

Social Security and Other Labor Taxes

The Federal tax system imposes two taxes on wages paid to farm laborers, a social security tax and an unemployment insurance tax. The social security (self-employment) tax is also imposed on a farmer's net earnings from self-employment.

Social Security and Self-Employment Taxes

Social security taxes include two components: the old age, survivor, and disability (OASDI) portion and the Medicare hospital insurance (HI) portion. Social security tax burdens have risen dramatically in recent decades because of increases in both the tax rate and the amount of income subject to taxation. The most recent rate increases stem from a decade of legislation, beginning with the Social Security Amendments Act of 1983 (table 18).

Unlike Federal income taxes which are progressive, the social security tax is a flat rate with a maximum taxable amount. In 1980, the total payroll tax on wage income was 12.26 percent and the maximum amount of earnings subject to the tax was \$25,900. By 1990, the tax rate had increased to its current level of 15.3 percent (7.65 percent for both the employer and the employee) and maximum earnings subject to tax were \$50,400.

Social security taxes increased again in 1991 when a separate, higher earnings cap was created for the Medicare hospital insurance (HI) portion of the tax. Previously, a single earnings cap applied to both the (HI) portion of the tax and the old age, survivor, and disability insurance (OASDI) tax. The earnings cap for the 2.9-percent HI tax (1.45 for both the employer and the employee) more than doubled from the OASDI cap and increased from \$125,000 in 1991 to \$135,000 in 1993. The HI cap was removed completely in 1994, making all wage and self-employment income subject to the 2.9-percent tax. While only about 1 percent of farm sole proprietors had wage or self-employment income above the cap, the removal of the cap added to the overall increase in social security tax burdens.

For 2001, a 7.65-percent rate for both the employer and employee (6.2 percent for OASDI, plus 1.45 percent for HI) applies to wages through \$80,400. Wages above \$80,400 are subject only to the Medicare or hospital insurance tax rate.

Generally, an employer must withhold social security and Medicare taxes on all cash wages paid to employees for agriculture labor if their wages for farm work meet either of two tests. The first test requires that social security taxes be withheld if an employee receives \$150 or more in wages for the year. Withholding must also occur if a total of \$2,500 is paid for all farm employees during the year. There is a limited exception for wages paid to a farm worker who receives less than \$150 in annual wages if the farm worker is employed as a hand-harvest laborer, is paid on a piece-rate basis, commutes daily from the worker's home, and worked in agriculture for less than 13 weeks in the prior year. Compensation paid to agricultural employees in-kind is not subject to social security taxes. This has encouraged some farmers to pay their employees in farm commodities.

Self-employed farmers must pay 15.3 percent of net farm profit up to a maximum of \$80,400. They pay 2.9 percent on net farm profit above \$80,400. Net farm profit for social security tax purposes does not include investment income or gains and losses from the sale of assets used in the farm business. However, since the tax is imposed on net farm profit, it can include income generated from assets such as land that are used in the farm business as well as the return to the farmer's labor. Because the share of social security taxes paid by an employer is not included in an employees' wage and salary income, self-employed individuals receive an income tax deduction for one-half of their self-employment tax and a 7.65-percent exclusion of self-employment income. Thus, the self-employment tax is comparable with social security taxes on wage and salary income.

In 1994, the average effective social security tax rate for all farmers was 10 percent, up from only 7.6 percent in 1987. Effective rates continue to be regressive and range from nearly 14 percent for farmers with income less than \$10,000 to only 2.6 percent for farmers with income over \$200,000. On average, farmers earning less than \$60,000 paid more in social security taxes than in Federal income taxes. This group, which represented about 80 percent of all farmers in 1994, paid an average of \$3,400 in social security taxes and only \$1,900 in Federal income taxes. For all farmers, average Federal income taxes were \$7,400, and social security taxes were \$4,600 (Durst and Monke, 1998).

While the sharp increase in tax rates and the amount of income subject to tax have increased individual self-employment tax liabilities, total self-employment taxes

paid by farmers have not increased nearly as fast. In 1996, farmers paid a total of \$1.8 billion in self-employment taxes. The primary reason that total self-employment taxes have not kept pace with the increase in tax rates is the drop in the number of farms reporting a farm profit. IRS data indicate that each year since 1980 farmers in the aggregate have reported negative

net farm income for taxes. The total amount of net farm losses increased annually from 1990 through 1996, reversing a recovery in farm income that started in 1984. The proportion of farm sole proprietors reporting a net farm profit on schedule F has been declining with only 33 percent of farms reporting profits in 1996, compared with 44 percent in 1989. The reporting of

Table 18—Social security tax rates, 1955-2001

Year	Maximum taxable earnings ¹	Self-employed		Employers and employees		
		Tax rates	Maximum tax	Tax rates		Maximum tax
				Each	Total	
	<i>Dollars</i>	<i>Percent</i>	<i>Dollars</i>	<i>Percent</i>		<i>Dollars</i>
1955	4,200	3.00	126	2.00	4.00	168
1960	4,800	4.50	216	3.00	6.00	288
1970	7,800	6.90	538	4.80	9.60	749
1971	7,800	7.50	585	5.20	10.40	811
1972	9,000	7.50	675	5.20	10.40	936
1973	10,800	8.00	864	5.85	11.70	1,264
1974	13,200	7.90	1,043	5.85	11.70	1,544
1975	14,100	7.90	1,114	5.85	11.70	1,650
1976	15,400	7.90	1,209	5.85	11.70	1,790
1977	16,500	7.90	1,304	5.85	11.70	1,931
1978	17,700	8.10	1,434	6.05	12.10	2,142
1979	22,900	8.10	1,855	6.13	12.26	2,808
1980	25,900	8.10	2,098	6.13	12.26	3,175
1981	29,700	9.30	2,762	6.65	13.30	3,950
1982	32,400	9.35	3,029	6.70	13.40	4,342
1983	35,700	9.35	3,338	6.70	13.40	4,784
1984	37,800	11.30 ²	4,271	7.00 ³	13.70	5,179
1985	39,600	11.80 ²	4,673	7.05	14.10	5,584
1986	42,000	12.30 ²	5,166	7.15	14.30	6,006
1987	43,800	12.30 ²	5,387	7.51	14.30	6,263
1988	45,000	13.02 ²	5,859	7.51	15.02	6,759
1989	48,000	13.02 ²	6,250	7.51	15.02	7,210
1990	51,300	15.30 ⁴	7,849	7.65	15.30	7,849
1991	53,400	15.30	10,246 ⁵	7.65	15.30	10,246 ⁵
1992	55,500	15.30	10,652 ⁵	7.65	15.30	10,652 ⁵
1993	57,600	15.30	11,057 ⁵	7.65	15.30	11,057 ⁵
1994	60,600	15.30	9,272 ⁶	7.65	15.30	9,272 ⁶
1995	61,200	15.30	9,364	7.65	15.30	9,364
1996	62,700	15.30	9,593	7.65	15.30	9,593
1997	65,400	15.30	10,006	7.65	15.30	10,006
1998	68,400	15.30	10,465	7.65	15.30	10,465
1999	72,600	15.30	11,108	7.65	15.30	11,108
2000	76,200	15.30	11,659	7.65	15.30	11,659
2001	80,400	15.30	12,301	7.65	15.30	12,301

¹Changes in maximum taxable earnings are tied to an index of wages.

²Tax rates shown are effective rates that reflect adjustments for income tax credits.

³Nominal tax rate was 7 percent for both the employer and the employee. A 0.3-percent income tax credit reduced the effective tax rate for employees to 6.7 percent and the total rate from 14 to 13.7 percent.

⁴Since 1990, self-employed individuals have had a deduction from net earnings equal to half of the self-employment tax rate and an income tax deduction equal to half of the self-employment tax paid.

⁵Maximum tax includes the 2.9-percent Medicare tax rate on wages and earnings up to \$125,000 in 1991, \$130,000 in 1992, and \$135,000 in 1993.

⁶Since 1994, the earnings ceiling on the Medicare tax rate was removed. Although the maximum tax consequently became unlimited, values in the table reflect the 15.3-percent rate times the regular earnings ceiling.

Sources: Compson and Durst (1992); Publication 17, Internal Revenue Service, various years.

losses for tax purposes varies by type of farm. While about 80 percent of farms with sales over \$100,000 report a profit, only about 25 percent of retirement and lifestyle/other farms report a profit and pay self-employment taxes (table 19).

The increases in the social security and self-employment taxes combined with reductions in future retirement benefits (through increases in the age at which full benefits are available and higher taxes on benefits) have lowered the expected rate of return on social security tax payments. Thus, farmers and their employees have an incentive to minimize the taxes they pay. This has led to tax-driven changes in farm business operations designed to lower social security and self-employment taxes.

Federal Unemployment Taxes

The Federal Unemployment Tax Act (FUTA) is designed to provide unemployed workers with partial income during a temporary period of unemployment. Employer taxes are the primary source of funding for

the unemployment compensation program. Farmers who pay cash wages of \$20,000 or more for agricultural labor in any calendar quarter in the current or preceding calendar year, or employ 10 or more farm workers during 20 different weeks during the current or preceding calendar year, must pay the Federal unemployment tax. The current wage base is \$7,000 at a tax rate of 6.2 percent. Employers may claim a credit for paying State unemployment taxes. The credit is allowable up to 5.4 percent of the first \$7,000 in wages paid to an employee, reducing the Federal tax to as little as 0.8 percent of the first \$7,000 paid to each employee. Self-employed farmers are not subject to unemployment insurance coverage. In addition, noncash compensation for agricultural labor is exempt from the definition of wages for FUTA purposes.

Most operators of small farms, along with many larger farms that are highly mechanized and employ little hired labor, are not affected by the unemployment insurance tax. However, for those farms that require substantial amounts of hired labor, the unemployment insurance tax further increases their hired labor costs.

Table 19—Self-employment taxes for farm sole proprietors, 1996

Item	Small family farms				Large family farms	All farm proprietors
	Limited-resource	Retirement	Lifestyle/other	Primary occupation		
				Farm sales (\$1,000)		
				<\$100	\$100-\$250	
				<i>Number</i>		
Farmers paying tax	87,294	58,802	290,840	169,987	118,670	792,997
				<i>Percent</i>		
Share within group	40.0	22.4	24.9	50.5	78.1	35.7
				<i>\$1,000</i>		
Amount paid	46,985	103,411	697,475	272,102	359,016	1,835,122
				<i>Dollars</i>		
Average, payers	538	1,759	2,398	1,601	3,025	2,314
Average, all farms	215	395	598	809	2,362	827

Source: Compiled by USDA-ERS from special tabulations by Internal Revenue Service.