your annual earned income prior to retirement, as long as you devote less than 45 hours to the business of farming during the retirement months. Additionally, income received after the initial year of entitlement to retirement benefits can be excluded from the earnings test, if the income is not attributable to services performed after the initial month of entitlement (hold-over grain inventory harvested prior to retirement).