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NEW RULES COMING ON PAYMENT OF WAGES IN-KIND

— by Neil E. Harl*

In our earlier articles on the payment of wages in kind,[1] we noted that payment of wages in kind rather than in cash to agricultural labor has not been subject to FICA[2] or FUTA[3] tax for dseveral years. Moreover, payments to agricultural labor are exempt from income tax withholding[4] except as the payments constitute *wages*.[5] Wages paid, *in any medium other than cash for agricultural labor*, are exempt from the term *wages.*[6] Further, payments in kind to agricultural laborers are not considered wages for purposes of determining the amount of earnings in retirement.[7]

Recent IRS rulings

Since 1979, the Internal Revenue Service has often objected to use of the provision involving FICA tax on the ground that the payment was in a form readily converted to cash and should be considered a cash wage payment[8] or the arrangement failed to give the employee dominion and control over the commodity serving as the payment in kind.[9] Under the latter theory, a compensation arrangement whereby a spouse was paid $200 in cash and 3,000 pounds of live hogs per month was held to be the equivalent of a payment in cash where the title to the hogs was transferred to the spouse on delivery to market.[10] In a 1993 ruling, payment to the husband in a family -owned farm corporation in the form of $6,000 in cash wages and 20 percent of all market-weight butcher hogs which produced $6,000 in cash and $34,941 in hogs one year and $11,000 in cash and $41,272 of hogs the following year was all considered to be the equivalent of cash compensation.[11] An earlier ruling, in 1982, involving the payment of wages in the form of milk and other commodities by a corporation carrying on a dairy operation, met the requirements for avoiding payroll taxes in a situation where employees were compensated with a percentage of the milk produced, a percentage of the calves and a percentage of grain production.[12]

In the latest ruling, payments were made in the form of grain to a married couple who were employees of their wholly-owned farm corporation and were treated as the equivalent of cash.[13] The grain was not removed to separate storage facilities nor was the couple charged for storage, although the couple bore the risk of loss after payment of the wages and sold the grain independently.[14] The grain was retained for periods ranging from one and one-half to two and one-half months before the sale occurred.[15] The ruling notes that "*...the intent at the time of the [wage payment] was to convert the grain into cash.*"[16]

Increasing the odds for success

Recent discussions involving IRS representatives, tax practitioners and academics involving this highly contentious issue indicate that guidelines should be published some time in the next several months outlining the major factors that must be met if a taxpayer is to be successful in avoiding payroll taxes by payment of wages in kind. Here are the principal factors —

• Whether the payment involves grain or livestock, it is important to isolate the commodity from that of the employer, preferably removing the commodity to the employee's facilities. If left in the employer's facilities, it is important that the employee bear all costs of care, storage, feeding and management.

• It is highly important for the employee to bear the risks of loss as well as the risks of price change.

• The transfer of the commodity to the employee should be carefully documented in writing with releases obtained for any security interests placed on the commodity by the employer.

• The decision to and the details of sale should all be handled by the employee and should be completely independent from the marketing decisions by the employer. Resale by the employee to the employer is viewed in highly negative terms.

• The commodity used for wage payment must have been produced or purchased for use in the trade or business and not purchased for the purpose of wage payment.

• Sufficient time should elapse between payment as wages by the employer and sale by the employee for the employee to establish dominion and control over the commodity.

In effect, the expected guidelines will lay out conditions to be met for a wage payment in commodities to be considered bona fide.

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FOOTNOTES

1 N. Harl, "Paying Wages in Kind," 3 *Agric. L. Dig.* 81 (1992); N. Harl, "Paying Wages in Kind: Proposed Repeal of the Provision," 3 *Agric. L. Dig.* 121 (1992). See generally 4 Harl,

Agricultural Law § 36.02[3] (1994); Harl, *Agricultural Law Manual* § 4.06[2][a] (1994).
[2] I.R.C. § 3121(a)(8).
[3] I.R.C. § 3306(b)(11.
[4] I.R.C. § 3401(a)(2).
[5] See I.R.C. § 3121(a).
[6] I.R.C. § 3121(a)(8).
[7] 20 C.F.R. §§ 404.429(c)(3), 404.1055.
[8] Rev. Rul. 79-207, 1979-2 C.B. 351.
[9] Ltr. Rul. 9136001, May 14, 1991.
[10] *Id.*
[11] Ltr. Rul. 9322003, Feb. 25, 1993.
[12] Ltr. Rul. 8252018, Sept. 17, 1982.
[13] Ltr. Rul. 9403001, Aug. 17, 1993.
[14] *Id.*
[15] *Id.*
[16] *Id.*

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

BANKRUPTCY

GENERAL-*ALM* § 13.03.*

EXEMPTIONS

AVOIDABLE LIENS. The debtors claimed a $15,000 homestead exemption for a residence which they owned as tenants by the entireties. After subtracting a first and second mortgage on the house, the debtors had $14,400 in equity. The debtors sought to avoid a judicial lien against the house as impairing their exemption. The judicial creditor argued that the lien could be avoided only to the extent the lien impaired the exemption, i.e., $600. The court upheld its own established rule that if the debtor's remaining equity in exempt property was less than the allowable exemption, any avoidable lien would be completely avoided. The court noted that its past decisions were cited with approval by the U.S. Supreme Court in *Owen v. Owen, 500 U.S. 305 (1991)*. ***In re*** **Cross, 164 B.R. 496 (Bankr. E.D. Pa. 1994)**.

The debtor filed for Chapter 7 and claimed an exemption in a homestead. The debtor's equity in the house was less than the available exemption amount and the debtor sought to avoid a judgment lien as impairing the debtor's exemption. The judgment creditor argued that, under Illinois law, judgment liens do not attach to the homeowner's exemption amount; therefore, the judgment lien did not impair the exemption. The court agreed with the creditor and allowed the judgment lien to continue against the homestead. ***In re*** **Harrison, 164 B.R. 611 (Bankr. N.D. Ill. 1994)**.

The debtor had received a discharge in March 1987 and the case was closed in June 1987. In September 1993, the debtor requested a reopening of the case to avoid a judicial lien on exempt property. The court noted that no time limit was set by statute or court rules for filing avoidance actions but held that more than six years was too long. The court also established a court rule that avoidance actions be filed within 60 days after the first date for meeting of the creditors. ***In re*** **Hunter, 164 B.R. 738 (Bankr. W.D. Ky. 1994)**.

HOMESTEAD. Within two months before filing for bankruptcy, the debtor conveyed the homestead to the debtor's son for "love and affection" at a time when the debtor was insolvent and the debtor had $27,000 of equity in the house. The debtor did not list the house on the bankruptcy property schedules or claim the homestead as exempt. The trustee learned about the transfer and told the debtor to list any interest in the house. Three days later the son conveyed the house back to the debtor for "love and affection." The debtor then claimed a homestead exemption for the house. The trustee sought denial of the exemption because the property was recovered by the trustee and the property had been fraudulently conveyed by the debtor. The debtor argued that the property was not "recovered by the trustee" because the trustee had not filed any formal motion to recover the house. The court held that the debtor's homestead exemption would be denied because the conveyance of the house to the son was a voidable preferential transfer and was recovered by the estate through the trustee's actions. ***In re*** **Glass, 164 B.R. 759 (Bankr. 9th Cir. 1994)**.

DISCHARGE. The debtor had operated a citrus nursery as a partnership with the creditor. After the creditor filed a suit for an accounting, alleging fraud, theft and breach of contract, the parties reached a settlement. The settlement provided for a promissory note from the debtor to the creditor, secured by the current inventory of trees. The debtor made two payments and sold the entire nursery to a third party who agreed to make the sale subject to the security interest held by the creditor. However, the trees were quarantined and eventually destroyed by the state because of citrus canker. Although the third party received compensation for the trees, the debtor was not paid and the debtor could not pay the creditor. The creditor sought nondischargeability of the debt for willful and malicious injury because the debtor sold the collateral trees in violation of the security agreement. The court held that the evidence did not demonstrate any willful or malicious intent by the debtor because the debtor did make payments when possible and made the sale of the trees subject to the security interest. ***In re*** **Jenkins, 164 B.R. 700 (Bankr. M.D. Fla. 1994)**.

CHAPTER 12-*ALM* § 13.03[8].*

ATTORNEY'S FEES. The Chapter 12 debtor had substantially completed all plan payments and had filed a Final Report and Account in preparation for requesting a final discharge. Two creditors and the trustee objected to the Final Report, arguing that all disposable income had not been paid. The debtor's counsel filed an interim fee application for services rendered in litigating the disposable income issue. The trustee and creditors objected to the fee application, arguing that attorney's fees should be paid by the debtor individually and not from the estate after the

**Agricultural Law Manual* (ALM). For information about ordering the *Manual*, see the last page of this issue.