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# Developments in Perspective: Definition of Agricultural Labor for Federal Tax Withholding Purposes

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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,<sup>9</sup> 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.<sup>10</sup> 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 em-

ployer 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,<sup>11</sup> 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

<sup>1</sup> Omnibus Budget Reconciliation Act of 1989, Sec. 7631, amending I.R.C. § 3401(a)(2).

<sup>2</sup> See I.R.C. § 3401(a)(2), before amendment by OBRA Sec. 7631, note 1 *supra*.

<sup>3</sup> T.D. 7096, 1971-1 C.B. 360.

<sup>4</sup> I.R.C. § 3121(a).

<sup>5</sup> I.R.C. § 3121(a)(8).

<sup>6</sup> See note 1 *supra*.

<sup>7</sup> I.R.C. § 162(a)(1).

<sup>8</sup> I.R.C. § 61(a)(1).

<sup>9</sup> Ltr. Rul. 8252018, Sept. 17, 1982.

<sup>10</sup> *Id.*

<sup>11</sup> Rev. Rul. 79-207, 1979-2 C.B. 351.

## 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<sup>1</sup> and the raising, shearing, training and management of livestock, bees, poultry, fur-bearing animals and wildlife.<sup>2</sup>

- Agricultural labor includes services involving the operation, management, conservation, improvement and maintenance (including carpenters, mechanics and painters)<sup>3</sup> of a farm if such services are performed on a farm.<sup>4</sup> 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.<sup>5</sup> Bookkeeping and office services are agricultural labor if performed on the farm operated, owned or leased by the employer.<sup>6</sup>

- Services involving the handling, drying, packing, packaging, processing, freezing, storing and delivery of an agricultural commodity in its unmanufactured state are agricultural labor if the operator of the farm produces more than one-half of the commodity.<sup>7</sup> If the employer is a group of farm operators, other than a farm cooperative,<sup>8</sup> all of the commodity must be produced by the group.<sup>9</sup> However, services provided as part of a commercial canning or freezing operation or after delivery to a terminal market for distribution for consumption are not agricultural labor.<sup>10</sup>

- Employees of a cotton gin are considered agricultural labor.<sup>11</sup>

- 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.<sup>12</sup>

- A farm includes orchards, nurseries, ranges, greenhouses and other structures used for raising of agricultural and horticultural commodities.<sup>13</sup>

IRS has issued several rulings involving the definition of agricultural labor for withholding tax purposes.<sup>14</sup> A list of the rulings and type of labor involved follows—

#### Agricultural labor

Harvesting of grain, straw and almonds  
Pulling stumps for orchard

Rev. Rul.  
70-52<sup>15</sup>  
70-112<sup>16</sup>

Processing milk on farm	70-208 <sup>17</sup>		Rev. Rul.
Hatching poultry	70-176 <sup>18</sup>	Clearing timberland for orchard	70-112 <sup>29</sup>
Raising, harvesting, packaging and transporting watercress	71-275 <sup>19</sup>	Processing peas not grown by processor	69-97 <sup>30</sup>
Raising and selling rats for experiments	75-534 <sup>20</sup>	Processing walnuts not grown by processor	69-363 <sup>31</sup>
Raising frogs	69-364 <sup>21</sup>	Racing and exhibiting horses	69-365 <sup>32</sup>
Cleaning and shipping seeds grown on farm	71-550 <sup>22</sup>	Processing nuts grown on processor's farm	58-581 <sup>33</sup>
Caring for cattle in feed lot	60-115 <sup>23</sup>	Maintaining irrigation part of which was used for domestic purposes	71-293 <sup>34</sup>
Harvesting peas by cannery employees	60-71 <sup>24</sup>	Breeding and raising dogs	68-340 <sup>35</sup>
Harvesting lettuce for other growers	56-35 <sup>25</sup>	Excavating and processing peat	60-277 <sup>36</sup>
Cleaning and treating wheat seed for other growers on their farms	56-14 <sup>26</sup>	Vining peas by cannery employees at cannery	60-71 <sup>37</sup>
Managing a farm for owner	54-383 <sup>27</sup>	Processing of tobacco at bulking plant	57-608 <sup>38</sup>
Growing and spawning mushrooms	75-484 <sup>28</sup>	Processing lettuce grown by others	56-35 <sup>39</sup>
		Manufacturing and selling of mushroom compost	76-227 <sup>40</sup>
Not agricultural labor			

**FOOTNOTES**

- <sup>1</sup> Commodities include, but are not restricted to, agricultural commodities listed under section 15(g), 12 U.S.C. § 1141j, of the Agricultural Marketing Act. I.R.C. § 3121(g)(3).
- <sup>2</sup> I.R.C. § 3121(g)(1). See Ltr. Rul. 8750024, Sept. 11, 1987 (worker on exotic deer ranch was agricultural laborer).
- <sup>3</sup> See Treas. Reg. § 31.3121(g)-1(c)(2).
- <sup>4</sup> I.R.C. § 3121(g)(2).
- <sup>5</sup> I.R.C. § 3121(g)(3).
- <sup>6</sup> Treas. Reg. § 31.3121(g)-1(e)(6).
- <sup>7</sup> I.R.C. § 3121(g)(4)(A).
- <sup>8</sup> See Treas. Reg. § 31.3121(g)-1(e)(3) (definition of cooperative).
- <sup>9</sup> I.R.C. § 3121(g)(4)(B).
- <sup>10</sup> I.R.C. § 3121(g)(4)(C).
- <sup>11</sup> I.R.C. § 3121(g)(3). See Rev. Rul. 70-207, 1970-1 C.B. 208.
- <sup>12</sup> I.R.C. § 3121(g)(5).
- <sup>13</sup> I.R.C. § 3121(g).
- <sup>14</sup> See Rev. Rul. 55-707, 1955-1 C.B. 420 and Rev. Rul. 54-587, 1954-2 C.B. 350 for IRS guidelines on determining who is an agricultural laborer for FICA purposes.
- <sup>15</sup> 1970-1 C.B. 206.
- <sup>16</sup> 1970-1 C.B. 207.
- <sup>17</sup> 1970-1 C.B. 208.
- <sup>18</sup> 1970-1 C.B. 213.
- <sup>19</sup> 1971-1 C.B. 288.
- <sup>20</sup> 1975-2 C.B. 405.
- <sup>21</sup> 1969-1 C.B. 265.
- <sup>22</sup> 1971-2 C.B. 351.
- <sup>23</sup> 1960-1 C.B. 396.
- <sup>24</sup> 1960-1 C.B. 394.
- <sup>25</sup> 1956-1 C.B. 453.
- <sup>26</sup> 1956-1 C.B. 450.
- <sup>27</sup> 1954-2 C.B. 350.
- <sup>28</sup> 1975-2 C.B. 412.
- <sup>29</sup> 1970-1 C.B. 207.
- <sup>30</sup> 1969-1 C.B. 264.
- <sup>31</sup> 1969-1 C.B. 264.
- <sup>32</sup> 1969-1 C.B. 265.
- <sup>33</sup> 1958-2 C.B. 732.
- <sup>34</sup> 1971-2 C.B. 351.
- <sup>35</sup> 1968-1 C.B. 437.
- <sup>36</sup> 1960-2 C.B. 275.
- <sup>37</sup> 1960-1 C.B. 394.
- <sup>38</sup> 1957-2 C.B. 638.
- <sup>39</sup> 1956-1 C.B. 453.
- <sup>40</sup> 1976-1 C.B. 324. But see *Kaolin Mushroom Farms, Inc. v. United States*, 79-2 U.S.T.C. ¶ 9652 (E.D. Pa. 1979) (employees of mushroom compost producer were agricultural laborers).

## Cases, Regulations and Statutes

### Bankruptcy

**Note: The latest issue of the *Bankruptcy Reporter* did not arrive in time for publication in this issue.**

#### FEDERAL TAXATION

**DESIGNATION OF PAYMENTS.** A Chapter 11 debtor could not designate the allocation of payments of employee withholding taxes in the Chapter 11 plan because the payments were involuntary. *In re Gilley Consulting Engineers, Inc.*, 90-1 U.S.T.C. ¶ 50,031 (Bankr. N.D. Ga. 1989); *In re Mold*

*Makers, Inc.*, 90-1 U.S.T.C. ¶ 50,047 (Bankr. N.D. Ill. 1989).

A Chapter 11 debtor was allowed to designate the allocation of payment of employee withholding taxes in a Chapter 11 plan because the payments were found to be voluntary because of no evidence of IRS efforts to collect the taxes or other coercion to pay the taxes. *In re Kare Kemical, Inc.*, 90-1 U.S.T.C. ¶ 50,044 (S.D. Fla. 1989).

**DISCHARGE OF INDEBTEDNESS.** In a case which illustrates the danger of selling assets before filing Chapter 7 bankruptcy, a farm debtor was held to have recognized gain from the pre-bankruptcy sale of farm equipment with

the proceeds used to reduce debt secured by the equipment. Thus, the debtor was personally liable for the federal income tax on the gain. The court held that I.R.C. § 108 (nonrecognition of discharge of indebtedness income) did not apply because indebtedness was not forgiven but only reduced by the amount of proceeds generated by the sale of the equipment. [Had the debtor disposed of the equipment after filing of bankruptcy, gain from the sale or transfer to the secured creditor would be recognized by the bankruptcy estate. See Harl, *Agricultural Law*, § 39.02 (MB 1990).] *In re Brubeck*, 90-1 U.S.T.C. ¶ 50,046 (Bankr. S.D. Ind. 1989).