

INTERNAL REVENUE SERVICE

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The Honorable Chuck Hagel
United States Senator
294 Federal Building
100 Centennial Mall North
Lincoln, NE 68508

Attention: Mr. Todd Wiltgen

Dear Senator Hagel:

This letter is in response to your inquiry dated May 5, 2000, to the Taxpayer Advocate, on behalf of your constituents. They were concerned that in order for both spouses to receive Social Security credit for the income earned in their farming business, they would have to file a partnership return in addition to their joint income tax return. You asked us to explain the various options a married couple has in filing returns and paying taxes for their unincorporated farming business that will result in Social Security coverage for both spouses. In addition to the explanation in this letter, I have enclosed two copies each of Publication 51 (Agricultural Employer's Tax Guide), Publication 225 (Farmer's Tax Guide) and Publication 541 (Partnerships), with more details on these topics.

We are addressing only how a hypothetical couple with various structures for their farming business might file returns and pay taxes so that both may obtain Social Security coverage. We are assuming the legal requirements have been met for each of these business forms. Taxpayers should seek legal advice about their particular circumstances and consider all relevant legal requirements that may apply. The Internal Revenue Code (the Code) has specific definitions of "partnership," "employment," and "wages" that affect how taxpayers must report tax information and pay federal taxes. State and local taxes may not follow the federal rules and may influence a taxpayer's choice of operations. Furthermore, other federal law concerning special agricultural programs may affect how a married couple might arrange the farming operations. In the discussion below, we assume the couple is filing one Form 1040 (U.S. Individual Income Tax Return) with a filing status of "married, filing joint return" and the couple has income from the farming business.

Social Security benefits are based on an individual's net earnings from self-employment and/or an employee's wages. We will first address Social Security coverage based on net earnings from self-employment arising from:

- A farm run as a sole proprietorship of one spouse
- Two farming businesses run as separate sole proprietorships of each spouse
- A partnership with each spouse as a partner.

Then, we will address Social Security coverage based on wages paid by one spouse to the other.

Social Security Coverage Based on Net Earnings from Self-Employment

The laws concerning the tax on self-employment income are found in sections 1401 to 1403 of the Code of 1986. In addition to other income taxes, a Self-Employment Contributions Act (SECA) tax is imposed for each taxable year on the net earnings from self-employment that fall between the minimum and maximum amounts specified in the Code for that year. Section 1401(a), (b). As relevant here, sole proprietors and general partners generally produce net earnings from self-employment.

For a Farm Run as a Sole Proprietorship

A married individual who runs a business as a sole proprietor reports as part of the married couple's Form 1040, the farming business income on Schedule F (Profit or Loss from Farming) and the net earnings from self-employment on Schedule SE (Self-Employment Tax). (The enclosed Publication 225, Farmer's Tax Guide, describes this process in greater detail.) The information on the sole proprietor's net earnings from self-employment and the amount of SECA tax paid is sent to the Social Security Administration with the Social Security number of the sole proprietor. Thus, the sole proprietor receives Social Security credit based on those amounts. Although a joint return is filed by the couple, the information sent to the Social Security Administration relates only to the sole proprietor who generated the income, not to the spouse.

For a Farm Run as Two Separate Sole Proprietorships

A married couple who runs farming operations as two separate sole proprietorships reports as part of their Form 1040, the business income from each business on separate Schedules F and each spouse's net earnings from self-employment on separate Schedules SE. The information on each sole proprietor's net earnings from self-employment and the amount of SECA tax paid relating to each spouse is sent to the Social Security Administration using each one's Social Security number. Thus, each spouse receives Social Security credit based on those amounts.

For a Farm Run as a Partnership

A married couple who runs their farming operations as a partnership must file a Form 1065 (U.S. Partnership Return of Income) for the partnership as well as the Form 1040 for their individual income tax. The partnership reports as part of its Form 1065, the business income from the farming operations on the partnership's Schedule F and prepares a Schedule K-1 (Partner's Shares of Income Credits, Deductions, etc.) for each partner, indicating the distributive share of partnership items for each partner. (The enclosed Publication 541, Partnerships, describes this process in detail.) In the Form 1040, the couple reports the items on both of the Schedules K-1 and prepares separate Schedules SE to report the net earnings from self-employment. The information regarding each spouse's net earnings from self-employment and the amount of SECA tax paid relating to each individual is sent to the Social Security Administration using their respective Social Security numbers. Thus, each spouse receives Social Security credit based on those amounts.

Social Security Coverage Based on Wages Paid by One Spouse to the Other

Social Security credit can also be based on the amount of wages earned by an individual. Section 3121(a) of the Code generally defines wages as "all remuneration for employment." There are many special rules governing whether certain kinds of payments to agricultural workers qualify as wages and whether certain kinds of agricultural labor qualifies as "employment" within the meaning of section 3121 of the Code. These special rules are described in the enclosed Publication 51, Agricultural Employer's Tax Guide.

For payments that qualify as "wages" paid to an employee, the employer must:

- Pay Federal Unemployment Tax Act (FUTA) taxes
- Withhold federal income taxes
- Withhold the employee's portion of Federal Insurance Contributions Act (FICA) taxes
- Pay the employer's portion of FICA taxes.

The employer must file quarterly and annual employment tax returns.

A married individual who runs the farm as a sole proprietorship may be able to provide for Social Security credit for a spouse if the spouse receives wages as an employee of the farming business. The farming business must file employment tax returns. The information on these returns regarding the employer's and the employee's portion of FICA is sent to the Social Security Administration under each employee's Social Security number. Thus, the employee spouse receives Social Security credit based on

those amounts. And, as discussed above, the information regarding the sole proprietor's net earnings from self-employment (reported on Schedule SE) and the amount of SECA tax paid (reported on Form 1040) is sent to the Social Security Administration using the sole proprietor's Social Security number, so the sole proprietor receives Social Security credit based on those amounts.

I hope this general information and the enclosed publications will be helpful in responding to your constituents. If I can be of further assistance in this matter, please contact me at (202) 622-6040.

Sincerely,

Lynne A. Camillo
Acting Branch Chief (ID # 50-01066)
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Enclosures (6)