CASH BASIS STRATEGY TO MAXIMIZE FARMERS' SOCIAL SECURITY BENEFITS

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ABSTRACT

U. S. Social Security benefits are based on the best 35 years of participation. Those who already have, or will soon have, 35 years of fairly level earnings may, especially if they own a business, possibly farming, be able to time their income recognition, possibly recognizing two years of income every other year, resulting in higher benefits. Frequently, but not always, there will be additional income tax. This paper explores the relationship between the additional income tax and the increased Social Security benefit in absolute and present value terms. For extremely low income individuals the benefits can be very positive.

Introduction

James Dorcie inherited the family farm in 1966, at age 18, when his parents were killed in an auto accident. James also graduated from high school that year and married Susan, his high school sweetheart. In the following years, together, they operated the farm and successfully raised four children, all of whom have been graduated from college and have moved on to successful non-farm careers. Because the farm and the children required all of James' and Susan's efforts, the only income they had during these years came from their relatively modest farm profits.

Having reached age 62 in 2010, James and Susan are faced with making their first decision about when to start their social security retirement benefits, because, while normal retirement for Susan and James is age 66, a reduced pension benefit may be elected as early as age 62.1. Because all of the farm income was treated as James' income for social security tax purposes, Susan will have earned no worker benefits of her own. However, she will be able to collect social security spousal benefits based on James' work record. Therefore, decisions that James makes concerning when to start his benefits, will also affect Susan's benefits.

To help them in their decision, James has received an evaluation of his social security retirement benefits, called the primary insurance amount (or PIA). The calculation of his PIA benefits [see SSA.gov] projects what his monthly benefits would be if he started his benefits at age 66. If he elects to start his benefits at age 62, he would receive 75 percent of his PIA. If he elects to defer starting his benefits until age 70, he would receive 132 percent of his PIA. Of course, if he elects to defer starting his benefits to any age later than 62, the PIA will be increased by cost of living adjustments, or COLAs. Because we cannot predict what the COLAs will be in future years, we have assumed no changes for the future years in our examples and illustrations.

THE CASH BASIS STRATEGY

Because James and Susan operate a qualifying family farm, they are allowed to file using the cash basis method. Because they normally sell their corn crop in November or December each year, they could very easily wait a month or two and have two years crops reported in one year and no income reported in the other year. For our example, we will assume that all of the prior 35 years in their base are uniform at $24,000 (inflation adjusted). We will also assume the every other year strategy results in income of zero in the first year and third year and $48,000 in the second and fourth years. Therefore, two of the 35 base years of $24,000 will be replaced by the two $48,000 years. The effect on James' PIA is:

New AIME = ($840,000 – 2(24,000) + 2(48,000) = $888,000)/420 = $2,114, and

New PIA = (761*.90 = 685) + ((2,114 -761)*.32=433) = $1,118.

Based on the new PIA, and disregarding potential COLAs, James's and Susan's benefits at two remaining election dates would be:

	Age 66	Age 70
James	$1,118	$1,476
Susan	$ 559	$ 559
Total	$1,677	$2,035

At age 66, the combined increase in benefits for James and Susan would be $54 dollars per month (pre-change benefits will be provided), or $648 per year. Before we advise them to use this strategy, we need to look at the cost. The good news is, the strategy creates no additional social security or Medicare taxes. Whether, pay on $24,000 every year, or $48,000 every other year, the total tax is the same. However, we need to look at the effect of this strategy on their income taxes (to be provided).

DEFERRING JAMES' BENEFITS TO AGE 70

Another way to increase their benefits would require James to wait until age 70 to start his benefits, which would increase his benefits by 8 percent for each year that he waits past age 66, bringing his benefits up to about 132 percent of the amount that he would have received by starting the benefits at age 66. However, while James' worker benefits increase for years deferred past normal retirement, Susan's spousal benefits will not. Therefore, it would appear that the best strategy for James and Susan would be to have James file for benefits when Susan reaches full retirement age, then immediately suspend his benefits by filing SSA Form 521, Request for Withdrawal of Application, with the Social Security Administration to get a "voluntary suspension" of his benefits. Susan will then be able to file for spousal benefits on James' suspended account, yet, James' benefits will continue to increase by 8 percent each year, exactly the same as if he had not filed for benefits at all. Without showing all the calculations, the benefits that they would receive under this strategy (to be provided when presented).

SUMMARY AND CONCLUSION

Although benefit increases are enjoyed by reporting two crops in alternating years, the additional income tax and the time value make it unprofitable for higher income farmers. However, there are many low income farmers who might benefit, especially for those who would pay no additional tax. If any of the benefit falls into the 90% range of the PIA, the payoff is extreme.