



## Agricultural Law Press

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## Meals and Lodging: Not Deductible for Non-employees

— by Neil E. Harl\*

Four cases,<sup>1</sup> decided on November 25, 2003, have re-emphasized the importance of being able to prove employee status if attempting to claim deductions for employee benefits. The four cases all involved meals and lodging as well as medical expense deductibility but the basic message extends to all employee benefits.<sup>2</sup>

### Tax Court cases

In the first of the cases, *Weeldreyer v. Commissioner*,<sup>3</sup> the taxpayers had formed Dreyer Farms, Inc.<sup>4</sup> and conveyed all of the taxpayer's farmland (including the farmhouse) to the newly-formed corporation with the corporation assuming the mortgage on the property. The taxpayers (husband and wife) owned all of the stock in the corporation. The corporation adopted a medical reimbursement plan and also paid the premiums on a health insurance policy covering the taxpayers and their children. The corporation adopted a resolution requiring all officers and employees "... to live at the worksite of the corporation to ensure security for the corporation property and operation ... [and] to supervise the care and feeding of the livestock of the corporation."<sup>5</sup>

The corporation proceeded to lease the farmland to the taxpayers under a 40:60 "share-crop" arrangement with 40 percent of the crop revenue going to the corporation as landlord and 60 percent to the taxpayers as tenants.<sup>6</sup> The corporation paid for the food consumed by the taxpayers and their children; utilities, repairs and maintenance on the farmstead; and the costs of telephone service. The husband (Weeldreyer) was paid \$750 per year as a corporate officer/employee in two of the years in question and \$1,000 per year for the third year.<sup>7</sup>

The Internal Revenue Service disallowed the deductions for medical costs, utilities, telephone and food as well as depreciation on the farmhouse and treated the amounts as constructive dividends to the taxpayers as shareholders of the corporation.<sup>8</sup> The taxpayers argued that the medical costs were deductible to the corporation and excludible to the employee and that the food and lodging expenses were employer-provided "meals and lodging" under I.R.C. § 119 and were deductible by the corporation and excludible from income by the employee.<sup>9</sup>

The Tax Court concluded that the medical expenses were deductible to the corporation as a plan for employees<sup>10</sup> and excludible from the employee's income.<sup>11</sup> However, because the taxpayer farmed the land in question as a tenant and not as a corporate

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employee, the food and lodging were not furnished to a corporate employee “for the convenience of the employer” so the meals and lodging were not eligible for deductibility to the corporation as employer and for excludability on the part of the tenant. The Tax Court also disallowed the deductions for repair, maintenance, remodeling and landscaping of the farmhouse<sup>12</sup> and the claimed deductions for utilities and telephone expenses<sup>13</sup> but allowed a deduction for depreciation on the farmhouse.<sup>14</sup> The amounts involved, other than for medical costs, were taxable to the individual taxpayer.<sup>15</sup> The portion of the rent attributable to the farmhouse was includible in the taxpayer’s income.<sup>16</sup>

Interestingly, the Tax Court imposed the accuracy-related penalty<sup>17</sup> although that penalty is rarely imposed if the taxpayers rely on the advice of an independent, competent professional tax advisor.<sup>18</sup> The attorney who set up the business plan also represented the taxpayers in the Tax Court proceeding but the taxpayers did not claim reliance on their attorney or other tax professional.<sup>19</sup>

The second case, *Schmidt v. Commissioner*,<sup>20</sup> involved facts similar to *Weeldreyer v. Commissioner*<sup>21</sup> except that the taxpayer agreed to pay \$6,000 per year for the use of the building site and improvements; the corporation leased the farmland to the taxpayer and received all of the crop proceeds and government payments. The outcome was the same as in *Weeldreyer*.<sup>22</sup>

In the third decision, *Tschetter v. Commissioner*,<sup>23</sup> the common stock of the newly-formed corporation was owned by the taxpayer and the taxpayer’s mother. The land, initially owned by the individual taxpayer was conveyed to the corporation and leased back for 30 percent of the calf crop and 40 percent of the crop produced. The taxpayer’s compensation from the corporation was \$400 in the first year in question, \$1,000 in the second year and \$2,000 in the third year. Again, the outcome was similar to the outcome in the other two cases.<sup>24</sup>

In the fourth case, *Waterfall Farms, Inc. v. Commissioner*,<sup>25</sup> the individual taxpayers owned all of the stock of their newly-formed corporation with the corporation leasing the farmland back to the taxpayers under a “share-crop” arrangement<sup>26</sup> with the individual taxpayer making a cash payment in two of the years in question as well as giving the corporation as lessor a portion of the crop. Again, the outcome was similar to the outcome in the other three cases.<sup>27</sup>

### The message of the cases

It is clear that deductions based on employee status of the recipient are not claimable if paid to a farm tenant for services even though the same individual may be a corporate officer. The fact situations in the four cases could have been structured in such a way as to have assured employee status. That was not done.

### FOOTNOTES

<sup>1</sup> *Weeldreyer v. Comm’r*, T.C. Memo. 2003-324; *Schmidt v. Comm’r*, T.C. Memo. 2003-325; *Tschetter v. Comm’r*, T.C. Memo. 2003-326; *Waterfall Farms, Inc. v. Comm’r*, T.C. Memo. 2003-327. See generally 7 Harl, *Agricultural Law* § 57.03[2] (2003); Harl, *Agricultural Law Manual* § 7.02[4][c] (2003). See also Harl, *Meals and Lodging on the Business Premises*, 10 *Agric. L. Dig.* 113 (1999).

<sup>2</sup> See 7 Harl, *supra* note 1, § 57.03[2].

<sup>3</sup> T.C. Memo. 2003-324.

<sup>4</sup> *Id.*

<sup>5</sup> *Id.*

<sup>6</sup> *Id.*

<sup>7</sup> *Id.*

<sup>8</sup> *Id.*

<sup>9</sup> *Id.*

<sup>10</sup> I.R.C. § 162(a); Treas. Reg. § 1.162-10(a). See I.R.C. § 105(b).

<sup>11</sup> I.R.C. § 105(b).

<sup>12</sup> *Weeldreyer v. Comm’r*, T.C. Memo. 2003-324.

<sup>13</sup> *Id.*

<sup>14</sup> *Id.*

<sup>15</sup> *Id.*

<sup>16</sup> No mention was made of Rev. Rul. 70-72, 1970-1 C.B. 15, which holds that occupancy of a dwelling by a farm tenant does not produce income for the tenant.

<sup>17</sup> I.R.C. § 6662(a).

<sup>18</sup> See Treas. Reg. § 1.6664-4(b).

<sup>19</sup> *Weeldreyer v. Comm’r*, T.C. Memo. 2003-324.

<sup>20</sup> T.C. Memo. 2003-325.

<sup>21</sup> T.C. Memo. 2003-324.

<sup>22</sup> *Id.*

<sup>23</sup> T.C. Memo. 2003-326.

<sup>24</sup> See notes 11-14, 21 *supra*.

<sup>25</sup> T.C. Memo. 2003-327.

<sup>26</sup> *Id.*

<sup>27</sup> See notes 11-14, 21, 23.