Social Security Planning for Farmers and Ranchers

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Overview

Many farmers and ranchers are reaching retirement age for Social Security benefit purposes. That raises numerous questions involving such things as benefits, earnings, what counts as "wages" and the cash renting of farmland. These are all important questions for farmers and ranchers to have answers to so that appropriate planning can be engaged in and expectations realized.

Details on Social Security benefits - it's the topic of today's post.

Full Retirement Age

Once a person reaches "full retirement age" (according to the Social Security Administration) earnings don't impact Social Security benefits. The full retirement age used to be 65 for those born in 1937 or earlier. Those born between 1943 and 1954 have a full retirement age of 66. The full retirement age further increases in two-month increments each year to 66 and 10 months for those born in 1959. For those who turned 62 in 2022, the full retirement age is 67.

During the calendar year in which an individual reaches age 66, an earnings limit applies for the months before the individual reaches full retirement age. For example, for an individual who turns age 66 during 2022, there is a monthly earnings limit of $4,330 ($51,960 ¸ 12 months) for the months before full retirement age is reached. Excess earnings for this period result in a $1 reduction in benefits for each $3 of excess earnings received before attaining the age of 66 years and four months. But, for a person who hasn't reached full retirement age, benefits are reduced by $1 for every $2 of earnings over the annual limit of $19,560 (for 2022). As noted above, for those drawing benefits after reaching full retirement age, there is no limit on earnings – benefits are not reduced.

Drawing Benefits

An individual can receive full Social Security benefits if they aren't drawn until full retirement age is achieved. Another way to state it is that if an individual delays taking Social Security benefits until reaching full retirement age, the individual receives additional benefits for each year of postponement until reaching age 70. The rate of increase is a fraction of one percent per month. In essence, the impact of drawing Social Security benefits before reaching full retirement age is that such a person must live longer to equalize the amount of benefits received over their lifetime compared to waiting until full retirement age to begin drawing benefits.

Taxability of Benefits

Federal. About 20 million people each year, some who are undoubtedly farmers and ranchers, pay tax on their Social Security benefits. These people are commonly in the 62-70 year age range. Taxing Social Security benefits seems harsh, inasmuch as the person has already paid income tax and Social Security payroll taxes on the earnings that generated the benefits. But not every dollar of benefits is taxed. What matters is a person's total income from non-Social Security sources such as wages and salaries, investment income (and capital gains on those investments), and pension income. To that amount is added one-half of the person's Social Security income. The total amount then is measured against a limit. For example, a person who files as married-filing-jointly (MFJ) will subject 50 percent of their Social Security benefits subject to tax if the total amount exceeds a base amount - $32,000 for 2022 (it's $25,000 for a single filer). The 50 percent changes to 85 percent once the total amount exceeds $44,000 (MFJ) or $34,000 (single) for 2022. Those are the maximum percentages in theory. In reality, however, there is a complex formula that often results in less Social Security benefits being taxed than that maximum percentage. For instance, for taxpayers that fall in the 50 percent taxability range, the amount of Social Security benefits that are included in income is the lesser of one-half of the Social Security benefits for the year or one-half of the difference between combined income and the base amount. The formula is more complex for those who trigger the 85 percent test.

Note: The IRS provides a worksheet to calculate Social Security tax liability in IRS Publication 915. The formula often results in about 20 percent of Social Security benefits being taxed once the total amount threshold is exceeded.

State. The following states tax Social Security benefits to some extent: Colorado; Connecticut; Kansas; Minnesota; Missouri; Montana; Nebraska; New Mexico; Rhode Island; Utah; Vermont and West Virginia. The taxability of benefits varies from state to state. In Kansas, for example, Social Security benefits are exempt if federal AGI is $75,000 or less. Above that threshold, Social Security benefits are taxed to the same extent they are taxed at the federal level. By comparison, Nebraska, for 2021, did not tax Social Security for joint filers with a federal AGI of $59,960 or less and other taxpayers with a federal AGI of $44,460 or less (the 2022 threshold is not available yet). For taxpayers exceeding these thresholds, Social Security benefits are taxed to the same extent they are taxed at the federal level. For 2022, taxpayers can choose to deduct 40% of Social Security benefits on the state return that are included in federal AGI instead of having them taxed in accordance with the above rule. The optional deduction percentage increases to 60% for 2023, 80% for 2024, and 100% for 2025 and thereafter.

Special Considerations

The "donut" hole. The computation of Social Security retirement benefits is based on an individual's earnings record. That record can include 40-plus years of earnings up to age 62 when eligibility for benefits begins. Earnings are adjusted based on wage inflation to equivalent dollars when an individual turns 60. That is the last year earnings are indexed for wage inflation. Earnings after age 60 are added to the earnings record but are not adjusted for inflation.

A cost-of-living adjustment (COLA) kicks in each year starting at age 62. The two-year gap where there is neither a wage inflation adjustment nor a COLA is particularly evident this year because of an inflation rate not seen in over 40 years. Presently this affects people born in 1960 and 1961. There is nothing that can be done about this; it's simply tied to when an individual turns age 62.

Wages in-kind. Some farmers receive wages in-kind rather than in cash. In-kind wages such as crops or livestock, count toward the earnings limitations test. The earnings limit test includes all earnings, not just those that are subject to Social Security (FICA/Medicare) tax. But, employer-provided health insurance benefits are not considered to be "earnings" for purposes of the earnings limitation test. They are not taxed as wages. *I.R.C. §3121; SSA Program Operations Manual System, §§RS 01402.040; 01402,048.*

Farm programs. Federal farm program payments that a farmer receives are not deemed to be "earnings" when calculating each calendar year's earnings limitation. *SSA Program Operations Manual System §RS 02505.115.* That is the case except for the initial year of Social Security benefit application. In that initial year, all FSA program payments are counted along with other earned income and earnings for purposes of the annual earnings limitation test.

Cash rent. For farmers who cash rent farm ground to their employer, the cash rental income that the farmer receives will likely be treated as "earnings" even though the farmer is getting a wage from the employer. This is particularly the case if the farmer is farming the ground on the employer's behalf. The result would be a "doubling-up" of the wage income and the cash rent income for purposes of the age 62-66 earnings test.

CRP payments. For a farmer who is drawing Social Security benefits, whether retired or not, Conservation Reserve Program Payments received are not subject to Social Security tax. *I.R.C. §1402(a)(1).*

Conclusion

Social Security benefit planning is an item that is often overlooked by farmers and ranchers. However, it is useful to know how such planning may fit into the overall retirement plan. It is just one piece of the retirement, succession, estate plan that should be considered in terms of how it fits in with other strategies. While a farmer or rancher may never actually "retire," there is a benefit to properly timing the drawing of Social Security benefits. In addition, as noted above, there are some special situations that a farmer or rancher should be aware of.

Also, the Social Security Administration website (ssa.gov) has some useful online calculators that can aid in estimating retirement benefits. It may be worth checking out.