Business point

Don't let retirement surprise you

***Editor's note:** Kent Vickre and Chuck Cagley author a tax and finance column for each issue of Pioneer* GrowingPoint® *magazine. Vickre is state coordinator of the Iowa Farm Business Association. Cagley is state coordinator of Illinois Farm Business Farm Management. They address issues that influence agribusiness success.*

Whether you're a wage earner or self-employed, retirement planning should be a lifelong process. If you can make regular investments in your retirement, you can accumulate substantial retirement assets.

The earlier you begin, the more the "multiplier effect" benefits you: You have more years for assets to benefit from compounded earnings. This should motivate you to begin early.

Farmers have the opportunity to diversify their portfolios beyond just agricultural assets. You may have multiple goals, including the continued operation of the farm into the next generation, passing the farm to your heirs as intact as possible, and creating sufficient retirement income.

Start with a review

It usually pays to start the retirement planning process by reviewing your current balance sheet. Unlike most wage earners, farmers don't have most of their retirement income-producing assets in the form of a formal retirement plan. To know whether retirement is even feasible, you need to go through a budgeting process and review detailed records you may already have.

Identify the potential income sources. These may include continued business income or wages, net rental income, interest and dividends, Social Security benefits, other pension income and retirement plan withdrawals.

Are there other assets on the balance sheet you could convert to income-producing property or to sources of cash through installment sales? For many people, several items on the balance sheet can be used as part of a viable retirement plan.

Compare these income sources against the projected expenses you'll have in retirement. Be sure to consider medical expenses, health insurance, family living costs, housing costs, travel expenses, etc. Medical insurance rates have escalated in recent years, making your 65th birthday a noteworthy date — it's the first time you'll be eligible for Medicare.

In recent years, high medical insurance rates have discouraged early retirement. The impacts of rising medical costs are being compounded by rising age requirements for full Social Security retirement benefits: The younger you are, the longer you'll have to work to earn full benefits.

Ways to fund retirement

Fortunately, a self-employed farmer can consider a number of retirement-plan options when trying to determine the best alternative to pursue. These vary all the way from a single formal plan, to a combination of formal plans, to more-extensive investment in business assets that might provide rental income when the farmer reaches retirement age.

Because farming is such a capital-intensive business, it may not be feasible to fund retirement plans at the same dollar level as many non-farm people. If no family members are likely to continue in the business, you probably will liquidate grain and livestock inventory, as well as machinery. These sales can provide

significant retirement assets.

The kind of tax planning you need in anticipation of retirement is very individualized thing. You can minimize the tax obligation if you anticipate your retirement date at least five years in advance.

Dealing with deferred income

Because they can report on the cash basis for income tax purposes, many farmers have deferred sales throughout their farming careers. Some producers could be carrying almost an entire year's production into the year they stop farming. They may have very little expense to charge against this revenue in the final year of sale.

With advanced planning, you may be able to collect for some fall sales and level the wide fluctuation of incomes caused by the uncertainty of production and price. Income averaging may offer benefits (see "Better than average," Pioneer *GrowingPoint®* magazine, January 2007, page 12). An individual may declare so much income on Schedule F that it exceeds the Social Security maximums.

Many farmers say their payments on land debt is their "deduction" for retirement-plan purposes. Certainly the interest portion of the payment can be a business deduction, and historically farmland has been a good hedge against inflation.

But a given land parcel may not match your needs for flexible income tax and retirement planning. It also may not be feasible because of other financial considerations.

Gauging the tax bite

You may face greater tax consequences with the sale or transfer of machinery and real estate tax because of rapid depreciation of machinery and relatively low basis combined with inflated values on farmland. Most income on machinery sales will be subject to ordinary tax rates. Although real estate will probably be eligible for capital gains rates, the magnitude of the dollars can still be great.

If retirement income sources permit, you and your heirs may save thousands of dollars in capital gains taxes if you hold onto low-basis land until death. Gifts of machinery to family members who are active in farming may allow them to use the value of the equipment over time rather than facing the tax all at once.

Raising the limits

Recent changes in the tax law provide increased deduction limits for retirement plans. The contribution limit for traditional individual retirement accounts (IRAs) is currently $4,000 for 2005 through 2007. Individuals age 50 and older can claim an additional $1,000 "catch-up" contribution in 2006 and 2007. These limits apply to both the traditional and the Roth IRA.

Be aware of income phase-out limits if either the taxpayer or spouse participate in another plan or are in a high tax bracket. For married couples, a traditional IRA combined with a spousal IRA or an employer-sponsored plan may provide all the investment they want for formal retirement plans.

The choice of a traditional IRA versus a Roth is primarily a function of age, tax bracket and expectations. Consider the relative level of income tax rates you expect when drawing on retirement funds. We lean toward the value of the immediate deduction and the time value of money, but only time will tell.

Plans for employees

For retirement plan alternatives that permit greater contributions and deductions — such as a SEP IRA or Keogh (HR10) plan — you generally run into provisions requiring contributions for employees who meet certain minimum qualifications. When these employees contribute significantly to the success of the business and you can afford to contribute, this is a fine situation.

You can set up plans for $15,000 to $40,000 in contributions, even more with certain defined-benefit plans. However, if your employees are likely to stay five years or less, the retirement benefit may not be as important to them as higher wages or other benefits.

The advantages and disadvantages of the retirement plans can be complex. Get advice from qualified tax and legal advisors and review tax publications such as Thomson PPC's Quickfinder series. Retirement planning is unique for every family. Using a team of accountants, farm management association field staff, retirement plan representatives and/or attorneys can help you reach your goals. ■

It's never too early to plan for the day when you hand the farm over to someone else.