

Agricultural Law Digest

An Agricultural Law Press Publication

Volume 6, No. 4

February 10, 1995

Editor: Robert P. Achenbach, Jr.

Contributing Editor Dr. Neil E. Harl, Esq.

ISSN 1051-2780

GUIDELINES ON PAYMENT OF WAGES IN KIND

— by Neil E. Harl*

In the May 27, 1994, issue of *Agricultural Law Digest*,¹ we reported that guidelines were expected from the Internal Revenue Service on paying wages in commodities or in kind rather than in cash. The guidelines were the result of a project involving a task force of IRS personnel and three representatives of farm and ranch taxpayers and tax practitioners. I was one of the three non-IRS members of the task force.

The guidelines were circulated in proposed form² with changes incorporated into the final version dated October 27, 1994. The guidelines were formally issued on December 20, 1994.³

Overview

Payments of wages in kind rather than in cash to agricultural labor have not been subject to FICA⁴ or FUTA⁵ tax. In addition, payments in kind to agricultural labor are exempt from income tax withholding⁶ and are not considered wages for purposes of determining the amount of earnings in retirement.⁷ These are powerful incentives to pay wages to agricultural labor in commodities rather than in cash, although the payment of wages in kind could jeopardize disability benefits and reduce retirement benefits under the social security system.

Although IRS had issued private letter rulings approving the payment of wages in kind,⁸ after 1990 the rulings turned negative with most of the arrangements for paying wages in kind disapproved.⁹ In 1993, the Commissioner was urged by members of Congress to examine the issue to see if the IRS position in the matter was appropriate. The Commissioner's response was to appoint the task force.

Published guidelines

The guidelines issued by IRS in late 1994¹⁰ specify that the validity of a plan for paying wages in kind is a facts and circumstances test and depends upon several factors.¹¹ In general, no single factor will assure success and no single factor is fatal in gaining IRS approval. Here are the major factors with an indication of the approach most likely to succeed.

- Ideally, an employment agreement should be entered into at the beginning of the year, establishing an employer-

employee relationship, specifying that the wage payment would be in designated commodities and expressing the wage payment in terms of commodities rather than in dollar terms to be fulfilled in commodities. The commodity used for in-kind wage payment should either be produced in the trade or business or acquired for use in the trade or business. Commodities should not be acquired merely for the purpose of paying wages in kind.

The in-kind wage payment should not be the equivalent of cash. The use of negotiable warehouse receipts or storage receipts may be treated as the equivalent of cash. In a 1979 revenue ruling,¹² the payment of wages in commodity storage receipts was considered the equivalent of cash. However, in the facts of that ruling, the value of the storage receipts was equal to the amount that the employees would otherwise receive and the employer immediately redeemed the employees' commodity storage receipts for cash.

The guidelines also specify that payment in the form of Generic Commodity Certificates is considered the equivalent of cash. Payments under a deferred payment contract will "under almost all circumstances" be considered the equivalent of cash inasmuch as sale of the commodity has already occurred.

- The transfer of the commodity to the employee as a wage payment should be clearly documented in writing.
- The risks of gain or loss on the price of the commodity and the risks of quality deterioration should be borne by the employee after the transfer of the commodity to the employee. The employer should not shield the employee from those risks by a hold-harmless or similar agreement.
- The employee should bear the costs incident to ownership of the commodity after transfer has occurred. Thus, storage costs for grain and feed, management costs and veterinary charges for animals should be the responsibility of the employee.
- The guidelines do not specify a minimum time for which the commodity must be held but the holding period should be long enough for the employee to establish dominion and control over the item.
- The employee should negotiate the sale of the commodity independently of the employer. The guidelines

* Charles F. Curtiss Distinguished Professor in Agriculture and Professor of Economics, Iowa State University; member of the Iowa Bar.

make it clear that the commodity should not be sold back to the employer.

- Any security interest against the commodity as collateral should be released as to the quantity of the commodity used for in-kind wage payment.

Consequences

If the arrangement is successful, the employee reports the fair market value of the commodity as wage income for income tax purposes and any gain or loss on subsequent sale should be reported on Schedule D (unless the employee is otherwise involved in the trade or business of producing the commodity). Apparently, the expenses associated with the commodity in an employee's hands are subject to the two-percent floor for employee business expenses.¹³ Direct costs of disposing of the commodity such as transportation to market should be reported as a reduction in the sales price of the commodity.

Conclusion

The key question now is whether and the extent to which the guidelines will influence the national office of IRS in issuing regulations. Presumably, the rulings issued in the future will reflect the guidelines.

Another major issue is how IRS will handle matters already in audit or that arise before taxpayers have had an opportunity to comply with the guidelines. The guidelines themselves do not address that question. It is believed that IRS agents will follow the guidelines but it is not clear

whether there will be a transitional period of less demanding requirements.

FOOTNOTES

- 1 N. Harl, "New Rules Coming on Payment of Wages In-Kind, 5 *Agric. L. Dig.* 81 (1994). See also 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 "Payment in Kind Guidelines," Sept. 8, 1994.
- 3 "Noncash Remuneration for Agricultural Labor."
- 4 I.R.C. § 3121(a)(8).
- 5 I.R.C. § 3306(b)(11).
- 6 See I.R.C. §§ 3401(a)(2), 3121(a), 3121(a)(8).
- 7 20 C.F.R. §§ 404.429(c)(3), 404.1055.
- 8 Ltr. Rul. 8252018, Sept. 17, 1982 (wages paid as percentage of milk, calves and grain); Ltr. Rul. 8738005, June 5, 1987 (employer-provided livestock production care).
- 9 See, e.g., Ltr. Rul. 9428003, April 5, 1994 (payment of grain to husband and wife as employees of farm corporation disapproved even though grain removed to employees' own storage and held from 5 to 60 days before sale by employees).
- 10 See n. 2 *supra*.
- 11 *Id.*
- 12 Rev. Rul. 79-207, 1979-2 C.B. 351.
- 13 I.R.C. § 67.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

ANIMALS

WILD ANIMALS. The plaintiff was engaged in the business of breeding and selling wild and exotic animals. The plaintiff had obtained a license under the federal Animal Welfare Act and the Indiana Department of Natural Resources. The plaintiff's business was within the city limits of the defendant and the defendant passed an ordinance prohibiting the keeping of wild animals within the city limits. The plaintiff filed a suit challenging the ordinance as preempted by the federal and state statutes, as a violation of the Commerce Clause of the U.S. Constitution, and as a taking of the plaintiff's interest in the state and federal licenses without compensation. The court held that the federal and state statutes did not preempt the ordinance because neither statute attempted to fully regulate the business of wild animals. The court also held that the ordinance was a reasonable exercise of the defendant's police power to protect its citizens from potentially dangerous animals. Finally, the court held that in order to recover for a governmental taking of property, the plaintiff should bring a state court suit for invalidation or inverse condemnation. **DeHart v. Town of Austin, IN, 39 F.3d 718 (7th Cir. 1994).**

BANKRUPTCY

GENERAL-ALM § 13.03.*

DISCHARGE. The debtors were in the business of buying and selling hogs and had filed for Chapter 7. One of the creditors had purchased or transported hogs owned by the debtors and objected to the debtors' discharge on the basis that the debtors failed to keep adequate records of their business. The creditor argued that the debtors' records did not comply with state and federal recordkeeping requirements. The court held that failure to comply with state and federal recordkeeping requirements was not per se sufficient to deny discharge if the debtors otherwise maintained sufficient records to determine the financial status of the business. The debtors' records consisted primarily of monthly profit and loss statements and balance sheets prepared by the debtors' accountant. The court held that these records were insufficient because the records did not create a complete "paper trail" of all transactions of the debtors' business sufficient to determine that the financial affairs of the business complied with all bankruptcy requirements. **In re Vandewoestyne, 174 B.R. 518 (Bankr. C.D. Ill. 1994).**

The debtors were husband and wife and farmed a farm owned by the wife's aunt on a 50 percent profit share basis.