3-5-1993

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Recommended Citation
Available at: http://lib.dr.iastate.edu/aglawdigest/vol4/iss5/1

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EARNINGS AFTER RETIREMENT

— by Neil E. Harl

Many farmers, approaching retirement, must make important decisions on — (1) the nature of their relationship to the farm business in retirement, (2) the extent of their personal involvement in business operations, and (3) the timing and manner of disposition of their inventory of crops and livestock during the retirement years.1

Allowable earned income

For 1993, individuals who have reached age 65 are allowed to earn $10,560 without loss of social security benefits.2 After age 70, there is no reduction of social security benefits regardless of the level of earned income.3 Before reaching age 65, the limit on earned income is $7,680 per year before reduction of social security benefits.4

Converting inventory to capital assets

Some individuals have tried, usually unsuccessfully, to transform crops and livestock on hand at retirement into capital asset status.5 Capital assets produce capital gain which is not reportable as earned income for social security purposes.6

The courts have generally agreed that whether an asset is held for sale in the course of business or is held as a capital asset depends upon the intent of the taxpayer.7 And the courts have generally been unmoved and unconvinced by arguments that an individual's intent shifts at the time of retirement sufficient to classify inventory items as capital assets.8 However, in one case a farmer succeeded in arguing that a crop held initially for sale had been converted to capital asset status.9 In that case, a rye crop produced several years earlier was stored under a Commodity Credit Corporation loan, redeemed from the CCC loan and held for four years before sale.10 The court agreed that holding the crop after redemption of the CCC loan indicated that the crop was considered a good faith investment with the result that sale of the crop was treated as a sale of a capital asset.11

Sale of previously produced crop

Under the social security regulations,12 an individual entitled to social security benefits excludes from gross earnings (for purposes of the earnings limitation in retirement) any self-employment income received in a year after the initial year of entitlement that is not attributable to services performed after the first month of entitlement to benefits.13 For this purpose, services means any significant work activity performed by the individual in the operation or management of a trade, profession or business which can be related to the income received.14 The regulations refer to this as significant services.15

The regulations specifically note that actions taken after the initial month of entitlement to social security benefits to sell a crop or other product if the crop or product was completely produced or created in or before the month of entitlement are not considered significant services.16 Therefore, such items may be sold without loss of social security benefits. The regulations caution that this rule does not apply to income received by an individual from a trade or business of buying and selling products produced or made by others, for example activities by a grain broker.17 This provision can be very useful for individuals entering retirement with substantial inventories of stored grain, for example. With some care in planning, sale of such items should not produce earned income for purposes of the limits on social security benefits.

The regulations also note that activities relating to protecting an investment in a currently operating business should not count as significant services.18 Thus, hiring a farm manager to operate the business,19 signing contracts negotiated by a farm manager,20 looking over financial and operating records to assess the effectiveness of a farm manager,21 or occasionally filling in for a farm manager in an emergency,22 should not be considered to be significant services.
FOOTNOTES
5 E.g., Shumaker v. Comm’r, 648 F.2d 1198 (9th Cir. 1981) (determining factor is taxpayer’s purpose or intent in holding property).
6 I.R.C. § 1402(a)(3).
7 Shumaker v. Comm’r, n. 5 supra.
8 Id.
10 Id.
11 Id.
14 Id.
15 Id.
17 Id.

CASES, REGULATIONS AND STATUTES
by Robert P. Achenbach, Jr.

BANKRUPTCY

EXEMPTIONS

AVOIDABLE LIENS. The debtor sought avoidance, to the extent of the homestead exemption, of a secured lien against the debtor’s homestead. The secured creditor argued that under Ford Motor Credit Corp. v. Dixon, 885 F.2d 327 (6th Cir. 1989), the exemption was not impaired by the lien because the exemption applied, under Ohio law, only in cases of attachment, execution, garnishment or sale. The court held that Owen v. Owen, 111 S. Ct. 1833 (1991) overruled Dixon and that the lien could be avoided to the extent of the homestead exemption. In re Boswell, 148 B.R. 31 (Bankr. N.D. Ohio 1992).

IRA. The debtor claimed an interest in an IRA as exempt under Ill. Rev. Stat. ch. 110, ¶ 12-1006. The trustee objected to the exemption, arguing that the statute’s presumption that an IRA was a spendthrift trust was unconstitutional and that the basic exemption was also unconstitutional as impairing contracts. The court held that the exemption was unconstitutional to the extent the IRA would be excluded from the bankruptcy estate as a presumptive spendthrift trust. But the court held that the IRA exemption was constitutional. In re Brilley, 148 B.R. 39 (Bankr. C.D. Ill. 1992).

CHAPTER 12

LOTTERY PROCEEDS. After the debtors’ Chapter 12 plan was confirmed, the debtors won $6 million in a state lottery. The debtors used the first year’s proceeds to pay the entire amount required by the plan which provided for 10 percent payment of unsecured claims. The trustee and creditors sought modification of the plan to increase the length of the plan to five years and to increase the payments to 100 percent of unsecured claims. The debtors argued that the motions for modification were untimely because all payments had been made and the plan was completed. In addition, the debtors argued that because the plan did not provide for any additional payments from disposable income, no increase in payments could be allowed. The court held that the modification motions were timely because the plan was not completed since one piece of property remained to be sold. The court also allowed the increase in payments and plan length, holding that to allow the debtors the windfall of the lottery winnings was inequitable and that the winnings were disposable income subject to bankruptcy administration. In re Cook, 148 B.R. 273 (Bankr. W.D. Mich. 1992).

TRUSTEE FEES. The Chapter 12 debtors sought reduction of the 10 percent standing trustee fee because the plan required very little effort or time from the trustee over the life of the plan. The court held that the trustee fee was not reviewable nor reducible by the court. In re Schollett, 980 F.2d 639 (10th Cir. 1992).

CHAPTER 13

PLAN. The debtors, husband and wife, filed a joint bankruptcy case, but the cases were not consolidated. The debtors’ plan provided for 100 percent payment of joint creditors’ claims but only 9.6 percent payment of the debtors’ individual creditors’ claims. The debtors claimed an exemption in their residence which was owned as tenants by the entirety. The trustee objected to the plan, arguing that unsecured creditors would not receive as much as they would in a Chapter 7 liquidation. The trustee argued that all of the creditors should be treated the same, as if the cases were consolidated. The court held that the cases were not consolidated and because the debtors’ joint creditors were to be paid in full, the homestead exemption would be allowed as against the separate creditors of each debtor and that the separate creditors would not need to be paid in full. In re Chandler, 148 B.R. 13 (Bankr. E.D. N.C. 1992).

FEDERAL TAXATION

ALLOCATION OF PLAN PAYMENTS FOR TAXES. The corporate debtor had filed a Chapter 11 liquidating plan which provided for allocation of plan payments first to employment trust fund taxes before payments on interest and penalties. The debtor also sought an injunction against the IRS from assessing the I.R.C. § 6672 penalty against the sole shareholder who was also the president of the corporation. The debtor argued that the allocation and injunction were authorized by U.S. v. Energy Resources, Inc., 495 U.S. 545 (1990). The court held that the allocation of plan payments was not allowed where the allocation would cause a decrease in the amount collected by the IRS and did not contribute to a successful reorganization, since the debtor was to be liquidated. The court also held that an injunction would not be granted.