Commodity Wages: What are they? How can they fit into your operation?

By Ben Kaup

As is the case with many parts of our tax code, agriculture producers typically play by a different set of rules. One instance in which this remains true is with commodity wages. What are "commodity wages" you may ask? Commodity wages are a way for agriculture producers to compensate employees (including family who work for the operation) without carrying the burden of many different taxes. Commodity wages are "paid" by transferring the ownership in a certain amount of a commodity (grain, hay, cattle, hogs, etc.) to an employee. The amount of wages "paid" is equal to the fair market value of the commodity on the date of ownership transfer. Commodity wages, when paid properly, are exempt from Social Security and Medicare taxes. They are also exempt from federal unemployment taxes and the producer is not bound by any withholding requirements.

Avoiding the payroll taxes that come with paying traditional wages does not come without a few administrative hoops to jump through. For commodity wages to be properly paid, the employer must take these steps:

1. The wage should be for labor related to agriculture only.
2. The employer must report the fair market value of the commodity on form W-2 at the end of the year. The fair market value to appear on the W-2 is the value on the date of transfer.
3. The employer still needs to recognize the revenue associated with the commodity "sale." They are also allowed to deduct the amount as wages paid.
4. The recipient of the commodity wage must bear some market risk. The change in price between the date of receipt and eventual sale, whether up or down, is to be recognized by the employee as a short-term capital gain or loss. Essentially, the IRS wants to see that the employee was not given a commodity on one day and sells it the next. They could deem this a cash equivalent transaction and would require payroll taxes to be paid on the transaction. A good rule of thumb would be to allow AT LEAST 2 weeks between the transfer and sale of a commodity.

5. There should be a document showing the employment arrangement which allows for the transfer of a commodity in place of cash wages. This document should show what the commodity is, and the amount transferred to the employee.

Can commodity wages fit into your operation? The answer to this question can vary. Commodity wages are a great way give your employees an incentive to take good care of livestock or put in the extra work necessary for increased yields. They are also a perfect way to compensate family members who work in your operation without paying any payroll taxes. There are also situations in which it may be beneficial to pay your family members and employees traditional wages to get them Social Security credits as well.

As with any major tax decision, we would be happy to assist you to see if commodity wages are a good fit for your tax and financial situation. At Kaup's Financial Advisors our team of tax and financial professionals are knowledgeable in the benefits and drawbacks of commodity wages and can aid in your decision of whether commodity wages should have a place in your operation's compensation structure.

Thanks,

Ben Kaup
Tax Specialist