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CORPORATE OWNERSHIP OF THE FARM RESIDENCE

— by **Neil E. Harl***

For farmers and ranchers considering incorporating, one of the major questions is whether the farm or ranch residence or residences should be transferred to the newly formed corporation.[1] From an income tax perspective, residential costs are deductible for an unincorporated taxpayer only to the extent of mortgage interest[2] and property taxes[3] and costs associated with business use of the residence such as an office "used regularly and on an exclusive basis" for business purposes.[4]

Deductibility of costs. For the residence as a business asset, all of the costs associated with the residence are income tax deductible for C corporations.[5] For residences owned by S corporations and occupied by a shareholder, in general, deductions are allowed only to the extent the residence is used regularly and on an exclusive basis for business purposes.[6]

Taxability of benefits. The greatest concern with corporate ownership of the residence is taxability of the benefits of shareholder occupancy. Those occupying corporate-owned residences have three choices — (1) pay a reasonable rental to the corporation for the right of occupancy, (2) report the value of occupancy as additional income as compensation[7] or as a dividend or (3) rely upon the section of the Internal Revenue Code providing that meals and lodging furnished to an employee for the convenience of the employer do not constitute taxable income to the recipient.[8] Another possibility, but one of very narrow applicability, is that the value of individual occupancy may be treated as a gift.[9]

For the value of lodging to be excluded, three tests must be met — (1) the lodging must be furnished on the business premises of the employer,[10] (2) the lodging must be furnished for the convenience of the employer and (3) the employee must be required to accept the lodging on the premises as a condition of employment.[11] The latter test means that the employee must be required to accept the lodging to enable the employee properly to perform the duties of employment.[12] This test is met if the lodging is furnished because the employee is required to be available for duty at all times or if the employee could not perform the services required of the employee without the lodging.[13] In a 1987 letter ruling, the value of housing provided by the employer was included in the employee's income where the housing was not provided at the work site but was scattered within housing generally available to the public.[14] Thus, housing provided in a nearby town is not eligible for the exclusion.

What about the need for an employee of a farm corporation to be on the premises at all times for livestock observation and periodic chores or for equipment security, crop drying and other tasks associated with a cropping operation? A pair of 1938 U.S. District Court cases allowed the exclusion for the value of living quarters provided to pineapple plantation managers[15] but a 1948 Tax Court case held that the rental value of a corporate-owned farm house occupied by a sole shareholder was taxable income to the occupant.[16] A 1966 Tax Court decision held that the benefits inuring to the president of a poultry breeding corporation from living in a house provided by the corporation adjacent to the corporation's poultry farm was taxable income.[17] In another 1966 case, *Wilhelm v. U.S.*,[18] the value of food and lodging provided by a ranching corporation was not taxed to the shareholder-employees. A board of director resolution had required residency and meal consumption on the ranch premises by all employees. In holding for the taxpayer, the court emphasized the distance from the nearest town (24-26 miles).[19]

In *Caratan v. Comm'r*,[20] a 1971 case, the Commissioner was not sustained in adding $1200 to the gross income of each shareholder-employee of a closely-held farm corporation who lived in a corporation-owned house on the business premises. In that case, a 10-minute drive was required to reach alternate housing. The taxpayers met the burden of proving that the lodging furnished to them was indispensable to the proper discharge of their employment.[21]

In one of two 1985 cases, *J. Grant Farms, Inc. v. Comm'r*[22] the value of lodging and the cost of utilities of a farm manager-sole shareholder and family were held to be excludable from the manager's income because the manager's residence on the farm was necessary and a condition of employment in the swine raising and crop operation involving grain drying. In the other 1985 case, *Johnson v. Comm'r*,[23] the husband and wife, sole shareholders in a corporation, were allowed to exclude the fair rental value of a corporation-owned residence located on the premises. The husband was manager of the corporation's grain drying and storing operation.

Scope of term "lodging." The term "lodging" includes such items as heat, electricity, gas, water and sewer service unless the employee contracts for the utilities directly from the supplier.[24] Thus, amounts for gas and electricity paid by a corporation in a grain and dairy operation were necessary for the residences to be habitable and so were excludable from incomes of

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the employees.[25] If the employee is required to pay for the utilities without reimbursement from the employer, the utilities are not excludable from income.[26]

Supporting resolution. If it is intended for the requirements to be met for employees to exclude the fair rental value of a corporate-owned residence from income, it is advisable for the corporation's board of directors to adopt a resolution requiring corporate employees to reside on the premises.[27]

FOOTNOTES

1 See generally 7 Harl, **Agricultural Law** § 57.03[2] (1990).
2 I.R.C. § 163(h)(2)(D).
3 I.R.C. § 164(a)(1).
4 See I.R.C. § 280A(c)(1).
5 See I.R.C. § 280A(a).
6 I.R.C. § 280A(a),(c)(1). See Proskauer v. Comm'r, T.C. Memo. 1983-395.
7 See Dean v. Comm'r, 187 F.2d 1019 (3d Cir. 1951) (value taxed as additional compensation).
8 I.R.C. § 119.
9 Peacock v. Comm'r, 256 F.2d 160 (5th Cir. 1958).
10 Crowe v. U.S., 84-1 U.S.Tax Cas. (CCH) ¶ 9327, 4 Cls. Ct. 734 (Ct. Cl. 1984).
11 See I.R.C. § 119.
12 Treas. Reg. § 1.119-1(b).
13 *Id.*
14 Ltr. Rul. 8826001, Oct. 14, 1987.
15 Greene v. Kanne, 38-1 U.S.Tax Cas. (CCH) ¶ 9206 (D. Hawaii 1938); Renton v. Kanne, 38-1 U.S.Tax Cas. (CCH) ¶ 9207 (D. Hawaii 1938).
16 Roberts v. Comm'r, 17 P-H Tax. Ct. Mem. 516 (1948).
17 Peterson v. Comm'r, T.C. Memo. 1966-196.
18 257 F. Supp. 16 (D. Wyo. 1966).
19 *Id.*
20 442 F.2d 606 (9th Cir. 1971).
21 *Id.*
22 T.C. Memo. 1985-174.
23 T.C. Memo. 1985-175.
24 Rev. Rul. 68-579, 1968-2 C.B. 61.
25 See Harrison v. Comm'r, T.C. Memo. 1981-211. But see Vanicek v. Comm'r, 85 T.C. 731 (1985), *acq.*, 1986-1 C.B. 1 (portion of cost of utilities for residence provided by employer not deductible because of lack of evidence by which utility costs could be apportioned between business and personal use.)
26 Turner v. Comm'r, 68 T.C. 48 (1977) (cost of utilities and furnishings purchased by welder for house in which welder required to reside not deductible because utilities and furnishings not provided by employer).
27 For a copy of such a resolution, see 7 Harl, *supra* note 1, App. 51C.

CASES, REGULATIONS AND STATUTES

ANTITRUST

PRICE FIXING. The plaintiffs were sellers of feeder cattle who sold cattle to the defendant meat packers. As a guide for setting prices to be paid to cattle sellers, the defendants used a publication called the Yellow Sheet which published the previous day's prices. The court relied upon the law of the case established in a similar suit by the plaintiffs against meat retailers who also used the Yellow Sheet to establish prices paid to the meat packers. *In re Beef Industry Antitrust Litigation, 542 F. Supp. 1122 (N.D. Tex. 1982), aff'd 710 F.2d 216 (5th Cir. 1983), cert. denied 465 U.S. 1052 (1984).* Under the first case, the court found that the use of the Yellow Sheet was only one of several factors used to establish meat prices. In the current case, the court held that the plaintiffs produced insufficient evidence of similar pricing by the defendants. The plaintiffs also alleged that the defendants acquired monopoly (one seller) power over boxed beef sales and monopsony (one buyer) power in the fed cattle procurement market. However, the plaintiffs also alleged that the defendants misused their power as oligopsonists (market of dominant buyers). The court held that the plaintiffs produced insufficient evidence of market control by the defendants to support either theory and that the evidence under one theory tended to negate the evidence supporting the other theory. ***In re* Beef Industry Antitrust Litigation, 907 F.2d 510 (5th Cir. 1990), *aff'g* 713 F. Supp. 971 (N.D. Tex. 1989)**.

BANKRUPTCY

GENERAL

DISCHARGE. A claim for state employment taxes owed by the debtor on wages earned by employees more than 90 days before the filing of bankruptcy was held dischargeable. ***In re* Pierce, 115 B.R. 523 (Bankr. N.D. Tex. 1990)**.

EXEMPTIONS. The debtor was not allowed to exempt the debtor's interest in an IRA under the Connecticut exemption for "profit sharing, pension, stock bonus, annuity or similar plan." **Matter of Spandorf, 115 B.R. 415 (Bankr. D. Conn. 1990)**.

The debtors were shareholders in a corporation which held title to their residences. The corporation was involuntarily dissolved many years before the debtors filed for bankruptcy and claimed their interests in the residences as exempt. Although the debtors did not take any action to revest title to the residences in themselves, the assets of the corporation revested in the sole shareholder in the corporation by law upon the dissolution; therefore, the debtors owned interests in the residences which were eligible for the exemption. ***In re* Morris, 115 B.R. 626 (Bankr. S.D. Ill. 1990)**.

PREFERENTIAL TRANSFERS. The debtors fed cattle belonging to another person and sold the cattle after the cattle reached a certain weight. The proceeds of the sales were then sent to the owner who returned the amount to be paid for the feeding. The court held that the payment of the sales proceeds within 90 days before the bankruptcy filing were not preferential transfers because the cattle and proceeds never belonged to the debtors. ***In re* Zwagerman, 115 B.R. 540 (Bankr. W.D. Mich. 1990)**.