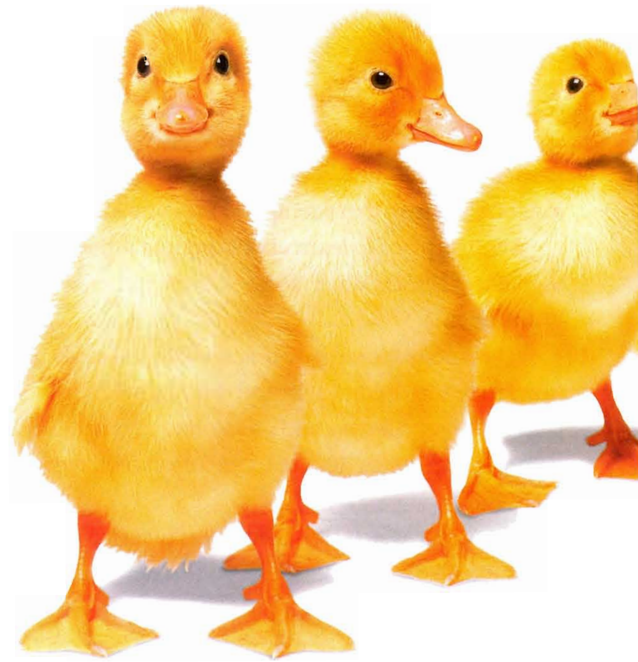
Business point

Get your retirement ducks in a row



Start planning early and avoid putting all your eggs in one basket.

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

Too often, the retirement planning discussions tend to start 10 to 15 years before retirement — which is better than one to two years before retirement, but still not soon enough.

A simple review of the time value of money offers a valuable lesson. A general rule to remember: Money doubles every 10 years at 7 percent interest and doubles every seven years at 10 percent interest. The earlier you begin saving for retirement, the more this "multiplier effect" benefits you. This should motivate younger growers to start early.

The uncertain stock markets and fluctuating land prices of recent months remind us of our grandparents' wisdom: Never put all your eggs in one basket. It's a timeless lesson.

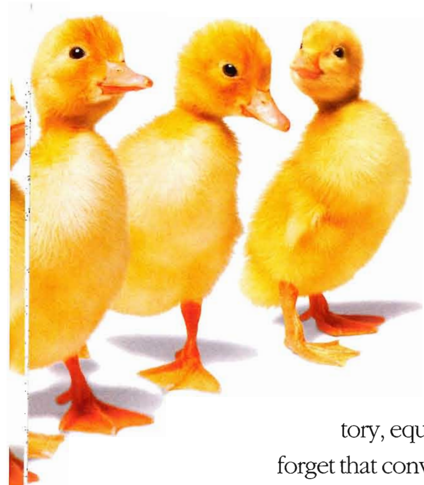
How much do I need?

The first question people ask is how much money they need at retirement. The answer depends on what you want to do when you retire. Growers may have multiple goals, including continuing the farm operation with the next generation, passing the farm to the heirs as intact as possible and creating a sufficient retirement income.

Consider these items as you think about attaining your goals:

1. Identify income sources available in retirement. These may include continuing business income or wages, net rental income, interest and dividends, Social Security benefits, other pension income and retirement plan withdrawals.

Unlike most other wage earners, farm producers may not have their retirement income in a formal plan such as a 401K. Income may come from farm business assets. You'll need to review the net worth of assets you can convert to income at retirement.



Examples would be inventory, equipment, or land. However, don't forget that converting these assets to cash likely will have tax consequences (see "Gauging the tax bite" below).

2. Project your retirement expenses. The key thing is to be realistic. If you plan to travel or start a new hobby, include these expenses in your projections. Also, because medical insurance and the cost of medicine have escalated in recent years, your 65th birthday should be a noteworthy date. This is the first time you are eligible for Medicare. In recent years, high medical insurance rates have discouraged early retirement.
3. Gauging the tax bite. Many people overlook this expense. If no family members are likely to continue farming, you'll probably liquidate grain and livestock inventory as well as machinery. Start discussing tax-planning strategies with your consultant at least five years in advance. Several tax issues are unique to farm producers:
   - **Deferred income.** Because producers can use cash basis reporting for income taxes, 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, with very little expense to offset the final year of income.

     With advanced planning, you may be able to collect for some fall sales and level off the wide fluctuation of incomes caused by the production and price uncertainties. Discuss this with your tax adviser in advance so you can use income averaging or the Social Security maximums.
   - **Ordinary capital gain income.** 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 farmland values. Most income on machinery sales is 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 spread the value of the equipment over time rather than facing the tax all at once.

Retirement funding issues

Fortunately, a self-employed farmer can consider a number of retirement plans. Among the most common are IRAs, Roth IRAs and SEP Plans.

IRA/Roth IRA

Recent changes in tax law have increased deduction limits for retirement plans. The contribution limit for traditional individual retirement accounts (IRAs) is currently the lesser of taxable compensation or $5,000 for 2009. Individuals age 50 and older can claim an additional $1,000 "catch-up." 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 is 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.

SEP plans

Typically, a sole proprietor can use a SEP plan for his employees' retirement funding (including himself). Since this is an employee plan, check into the plan provision regarding contribution requirements for "qualified employees."

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.

Review your goals

Remember, your retirement needs depend on your goals, which are constantly changing. Be sure to discuss your retirement plan often.

Try not to get "stuck" on the details, such as inflation or rate of return percentage. It's impossible to predict the future, so focus on the process, not the "exact" projection.

Golden rules: (1) start early to let the "multiplier effect" work for you and (2) diversify your investments.