2-16-1990

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Available at: http://lib.dr.iastate.edu/aglawdigest/vol1/iss7/1

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PAYING WAGES IN KIND FOR AGRICULTURAL LABOR

by Neil E. Harl*

Beginning in 1990, cash remuneration paid to an agricultural laborer is subject to mandatory income tax withholding.¹ Prior to 1990, employers were not required to withhold federal income tax on wages paid to agricultural labor.² However, agricultural employees could, if their employers agreed, choose voluntarily to have income tax withheld from wages.³ The enactment of mandatory income tax withholding plus the gradual increase in FICA tax (increasing from 7.51 percent of the first $48,000 of wages in 1989 to 7.65 percent of the first $51,300 of wages in 1990) have given added impetus to the payment of wages in kind.

Wages paid in cash to agricultural labor are, of course, subject to FICA tax.⁴ However, wages paid in kind for agricultural labor are not subject to FICA tax.⁵ This provision is a surprise to many because it applies only to agricultural labor. Specifically, the Internal Revenue Code states that "wages" includes all cash and noncash remuneration except for — 

"...remuneration paid in any medium other than cash for agricultural labor...." This is a major factor for every employer hiring agricultural labor. The combined employer and employee shares of FICA tax total $7848.90 for an employee receiving the maximum of $51,300 of covered wages. The combined FICA tax is $2295 for an employee paid $15,000 per year.

Remember, wages paid in kind not only escape FICA tax, the wages are not subject to mandatory income tax withholding, either.⁶

How handled by the employer. If wages are paid to agricultural labor in kind, such as with farm commodities, the payment must be reported by the employer as though the employer had sold the commodity for its fair market value and paid the proceeds to the employee. For employers filing a Schedule F, the commodity involved would be reported on that schedule. Employers on the cash method of accounting ordinarily would have a zero income tax basis in the commodity if raised so the entire amount of fair market value would be ordinary income to the employer.

Example: A farm employer pays an employee 550 bushels of corn per month. If the fair market value for the corn is $2.25 per bushel at the time of payment, the employer would report $1237.50 of income from the corn used to make the in-kind wage payment for that month. If repeated for the entire year, and the per bushel price and the number of bushels involved did not change (which is not realistic), the employer would have income to report of $14,850.

An employer paying wages in-kind, like all employers, has an income tax deduction for the amount of wages paid.

The employer is to report the fair market value of in-kind wages on the Form W-2. The amount is reported in the box on the form labeled "non-FICA wages."

How handled by the employee. An employee receiving wages in kind must report the fair market value as wage income for income tax purposes.⁸ That reporting is the same as for cash wages. The difference is that no FICA tax has been withheld. Because the fair market value of the in-kind payment is reported as income, the employee has an income tax basis in the commodity equal to the fair market value on the date the commodity was received.

Example: Returning to the above example, the employee would have an income tax basis of $2.25 per bushel in the corn received as an in-kind wage after reporting that amount as income. If the employee sold the 550 bushels of corn six weeks later for $2.40 per bushel, the employee would have $.15 per bushel gain on the commodity for a total gain of $82.50. Ordinarily, the gain or loss on commodities received as payments of wages in kind should be reported on Schedule D and should not be subject to FICA or self-employment tax.

Areas of possible challenge. Payment of wages in the form of grain, soybeans, cotton or other "passive" commodities poses relatively few problems. The principal concerns are that the amounts be paid periodically (weekly or monthly) and that the employee exercise dominion and control over the commodities. Amounts paid in one amount, at year end, are more likely to be suspect, particularly if paid to a related party such as a spouse. The question is whether the payment was really payment for services rendered.

By dominion and control is meant control over the storage and eventual sale of the commodity. Preferably, the employee’s commodity should be sold some time other than when the employer sells similar or identical commodities. If the employee does not exercise dominion and control over the commodity, the danger is that the employee would be considered as

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receiving cash wages — which would be fully subject to FICA tax.
Payments of wages in kind in the form of livestock or the products of livestock pose additional problems. The care and management of the animals paid as compensation should be the responsibility of the employee after wage payment. The employee should bear the expense of feed and other costs after wage payment. In a 1982 private letter ruling, wages paid in the form of milk by a corporation carrying on a dairy operation met the requirements for avoiding FICA tax in a situation where the employees were compensated with a percentage of the milk produced, a percentage of the calves and a percentage of grain production. The milk was shipped on the same truck as the employer's milk and sold to the same milk producer's association to which the employee belonged. The calves were commingled with the employer's calves but were specifically identified. Likewise, the grain was commingled but the employees chose when to sell their portion of the grain. Under the arrangement, the wages paid in kind were not subject to FICA tax.

Payments in a form readily converted to cash may be treated as payment in cash and not as a payment in kind. In a 1979 revenue ruling, farm labor was paid in the form of commodity storage receipts that were immediately converted to cash. IRS ruled that the payment was in cash with the result that FICA tax was due on the payment amount.

Disadvantages of in-kind payments. An employee receiving payments of wages in kind does not accrue eligibility for disability or retirement benefits. That can pose serious problems for employees who are injured or become ill and can pose long term problems of retirement security. Keep in mind, however, that a spouse's retirement benefits as the spouse of a taxpayer covered by social security may exceed the amount to which the spouse is entitled based upon his or her own earnings record. In that event, payment of wages in kind may sidestep the usual long term disadvantage.

It is important to note that payment of wages to a spouse reduces the employer-spouse's income subject to self-employment tax (for a sole proprietor). The reduction in self-employment tax may be a short run advantage but poses the same disadvantages in terms of disability or retirement benefits.

FOOTNOTES

2 See I.R.C. § 3401(a)(2), before amendment by OBRA Sec. 7631, note 1 supra.
4 I.R.C. § 3121(a).
5 I.R.C. § 3121(a)(8).
6 See note 1 supra.
7 I.R.C. § 162(a)(1).
8 I.R.C. § 61(a)(1).
10 Id.

DEVELOPMENTS IN PERSPECTIVE

DEFINITION OF AGRICULTURAL LABOR FOR FEDERAL TAX WITHHOLDING PURPOSES

Eligibility for the exception from withholding requirements for payment of wages in-kind for agricultural labor depends upon whether the work performed by the agricultural employee can be considered agricultural labor.

The statutory definition lists several types of services which qualify as agricultural labor—

• Generally, agricultural labor includes the cultivation, raising and harvesting of agricultural and horticultural commodities and the raising, shearing, training and management of livestock, bees, poultry, fur-bearing animals and wildlife.

• Agricultural labor includes services involving the operation, management, conservation, improvement and maintenance (including carpenters, mechanics and painters) of a farm if such services are performed on a farm. Such services also include the operation and maintenance of reservoirs and waterways used exclusively for supplying and storing water for farming purposes and not operated for profit. Bookkeeping and office services are agricultural labor if performed on the farm operated, owned or leased by the employer.

• Services involving the handling, drying, packing, packaging, processing, freezing, storing and delivery of an agricultural commodity in its unmanufactured state are agricultural labor if performed on the farm operated, owned or leased by the employer. The calves were commingled with the employer's calves but were specifically identified. Likewise, the grain was commingled but the employees chose when to sell their portion of the grain. Under the arrangement, the wages paid in kind were not subject to FICA tax.

• Services provided on a farm are not agricultural labor if not performed for the employer's trade or business or if performed in the private home of the employer.

• A farm includes orchards, nurseries, ranges, greenhouses and other structures used for raising of agricultural and horticultural commodities.

IRS has issued several rulings involving the definition of agricultural labor for withholding tax purposes. A list of the rulings and type of labor involved follows—

Agricultural labor

Rev. Rul.

Harvesting of grain, straw and almonds 70-52

Pulling stumps for orchard 70-112

Harvesting of grain, straw and almonds 70-52

Pulling stumps for orchard 70-112