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Compensation Packages for Farm Employees

Important considerations for using various forms of compensation for farm employees are covered here.

Raymond E. Massey, Extension Economist--Farm Management
Gary L. Bredensteiner, Associate Extension Agriculturist

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Most agricultural employees receive mainly monetary compensation in the form of wages or salary, vacation and overtime pay, and bonuses. But agricultural producers frequently have the opportunity to compensate their employees with fringe benefits.

Such benefits as farm commodities, personal use of farm assets, housing, meals, clothing, education, and insurance and retirement benefits are all fringe benefits.

Compensating employees with fringe benefits has many potential tax advantages. Neither the employer nor the employee are obligated to pay social security taxes (FICA) on noncash wages. Compensation in

the form of gifts, housing, meals, work clothing, educational opportunities, insurance and retirement plans offers potential income tax savings to the employee and/or family.

Often fringe benefits provide more value to the employee than they cost the employer. Compensation in the form of farm commodities or produce, housing, and use of farm assets may represent more value to the employee than the actual cost to the employer.

On the other hand, some forms of compensation benefit the employer as much as the employee. Supplying protective clothing may reduce work-related accidents. Bonuses may keep employees from quitting during critical times. Employee educational opportunities paid by the employer should help develop the employee into a more valuable resource.

This NebGuide details important considerations for using various forms of compensation. It is intended for educational purposes only and is not a substitute for competent legal or accounting advice.

Monetary Compensation Forms and Their Primary Function

Wages and Salary	primary compensation for work performed
Vacation pay	reward for full-time employees
Overtime pay	reward for dedication to the job
Bonuses	incentive to remain with the business

Cash Wages

Cash wages, such as hourly pay or monthly salary, should make up the majority of an employee's compensation package. They are considered taxable income to the employee and a tax-deductible business expense to the employer. The employee and employer must both pay social security taxes on cash wages. The employee must pay state and federal income taxes on cash wages.

Agricultural employers are responsible for withholding social security taxes and federal and state income taxes from the cash wages of their employees.

Vacation Pay

Vacation pay is the amount employers pay their employees while their employees are on vacation. Giving vacation pay to farm employees rewards them for hours worked throughout the year and puts them on an equal footing with non-agricultural workers who frequently receive vacation pay. Vacation pay is considered regular wages for taxation purposes.

Overtime Pay

Though overtime pay is not normally a state or federal requirement under the current labor laws regarding agriculture, it may be a very simple way to reward employees for working long days. It is a type of incentive pay that gives the employee more than the normal wage for hours worked over a certain, specified minimum during any week.

Non-agricultural workers frequently receive 1 1/2 times their normal wages for hours over 40 worked in any week. The per hour increase in wages and number of hours at which overtime wages begin are left to the employer's discretion in most agricultural situations.

Bonuses

Bonuses paid to employees are considered wages paid and taxed as such. Bonuses are often a set dollar amount (i.e. \$200), an extra month's salary, or a percentage of either normal wage or gross income of the farm, paid at year's end.

Bonuses can be used to reward employees for their contribution to a successful year for the farm. Bonuses frequently are used to encourage employees to stay with the employer until a specified date when the bonus will be paid. Employees who leave before the bonus is paid do not receive any bonus.

Fringe benefits that may offer tax advantages to the employee, employer or both

Farm Commodities & Produce	Housing & Utilities
Use of Farm Assets	Gifts in Merchandise
Meals	Retirement Plans
Protective Clothing	Insurance Plans
Educational Expenses	

Farm Commodities and Produce

Wages paid in the form of farm commodities and produce are considered tax deductible expenses for the employer and income for the employee. Income taxes must be paid on the value of compensation in commodities.

Neither the employee nor the employer are responsible for paying social security taxes on wages paid in farm commodities and produce if certain specific conditions are met¹. See your tax consultant for the specific rules regarding payment in farm commodities.

If wages are going to be paid in commodities or produce for the purpose of reducing social security taxes paid, take care to ensure that the employer gives control of the commodity or produce to the employee. Ideally, a written agreement between the employer and employee should specify that a certain amount of commodity will be given to the employee for services rendered throughout the year. Then the commodity should be given to the employee and marketed by the employee at the employee's discretion.

Failure to give the employee full discretion in the handling and sale of commodities may cause wages paid in commodities not to be considered exempt from Social Security tax during an audit by a taxing agency.

Often employers compensate employees in commodities to avoid paying Social Security tax. Not paying Social Security taxes may give greater current spending income to an employee and lower the employer's cost of hiring, but it may also jeopardize the disability and retirement income of the employee. Social

Security benefits are based on contributions made by employees during their working years. Lower contributions means lower benefits upon retirement or disability.

Employees should be aware of the impact reduced Social Security contributions may have on their retirement and disability benefits. An estimation of Social Security benefits can be obtained by filling out a "Request for Earnings and Benefit Estimate Statement" form available from the Social Security Administration. With the Social Security tax savings from wages paid in commodity or produce, the employee may be able to purchase disability insurance or fund a retirement account that will more than offset losses in Social Security benefits.

Use of Farm Assets

Giving an employee the use of farm assets such as pasture for personal animals, or the use of farm shop and tools can provide a benefit to the employee with little or no increase in cost to the employer. If there is no cost to the employer of providing an employee with the use of farm assets, their value to the employee is not considered taxable income².

If the use of a farm asset by an employee for personal use is a real cost to the employer, the value of the benefit must be included in the employee's gross income. Personal use of farm vehicles is considered to cost the employer and therefore the value of providing that benefit is considered taxable income of the employee. The employer can deduct as a business expense only the cost incurred to provide the benefit³.

The liability aspects of the personal use of business assets needs to be discussed and formalized. An agreement regarding liability, perhaps with advice from an attorney, should be written. Adequate insurance coverage should be checked.

Housing and Utilities

Many times a producer has a farm house that is vacant. Use of such a house might be ideal compensation for an employee. The house is generating no income for the employer while vacant but can reduce the employee's cost of living if given as noncash compensation.

If housing, and/or associated utilities, supplied to an employee meets the three tests below it is a deductible business expense to the employer and is not considered taxable income to the employee.

- **Test 1.** The housing must be furnished on your business premises (i.e., a house on the farm qualifies, a house in town does not qualify).
- **Test 2.** The lodging must be furnished for the employer's convenience.
- **Test 3.** The employee must be required to accept the lodging as a condition of employment⁴.

Having an employee live in a house owned by the farm business not only meets some of the employee's living needs but also meets the needs of the employer. Security of the house and surrounding farm is greater if someone lives there. Maintenance of the house may be better since small problems can be detected and repaired earlier.

The benefits to employer and employee of having an employee live in a house owned by the employer may justify the employer moving a trailer house to the farm for the employee to use.

Meals

Meals provided to employees may be a tax deductible expense to the employer but not considered income to the employees if they meet tests 1 and 2 in the section on housing. Such compensation may only be 80 percent deductible to the employer, depending on the situation⁴. Consult a tax advisor regarding the rules and tax consequences of providing meals for employees.

Clothing

Supplying protective clothing such as safety shoes or boots, and work gloves, has the potential to increase employee productivity by reducing work-related injuries.

Protective clothing used for work is tax deductible for the employer and not considered income to the employee if paid by the employer. If an employee is required to purchase protective clothing, such clothing is tax deductible only after it, and all other non-refunded business expenses incurred, exceeds 2 percent of the employee's adjusted gross income⁵.

Educational Expenses

Increased education is generally believed to benefit the person receiving the education, that person's employer, and society in general. From the viewpoint of the employer, an employee trained in a special skill needed by the employer makes that employee a more valuable resource to the farm. Employers may want to pay for certain educational opportunities for their employees.

Educational expenses not job related but paid by the employer for the employee are treated as wages. They are a deduction to the employer and a taxable income to the employee.

If the educational expense is job related, such as attending a seminar or conference which improves the skill of the employees in their present duties, it is a deductible expense to the employer and not taxable income to the employees⁴.

Complex, specific rules surround the taxability of educational benefits. A tax advisor should be consulted regarding the tax consequences of educational expenses.

Gifts

Merchandise gifts of nominal value, such as turkeys or hams, given to promote employee goodwill, are tax deductible expenses to the employer but are not considered taxable income for the employee. Gifts cannot be made in cash or items easily convertible to cash if they are not reported as income of the employee receiving the gift. There is a \$25 annual limit on such gifts to any one employee⁶.

Insurance and Retirement Plans

Medical and life insurance provided for the employee by the employer often provide value to the employer, employee and/or employee's family, and save money over having employees provide for their own insurance needs. Workmen's compensation and unemployment insurance are benefits offering protection to employees in an occupation at high risk.

Several retirement packages are available that increase an employee's compensation by using pre-tax

dollars to pay for them. Because of the complexity of the issues surrounding insurance and retirement plans as an employee benefit, insurance is covered in more detail in NebGuide [G92-1072](#), and retirement plans in NebGuide [92-1066](#).

Disclosure of Full Cost of Employing People

The true cost of employing people often is not understood. Because much of the compensation for agricultural employees may be fringe benefits, it is important the employer let employees know the full cost of hiring employees. It is recommended that at least once a year a detailed statement of all compensation, cash and noncash, paid to an employee be given to each employee. [Table I](#) gives an example of an Employee Wage & Benefit statement, along with summary comments regarding the taxability of different forms of compensation.

When employees are given a complete detailed breakdown of their compensation they are better able to compare their compensation to non-agricultural wages. Employers aware of the full cost of hiring are able to make better management decisions regarding labor and expansion.



[Table I](#). Summary Wage and Benefit Table

References

1. Circular A, *Agricultural Employer's Tax Guide (1990)*, Section 2.
2. Circular E, *Employer's Tax Guide (1990)*, Section 6: Nontaxable Fringe Benefits.
3. IRS Publication 535, *Business Expenses (1990)*, Chapter 3.
4. IRS Publication 535, *Business Expenses (1990)*. Chapter 2.
5. IRS Publication 529, *Miscellaneous Deductions, (1990)*, Deductions Subject to the 2% Limit.
6. IRS Publication 334, *Tax Guide for Small Business (1990)*, Chapter 10.



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pubs@unlvm.unl.edu

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