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**Agricultural Personnel Issues - Employee Compensation**

**Quick Notes...**

It is important to adequately compensate employees for their efforts.

Employer's must withhold taxes on "cash" wages but generally not on "noncash" wages.

Some "noncash" wages will cost the employer relatively little and greatly benefit the employee.

Securing human resources is a complex issue. Is the person an employee or an independent contractor? What forms need to be completed and on file? What is a fair wage? What about benefits? When and how much salary withholdings should be made? And the questions go on and on.

This article discusses some of the various forms of compensation for farm employees. It is intended for educational purposes only. Appropriate legal and accounting counsel should be sought for individual situations. Tax considerations are based on tax laws in effect as of June 30, 1995.

**Compensating Employees**

Most employees receive monetary compensation for their efforts. However,

agricultural producers frequently have opportunities to compensate their employees with "noncash" benefits. Commodities, housing, personal use of business assets, clothing, etc. are all noncash, fringe benefits.

Compensating employees with fringe benefits has potential tax advantages for the employer and/or the employee. Neither the employer nor the employee are obligated to pay social security taxes (FICA) on noncash wages. Furthermore, the value of noncash compensation to the employee may be greater than the actual cost to the employer.

Some forms of compensation benefit the employer as much as the employee. Protective clothing and education may reduce work related accidents when the employee is working with pesticides. Bonuses may keep employees from quitting during critical times.

Cash wages should make up the majority of an employee's compensation. They are taxable income to the employee and a tax deductible business expense to the employer. Cash wages are subject to social security taxes for the employer and the employee and to income taxes for the employee.

Vacation pay is the amount employers pay their employees while the employees are on vacation. It rewards them for time worked

throughout the year and helps equalize them with nonagricultural workers. Vacation pay is considered regular wages for taxation purposes.

Overtime pay is not generally required under current agricultural labor laws. However, it may be a way to reward employees for working more hours than would normally be required during a week. Non-agricultural workers normally receive 1 1/2 times their normal wages for hours worked in excess of 40 per week. Overtime pay, the per hour increase, and minimum number of required hours before overtime pay begins are left up to the employer's discretion in most agricultural situations. Overtime pay (in the form of cash wages) are subject to both social security taxes and income taxes.

Bonuses are not required under current agricultural labor laws. They can be used to reward employees for their contributions to a successful year, harvest, or other time period. Bonuses are often a set dollar amount, an extra month's salary, a percentage of normal wages, or a percentage of gross income of a particular enterprise or the whole farm/ranch.

Farm/ranch commodities, when paid as wages, are considered tax deductible expenses for the employer and income for the employee. Income taxes are paid on the value of the commodities. Neither the employer nor the employee are responsible for paying social security taxes on wages paid in the form of commodities if certain conditions are met.

The employer should give control of the commodity to the employee -- the employee must have ownership and make marketing decisions regarding the commodities. Ideally, a written agreement between the employer and employee should specify the amount and date of ownership transfer. Failure to give the employee full discretion in the handling and

sale of the commodities may cause such wages to be subject to social security taxes.

Often employers compensate employees with commodities to avoid paying social security taxes. While it may reduce FICA and labor costs, it may also jeopardize the disability and retirement benefits of the employee. Social security benefits are based on contributions made by employees during their working years. Hence, lower contributions mean lower benefits upon retirement or disability.

Housing is sometimes available for an employee. Such housing makes excellent compensation for the employee, since the house is generating no income for the employer while vacant and it can reduce the employee's cost of living.

Housing, and/or utilities, given to an employee must meet three tests to be considered a deductible business expense to the employer and not considered taxable income to the employee.

1. The housing must be furnished on the business premises.
2. The housing must be furnished for the employer's convenience.
3. The employee must be required to accept the housing as a condition of employment.

Farm/ranch assets, available for use by an employee, such as pasture for personal animals, may also serve as part of the compensation package. If there is no cost to the employer, the use of business assets is not considered taxable income to the employee. The liability aspects of the personal use of business assets should be discussed and formalized.

Personal use of farm/ranch vehicles is considered to cost the employer and therefore the value of providing that benefit is considered taxable income of the employee. The cost incurred to provide the benefit is considered a tax deductible business expense.

Other types of compensation include meals, protective clothing, education, and insurance. Meals provided to employees may be tax deductible to the employer and not considered income to the employees if they are furnished on the business premises and are for the employer's convenience.

Protective clothing may increase employee productivity by reducing work-related accidents. The costs of protective clothing used for work are tax deductible to the employer and not considered income to the employee. If an employee is required to purchase the protective clothing, the cost of such clothing is tax deductible to the extent that other conditions are met on the employee's tax return.

Employee education is generally thought to benefit the employee and employer. Knowledgeable employees may have greater productivity and fewer work related injuries. Some education may be required under

current labor laws (example, working with pesticides). The cost of job related education is tax deductible to the employer and not taxable income to employees.

Medical and life insurance may be provided to employees. There are many types of policies available, so specific questions and tax consequences should be addressed by appropriate professionals.

### **Disclosure**

It is important for the employer to let employees know the full costs of hiring employees. It is advisable that the employer give each employee a detailed statement of all compensation (cash and noncash) paid during the year. Employees will be better able to compare their compensation to non-agricultural wages. Employers aware of the full cost of having employees will be able to make better management decisions.

The employer must furnish every employee a Form W-2. The form must be sent to the employee by January 31st of the year following payment of compensation for services. A copy of the form must also be sent by the employer to the Social Security Administration.

Sources: 1) "Compensation Packages for Farm Employees", NebGuide G92-1067-A, University of Nebraska-Lincoln; 2) IRS Circular A, "Agricultural Employer's Tax Guide", 1994.

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