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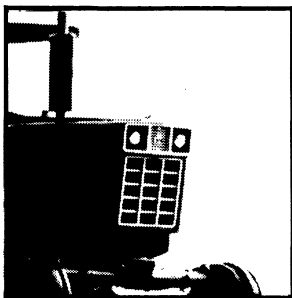
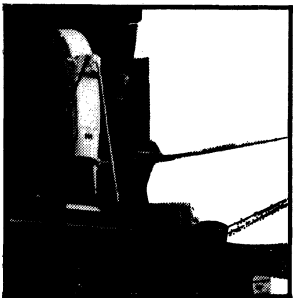
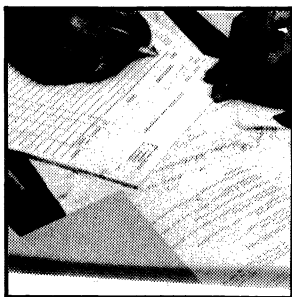
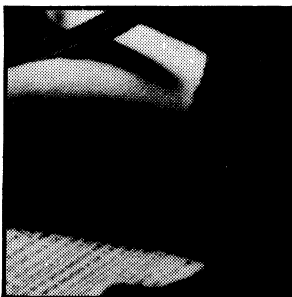
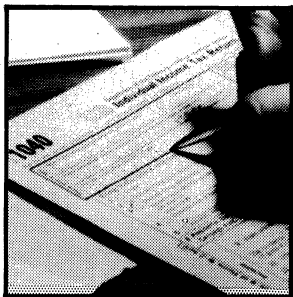
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Indirect Farm Labor and Management Costs

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Kenneth R. Krause



Indirect Farm Labor and Management Costs by Kenneth R. Krause. National Economics Division, Economic Research Service, U.S. Department of Agriculture. Agricultural Economic Report No. 496.

Abstract

Farmers' contributions to their employees' (and their own) social security, insurance and retirement programs, and other fringe benefits can add more than a third to farm labor costs. Those contributions (some required by law) can also sway farmers' views of mechanization and farm organization (that is, operating as a sole proprietorship, partnership, or corporation). Yet these costs are usually omitted from agricultural studies, so one cannot determine how much the programs add to farm production costs. This report describes the basic employee fringe benefit programs and the range of costs involved so future cost studies can include them.

Keywords: Farmer payroll taxes, insurance, fringe benefits, social security, unemployment insurance, workers' compensation, retirement programs, life and health insurance.

Caution

Farmers who use this report and are required to pay payroll taxes and participate in insurance and fringe benefit programs covered here should seek expert advice from attorneys, accountants, and other specialized advisors. The applicable laws and regulations are complex and frequently change, creating a potential for errors. The Economic Research Service is not regularly funded to do extensive analysis of the topics covered here and updating is not planned.

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Preface

Tax laws and regulations are constantly being modified and any discussion of them can give only an idea of the situation at a given moment. The analysis presented in this report was substantially completed before the Economic Recovery Tax Act of 1981 was enacted. Some of the provisions of that act became effective immediately, while others will be phased in over several years. The general descriptions of the programs presented here (like that of the Individual Retirement Accounts) were updated where possible to reflect the new law. The Tax Equity and Fiscal Responsibility Act of 1982, enacted after production work began on this report, made other changes in the laws governing unemployment insurance, retirement programs, and other topics discussed in this report. Researchers, analysts, and farmers should be sure to consult regulatory interpretations of the acts before acting on any information in the ensuing pages.

Actual farm data were not available for cost illustrations used in this report so approximations were used for general situations. Researchers and policymakers should develop their own data for specific farm situations since several reviewers thought the cost illustrations were too low, while others thought them too high. Both sides may be correct, depending on differences in individual farm situations, type of farming activities, State involved, the farm operator's financial position and objectives, and particular cost-price relationships in a given accounting period. In earlier years, better data would have been available in at least some States where surveys were conducted of life insurance coverage of farmers. Universities may now be encouraged to resume such studies and include the broader range of programs covered in this report.

The discussion of programs in this report is not limited to agricultural provisions. More general provisions are included where they are relevant to agricultural workers likely to be employed off the farm. The dates when legislative acts were effective or amended, included to give a perspective on Federal or State interest, may also be useful in appraising future changes.

In the absence of opportunity to obtain actual empirical farm data, the information in this report, which provides details of the various programs, can be used as a guide for simulation studies. The information should be updated when specific studies are undertaken. There is, however, no one specialist or group of specialists covering the several areas in the U.S. Department of Agriculture. Therefore, the preferred method for obtaining the necessary information is to contact specialists in the various Federal and State agencies for each of the programs such as the Social Security Administration, the U.S. Department of Labor, State Unemployment and Workers' Compensation offices, and the Federal Internal Revenue Service for tax treatment of each of the programs. Private individuals and firms, such as accountants, bankers, attorneys, and financial consultants, also specialize in one or more of the programs. A good general set of references on many of the programs was made available in 1981 by Neil Harl's multiple-volume "Agricultural Law" series, which will frequently be updated and can provide a ready reference on some of the programs. Leslie A. Whitener and Robert Coltrane, of the Economic Development Division, Economic Research Service, U.S. Department of Agriculture, reviewed several sections of this report and may be able to continue to provide aggregate data on farm employment.

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Summary

Farmers' labor costs can rise by 30 percent or more if farmers and their hired help are covered by the employee protection programs almost universally required of nonfarm businesses. Such costs may encourage or retard the rate of farm mechanization or sway farmers' attitudes on incorporating. Despite the potential impact of these programs on farming, their costs are usually not included in agricultural studies. This report highlights the potential effects of the programs on farms by describing the provisions that can apply to farms and by giving general estimates of the programs' costs to farmers.

The major programs are social security, unemployment insurance, workers' compensation, health and life insurance, retirement programs, and other fringe benefits—vacations, training, housing, transportation, and so forth. Some programs are mandatory depending on the type of farm, the number of farm employees, the size of the farm payroll, and the type of farm organization.

For small farms, the administrative costs of the programs may exceed the required contributions. Some farmers hire management firms to handle the administrative details: learning program requirements, staying current with regu-

lations, recordkeeping, filing reports, all of which can add substantially to the programs' costs.

The costs of the programs can influence farm organization because some costs may be tax deductible for a corporation but not for a sole proprietorship or vice versa. The programs may retard farm mechanization because the advantages of mechanization (higher productivity, fewer workers) may not always offset its disadvantages (higher initial capital costs, higher workers' compensation payments because of more accidents by workers using machinery).

The programs can add from about 20 percent to more than 40 percent to total farm labor costs (see accompanying table). In almost all cases, social security taxes are higher for an incorporated farm, even an incorporated family size farm. The overall Federal tax effects of incorporating may, however, outweigh the added costs of participating in the programs.

Payroll taxes have different effects on sole proprietorship farms than on incorporated farms. Social security is the only mandatory program for sole proprietor farmers with no employees. A sole proprietor's personal social security tax rate was 9.3 percent in 1981. If the same farm were incorporated with the owner as an employee, the owner

Self-employed and payroll taxes and insurance and fringe benefit costs for three illustrative farms

| Item | Sole proprietor farm: no hired labor | | Sole proprietor farm: 2 full-time employees, 2 seasonal employees | | Corporate farm: 5 full-time employees 5 seasonal employees | |
|---|---|--------------------------------|---|--------------------------------|--|--------------------------------|
| | | | | | | |
| <i>Dollars</i> | | | | | | |
| Gross sales | 80,000 | | 250,000 | | 1,000,000 | |
| Net farm earnings | 20,000 | | 45,000 | | 175,000 | |
| Salary and wages | 0 | | 40,000 | | 130,000 | |
| Family living | 15,000 | | 25,000 | | 0 | |
| <hr/> | | | | | | |
| | Before Federal income tax | After Federal income tax | Before Federal income tax | After Federal income tax | Before Federal income tax | After Federal income tax |
| <hr/> | | | | | | |
| <i>Dollars</i> | | | | | | |
| Payroll tax | 1,620 ¹ | 1,620 ¹ | 4,550 ² | 3,496 ² | 7,969 | 4,303 |
| Insurance | 1,400 | 1,288 | 6,548 | 4,742 | 14,790 | 7,987 |
| Other fringes | 4,500 | 3,520 | 18,750 | 9,991 | 29,500 | 15,930 |
| Total | 7,520 | 6,428 | 29,848 | 18,229 | 52,259 | 28,220 |
| <hr/> | | | | | | |
| <i>Percent</i> | | | | | | |
| Total as a percentage of net farm earnings | 37.6 | 32.2 | 66.3 | 40.1 | 29.9 | 16.1 |
| Total as a percentage of salary, wages, and family living | 50.1 | 42.9 | 45.9 | 28.0 | 40.0 | 21.7 |

¹Social security taxes for the sole proprietor alone.

²Social security taxes for the sole proprietor and employees.

would pay 13.3 percent on the same salary. In addition, when a farmer incorporates the farm business, the number of farmworkers or their salary levels may be high enough to require unemployment insurance and workers' compensation payments—both of which can often be avoided by sole proprietorship farmers.

Unemployment insurance, designed to provide unemployed workers with a minimum income, is a combination of Federal and State programs that impose a 3.4-percent tax on the first \$6,000 of farm salary and wages. The minimum insurance rate has escalated in recent years. The cost to farmers may continue to increase if States continue to broaden farm coverage or if the Federal Government imposes lower minimum participation requirements. Rate assessment, however, depends on a firm's own unemployment experience over time and that of similar firms in the industry.

Workers' compensation is essentially a State program that provides benefits to workers (or their survivors) who are injured (or killed) in work-related activities. Like unemployment insurance rates, workers' compensation tax

rates depend to a large extent on claims experience of similar firms and on a firm's own claims record. Rates can run as high as \$15 per \$100 of payroll for farm activities with a high accident rate.

Other types of insurance programs (health, life, retirement) are largely discretionary for the farm firm, but are increasingly requested by farm employees, and they can offer tax deductions for employers. Contributions to such programs can be paid by the individual alone, by the firm alone, or by the individual and the firm jointly. Several retirement programs (Keogh plans, Individual Retirement Accounts, and corporate plans) will defer Federal income taxes on some earned income and earnings from the plan.

Other fringe benefit programs for farmers and their employees are as varied as the farm activities and the interests of the employers and employees. Housing, clothing, and transportation provided by the employer have long been a part of some farms' fringe benefits. Others (paid vacations, sick leave, training, prepaid dental and legal programs, group automobile insurance) may also become more commonly used by farmers to attract and retain skilled employees.

Indirect Farm Labor and Management Costs

Kenneth R. Krause

Agricultural Economist

Introduction

The costs of taxes, insurance, and employee fringe benefits continue to escalate steadily, spurred by changes in employee coverage and by general inflation. Recent legislation and regulations have extended the coverage of farmworkers under payroll taxes, unemployment insurance, and workers' compensation insurance. In addition, changes in Federal tax provisions and tax bracket creep have probably encouraged more voluntary participation in tax deductible fringe benefits. The costs of these employee benefit programs may raise the cost of basic farm wages for some farm operations by more than a third. There is thus a need to give more attention to these items in studies of agricultural costs of production and economies of size.

The potential effects of the programs on farm organization can only be hypothesized. Under some circumstances, the programs could influence changes in the organization and structure of U.S. agriculture. Substitution of capital for labor, for instance, may be more rapid in certain types of agricultural production, necessitating fewer highly skilled laborers and thus altering the effects of government programs for agricultural employers. Requiring the programs only on farms that employ many workers was thought at first to favor the small family farms, which are not required to participate in the programs (1, 2).¹ Whether this is still the case is not known, given increasing social security requirements and increasing voluntary participation in insurance and retirement programs.

This report describes and suggests applications of the relevant self-employed and payroll taxes and insurance and fringe benefit programs that should be included as cost components in agricultural research. Program requirements that vary by type and size of farm are also emphasized. The information in this report provides a benchmark for researchers doing more detailed cost and size studies. Public policymakers concerned with farm commodity price-support programs may also find the information useful.

Although provisions covered in this report were in effect during its preparation (1979 through early 1981), they are not covered in sufficient legal detail to prepare payroll taxes and insurance and fringe benefit programs. Current Federal and State regulations and technical interpretations should be used for such purposes. The material here is presented only as a guide. Researchers and policy analysts

should refer to the most recent regulations and applications, and use actual farm costs when available.

The programs' coverage costs are likely to increase over the next several years. Historically, agriculture was excluded from mandatory payroll taxes enacted for most other sectors of the economy. When the legislation was first considered in the midthirties, agricultural interests successfully argued to exclude agricultural workers on the grounds that farms were small, income was low, farmers would be burdened by the recordkeeping requirements, and the Federal costs of assuring compliance and administering the programs might exceed the benefits. In the sixties, resistance lessened and some parts of agriculture were included, followed in the seventies with substantially more coverage. This change was supported by Dale Dahl, et al., who recently observed that, "... it has become exceedingly difficult to accept the proposition that there is something peculiar about agriculture [now] that creates insurmountable administrative problems and a market structure that does not allow added costs of production to be absorbed" (2). Other recent studies and legislative proposals also suggest that agricultural workers will become subject to broader and more expensive payroll tax and insurance coverage (1, 6). Out-of-pocket fringe benefits for agricultural workers may likewise be extended as employees demand more benefits to improve their welfare, and as employers and governmental bodies recognize the importance of bringing farmwork coverages, particularly on the larger farms, to levels comparable with those in other sectors.

Several important public policy issues concerning Federal involvement in the payroll tax and fringe programs are not covered here but are covered in other reports (6, 7). The actual number of farmworkers covered by the programs, the number who are not covered (whether legally or illegally), the number who would be covered under various legislative proposals, as well as the administrative costs to Federal and State governments are unknown. Reliable data are not available to appraise current participation or analyze potential participation in the programs by farmers using either little hired labor or substantial labor.

The unavailability of reliable data has generally resulted in the costs of the programs being excluded from agricultural cost studies. The exclusion has probably also been due to the separate nature of the programs and, until a few years ago, to the rather low costs of the programs. As a result, there is insufficient information to quantify how the programs add to the basic costs of commodities such as a bushel of wheat or a pound of carrots.

¹Italicized numbers in parentheses refer to sources cited at the end of each section in this report.

In general, the number of farm employees will determine the cost of participation in the programs because larger farms with more employees are required to participate in more of the programs. In addition, farmers who incorporate and provide labor and management themselves, although required to participate in more of the programs, can enjoy some income tax incentives (deductions) not as readily available to sole proprietorships (appendix I).

Policy questions about what changes should be made in each of the programs to achieve desired social and economic objectives are not covered here, but do merit attention in other studies. Inequities that may exist in the programs are also not covered and only limited attention is given to complementary and competitive benefits that agricultural workers may derive when they are eligible for two or more programs.

Present and future cost estimates of each fringe program, where available, are presented along with illustrations of their effects on firms of various types, sizes, and income levels. Moderately detailed abstracts of each program's regulations are presented so that researchers and policymakers can use their own assumptions about particular farm situations to determine the costs of participation in the programs.

* * *

Several major programs are summarized below and discussed in more detail in the following sections. Social security is the major payroll tax and is mandatory for nearly all self-employed workers and employees (table 1). Four types of insurance—unemployment, workers' compensation, health and accident, and life—are discussed in the following sections. Where required, unemployment insurance is essentially a payroll tax for employers. Workers' compensation is an insurance program handled mostly by private insurance carriers and States.

Many farm firms also provide some fringe benefits voluntarily. Some of the programs have become so firmly established that some farms treat them like required programs. Self-employed farmers, as well as employees of partnerships and corporations, may participate although the tax benefits may be larger in absolute dollars for a corporate farm. Farmers are increasingly participating in health and life insurance and in retirement programs. Farm employees are increasingly able to bargain for coverage under one or more of the insurance and fringe programs, and self-employed farmers find that participation is in their self interest.

Several Federal and State laws specify that if employers participate in the programs themselves, they must include their employees in the programs as well. In some cases, Federal tax deductions encourage employers to include their employees in the programs. This is particularly the case with Individual Retirement Accounts (IRA's), HR-10 (Keogh) plans, and corporate retirement plans. Certain deductions can also be taken for life insurance and health and accident insurance coverage.

The remaining fringes, when used in combination, can cost as much as or more than any of the others. Paid leave days for vacations, sickness, and other personal reasons are becoming more common for full-time employees. Training of various types is also becoming common—whether required by law to handle a new farm chemical, to operate a new planting or harvesting implement, or to learn farm accounting through a college course. If needed by the farm business, training costs are usually tax deductible. Farm operators have long provided housing and, in some cases, food and transportation for some full-time and seasonal employees. Some of the items that had not been tax deductible earlier may now be so, especially when a corporate form of business is used and the operation involves livestock or other production that requires the employee to be on the farm constantly. In these cases, if properly handled, the fringes may not be taxable income to the employee. Federal income tax consequences of the payroll tax and fringe benefit programs are more fully covered in the second part of appendix I.

Taken together, the programs required by statute along with fringe benefits could amount to between a third and a half of wages and salaries—a level common in other economic sectors of the Nation. These percentages, however, do not include bookkeeping, filing, and compliance costs, nor administrative time to keep up with changes in State and Federal requirements and changes in the fringe programs offered by individual firms. Such costs can sometimes equal or exceed the actual payments for the programs, particularly where a farm unit employs just over the minimum number of employees needed to participate in a program. Such costs can add another 5 or 10 percent to wage costs, especially in smaller firms where payrolls are relatively small. In some cases, the bookkeeping requirements, along with the time needed to stay on top of changing legal requirements, cost more than the actual payments to the programs.

For studies of sole proprietors, where the family provides the labor and management, the cost of the programs may be 5 percent or less of the farmer's opportunity cost for labor since only social security taxes are required. Such taxes need not be very high if taxable farm income is low. In comparison, the costs for sole proprietors who hire employees and develop fringe benefit programs for themselves and their employees could be over 30 percent of payroll.

The specific cost of the programs varies from one farm to another and from one State to another. Thus, there is no substitute for obtaining actual farm information for studies on costs of production or economies of size. In doing such studies, researchers need to pay particular attention to differences among States, especially for unemployment insurance and workers' compensation coverage.

Some of the insurance and fringe programs are mandatory and others are voluntary, depending on a farmer's situation. Mandatory programs raise the farmer's production costs and reduce the amount of retained income for investment in the farm business, for savings, or for family living. The cost of the programs probably tends to reduce reinvestable farm funds rather than family living funds.

Table 1—Payroll taxes, insurance, and fringe benefits highlights¹

| Item | Social security | Unemployment insurance | Workers' compensation insurance |
|---|--|--|--|
| Coverage | Mandatory, in most cases | Mandatory since 1978 in situations where 10 or more agricultural workers are employed. Voluntary in certain States and over and above mandatory coverage. | Mandatory in 13 States which require equal coverage treatment of agricultural workers. Large variations in required coverage situations exist between States. Voluntary in most States over and above mandatory coverage and in States not requiring mandatory coverage. |
| Regulatory unit | Federal | Federal and State | State |
| Cost | Self-employed— 9.3% of from \$150 to \$29,700 in 1981 Employer— 6.65% of from \$150 to \$29,700 in 1981 Employee— 6.65% of from \$150 to \$29,700 in 1981 | Self-employed— Not applicable except in rare cases Employer— 3.4% of the first \$6,000 of income in most States. Individual rates are adjusted up or down depending on employer's claim record. Employee— Not applicable. | Self-employed— Not applicable. Private or group health and accident insurance is more commonly used. Employer— 7.5% average in 34 States up to minimum coverage required per State as agreed to by employer and employee. Individual firm rates are adjusted after 3 years' experience. Employee— Not applicable. |
| Costs deductible for Federal taxes: | | | |
| Self-employed | No | Not applicable | Not applicable |
| Employer | Yes | Yes | Yes |
| Employee | No | No | No. Employees may elect more coverage than provided by their employers or may choose private or group health and accident coverage. |
| Potential cost as a percentage of wages or salaries to employers or employees | 9.3 to 13.3 | 3.4 | 7.5 |
| Comments | Costs should be included in all studies except a few where less than \$150 of one person's labor is used annually or where an employer uses an employee less than 20 days a year and in certain retired and youth cases. | Costs should be included in most studies where 10 or more employees are involved or where \$20,000 or more of cash wages are paid in a quarter. | Costs depend entirely on State requirements, which vary by type of seasonal, physical, and mental health risks faced by farm employees. |

Continued—

See footnote at end of table.

Table 1—Payroll taxes, insurance, and fringe benefits highlights—Continued¹

| Item | Individual Retirement Account (IRA) | HR-10 (Keogh) retirement program | Corporate retirement program | Life insurance |
|--|--|---|---|---|
| Coverage | Voluntary | Voluntary | Voluntary (but, once the employer or firm starts a program, certain employees must be included) | Voluntary (but is a bargaining item between employee and employer) |
| Regulatory unit | Federal | Federal | Federal | State |
| Cost | 100% of compensation up to \$2,000 | Self-employed and employer—15% of income, up to \$15,000 Employee—Not applicable | Self-employed—Not applicable Employer—25% up to a maximum of \$41,500 in 1981 Employee—Not applicable | From \$3 to \$20 per \$1,000 of term coverage depending on age and health. Sufficient coverage to repay debt is frequently recommended plus 2 to 5 times annual earnings. The cost to a self-employed and farm employee is similar to that for an employer though the employer may more easily obtain a group rate. \$100,000 would involve a range of costs between \$300 and \$2,000. |
| Costs deductible for Federal taxes: | | | | |
| Self-employed | Up to \$2,000 (\$7,500 in some cases) | Up to \$15,000 | Not applicable | No |
| Employer | Up to \$2,000 (\$7,500 in some cases) | Up to \$15,000 per employee | Up to \$41,500 in 1981 per employee | An employer can purchase up to \$50,000 group term insurance for each employee. |
| Employee | Up to \$2,000 | Not applicable | Not applicable (unless employee sets up his or her prior IRA program) | No |
| Potential cost as a percentage of wages or salaries to employees | 100% (up to \$2,000 annual contribution) | 15% (up to \$15,000 per self-employed and employee) | 25% (up to \$41,500 per employee) | 2 to 3% |
| Comments | Programs are voluntary except where established for the employer or company officers and directors. Maximum allowed contribution need not be made. An increasing number of self-employed farmers are setting up retirement programs. Where several employees are involved, employers' retirement contributions are a bargaining point. From a social public policy perspective, 15 percent of self-employment earnings or employee wages and salary can be included in cost studies. | | | Programs are voluntary but the group term life insurance tax deductibility feature may be attractive to farm businesses to provide liquidity for estate settlements. Use of life insurance is an accepted farm management practice whether the farm operates as a sole proprietorship or as a corporation. |

Continued—

See footnote at end of table.

Table 1—Payroll taxes, insurance, and fringe benefits highlights—Continued¹

| Item | Health and accident insurance | Paid pregnancy, death and sick leave, and vacation | Employee training | Low-interest loans | Housing, food, clothing, transport, auto, etc. |
|--|---|---|---|---|---|
| Coverage | Voluntary | Voluntary | Voluntary (may be required by State law in some cases) | Voluntary | Voluntary |
| Regulatory unit | State | State | Not applicable | Not applicable | Not applicable |
| Cost | From \$250 to \$1,000 annually per policy, depending on level of coverage, size of deduction, number of persons covered, and ability to qualify for a group plan. Employer may pay all the cost or employee may contribute too. | Generally is part of the wage or salary agreement. Self-employed may reduce net income by excessive days away from work | In addition to wages and salary, transportation, lodging, registration, or tuition can be from a few dollars to several thousand. | Opportunity cost lost; on \$10,000 loaned at 3% (with an alternate return of 8%), \$500 per year is lost. | Generally negotiated as part of the wage and total compensation package. |
| Costs deductible for Federal taxes: | | | | | |
| Self-employed | Up to \$150 is deductible and the remainder adds to other medical costs and is deductible to the extent it exceeds 3% of adjusted gross income. | Not applicable | May be able to deduct out-of-pocket expenses | Not applicable | Not applicable (but specialized protective clothing, farm business use of auto, etc., may be deductible). |
| Employer | Yes for group plans. Payments are not income to the employee when they do not discriminate in favor of high-paid employees. | Yes, as part of salary agreement. | Yes | No | Yes for certain types of corporations that require an employee to be at the farm. Cost is then counted as income to the employee unless the item is deemed necessary for the employer's business. |
| Employee | Same as "self-employed" above. Premiums not deductible if paid by employer. | Not applicable (except in certain illness situations) | Generally not counted as income to the employee | The interest subsidy is generally not counted as income to the employee | Where it is not, a reasonable estimate of the market value must be reported. |
| Potential cost as a percent of wages or salaries to employers or employees | 1 to 2 | Not estimated | Not estimated | 3 to 15 | Not estimated |

¹ See footnote at the end of table.

Continued—

Table 1 — Payroll taxes, insurance, and fringe benefits highlights — Continued¹

| Item | Health and accident insurance | Paid pregnancy, death and sick leave, and vacation | Employee training | Low-interest loans | Housing, food, clothing, transport, auto, etc. |
|----------|---|--|-------------------|--------------------|--|
| Comments | Programs are voluntary but health costs are leaders in the increasing Consumer Price Index, which encourages farmers and their employees to seek insurance protection. The tax deductibility feature of group plans is attractive to multiple-employee farmers and is an expense most farm firms incur. | One or more of the items in this category are generally provided for full-time employees. Specialized training may be necessary before part-time employees can start a specialized task. New technology is continually being introduced in farm production units—some by State law requires user training. Self-employed as well as employee use of on-the-road vehicles for personal use is common. | | | |

¹Explanations are necessarily generalized in this table, but in many cases there are exceptions and specific regulations which are covered in the later text and suggested references.

The strongest case for not including the programs in farm costs can be made for sole proprietor farmers who hire no labor. They are required only to pay social security taxes on their net taxable farm income and are either not eligible for the other programs or the other programs are voluntary. However, when the sole proprietor incorporates and becomes an employee of the corporation, the corporation clearly has an expense that comes directly from gross income for social security and the other programs which are less likely to be optional under a corporate form of business organization. A sole proprietor who hires labor faces similar added costs.

In addition, the payroll tax and insurance and fringe programs may provide funds for the welfare of farm laborers and operators during their working career should they be laid off, injured, or die rather than their having to rely on public welfare for support. Farm laborers and operators may also be able to retire earlier as a result of programs that provide health insurance into retirement as well as sufficient retirement income. Thus, higher food costs that result from the programs may be justified if freeing up resources for younger workers and entrepreneurs is a social goal.

In general, the programs are more widely required in land-intensive farming operations (fruit, vegetable, and livestock production) than in land-extensive production (corn, soybean, and wheat production). This is because more labor is required per dollar of gross sales to produce fruits and vegetables and milk, and in some methods of raising cattle and hogs.

On the other hand, rates for workers' compensation are higher on farms with livestock handling and machinery than on fruit and vegetable farms. In obtaining actual farmer data, attention should be given to experience ratings, levels of coverage, use of group plans, and arrangements that farmers use to minimize or maximize their participation in the various programs.

Particular attention should be given to: (1) use of multiple farm business entities that provide coverage for only selected owners and employees; (2) the substitution of machines and chemicals for labor or labor for machines and chemicals where workers' compensation coverage is high for mechanization; and (3) the failure to participate in programs due to unawareness of legal requirements or lack of information about potential tax benefits.

Illustration of Information Needed to Measure Costs of the Programs

This section abstracts some of the key variables from each of the program sections that follow later and illustrates the cost of some farm situations and strategies. The illustrations show, where possible, a no-cost and a full-cost situation for each of the major programs. The effects on form of business organization and aftertax costs are not considered here. Since the program variables are specific for a given type of farm, many types of farms would need to be analyzed to explain fully the application of the programs and to measure actual costs. Such activity is beyond the scope of this report.

While the general nature of the material here is to provide a reference point for measuring actual farm costs of the programs and their effects on economies of size and farm structure, the material can also be used by farmers and their advisors. Appendix I, for instance, provides a comparison of program costs under a sole proprietorship and under a corporate form of business organization. The following sections also show costs under various situations.

Social Security

Some farmers can avoid paying social security taxes entirely (no-cost situation), while others will have to pay the normal social security tax (cost situation).

| | <u>Social security costs</u> | <u>Percent of salary</u> |
|---|----------------------------------|------------------------------|
| Sole proprietor income subject to the tax (\$29,000) | \$2,762.10 | 9.30 ¹ |
| Two employees each paid \$20,000 in salary | \$2,660.00 | 6.65 |
| Average of self- employed income and employee salaries on which the sole proprietor pays the tax | | 7.86 ² |

No-Cost Situations. Some farmers may not be required to pay social security taxes, even though their gross farm income may be \$500,000 or more. Such a situation may occur in at least three ways:

- The farm-owner-decisionmaker could contract all farmwork done by other individuals and firms who pay the tax. The farmowner would indirectly pay the tax through the contract terms.
- The owner-decisionmaker may operate the farm, but it does not generate net taxable income for Federal taxes.
- The owner-decisionmaker may have off-farm income that is covered at the maximum under social security and therefore farm income is not subject to social security taxes. In addition, if the owner-decisionmaker's off-farm income is less than the maximum for social security purposes, and he (she) has net taxable farm income, he (she) may be able to pay his (her) spouse and children sufficiently large compensations, not subject to social security coverage, so that the farmowner's net taxable income is zero and not subject to the tax. (Such a strategy is not possible in a corporation where the owner is an employee and receives a salary—see the following section on farm size and business organization.)

Even if a farmer uses hired labor, the farmer can arrange so that no social security coverage is required. Crew leaders can be employed, and payment of the tax will be their responsibility. Also, workers can be employed who are paid less than \$150 in cash wages or who work less than 20 days per year. Certain types of farmwork may also be set up as piecework that does not have to be covered. Likewise, aliens who are admitted on a temporary basis to perform agricultural labor do not have to be covered.

Cost Situation. If the farm is "profitable" for Federal tax purposes, a self-employed farmer would have paid 9.3 percent of net taxable income in 1981 and 6.65 percent of an employee's salary. Thus, a self-employed farmer subject to the maximum tax situation with two full-time employees could have a situation as follows:

¹The net income of a sole proprietor is not necessarily salary income.
²In accounting for social security tax cost on a commodity, the tax paid by landlords whose farm incomes are taxed under social security should be included.

Unemployment Insurance

Some farmers will be able to avoid paying unemployment insurance (no-cost situation), while others will have to pay the normal insurance rate for their States (cost situation).

No-Cost Situation. Most operators of small farms, along with moderate and large ones that are highly mechanized and employ little hired labor, are not required to carry unemployment insurance by either Federal or State statute. Furthermore, operators of large farms who require substantial amounts of hired labor may avoid direct payment of the insurance costs by having their work done under contractual arrangements or by using crew leaders who pay the tax. Under such situations, the farmer indirectly pays the tax when he (she) pays the contractor or crew leader. A self-employed farmer who hires sufficient labor so that the coverage must be provided by statute, in most cases, does not need to pay the insurance cost on his (her) own labor and management nor on that of his (her) spouse or minor children.

Cost Situation. Federal and State laws require that unemployment insurance be provided when the farmer employs a certain number of laborers or has a payroll of a certain size. The Federal Government and most States require that the coverage be based on a minimum annual \$6,000 per employee wage base. The rates vary greatly from State to State and from one farm to another. In the following illustration, the Federal tax rate of 3.4 percent is used. The employee generally does not pay any of the cost of coverage.

| | <u>Unemployment insurance cost</u> | <u>Percent of total salary</u> |
|---|--|------------------------------------|
| Sole proprietor income subject to coverage | \$0 | 0 |
| 6 employees, each paid \$12,000 salary | \$1,224 | 1.7 |

Workers' Compensation Insurance

Some farmers can avoid paying workers' compensation insurance (no-cost situation), while others will have to pay the tax for their type of operation (cost situation).

No-Cost Situation. Workers' compensation insurance is not required on farms that employ no hired workers. As with social security and unemployment insurance programs, large farmers may avoid providing the coverage by having their work done under contractual arrangements. Beyond these general principles, coverage depends on State requirements and the ability of employees to bargain with their employers to provide the coverage. In some situations, coverage must be provided when as little as \$1,000 is expended for hired labor. In situations where such requirements are imposed and the rate per \$1,000 coverage is high, farmers would likely soon stop using small amounts of hired labor or expand their operations to a size that requires sufficient hired labor to lower the average cost of the coverage per \$1,000 of salary or wages.

Cost Situation. State laws do not require that sole proprietors cover themselves, their spouses, or their minor children. Farm employees generally do not pay any of the cost of the coverage themselves. Rates paid by employers depend on rates set by State regulations and the nature of the hazards faced by workers employed by individual farmers.

| | <u>Workers' compensation cost</u> | <u>Percent of total salary</u> |
|---|---|------------------------------------|
| Sole proprietor income subject to coverage | \$0 | 0 |
| 2 employees, each paid \$20,000 salary and covered at full salary at a 5-percent rate | \$2,000 | 5 |

Health and Life Insurance

Most farmers are not compelled to provide health and life insurance for themselves or their employees (no-cost situation), but many do, either voluntarily or as a result of bargaining with employees (cost situation).

No-Cost Situation. Health and life insurance are not required by either Federal or State law. In addition, even if employers are covered themselves, they need not provide such coverage for employees unless employees have bargained to be covered. Farmers, however, frequently elect both coverages as part of their household and farm business financial management.

Cost Situation. Life and health insurance purchased by farmers for themselves and their families are generally provided by private agents and insurance companies. Employees are frequently covered by employers under group policies since group

rates are lower and employers can deduct the cost of coverage (up to specified limits) from their taxable income. Premiums paid by employers are not taxable income to employees. Rates for life insurance are generally based on the age of the insured and whether the policy provides cash value in addition to a guaranteed amount upon death. Health and accident insurance rates depend on the extent of the coverage; for example, major medical, hospital, nursing facilities, and so forth, and the general health situation of the person or group seeking insurance.

| | <u>Cost</u> | <u>Percent of income or salary</u> |
|---|-------------|--|
| Life insurance | | |
| Sole proprietor (\$30,000 income) purchases \$100,000 of coverage | \$600 | 2.0 |
| 2 employees, each paid \$20,000 salary and provided \$50,000 coverage | \$800 | 2.0 |
| Health insurance | | |
| Same situations as for life insurance and full coverage with \$100 deductible and 20-percent co-insurance | \$1,200 | 1.7 |

Retirement

Farmers need not provide retirement programs if they do not want to for either themselves or their employees (no-cost situation), but they can if they wish (cost situation). Like health and life insurance discussed earlier, retirement programs are often a bargaining point between farmers and employees.

No-Cost Situation. Farmers are not required to participate in retirement programs other than the social security program. Farmers have traditionally looked to their farmland holdings as providing a source of security and income in their old age. However, in recent years as farm incomes have increased, farmers have been able to shelter their income from taxes by investing in retirement programs.

While a farm operator may set up a tax-sheltered retirement program for himself (herself) and family members, he (she) may not have to cover his (her) hired workers if the hired workers have 3 years or less of service with the farmer or work less than 1,000 hours per year. If a farmer bargains with employees under a collective bargaining agreement, he (she) may be able to exclude employees from his (her) retirement program.

Cost Situation. If a farm is "profitable" for Federal income tax purposes, a self-employed farmer can tax shelter up to 15 percent of the profit to a maximum of \$15,000 in a standard Keogh plan or a maximum of \$2,000 (\$2,250 for a married couple with one income) under a standard Individual Retirement Account. A self-employed farmer could also tax shelter a like amount for his (her) employees. The following

illustration assumes that the self-employed farmer uses a standard Keogh plan:

| | <u>Retirement program cost</u> | <u>Percent of salary</u> |
|--|--|------------------------------|
| Sole proprietor, \$30,000 income | \$4,500 | 15 |
| 2 employees, each paid \$20,000 salary | \$6,000 | 15 |

Under special Keogh defined benefits or "plus plans," the self-employed farmer can shelter more than \$15,000 if an additional amount is needed to meet a specified income from a plan upon retirement. Under corporate profit-sharing plans, a corporation can tax shelter up to 25 percent of an employee's compensation.

Other Programs

Other fringe benefit programs can range from none (no-cost situation) to several (cost situation). They depend only on the imagination of farmers and employees, employment contracts, and the farm's profitability.

No-Cost Situation. Farmers, for the most part, are not required to participate in other fringe benefit programs either for themselves or for their employees. In some cases where farmers apply certain chemicals in their farming operations, minimum training to obtain application certificates is required. However, if a farmer contracts for the work to be done, he (she) need not have the certificate but indirectly pays the cost to the custom applicator.

Cost Situation. Most farmers who use hired labor will participate in one or more programs that benefit the farmer and the employees. The self-employed farmer and family members also frequently now participate in various training programs that benefit the farm business. In the following illustration several programs are included:

| | <u>Cost of programs</u> | <u>Percent of salary</u> |
|--|-----------------------------|------------------------------|
| Sole proprietor, \$30,000 income | | |
| Training | \$800 | |
| Clothing | 300 | |
| Prepaid legal services | 400 | |
| Farm and commodity organization | 400 | |
| Total | \$1,900 | 6.3 |
| 2 employees, each paid \$20,000 salary | | |
| Training | \$ 600 | |
| Housing | 4,000 | |
| Paid vacations as part of salary | (2,000) | |
| Total | \$4,600 | 11.5 |

Farm Size and Type of Business Cost Illustration

The effects of payroll taxes and insurance and other fringe benefits are illustrated below among three hypothetical farm businesses. The first business is a one-person farm operating as a sole proprietorship with no hired labor. The second farm business involves a sole proprietorship with two full-time employees and seasonal help. The largest farm operates as a corporation with several full-time and part-time employees.

Table 2 shows simulated costs for each of the three farms. The total costs of the payroll tax, insurance, and fringe programs increase as the farms become larger, though there are differences in individual items. The only program in which the sole proprietor with no hired help needs to participate is social security. Costs for some other programs are also included, however, since farm operators with net farm earnings of \$20,000 typically participate in the programs voluntarily. The two largest farms participate in all the programs, though in some States, unemployment insurance and workers' compensation are not required; where required, rates may be different from those assumed in the illustration.

The sole proprietor with two full-time employees and some part-time help spent the greatest percentage of net farm earnings on payroll taxes and insurance and fringe programs. This is partly because sole proprietors must pay the highest amounts into the mandatory programs while the net earnings are not proportionately as high per worker as they are for the smaller sole proprietor.

Aftertax costs are important in appraising the programs. The percentage of net farm earnings after taxes required for the programs drops the most for the sole proprietor farm with two full-time employees, from among the three farms illustrated. This is the case since the farm was in the 43-percent tax bracket (for taxable income). A prudent manager would be unlikely to continue such a situation if net farm taxable earnings were expected to continue at such a level. The owner would likely shift to a corporate form of business organization under which a similar farm (\$45,000 in net earnings) will be in the 20-percent tax bracket (see appendix I).

The sole proprietor with no hired labor (\$15,000 assumed for family living expenses) has the highest percentage of payroll tax, insurance, and fringe programs in total salary, wages, and family living. The percentage is lower for both the before-tax and aftertax situations for the larger sole proprietor and for the corporate operation. The small percentage decline in the aftertax situation for the smallest sole proprietor results from that farmer's being unable to use a number of the items as tax deductions.

A word of caution is again advanced about the broad generalizations illustrated in table 2. There is no good substitute for obtaining actual farm program participation and cost data. The many variations among requirements by State and legal strategies employed to avoid or to participate in the programs can materially change the outcome illustrated.

Table 2—Illustration of costs of payroll taxes and insurance and fringe benefit programs, by size of farm and form of business organization

| Item | Sole proprietor: No hired labor | | Sole proprietor: 2 full-time employees, 2 seasonal employees | | Corporation: 5 full-time employees, 5 seasonal employees | |
|--|------------------------------------|-----------------------------|--|-----------------------------|--|-----------------------------|
| | <i>Dollars</i> | | <i>Dollars</i> | | <i>Dollars</i> | |
| Gross sales | 80,000 ¹ | | 250,000 ¹ | | 1,000,000 ¹ | |
| Net farm earnings | 20,000 ² | | 45,000 | | 175,000 | |
| Salary and wages | 0 | | 40,000 | | 130,000 | |
| Family living | 15,000 | | 25,000 | | 0 | |
| | Before Federal income tax | After Federal income tax | Before Federal income tax | After Federal income tax | Before Federal income tax | After Federal income tax |
| | <i>Dollars</i> | | <i>Dollars</i> | | <i>Dollars</i> | |
| Payroll taxes: | | | | | | |
| Social Security | 1,620 | 1,620 | 4,549.30 ³ | 3,495.54 ⁴ | 7,969.00 ⁵ | 4,303.26 ⁶ |
| Insurance: | | | | | | |
| Unemployment insurance | 0 | 0 | 748.00 ⁷ | 426.36 | 2,040.00 ⁷ | 1,101.60 |
| Workers' compensation | 0 | 0 | 2,000.00 ⁸ | 1,140.00 | 8,750.00 ⁸ | 4,725.00 |
| Health and accident insurance | 400 | 288 ⁹ | 1,200.00 ¹⁰ | 720.00 ¹¹ | 2,000.00 ¹² | 1,080.00 |
| Life insurance | 1,000 | 1,000 | 2,600.00 ¹³ | 2,456.00 | 2,000.00 ¹⁴ | 1,080.00 |
| Other fringe benefits: | | | | | | |
| 15 percent to Keogh defined contribution program | 3,000 ¹⁸ | 2,160 ¹⁵ | 12,750.00 ¹⁹ | 6,571.00 ¹⁶ | 19,500.00 ¹⁷ | 10,530.00 ¹⁹ |
| Paid leave | | | | | | |
| Training | 500 ²⁰ | 360 | 1,500.00 ²⁰ | 855.00 | 2,500.00 ²⁰ | 1,350.00 |
| Housing | 1,000 ²¹ | 1,000 | 4,500.00 ²² | 2,565.00 | 7,500.00 ²² | 4,050.00 |
| Total | 7,520 | 6,428 | 29,847.90 | 18,318.90 | 52,259.00 | 28,219.86 |
| | <i>Percent</i> | | <i>Percent</i> | | <i>Percent</i> | |
| Total as a percent of net farm earnings | 37.6 | 32.2 | 66.3 | 40.1 | 29.9 | 16.1 |
| Total as a percent of total salary and wages and family living | 50.1 | 42.9 | 45.9 | 28.0 | 40.0 | 21.7 |

¹The sole proprietors' payroll taxes and relevant fringe benefits are based on net taxable income and on wages paid to employees. A corporation's payroll tax and fringe program is based on wages and salaries paid. ²Net farm earnings have a specific meaning for determining self-employment social security taxes. Excluded from the farm earnings computations are: farm rents where the owner does not materially participate in the production or management of production; gain or loss from sale or exchange of livestock held for draft dairy, breeding, or sporting purposes and not held for sale regardless of how long held or whether purchased or raised; gain or loss from sale or exchange of depreciable property such as machinery, trucks, and equipment used in the trade or business regardless of the period held; plus several other categories of ordinary gains and losses and capital gains and losses. ³The sole proprietor is taxed on \$25,900 of taxable income and pays \$40,000 of wages (two at \$15,000, one at \$6,000, and one at \$4,000) and salaries which were taxed at 4.13 percent. Employees also receive fringe benefits. ⁴The sole proprietor filed a joint return and was in the 43-percent marginal income tax bracket and did not pay the employees' part of social security tax. ⁵\$90,000 wages and salaries for full-time employees and \$40,000 for seasonal employees. Employees also receive fringe benefits. ⁶The corporation was in the 46-percent marginal income tax bracket and did not pay the employees' part of the social security tax. ⁷A 3.4-percent rate was used on the first \$6,000 of salary. ⁸Assume that employer provided the same dollar coverage as the gross salary at a \$5 per \$100 rate. ⁹Half of the premium was tax deductible. ¹⁰\$400 premium each for the sole proprietor and the two full-time employees. ¹¹Half of the premium for the sole proprietor was deductible and the full premium for the two full-time employees was deductible. ¹²\$400 premium for each of the five full-time employees. ¹³\$2,000 premium for the sole proprietor owner which is not tax deductible and \$50,000 term at \$400 each, for the two full-time employees which is tax deductible. ¹⁴\$50,000 of term coverage at \$400 for each of the five full-time employees. ¹⁵The sole proprietor's income was taxed at 28 percent. ¹⁶Contributions to the retirement program reduced the sole proprietor's marginal tax rate from 49 percent to 43 percent. ¹⁷Contribution was based on the \$130,000 wage and salary bill. ¹⁸The self-employed sole proprietor farmer may reduce his (her) own income by taking days off; however, the days off may provide needed rest to maintain and renew entrepreneurial vigor. ¹⁹Paid leave is included in the gross wages and salary. ²⁰\$500 each for the sole proprietor and each full-time employee. ²¹While family housing is not tax deductible for a sole proprietor, the proprietor, nonetheless, has housing needs and \$1,000 is included for maintenance and repair of housing. A portion of the house that may be used for a business office, and other business purposes can be deducted but such deductions are not considered in the example. ²²Housing is provided for each full-time employee and \$1,500 is allowable for each for depreciation and repairs.

More complete analysis would involve modeling each variable for each program. For instance, the social security costs for the smallest farm operation in the illustration can materially change if the business is organized so that a spouse and children also pay into the fund. Similar cost changes can occur if other family members are covered under retirement programs.

Program costs can be quite different for larger sole proprietorships also. The operation might be located in a State that does not require unemployment insurance or workers' compensation. A farmer may choose not to participate in a retirement program, or can arrange the employees' situations so that they need not be covered, especially if employee turnover is frequent. The corporate farmowner can also try to minimize costs in the same way as the larger sole proprietor and thereby incur substantially lower program costs.

Implications for Farm Economies of Size

Several general conclusions can be drawn about the effects of the payroll tax and insurance and fringe programs on farm economies of size. The way a farm business is organized legally in relation to the number of employees, characteristics of employees (such as full-time, part-time, salary level), and net taxable income affects its longrun costs. For small farms, a sole proprietorship may entail the least cost since only social security need be paid if no hired workers are involved. As a firm increases its net taxable income and number of hired workers, thereby meeting the minimum requirements to participate in such programs, a corporate form of business organization may offer the lowest aftertax cost of the programs. The corporate advantage is greatest when net taxable farm income reaches \$25,000, at which point corporate income tax rates are lower than sole proprietorship tax rates.

Farm operators have long substituted capital for labor when the marginal cost of an additional hour of hired labor exceeds the marginal cost of capital in the form of machines, equipment, and chemicals. In general, the added costs of the payroll tax and insurance and fringe programs, particularly as they are made mandatory in more and more farming operations, will encourage farmers to continue substituting capital for labor, whether on single-family farms or those where hired help is used. Even where hired help is used, some of the mandatory programs may be avoided when the number of employees is small enough or their gross salary is below the threshold for mandatory coverage. Nevertheless, exceptions to the general trend to substitute capital for labor can be expected. Where workers' compensation is required and rates are much higher for workers operating mechanized equipment than those doing handwork, farm operators may mechanize more slowly. The added workers' compensation costs resulting from mechanization will have to be balanced against costs for hired labor and the added costs of all the other payroll taxes and insurance and fringe programs.

Implications for Farm Structure

Farmer participation in the programs (whether mandatory or voluntary) can affect the individual farm as well as the

overall structure of agriculture. Money that is taken from the farm business to pay for the programs is not available to expand the business or for household use. In addition, a farmer's equity in the programs will not usually serve as security for a loan. Where costs of the programs for hired farm labor become too high, a farmer may try to produce more output from the same labor, may reduce hired labor and output, or may mechanize to increase output. These responses are not particularly new.

Since the savings and retirement aspects of social security and retirement programs are relatively new and since farmers can now obtain health insurance for retirement years, these programs may have relatively new structural aspects. Those programs may encourage farmers to retire from active farming at an earlier date and transfer farm resources to their heirs or sell resources prior to death. Social security benefits are reduced by earned income, and income from tax-sheltered retirement programs is subject to ordinary income tax rates. These program features may encourage retired farmers who want to do some farmwork to do so on a part-time basis and at low rates. Older farmers who continue as farm operators may do so on a reduced scale or intensity while still collecting some net benefits from the retirement program.

In designing questions to ask farmers to appraise the effects of the retirement programs on farm structure, it will be important to focus on a group of farmers that are 20 or more years from retirement and another group closer to retirement. In addition to determining their investment in each program and their strategies in program participation and potential dollar benefits upon retirement, it will be important to determine the farmers' perceptions of what they intend to do as a result of their likely benefits upon reaching retirement age. By comparing the actions of a group of farmers at retirement age against the plans of a group some years away from retirement, it may be possible to draw conclusions about the impact of social security and tax-sheltered retirement on future farm resource ownership and use patterns.

Summary

Given recent and projected coverage trends, payroll taxes and insurance and fringe program costs will continue to increase and add to farm production costs. The added costs are not neutral as to farm size and seem to influence the form of business organization a farm uses. The increasing costs of the programs encourage substitution of capital for labor (particularly where labor is fully employed but with less than the largest, most efficient machines and equipment, and potential exists for substituting chemicals for labor). In addition, since the programs have limits on their tax deductible contributions, farm firms may use already employed labor for overtime purposes instead of hiring more labor and paying the program costs of new employees. As required coverage of farmworkers increases under the various programs, consumers can expect to pay higher prices for food to the extent that farm production costs are reflected in food prices. This in turn may increase pressure for greater public expenditures on research and development of labor-reducing technology.

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Social Security

Farmers consider a number of factors in appraising social security costs: self-employment earnings and salaries, child labor, business income, and eligibility for benefits upon retirement even if one continues to earn some income. Farm operators, retired farmers, and farmworkers appear to use different strategies in qualifying for and obtaining minimum and maximum benefits.² The maximum amount of farm income subject to the social security tax and the tax rate have both increased in recent years and are projected to continue to increase (table 3). Thus, the required payments to social security may be increasing more rapidly than farm income.

Benefits received from the Federal Government under the social security program are not subject to Federal income taxes.

Required Coverage and Costs

Table 3 shows the tax rates for the two types of people covered under social security: employers/employees and self-employed persons. Employees and employers each are required to pay equal amounts into the social security program, though employers can make the employees' contributions. If the employer pays the employee's share, such contributions are counted as taxable income to the employee, but they are not subject to additional social security taxes. Social security taxes apply to agricultural workers who are paid \$150 or more cash wages in a year for agricultural labor and to those who perform agricultural labor (excluding piece workers) on 20 days or more during the year for any amount of cash wages computed on a time basis (that is, by the hour, day, or week).

No social security taxes are due, regardless of the amount paid, for the services of share-farmers, although share-farmers may be subject to self-employment taxes. Likewise, no social security taxes are due for services of employees from any foreign country who were lawfully admitted to the United States on a temporary basis to perform agricultural labor.

Crew leaders are generally treated like self-employed individuals for social security coverage. Crew leaders are those who are not named as employees in a written agreement entered into with the person or firm for whom the agricultural services are performed. Farm crew workers are employees of the crew leader if the crew leader arranges with the farm operator to furnish workers and pays the workers either on his (her) own behalf or on behalf of the farm operator, and if the workers are not designated as the farm operator's employee in any written agreement with the farm operator.

²Incentive exists for noncompliance in some cases since low-income workers regard the value of a dollar presently in hand to be worth more than the future program benefits. Employers who hire these employees also benefit from noncompliance through reduced book-keeping and operating expenses. Farm employers may legally be able to avoid participation if they employ workers for only a few days or hours during critical planning and harvesting operations or if they employ the workers for less than the minimum period required for coverage.

The minimum income for social security coverage was \$310 per quarter in 1981, up from \$250 in 1978 (this minimum income level replaces the old rule of \$50 per quarter). The minimum income qualification is scheduled to be adjusted annually. The maximum earnings on which employee coverage is taxed are projected to rise from \$29,700 per year in 1981 to \$42,600 in 1987. The tax rate on employee income is scheduled to rise from 6.65 percent in 1981 to 7.15 percent in 1986.

Self-employed people (farm operators, as contrasted with employees) pay a higher percentage of their earnings into social security: from 9.3 percent in 1981 to a projected 10 percent in 1986. Any self-employed person who earns more than \$400 annually is required to pay social security taxes; the maximum earnings on which social security taxes are due is the same as for an employee. A self-employed person received one quarter of credit in meeting social security minimum qualifications for coverage for each \$310 income in 1981, up to a maximum of four quarters for earnings of \$1,000 or more.

In order to increase their social security retirement benefits, some self-employed farmers, as they neared retirement, have incorporated their farm businesses and paid themselves a higher wage, subject to social security taxes, than they could show as sole proprietors. Farm operators usually consider many other factors, like estate transfer, when deciding on whether to incorporate.

There is a substantial difference in the maximum amount of social security tax, depending on employment status: the tax range for a self-employed person in 1981 was \$32.40 to \$2,762.10; for an employee-employer, the range was \$41.24 to \$3,950.10.

Additional Rules for Coverage

The Congress recognized many different farm situations for social security taxes, the four major distinguishing factors

Social Security

About 75 percent of the cash remuneration paid to farmworkers in 1975 was subject to the social security tax. Farm coverage under the social security program has been mandatory since 1954 for old age, surviving relatives, disability, and health insurance (OASDHI). In addition to the Social Security Act of 1935 and subsequent amendments, two parts of the Internal Revenue Code provide for the collection of revenue needed to fund the program, the Self-Employment Contributions Act, and the Federal Insurance Contributions Act. While OASDHI is technically labeled an insurance system, it does not have the characteristics of private insurance programs since a person may make payments into the program for many years, draw no disability, die before retirement age with no eligible beneficiaries, and collect only a lump sum death benefit of \$255.

being self-employment, farm rental income, the presence of children and spouses, and limited partnerships.

Self-Employment. Most farmers are self-employed (sole proprietors or partners) and nearly all self-employed persons must contribute to social security. A self-employed person is defined as one who engages in a trade, business, or profession either individually or as a partner.

In addition to providing coverage for a self-employed person with net earnings of at least \$400, low-income farmers (gross annual income between \$600 and \$2,400) can file under an optional method which can also secure social security coverage for some farmers with annual net incomes less than \$400. Under the optional method, individuals may report as self-employment income either two-thirds of the gross income or actual net earnings of \$400 or more. If gross income is over \$2,400 and actual net earnings are not more than \$1,600, either \$1,600 or actual net earnings may be reported as self-employment income. If gross income is over \$2,400 and

actual net earnings are over \$1,600, the actual net earnings must be reported.

People with low farm earnings can decide each year if they want to pay social security taxes under the optional method. While there is no limit on the number of times the farm option method can be used, the optional method has more limited application in nonfarm self-employment situations. Individual members of a partnership can also use the option. Generally, the partnership's gross income is divided on the same basis as the profit or loss, and this proportion is allocated to the partners for the purpose of the option. Social security contributions may thus be due even though a self-employed person owes no Federal income taxes. The contribution, if due, must be paid even if the person has started receiving social security benefits.

Net farm profits constitute the earnings subject to the social security tax for a self-employed farmer. Net farm profits are determined on the Internal Revenue Service

Table 3—Social security minimum and maximum earnings, tax rates, and contributions

| Year | Minimum earnings per quarter from wages ^{1,2} | Minimum earnings from self-employment ³ | Maximum annual earnings subject to social security tax | Contribution rate | | Minimum contribution to receive 1 quarter of credit | | | Maximum contribution | | |
|-----------------------------|--|--|--|-------------------|--------------------------------|---|------------------------------------|-------------------------|----------------------------|------------------------------------|--------------------------------------|
| | | | | Self-employed | Employer-employed ⁴ | Self-employed ⁵ | Employer-employed ^{4,6,7} | Employer-employed total | Self-employed ⁵ | Employer-employed ^{4,6,7} | Employer-employed total ⁸ |
| | Dollars | | | Percent | | Dollars | | | | | |
| 1978 | 250 | 400 | 17,700 | 8.10 | 6.05 | 32.40 | 15.13 | 30.26 | 1,433.70 | 1,070.85 | 2,141.70 |
| 1979 | 260 | 400 | 22,900 | 8.10 | 6.13 | 32.40 | 15.94 | 31.88 | 1,854.90 | 1,403.77 | 2,807.54 |
| 1980 | 290 | 400 | 25,900 | 8.10 | 6.13 | 32.40 | 15.94 | 31.88 | 2,097.90 | 1,587.67 | 3,175.34 |
| 1981 | 310 | 400 | 29,700 | 9.30 | 6.65 | 37.20 | 20.62 | 41.24 | 2,762.10 | 1,975.05 | 3,950.10 |
| 1982 ⁹ | 340 | 400 | 31,800 ¹⁰ | 9.35 | 6.70 | | | | | | |
| 1983 ⁹ | | 400 | 33,900 ¹⁰ | 9.35 | 6.70 | | | | | | |
| 1984 ⁹ | | 400 | 36,000 ¹⁰ | 9.35 | 6.70 | | | | | | |
| 1985 ⁹ | | 400 | 38,100 ¹⁰ | 9.90 | 7.05 | | | | | | |
| 1986 ⁹ | | 400 | 40,200 | 10.00 | 7.15 | | | | | | |
| 1987 ⁹ | | | 42,600 | 10.00 | 7.15 | | | | | | |
| 1988 ⁹ | | | | 10.00 | 7.15 | | | | | | |
| 1989 ⁹ | | | | 10.00 | 7.15 | | | | | | |
| 2010 ⁹ | | | | 10.75 | 7.65 | | | | | | |
| 2011 and later ⁹ | | | | 10.75 | 7.65 | | | | | | |

Blank fields indicate data not available.

¹An agricultural worker, employee, and employer must pay the social security tax when the employee earns \$150 minimum. No provision is made for a refund when the employee earns between \$150 and \$249. Both agricultural worker and employer must pay the social security tax when an employee performs agricultural labor for an employer on 20 or more days during a year for any amount of cash wages computed on a time basis (hour, day, week, etc.). The employee must earn a minimum of \$250 to obtain one quarter of credit.

²The Social Security Administration will adjust annually the minimum based on Bureau of Labor Statistics' average change in wages.

³Effective in 1978, self-employment income had to be a minimum of \$400 in order to qualify for Social Security coverage; credit is given on a quarter basis the same as for wages. Thus, a self-employed person needed \$1,000 of earned income in 1978 to earn four quarters of coverage.

⁴Employee and employer each contribute up to the maximum earnings.

⁵Self-employed contributions are not deductible against other income for Federal income tax purposes.

⁶Assumes the employee earns the minimum in one quarter.

⁷Employer's contributions are tax deductible against other income to the employee.

⁸If a person has income from wages as well as self-employment, wages count first for coverage. If wages total less than the maximum earnings covered in a year, the self-employed contribution is paid only on the difference between the amount of wages and the amount of self-employed income up to the maximum earnings. Net losses from self-employment may be deducted from employee income.

⁹Maximum earnings estimated to be in effect by the Social Security Administration.

¹⁰Alternative projections have shown higher maximums as follows: 1982, \$32,700; 1983, \$35,700; 1984, \$39,600; 1985, \$43,500.

Schedule F (form 1040), Farm Income and Expense Statement, by subtracting total allowed deductions from gross farm profits under either a cash or accrual method of filing a tax return.

Any taxpayer subject to social security coverage may have income from several sources—tips, for example, as well as earnings from self-employment. Salary income is used first for social security coverage. If it does not reach the maximum earnings for the year, self-employment earnings, including tips, must be reported and are included up to the maximum earnings.

Net farm profits for social security coverage may be affected by several different income and expense items. Farm rental income is an issue of wide interest and is covered in the next subsection. The following types of farm income and expenses are *not* subject to the social security tax:

- Rental income when the landlord does not materially participate in the production or management of production of the farm commodities.
- Gain or loss from sale or trade of livestock held for draft, dairy, breeding, or sporting purposes, and not held as stock in trade or primarily for sale, regardless of how long held or whether they are raised or purchased.
- Gain or loss from sale or trade of depreciable property such as machinery or trucks used in a trade or business, regardless of the period held, and not held as stock in trade or primarily for sale.
- Gain or loss from the sale of standing crops sold with land that was held more than 1 year if it was not held as stock in trade or primarily for sale.
- Gain or loss from the cutting of timber, if it is treated as a sale or exchange and not held as stock in trade or primarily for sale.
- Gain or loss from the disposal of timber, coal, or iron ore held more than 1 year where an economic interest has been retained; for example, a right to receive coal royalties and not held as stock in trade or primarily for sale.
- Gain or loss from a sale, trade, involuntary conversion (including certain casualty losses), or other disposition of property that is neither stock in trade nor held primarily for sale to customers.
- Capital gains or losses on sale of investment property or a residence.
- Dividends on shares of stock unless the self-employed person is a dealer in securities.
- Interest received, unless it is received in connection with the conduct of a trade or business (such as interest received on accounts receivable).
- Any other income, gain, loss, or expense not resulting from the conduct of a trade or business.
- Net operating loss deductions.
- Deductions for personal exemptions for the self-employed, including spouse or children.

- Income received by a retired partner under a written plan of the partnership that provides for lifelong periodic retirement payments if the retired partner no longer has any interest in the partnership and did not perform any service for it during the year.

Farm Rental Income. Farmowners can arrange their farming affairs to qualify (or not qualify) for social security coverage under several farmownership situations. However, achieving other entrepreneurial, investment, and management objectives may involve more money and be more important than qualifying (or not qualifying) for social security coverage. Some situations include:

- Farm operators who also rent out some farm real estate. Such operators may be indifferent to qualifying for coverage if their own farm activities provide maximum earnings coverage. Others without maximum earnings, however, may want the coverage from rented-out real estate income if they are trying to maximize coverage.
- Owners who do not operate their farms and who are retired, draw social security benefits, and do not want the added coverage and associated costs involved nor want to reduce their current benefits.
- Nonfarm owners who are not yet drawing benefits—some of whom want the coverage and others who do not.
- Farm operators and owners who want to qualify for the use value provisions in estate transfers, which can lower estate taxes, and who need social security coverage as evidence that they have materially participated in the farm business so they can qualify for the use value provisions.³

Rental income from real estate and personal property leased with real estate, regardless of whether the rent is received in crop shares, cash, or other property, is usually not subject to social security taxes. Deductions connected with such items for income and loss are excluded too. Rents received by a farmer in the course of transactions as a real estate dealer are taxable income. However, farm rental income qualifies for social security purposes if, under the rental arrangement, the farm landlord “materially participates” in the actual production of farm products or livestock or in the management of production (§4A).

The social security regulations and rules defining material participation are detailed and specific. The rental arrangement, to qualify for material participation, must provide for the owner to take a significant part in producing the farm commodities; the owner must actually take part in the production or management activities to the extent described in any one of four tests described by the Social Security Administration (§4A). Activities of a landowner’s agent in the

³Use value provisions were provided in the 1977 Tax Act to allow valuation of assets and certain estates at less than market value.

owner's behalf do not count toward material participation. Those who want to qualify for use valuation but do not want social security coverage essentially have only one alternative: one of their heirs who would be covered by social security must materially participate in the farm operation.

Agricultural program payments such as Federal wheat and cotton program payments received by a farm landlord who "materially participates" are subject to social security taxes just as they are for farm operators. Such payments received by a farm operation in which the farm landlord does not "materially participate" are not subject to the social security tax.

Children and Spouses. Sole proprietor farm operators can reduce their income subject to social security taxes by paying wages to their children and spouses. Social security taxes do not apply to payments to an employer's spouse or children under age 21, if the business is a sole proprietorship. At the same time, such payments can be deducted from employer income on which the social security tax is based. As a general rule, wages paid by parents to children under 21 for work after school, on weekends, or during summer months are not taxed for social security if the parents operate a sole proprietorship. Likewise, if a farmer's spouse is paid for bookkeeping or other farmwork, no social security taxes are due on the wages as long as the farm is a sole proprietorship. However, such wages are subject to both employer and employee social security taxes in farm corporations.

Where a parent and child work together in a business as partners or joint venturers, both are self-employed and both must report their shares of the business profits as net earnings for social security coverage.

Limited Partnerships. Partnership income or loss is not includable for self-employment income, although payments received for services performed are taxable for social security purposes.

Eligibility Restrictions on Retirement Benefits

Many farm operators and laborers want to continue to do some work after retiring in order to stay active and to supplement their social security income. By properly arranging their work and income, they can collect their benefits as well as earn income not subject to social security taxes. Such retirees may in fact be willing to work for lower wages and during peak farm labor seasons such as planting, cultivating, harvesting, and vacation times. Often they contribute to their children's, friends', or neighbors' farm efficiency and output.

Both the retired worker and the employer, under certain conditions, can avoid paying social security contributions. At age 72, a social security beneficiary can receive any amount of salary or self-employment income with no reduction in benefits, including Medicare benefits (in 1982, the age will be lowered to 70). A beneficiary between ages 65 and 72 can earn \$5,500 in 1981 and \$6,000 in 1982 with no reduction in benefits; after 1982, the ceiling is scheduled to increase

annually. Between ages 62 and 65, a retired person could earn \$4,080 in 1981, with the ceiling scheduled to be raised each January thereafter.

If earnings exceed the maximum, \$1 in social security benefits is withheld for each \$2 of earnings. Benefits can be substantially reduced if earned income is high in relation to benefits that would otherwise be due (table 4). For instance, if a retired person earned \$21,000, benefits would be reduced from \$9,600 (if no outside income had been earned) to \$1,350. There is a special one-time-only monthly rule that applies to the first year that a retiree has little or no earnings in some months. The retiree can receive full benefits for any month his (her) wages do not exceed one-twelfth of the annual exempt amount providing he (she) does not perform substantial services in self-employment. The monthly exempt amount in 1979 was \$375 for wages for those 65 and older and \$290 for those under 65. If the income was earned as an employee, the month when the wages were received is immaterial in determining benefits for a particular month. The controlling factor is when the money is earned. If the earnings are from self-employment, the main consideration is whether the retiree is active in the business or is performing substantial service.

The regulation considers a self-employed person retired any month he (she) does not perform substantial service. The Social Security Administration considers the amount of time devoted to a business, the kind of work done, and how the work done compared with that done in the past in determining whether services are substantial. Working more than 45 hours per month in a business, managing a sizable business, or being in a highly skilled occupation is considered "substantial." Work of less than 15 hours per month is not considered "substantial," regardless of size of the business or the value of the service. A sizable reduction in the amount or the importance of work is an indication that a retiree's service is not substantial.

Several types of income do not count as earnings:

- Investment income in the form of stock dividends, unless the retiree is a securities dealer.
- Interest on a savings account.
- Income from social security benefits, pensions, Veterans' Administration benefits, and other retirement pay.
- Income from annuities.
- Gain or loss from the sale of capital assets.
- Gifts or inheritances.
- Rental income from owned real estate unless the retiree is a real estate dealer or materially participates in the production or management of production from the real estate.
- Royalties received in the year after becoming 65 from patents or copyrights that were obtained before that year.
- Partnership income if the retirement income is to continue for life under a written agreement that provides for payments to all partners (or to a class or classes of them) and if the retiree's share of the partnership capital was paid to him or her before the end of the partnership's taxable year and if there is no obligation from the part-

nership to the retiree except to make retirement payments. Since 1978, income from a limited partnership is considered investment income rather than income from self-employment.

- Other types of income, such as sick pay, payments from certain trust funds and annuity plans, sick pay received more than 6 months after the employee last worked or was paid after employment was terminated, loans from employers, moving expenses, travel expenses, and pay for jury duty.

Some retirees age 62 or over may be able to retain employee status on a standby basis and receive wages in regular pay periods. Such a retiree does not lose social security benefits in pay periods when he (she) receives no income except for vacation or sick pay. Payment must be received at a regular time. Such payments are exempt from social security taxes when no work is actually performed. Wages for pay periods when work is performed are treated as regular earnings for social security purposes, and both the employee and employer pay social security taxes on it. If income from pay periods when work is actually performed does not exceed the maximum annual earnings limitation, benefits are not reduced.

Such a standby arrangement may be difficult for retired employees to obtain with an employer, who will have to provide all regular employee benefits for the standby employee. In addition, the employee may forfeit other pension rights while employed under a standby arrangement. Thus, the arrangement may be most attractive to employees with little or no pension benefits or those who can set up standby

arrangements with a new employer without reducing pension benefits from former employment.

In recent years, more farm businesses have incorporated. Income earned after retirement may reduce social security benefits, especially for a Subchapter S corporation (an IRS regulation that applies to closely held corporations, that is, 15 or fewer shareholders). In 1981, a stockholder-employee over 65 could draw a \$5,500 yearly salary and not have his (her) social security retirement benefits reduced. However, the IRS examines income to determine if it constitutes salary. If the payments are true dividends on stock held in a corporation or undistributed income from a corporation, they are not considered earnings from employment by others or self-employment. If, however, payments were made for remuneration for services rendered to a corporation, such earnings are subject to social security withholding and may offset some social security benefits.

Restrictions on Children's Benefits from Work Income

Some children receive social security benefits as a result of their parents' death, disability, or retirement coverage. They may also receive benefits, under certain conditions, from grandparents' coverage. Such benefits stop at age 18 unless the child continues full-time training or is disabled. Coverage can continue for a child in college working toward a bachelor's degree until the end of the semester or quarter when he (she) reaches age 22.⁴ If the child attends a trade

⁴The educational benefits are scheduled to be phased out by 1985.

Table 4—Social security benefits for employees working after age 65, as offset by outside income, 1979¹

| Total social security benefits payable for the year if total earnings in calendar year are: ³ | | | | | | | |
|--|-----------------|---------|---------|----------|----------|----------|----------|
| Normal social security benefits in calendar year ² | \$4,500 or less | \$6,000 | \$9,000 | \$12,000 | \$15,000 | \$18,000 | \$21,000 |
| <i>Dollars</i> | | | | | | | |
| \$3,600 | 3,600 | 2,850 | 1,350 | 0 | 0 | 0 | 0 |
| \$4,200 | 4,200 | 3,450 | 1,950 | 450 | 0 | 0 | 0 |
| \$4,800 | 4,800 | 4,050 | 2,550 | 1,050 | 0 | 0 | 0 |
| \$5,400 | 5,400 | 4,650 | 3,150 | 1,650 | 150 | 0 | 0 |
| \$6,000 | 6,000 | 5,250 | 3,750 | 2,250 | 750 | 0 | 0 |
| \$6,600 | 6,600 | 5,850 | 4,350 | 2,850 | 1,350 | 0 | 0 |
| \$7,200 | 7,200 | 6,450 | 4,950 | 3,450 | 1,950 | 450 | 0 |
| \$7,800 | 7,800 | 7,050 | 5,550 | 4,050 | 2,550 | 1,050 | 0 |
| \$8,400 | 8,400 | 7,650 | 6,150 | 4,650 | 3,150 | 1,650 | 150 |
| \$9,000 | 9,000 | 8,250 | 6,750 | 5,250 | 3,750 | 2,250 | 750 |
| \$9,600 | 9,600 | 8,850 | 7,350 | 5,850 | 4,350 | 2,850 | 1,350 |

¹Higher benefits will be payable in the future as the amount of exempt earnings increases above \$4,500.

²The employee's maximum benefit includes all amounts payable, including benefits for an eligible spouse, child, or parent, which are based on the employee's own social security earnings record.

³While receiving the benefits, an individual may be liable for Federal and State income taxes in addition to social security taxes. These taxes, along with the reduced benefits, may mean an actual net loss from continued employee and self-employment income.

or vocational school, coverage can continue until the course is completed or for 2 months after reaching age 22, whichever comes first. A child is not eligible for social security benefits, if his (her) employer pays him (her) while he (she) attends school.

Should a child otherwise eligible for benefits start working and earn income subject to social security withholding, his (her) benefits under parental coverage would be reduced the same as those for social security beneficiaries under age 62. (A beneficiary under age 62 will never lose more than \$1 in benefits for every \$2 earned.) To be eligible for coverage from his (her) own earnings, a child must have earned \$250 or more per quarter in 1978.

It is possible to reduce substantially the amount of benefits lost by earning income in short periods of time since, in general, benefit reductions are calculated on the basis of earnings each month. Thus, a child eligible for benefits may work during the summer months away from school and incur loss of social security benefits then, but not have benefits substantially reduced during the school year. This is particularly the case for the 1-year provision mentioned earlier in this section. Benefits for a child, however, are also affected by parents' earnings. For instance, if parents do not receive a benefit check for one or more months because their earnings are above the maximum permitted, their child will receive no check in those months either, even if the child did not work.

Tax Deductibility of Social Security Payments

Self-employed contributions to the Social Security Trust Fund are not tax deductible. Employer contributions are tax deductible whether the employer pays only his (her) required part or also pays the employee's share. The employee's portion of the tax must be reported as taxable income, whether the portion is paid by the employee or by the employer. If paid by the employer, however, the amount is not counted as additional employee income subject to social security taxes.⁵ Thus, the real cost to an employer of social security coverage for an employee depends on the income tax bracket of the employer. The 1980 income tax rates for sole proprietorships were graduated from 14 to 70 percent and for corporations from 17 to 46 percent.

A farmer who incorporates his (her) farm business and is the sole employee of the corporation may be able to reduce his (her) social security costs. For instance, a self-employed farmer earning the \$29,700 maximum subject to social security

in 1981 will pay \$2,762.10 to the social security fund, none of which is tax deductible. If the same farmer is an employee of his (her) own corporation and the corporation pays his share of the contribution, the total will be \$3,950.10. If the corporation is in the 46-percent tax bracket, the total cost to the corporation after deducting the tax savings will be \$2,133; in the 30-percent bracket the aftertax costs will be \$2,765.10. Of course, such a corporate employee will have to pay the added individual income tax on the \$1,975.05 if the employer makes the payment, but the total of his (her) own income tax cost and the net cost to the corporation may be less than the \$2,762.10.

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⁵Legislation is being considered to require the employer to pay social security tax on the amount of the employee's contribution paid by the employer where the employee's earnings did not exceed the maximum.

Unemployment Insurance

The U.S. system of unemployment coverage is a combination State and Federal program that provides a modest income to eligible workers during relatively short periods of involuntary unemployment. The system has become important for agriculture due to changes, effective in 1978, that made agricultural operations employing 10 or more agricultural workers subject to the Federal provisions. The U.S. Department of Labor administers the Federal program; the Internal Revenue Service collects the Federal Unemployment Tax. Each State administers its program under a State employment security agency (the exact title varies from one State to another and includes such titles as Department of Labor or Department of Human Resources).⁶

More realistic cost of production and structural analysis can be done by including these costs where appropriate. California and Rhode Island require the coverage when a firm has one employee; Minnesota requires coverage when firms employ four or more employees in 20 weeks. Required coverage in the other 47 States depends on the number of employees in the firm and their wages. In addition, some noncovered firms provide voluntary coverage of their workers. Particular emphasis should be placed on recordkeeping costs for unemployment insurance, since unlike other programs discussed in this report, each worker covered under unemployment insurance must have a separate record.

Federal

Required Coverage. Starting on January 1, 1978, certain farm employment became subject to the Federal Un-

The assistance of Neil Cook, Tax Administrative Group, and Gene Biglin, Chief, Division of State Program Management, Unemployment Insurance Services, U.S. Department of Labor, is gratefully acknowledged.

⁶ State coverage includes the 50 States as well as the Commonwealth of Puerto Rico, the Virgin Islands, and the District of Columbia.

The Nature of Unemployment Insurance

The unemployment insurance system was authorized by the Social Security Act of 1935. Its purpose was to encourage States to provide income security to hired workers during periods of unemployment. By mid-1937, all States and the District of Columbia had adopted statutes for inclusion in the Federal-State system.

The act attempted to assure adequate provisions for administering the Unemployment Insurance Program in all States by authorizing Federal grants to States to meet the total administrative cost of approved State unemployment insurance laws. Consequently, the States have not had to collect any tax from employers or make any appropriations from general State revenues for the administration of the employment security program, which includes the unemployment program. Employer contributions collected by the States are held in the Unemployment

employment Tax Act (FUTA) on a permanent basis (5). In most farm employer situations, coverage is not required at the Federal level until several people are employed. Thus, for the most part, only larger farm operations and those with several employees are covered. Employee status is the key determinant in whether a farm employer has to pay a Federal unemployment insurance tax. Even though an employer is required to pay the Federal tax, a worker may not receive unemployment insurance benefits if the State does not provide coverage. The Federal tax is imposed to administer the unemployment insurance programs of the States.

Farmers are required to pay Federal unemployment taxes if they pay cash wages of \$20,000 or more for agricultural labor in any calendar quarter during the current or preceding calendar year, or hire 10 or more farmworkers in 20 different weeks during the current or preceding calendar year.⁷ The Federal tax is imposed on the employer and cannot be collected or deducted from employee wages. A self-employed farmer's spouse, parents, or children under 21 years of age are usually not included. Over 450,000 farm employees employed by 17,400 farm employers are estimated to be covered (1). Thus, the required Federal coverage may include about one-sixth of the Nation's hired farmworkers.

Self-Employment. Self-employed workers are excluded from Federal and State unemployment insurance coverage in most States, since it is generally not feasible to determine whether a self-employed worker is unemployed in any given week. California has made an exception. An employer in California may apply for self-coverage if his (her) employees

⁷Three tests are applied in determining whether services are agricultural labor (as defined in an amendment to the Federal Unemployment Tax Act) at both the Federal and State levels. They are: (1) the service must be performed in the employ of the operator of a farm, (2) the service must be performed with respect to a commodity in its unmanufactured state, and (3) the operator must have produced more than one-half of a commodity with respect to which the service is performed.

Trust Fund in the U.S. Treasury. Interest is credited to the State accounts. Money drawn from the Unemployment Trust Fund may be used only to pay benefits to individuals. The Federal Government itself does not provide unemployment benefits. Benefits are paid by the States. The Federal Government collects the unemployment taxes at the rates set by the States and holds the funds until the States need them to satisfy unemployment claims.

Employment in agriculture was not covered under the 1935 Act. While a few States enacted provisions to cover agricultural employment, it was not until major changes were made in Federal laws in the seventies that a substantial number of agricultural employees were working in covered employment. Rate increases over the last decade, from 3.1 to 3.2 percent in January 1970, and to 3.4 percent in January 1977, may indicate a trend for future increases.

are covered. If the application is approved, wages for purposes of contributions and benefits are deemed to be the quarterly wages needed to qualify for the maximum weekly benefit amount. The contribution rate is fixed at 1.25 percent of wages in California.

Corporations and Partnerships. A self-employed farmer (sole proprietor) becomes an employee of a corporation by forming a corporation and continuing to do agricultural work as an employee of the corporation. A net effect of incorporation, however, may be to qualify a formerly self-employed farmer and family members who had been excluded from unemployment coverage. This may be the case if (1) the farmer's wages and those of other family members raise the firm's cash wages to \$20,000 or more in a calendar quarter, or (2) the farmer and working family members raise the number of employees to 10 or more agricultural laborers for at least one day during each of 20 different calendar weeks during a calendar year or in the preceding calendar year.

General and limited partners are not considered employees for unemployment insurance purposes. However, a general or limited partner may perform agricultural labor and be considered for coverage if the partnership meets the qualifications of an employer. Certain Subchapter S corporations are treated as partnerships for employee-employer status.

Crew Leaders. In connection with the extension of coverage to some agricultural workers, the FUTA established a special rule for determining who will be treated as the employer and, therefore, liable for the Federal tax. Individuals who are members of a crew furnished by a crew leader to perform agricultural services for a farm operator are treated as employees of the crew leader if the leader is registered under the Farm Labor Contractor Registration Act of 1963, or if almost all the members of the crew operate or maintain mechanized equipment furnished by a crew leader. An individual furnished by a crew leader to perform agricultural services for a farm operator will not be treated as an employee of the crew leader if the individual is an employee of the farm operator within the meaning of the State law. Conversely, any worker who is furnished by a crew leader to perform agricultural services for a farm operator but who is not treated as an employee of the crew leader is treated as an employee of the farm operator. This special rule is intended to resolve any questions as to whether an individual's employer is the farm operator or the crew leader. The same provisions about the size of the firm apply to crew leaders as to farm operators, that is, 10 workers for 20 weeks per year or \$20,000 of wages in a calendar quarter.

Tax Rates. The Federal tax rate is currently 3.4 percent on the first \$6,000 of wages paid to each employee during the calendar year. The net Federal liability is generally 0.7 percent since an employer receives a credit of 2.7 percent if he or she has paid the State unemployment insurance taxes. Employers may have to pay more than 2.7 percent to the State program when rates are higher, but even in such cases, 0.7 percent is the maximum Federal credit they can obtain. The payment must have been made to the State government on a timely basis to qualify for the Federal

credit. Employers are liable for the Federal tax even though in rare instances they may be exempt from a State unemployment tax or their employees may be ineligible for unemployment insurance benefits.

Federal Taxation of Unemployment Insurance Costs.

Employers are responsible for paying both the Federal and State unemployment insurance costs and may not deduct them from an employee's salary or other form of payment (except as noted later in three States where employees may be required to make contributions to the State fund). The amount paid by the employer is not taxable income to employees even though they receive the benefits. However, the cost at both the Federal and State levels is a tax-deductible item to the employer for Federal income tax purposes.

State

The States have been free to develop programs adapted to their conditions. Consequently, no two State laws, coverages, costs, and benefits are the same. Most States require that any employment covered at the Federal level also be covered at the State level. States may also cover employment that Federal laws require for benefit purposes even though the wages are not taxable at the Federal level.

Most States permit employers to choose whether or not to cover workers employed outside the State if they are not covered by the State in which they work. Likewise, most States have entered into reciprocal arrangements with other States to provide continuity of coverage for individuals working in different States for the same employer.

Required Coverage. Most States follow the Federal provisions relating to agricultural labor and therefore limit required coverage to employees on the larger farms. Three States and the three additional jurisdictions at the end of 1979, however, required coverage for fewer workers or for shorter employment periods or both:

| <i>State</i> | <i>Required coverage</i> |
|----------------------|--|
| California | 1 or more employees at any time and wages or equivalent in excess of \$100 in a calendar quarter. |
| District of Columbia | Agricultural workers are not excluded from general unemployment coverage, which requires all employees to be covered. |
| Minnesota | 4 or more employees in 20 weeks or \$20,000 wages or equivalent in a calendar quarter. Agricultural labor performed by an individual 16 years of age or younger is excluded from agricultural coverage unless the employer is covered under the Federal law. |
| Puerto Rico | 1 or more employees at any time. |
| Rhode Island | 1 or more employees at any time. |
| Virgin Islands | 1 or more employees at any time. |

Voluntary Coverage. The significant feature of voluntary coverage is that the State agency, not the parties involved, is the decisionmaker in most cases. Forty-seven States allow employers, with the approval of the State unemployment agency, to cover most types of employment that are exempt under their laws, including agricultural labor. New York State law permits employers who are not otherwise covered as agricultural employers to elect coverage of agricultural employees under certain conditions. Alabama and Massachusetts do not allow voluntary coverage of excluded types of employment. The three additional jurisdictions essentially bring all agricultural labor under State coverage (see above tabulation).

Several situations could exist where employers or employees may want voluntary coverage. For instance, employers may want to offer the coverage as incentive for good quality employees to join and stay with them. On the other hand, employees may bargain to waive coverage but to have the amount of the tax included in their wages where they believe that the prospects for being unemployed by their present employers are small or that they would have immediate alternative employment opportunities.

In other situations, employees will bargain very hard with their employers to provide the coverage (many union contracts require coverage), particularly where the employees are uncertain about being laid off and about readily available alternative employment. In such situations, employers may resist providing the coverage voluntarily since they will probably have a readily available labor supply and since such coverage will add to their total labor costs.

Required Employee Contributions. Only Alabama, Alaska, and New Jersey collect employee contributions. The wage base used for the employee contributions is the same as that used for their employers. Alabama and New Jersey employees' contributions were 0.5 percent of salary in 1979. However, in Alabama, employees make contributions only when the fund falls below a minimum amount; otherwise they are not liable for contributions. Alaska's employee contribution rate varies from 0.3 to 0.8 percent, with the rate schedule depending on the type of employee. Employee contributions are deducted by the employer from the workers' pay and forwarded to the State agency along with the employer's contribution.

Tax Rates. In most States, the standard tax rate is 2.7 percent (table 5).⁸ Employers' rates are adjusted after a period of time based on their layoff experience. Tax rates vary widely, with large differences in minimums and maximums, and are essentially a measure of employment volatility in the various types of farm operations in a State. Farms with high turnover caused by frequent layoffs will have the poorest experience ratings and the highest tax

rates. Employers' minimum rates vary from zero in Kansas, South Dakota, and West Virginia, when good experience is held and no claims made, to a maximum of 7.5 percent in Michigan and Minnesota. Michigan and Minnesota apparently have the widest rate range of tax rates of the States—from 1.0 to 7.5 percent.

Taxable Wage Base. Fourteen States have a higher tax base than the \$6,000 per employee provided in the Federal Unemployment Tax Act (table 5). In those States, an employer pays a tax on wages paid to each worker within a calendar year up to the amount specified in the table. In Puerto Rico, the tax is levied on all the workers' wages. Most States provide an automatic adjustment of their wage base if Federal law is amended to apply to a wage base higher than that specified under State law.

Calculation of the Agricultural Wage Cost Under Mandatory Federal Coverage. Employers must usually pay the State tax when their labor requirements meet the Federal criterion for 10 workers, including several workers hired for seasonal planting, tending, and harvesting of crops, and seasonal workers used in livestock operations. In addition, crop and livestock farmers who hire several workers year around may meet the \$20,000 wage criterion in a calendar quarter. For instance, a farmer with five agricultural laborers, each paid \$16,000 annually (\$1,333.34 per month), will pay \$20,000 in wages in a calendar quarter and will be required to pay the tax. Likewise, a farmer with 14 laborers, each paid \$6,000 annually (\$500 per month), will pay \$21,000 in wages in a calendar quarter and will also be required to pay the tax. If both farmers operate in one of the 36 States where the maximum taxable wage base is \$6,000 (table 5), they will pay identical amounts of tax per worker but the percentage of the wage base for employers paying wages of \$16,000 per worker will be lower compared with that of an employer paying only \$6,000 per worker. In States where the wage base is higher than \$6,000, employers paying \$16,000 in wages per worker will still pay a lower rate on total wages (unless the employer is located in Puerto Rico) than the employer paying only \$6,000 per worker.

The firm that employs 10 or more agricultural laborers for at least 1 day during each of 20 different calendar weeks presents a different situation. If each worker is paid \$3 per hour (close to the minimum wage rate), or \$24 per day for a 20-week total of \$480, the firm will pay \$4,800 annually in wages; the firm's wage base is substantially under the \$6,000 maximum in the 36 States and the Federal maximum, but it still must pay the tax. If a firm employed each laborer only 20 days during a calendar year, it would have to pay each of the 10 employees \$30 per day to reach the maximum \$6,000 coverage level in the 36 States.

There are many variations in the actual percentage costs of total wages paid, which depend on each State's regulations and the experience rating of each firm. Of most interest for this report is the general range of costs for various States. For example, a farmer in Minnesota who pays \$20,000 per quarter in wages to five agricultural laborers, who are each

⁸Material in this section simplifies the actual situation. The material presented gives the general rate ranges that are of most interest in analyzing unemployment tax costs. Researchers can obtain the exact rates in effect when a study is made from the U.S. Department of Labor. Rates for individual firms, however, will have to be solicited directly from the firm.

paid \$1,333.34 per month, will pay a total of \$3,210 (\$642 per employee). The employer will pay \$3,000 to the State (\$600 per employee) at the maximum 7.5-percent rate and \$8,000 taxable wage base (see table 5). In addition, the farmer will pay \$210 (\$42 per employee) for the 0.7-percent Federal tax on the first \$6,000 of wages. The total payment of \$642 per employee is 4 percent of the \$16,000 wage base. If the firm's unemployment experience were the best in Minnesota, qualifying it for the 1-percent State rate and appropriate Federal credit, the total State and Federal tax would be \$122 per employee, or 0.76 percent of the \$16,000 wage base.

Louisiana has one of the lowest tax rates, with a 0.1-percent minimum and 2.7-percent maximum. The Minnesota farmer, above, operating in Louisiana instead, would pay a maximum total State and Federal tax of \$1,020 or \$204 per worker. This is about 1.3 percent of the wage base. The minimum tax under the most favorable rating would be \$240 or \$48 per worker, about 0.3 percent of the \$16,000 wage base.

Under the 7.5-percent tax rate in Minnesota, a farmer paying each worker \$480 will pay \$39.36 in unemployment tax or 8.2 percent of the wage base. Under the 1-percent tax rate, the farmer will pay \$8.16 or about 1.7-percent of the wage base. In Louisiana, under the 2.7-percent maximum tax rate, the farmer will pay \$3.84 or about 0.8 percent of the wage base.

Linkage to Other Programs

Unemployment insurance costs depend, for the most part, on an employer's own claims experience. Consequently, benefit claims become relevant to determining farmer costs for unemployment insurance. To draw unemployment insurance benefits, an employee must be able to work and available for employment. Claims are based on weekly employment experience.

Federal and most State laws are specific on ineligibility to claim unemployment insurance benefits. Almost all the

Table 5—Unemployment insurance: Taxable wage base and taxes, by State, July 1979

| State | Calendar year 1979 taxable wage base ¹ | Calendar year 1978 tax rates | | State | Calendar year 1979 taxable wage base ¹ | Calendar year 1978 tax rates | |
|----------------------|---|------------------------------|---------|-----------------------------|---|------------------------------|---------|
| | | Minimum | Maximum | | | Minimum | Maximum |
| | Dollars | — Percent — | | | Dollars | — Percent — | |
| Alabama ² | 6,600 | 1.0 | 4.0 | Montana | 7,400 | 3.1 | 3.1 |
| Alaska ² | 10,000 | 2.6 | 5.1 | Nebraska | 6,000 | .1 | 2.7 |
| Arizona | 6,000 | .15 | 3.55 | Nevada | 7,400 | 1.1 | 3.5 |
| Arkansas | 6,000 | .5 | 4.4 | New Hampshire | 6,000 | .05 | 6.5 |
| California | 6,000 | 1.4 | 4.9 | New Jersey ² | 6,600 | 1.2 | 6.2 |
| Colorado | 6,000 | .3 | 3.6 | New Mexico | 6,600 | .6 | 4.2 |
| Connecticut | 6,000 | 1.5 | 6.0 | New York | 6,000 | 1.5 | 5.2 |
| Delaware | 6,000 | 1.6 | 4.5 | | | | |
| District of Columbia | 6,000 | 2.7 | 2.7 | North Carolina | 6,000 | .1 | 5.7 |
| Florida | 6,000 | 1.1 | 4.5 | North Dakota | 7,000 | .5 | 4.2 |
| Georgia | 6,000 | .06 | 5.38 | Ohio | 6,000 | 1.1 | 4.8 |
| | | | | Oklahoma | 6,000 | .5 | 3.2 |
| Hawaii | 10,400 | 3.5 | 3.5 | Oregon | 9,000 | 2.6 | 4.0 |
| Idaho | 10,200 | 1.1 | 4.2 | Pennsylvania | 6,000 | 1.0 | 4.0 |
| Illinois | 6,000 | .1 | 4.01 | Puerto Rico ³ | 3 | 2.95 | 3.45 |
| Indiana | 6,000 | .3 | 3.3 | Rhode Island | 6,000 | 2.2 | 4.0 |
| Iowa | 6,900 | .6 | 6.0 | South Carolina | 6,000 | 1.3 | 4.1 |
| Kansas | 6,000 | 0 | 3.6 | South Dakota | 6,000 | 0 | 4.5 |
| Kentucky | 6,000 | 2.7 | 5.0 | Tennessee | 6,000 | .30 | 4.0 |
| Louisiana | 6,000 | .1 | 2.7 | | | | |
| Maine | 6,000 | 2.4 | 5.0 | Texas | 6,000 | .1 | 4.0 |
| Maryland | 6,000 | 2.1 | 5.0 | Utah | 10,400 | 1.3 | 2.8 |
| Massachusetts | 6,000 | 2.6 | 6.4 | Vermont | 6,000 | 1.7 | 6.0 |
| | | | | Virginia | 6,000 | .05 | 3.2 |
| Michigan | 6,000 | 1.0 | 7.5 | Virgin Islands ³ | 6,000 | 2.7 | 2.7 |
| Minnesota | 8,000 | 1.0 | 7.5 | Washington | 9,000 | 3.3 | 3.3 |
| Mississippi | 6,000 | 2.6 | 2.7 | West Virginia | 6,000 | 0 | 3.3 |
| Missouri | 6,000 | .5 | 3.2 | Wisconsin | 6,000 | .5 | 6.5 |
| | | | | Wyoming | 6,000 | .51 | 3.21 |

¹\$6,000 is minimum for Federal coverage. Under State law, wages include all kinds of remuneration subject to the Federal Unemployment Tax Act. For instance, the cash value of remuneration paid in any medium other than cash is included. In many States, gratuities received in the course of employment from other than the employer are also considered as wages.

²These States require an employee contribution as well; see text.

³Puerto Rico and the Virgin Islands have no experience-rating systems. Puerto Rico levies a tax on all wages and the Virgin Islands levies on the first \$6,000.

Source: (5).

State laws provide that a claimant is disqualified from benefits for any week during which he or she is receiving or is seeking benefits under any Federal or other State unemployment law. Under most of the laws, no disqualification for unemployment insurance is imposed if the claimant is ineligible under the other law. In a few situations, an employee who is ill can still collect unemployment insurance. For example, a worker who has contracted arthritis may be able to collect unemployment insurance for the coverage period.

Other payroll tax and fringe benefit programs may help to reduce unemployment benefit claims. Forty-eight States disqualify a claimant for unemployment insurance benefits for any week during which he or she is receiving or has received other types of remuneration, such as wages in lieu of notice, dismissal wages, workers' compensation for disability, social security, or benefits under an employer's pension plan or under a supplemental unemployment benefit plan. In many States, if the other income is less than the weekly benefit under unemployment insurance coverage, the claimant (employee) receives the difference. In other States, no benefits are payable for a week in which such payments were received, regardless of the amount of such payments.

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Workers' Compensation Insurance

Workers' compensation insurance is designed to provide income maintenance, medical care, income of an intermediate nature to survivors, and rehabilitation in situations where workers are disabled by work-related accidents or activities. The legislation authorizing workers' compensation coverage is, for the most part, based on the premise that the employee should not incur any substantial loss in wages. The premise suggests that the insurance coverage is a cost of production. Coverage for most workers has been provided for and administered at the State level with no direct Federal supervision or funding (except for employees of the Federal Government, District of Columbia employees, and longshoremen and harbor workers).⁹ States have been free to develop programs best suited to their own economic and political conditions, so no two States' laws, coverage, costs, and benefits are the same.

State programs are generally regulated by an agency of the State government. Rating bureaus usually rate risks and State insurance commissioners grant rate changes. Some States operate a workers' compensation fund or company to insure individual firms either on a compulsory or an elective basis.

Although the laws have not been unified at the Federal level, State coverage is related and linked to Federal programs. For instance, the disability and survivor benefit features of social security coverage can supplement workers' compensation programs. Dependents of a disabled worker, to the extent permitted by offsets, receive assistance from both Federal and State sources. Veterans' Administration benefits are also linked to State programs. Other examples of the Federal-State linkage include occupational safety and health regulations, which seek to improve working conditions and reduce workers' injuries, and occupational programs designed to rehabilitate and retrain workers.

To date, few States require coverage for work absence due to health hazards such as chemical use and unclean air. In general, recommendations for change in workers' compensation coverage have suggested continuation of State programs, but have suggested numerous changes in coverage and in Federal programs that relate to workers' health, safety, and income maintenance. The basic objectives for workers' compensation programs include the following:

The assistance of the Office of State Workers' Compensation Standards, Employment Standards Administration, U.S. Dept. of Labor, is acknowledged. Parts of this section draw heavily on an unpublished report by Walter Sellers (12).

⁹A few notable exceptions are covered under Federal Statute, e.g., Federal Employees' Compensation Act (5 U.S.C. 8101-8150 (FECA)) and harbor workers and longshoremen who are covered under the Longshoremen and Harbor Workers' Compensation Act (33 U.S.C. 901-950). Railroad workers in interstate commerce, sailors in the United States, and merchant marines are covered by statutory provisions for employer liability rather than by a workers' compensation law. While not a workers' compensation program *per se*, the Federal Coal Mine Health and Safety Act, enacted on December 30, 1969, established a Federal program of cash benefit payments to coal miners and their spouses for disability or death from pneumoconiosis ("black lung" disease, contracted from working in and around coal mines).

- Broad coverage of employees for work-related injuries and diseases.
- Substantial protection against interruption of income.
- Sufficient medical care and rehabilitation services.
- An effective system for delivering benefits and services.

The major recommendation for farm production was that all agricultural employers whose annual payrolls exceed \$1,000 should provide coverage. Societal interests may best be served by making workers' compensation coverage in agriculture mandatory for the majority of workers if that will provide incentive for farm employers to eliminate hazards and develop safety programs that lead to a reduction in injuries and disease. The medical costs of treating an injured or sick worker who can then return to work may be less than that of permanently providing welfare benefits.

Because farm labor costs can be raised significantly if agricultural workers are included under workers' compensation laws, the cost of such coverage should be included in farm studies on costs of production, economies of size, and organization. Primary data from individual farms should be used to estimate the cost for a particular size and type of

Coverage Since 1908

The bulk of the workers' compensation (formerly called workmen's compensation) system was enacted between 1908 (Federal civilian employees in hazardous work) and 1919 and included 43 States and programs for Federal workers. By 1949, all States had programs to furnish income protection to workers in the event of disability from work-related injury or illness. Coverage was selective and generally did not cover agricultural workers since it was thought that agricultural labor was provided by the farm family that could care for themselves and that recordkeeping requirements of the program would be a burden for the family farmer. It was not generally recognized that many family farms hire labor during peak harvest periods and that some farms were not run by the family and hired substantial amounts of labor.

The laws changed slowly between 1920 and 1970. The seventies, however, witnessed a major wave of studies and legislation to expand the scope of coverage, raise benefits, and reduce or eliminate restrictions on benefit eligibility. A number of States now have laws that require that benefits be adjusted on the basis of workers' compensation experience data that apply to injuries. Forty-two States at the end of 1977 had enacted provisions that require weekly benefits to be automatically increased as wages or prices increase. In the period from July 1, 1978, to July 1, 1979, alone, about 220 amendments to workers' compensation laws were enacted in the various States from among several hundred proposed bills (see appendix III).

farm. Where such data cannot be obtained, table 9 can be used as a reference point and updated as appropriate. Where studies are made of more special types of agricultural production, data in the reference manuals can provide a useful approximation of rate levels and minimum premium levels for most of the States.

The average premium cost for the 34 States and District of Columbia with field crops and farm coverage in 1977 was \$7.52 per \$100 of coverage with an average minimum premium of \$353.89, excluding the policy-writing charge. Charges for the individual States ranged from \$3.67 to \$26.25 per \$100 and the minimum premium per policy ranged from \$172 to \$706. This contrasts with average payroll costs of \$1.71 per \$100 of coverage in 1977 for all industries. The higher cost for agricultural workers reflects the higher risks in agricultural employment and does not reflect actual operating experience of agricultural firms after the first 3 years of operating experience.

States' rates did not form any noticeable pattern by geographic region. Alaska, Colorado, Hawaii, Iowa, Maine, Montana, New Mexico, and Oregon were high-cost States because they had high minimum premiums and apparently high associated benefits. Arizona, Massachusetts, and North Carolina had minimum enrollment premiums of \$200 or less. Alabama, Indiana, North Carolina, and South Dakota had rates of less than \$4 per \$100 of wages.

Nature of Coverage

Workers' compensation provides medical care, cash payments to disabled workers for temporary, permanent partial, or total disability, and indemnity benefits to survivors of workers who die of employment-related causes. Benefits are also available to workers for physical and vocational rehabilitation. Cash wage benefits usually amount to between half and two-thirds of the average wage along with payment of medical expenses. All employed minors are covered and may receive increased compensation if illegally employed.

During 1976, some 70 million persons, or 88 percent of the average monthly number of wage and salary workers, including Federal employees, were covered by workers' compensation. In 1976, 58 percent of cash benefit payments were for disability, 31 percent for medical and hospital costs, and 11 percent for death benefits.

As with other social programs, however, agricultural workers have been slower to come under workers' compensation coverage (1,11). In addition to reasons given for excluding agricultural workers from other programs, some emphasis has been given in recent years to the high cost of farm coverage due to the greater risks.¹⁰ Many jobs in agriculture

are among the more hazardous in this country, and agriculture is claimed by some analysts to be the third most hazardous occupation, behind mining and extractive industries and construction (12). Such classification may be too high, though, given the general accident data shown in appendix table 6.

Workers' compensation is necessary to help farmworkers by providing income and rehabilitative services when a worker is unable to work after exposure to noxious chemicals or injury by livestock or machinery. The continuous trend toward greater mechanization and use of crop and livestock chemicals, confinement care of livestock, and shifts away from hand labor and open space raising of livestock may increase farmworkers' exposure to hazards (2). In general, the incidence of worker claims may be coming predominantly from larger farms where a worker's exposure to hazards is higher. Potentially hazardous machines and chemicals, for example, may be used more frequently on the larger farms. Agricultural establishments with 11 to 19 employees reported an incidence of 6.5 accidents per 100 full-time workers in 1978, compared with 21.7 incidents for full-time workers on farms with 1,000 to 2,499 hired workers (2).

Each State determines the extent of workers' compensation coverage and the level of benefits. Employers, however, are responsible for paying benefits and can cover risks through several options: purchasing a policy with a private insurer (44 States); purchasing a policy from a State-operated insurance fund (18 States—the fund is generally operated by a State agency other than the regulatory agency); or self-insuring, in which case the employer must meet specified criteria for establishing proof of financial security (47 States). Premium payments for workers' compensation coverage were distributed as follows in 1977: private carriers, \$9,920 million; State funds, \$2,226 million; Federal employee compensation program (including administrative expenses), \$589 million; and self-insurers (including administrative expenses), \$1,213 million. Only six of the State funds are exclusive; that is, State law does not allow private companies to provide workers' compensation coverage (7).

A self-insured employer usually posts an indemnity bond or resorts to a negligence system as may be established in court rulings. Few farmers with large payrolls are self-insured. Farmers who hire part-time or temporary labor probably most frequently self-insure out of a sense that they can carefully supervise their help. However, some may not insure due to lack of information about required coverage.

Workers' compensation coverage is set apart from other closely related benefit programs in that it provides benefits only for accidents or diseases arising out of and in the course of employment in the workplace. Compensation for loss of work from a common cold, for instance, is usually not provided, even though contracted on the work premises, since it does not generally arise out of the nature of the employment. Black lung disease probably would be covered since it is an injury or disease contracted while the employee is actually at work, and is recognized as an occupational disease by law. Many other situations fall between these extremes and are determined on a case basis.

¹⁰The risk exposure of private and public workers' compensation insurance in agriculture results from the nature of farm resources and activities, for example, animals, the environment and terrain, insects, and workplaces on farms. Injuries to rural residents and nonfarm people that occur on farms are also classified as farm accidents (by the National Safety Council) even though such people cannot collect workers' compensation unless they were working and covered when injured.

The coverage is not designed to compensate fully for the effects of an on-the-job accident or disease, except in cases where no time is lost from work and only medical expenses are incurred. Compensation usually includes all medical costs, including medical rehabilitation, replacement of lost income, and, in some cases, costs for nonmedical rehabilitation such as vocational training and job counseling. Employees, of course, are not compensated under workers' compensation if proof can be established that an injury was self-inflicted or that other unusual circumstances existed. With a few exceptions, workers' compensation does not fully replace all lost wages or loss of other fringe benefits such as medical insurance, nor does it pay for psychic distress.

In addition, workers' compensation is a no-fault program and participants can avoid the question of negligence. Implications of negligence on the part of employer or employee are absent and payment is frequently very prompt. In return for guaranteed compensation, the employee gives up any right to common law action against an employer, but may have a cause of action against a third party.

The number of agricultural workers eligible for coverage is difficult to estimate, partly because each State program has its own provisions, which differ from those in other States. Nonetheless, Sellers estimated that the 1.3 million hired farmworkers in 1979 accounted for 34 percent of the total farm work force and were employed on about 40 percent of the farms (12). This proportion contrasts with that of 30 years earlier, when only 23 percent of the farm work force was hired. For the most part, the hired farm work force is concentrated in States that produce specialty crops, such as California, Hawaii, and Florida. Farm operators and their families accounted for about 2.4 million workers in 1980; about 30,000 of them (excluding the operators themselves) were paid employees who would be eligible for workers' compensation coverage in some States.

Firms that provide on-farm services to assist farmers in their production work appear to be becoming more important. Employees of such firms may be strong candidates for workers' compensation coverage since they are exposed to hazards for longer periods of time than most agricultural workers. They frequently are involved in handling and applying crop and livestock chemicals, handling livestock, and operating machines like balers, pickers, threshers, trucks, tractors, crop seeding and treating airplanes, and irrigation equipment. These activities are thought to be among the most hazardous in agriculture.

Required State Coverage

As of January 1, 1980, 18 States, the District of Columbia, and Puerto Rico required coverage for agricultural workers equal to that of workers in other industries. Hired workers in 12 of the States were covered by statute, while Michigan exempted employers who hired only two part-time workers. An additional 19 States required coverage of agricultural workers based on various criteria such as size of payroll, number of employees, part-time employment, number of workdays, and use of power machinery (tables 6 and 7).

The remaining 18 States did not require workers' compensation coverage of agricultural workers, but rather let employees choose to participate voluntarily (table 8).

Between 1971 and 1979, a number of States brought agricultural employees under required coverage.¹¹ Eight States that did not cover agricultural employees in 1971 either required coverage on the same basis as that for other employees or had special requirements for coverage in 1979. Montana required the same coverage for agricultural workers as for other industries, while Delaware, Iowa, Missouri, Pennsylvania, Utah, Virginia, and West Virginia required coverage of agricultural workers in 1979, but under limited circumstances not applicable to other industries. During the same time period, Arizona and Louisiana changed from selected coverage of agricultural workers to requiring coverage the same as for employees in other sectors of the economy. Kentucky eliminated its required coverage. Nine additional States had some changes in their requirements between 1971 and 1979. Alaska, Florida, Illinois, Maryland, Wisconsin, Michigan, New York, Vermont, and Washington required that agricultural workers be covered in 1971, but between 1971 and 1979, three States changed to make agricultural coverage more limited than that for employees in other sectors.

There were no particular national or regional patterns, as of January 1980, regarding required coverage of agricultural workers in terms of special requirements, covering workers on the same basis as other industries, or excluding agricultural workers. There was a wide range in coverage among the States that had special requirements for agricultural employees (table 7). They are not consistent by the most prevalent type of farming in a State, or by the size of farm in terms of number of employees (either seasonal or full-time). For instance, in States with requirements like those of Washington and Iowa, almost all employees would be covered; Washington requires coverage of all agricultural employees except those who earn less than \$150 per calendar year from one employer, and Iowa requires employers to cover agricultural employees if the employer's cash wage payments exceeded \$1,000 in the preceding year.

At the other end of the spectrum (less restrictive coverage), South Dakota required coverage only of workers engaged primarily in the operation of certain machines, such as grain combines and corn shellers, while Maryland required coverage if an employer had three or more full-time employees or a yearly payroll for full-time employees of \$25,000 or

¹¹ Various studies and commissions had recommended such an extension of coverage. They generally stated that earlier misgivings of workers' compensation laws involved the difficulties of administration, which are not as true today. Some States had shown that the farmworkers could be effectively covered. Sellers, however, contends that several major problems remain in the way of wider mandatory coverage of agricultural workers (12). The classification of the statutes in 1971 and 1979 was done by different research workers and may not be completely compatible between periods. A comparison found that only 1 of the 18 States without significant agricultural workers' coverage in 1976 had been added to the group by 1978. The number of States that provided some coverage for agricultural workers had risen from 21 at the end of 1968 to 32 in 1979.

more (migratory laborers not operating machinery and office workers were exempt from coverage). Thus, in Washington, Iowa, and other States with similar requirements, farm operators who use very little hired labor are required to provide coverage. In States with requirements like those of South Dakota and Maryland, coverage is required only on the larger specialized farm operations or those that use particular types of machinery.

Among the 15 jurisdictions that require coverage of agricultural workers on the same basis as other types of employees, all have compulsory coverage except New Jersey (table 6). Six permit waivers, none exempt small numbers of workers, and only Ohio requires coverage through a State fund. Among the 18 States without requirements for coverage of agricultural workers, South Carolina and Texas permit elective coverage and 9 permit waivers; 4 permit exemptions for two or fewer workers, 3 permit exemptions for three or fewer workers, and 2 permit exemptions for four or fewer workers. Also, among those 18 States, only Nevada and North Dakota require coverage through a State fund and do not permit self-insurance or placement with a private company. The rest of the States in both groups permit the use of private insurance companies and self-insurance.

Voluntary Coverage

As of January 1, 1980, 33 States had special requirements for coverage of agricultural workers or required that they be covered the same as other workers in the State. The remaining 17 States do permit voluntary participation. Coverage requirements in the 33 States are generally not all inclusive, so that some workers are not covered by Statute and covered workers may not be covered at a level they desire. Thus, some employees in the 33 States may want coverage or additional coverage.

As contrasted with unemployment insurance, where some employees may not want the coverage but would rather have the insurance cost in wages, employees will probably be more demanding for workers' compensation coverage. The preference for coverage is probably especially pronounced among workers in the more hazardous lines of agricultural employment, where they can be disabled to such an extent that their employment opportunities will be reduced.

Insurance Rates

Many firms that are required to provide workers' compensation coverage insure their risks through private carriers

Table 6—Workers' compensation coverage required in the 15 jurisdictions that require farmworkers to be covered on the same basis as other employees, 1979¹

| State | Type of coverage | Waivers permitted | Number of workers | Insurance required or permitted through: | | |
|-----------------------|------------------|-------------------|-------------------|--|-----------------|----------------|
| | | | | State fund | Private company | Self-insurance |
| Arizona ² | Compulsory | Yes | 0 | Competitive ³ | Yes | Yes |
| California | do. | No | 0 | Competitive ³ | Yes | Yes |
| Colorado | do. | Yes | 0 | Competitive ³ | Yes | Yes |
| Connecticut | do. | Yes | 0 | No | Yes | Yes |
| District of Columbia | do. | No | 0 | No | Yes | Yes |
| Hawaii | do. | No | 0 | No | Yes | Yes |
| Louisiana | do. | Yes | 0 | No | Yes | Yes |
| Massachusetts | do. | No | 0 | No | Yes | Yes |
| Michigan ⁴ | do. | No | 2 | Competitive ³ | Yes | Yes |
| Montana | do. | Yes | 0 | Competitive ³ | Yes | Yes |
| New Hampshire | do. | No | 0 | No | Yes | Yes |
| New Jersey | Elective | No | 0 | No | Yes | Yes |
| Ohio | Compulsory | Yes | 0 | Exclusive ⁵ | No | Yes |
| Oregon | do. | No | 0 | Competitive ³ | Yes | Yes |
| Puerto Rico | do. | No | 0 | Exclusive ⁵ | No | No |

¹Hart also includes Pennsylvania and Vermont as covering agricultural workers in the same manner as nonagricultural workers, but without detailing the classification criteria. He did not include Michigan (3, Vol. 3, 20.01, page 20-3).

²Hart does not show Arizona as having a competitive State fund (3, Vol. 3, 20.02, p. 20-14).

³Employers may insure with a State fund or private company.

⁴The Office of State Workers' Compensation Standards Administration, Employment Standards Administration, U.S. Department of Labor, lists Michigan as requiring special farmworker coverage as follows: (a) farmworkers working for an employer who regularly employs three or more employees at one time; (b) farmworkers working for an employer who regularly employs fewer than three employees if at least one of them has been regularly employed by that employer for 35 or more hours per week for 13 or more weeks during the preceding 52 weeks.

⁵Employer may only insure with a State fund or self insure.

Table 7—Workers' compensation requirements in 19 States with special provisions for agricultural employment, 1979

| State | Farmworkers covered | Type of coverage | Waivers permitted | Insurance required or permitted through: | | |
|-----------|---|------------------|-------------------|--|-----------------|----------------|
| | | | | State fund | Private company | Self-insurance |
| Alaska | All except those employed on a part-time basis. | Compulsory | Yes | No | Yes | Yes |
| Florida | All, except those working for a farmer or association of farmers, employing 5 or fewer regular employees and employing fewer than 12 other employees at one time for seasonal employment in less than 30 days, provided such seasonal employment does not exceed 45 days in the same calendar year. | Compulsory | Yes | No | Yes | Yes |
| Illinois | All, except those working for an employer who employed fewer than 500 worker days of agricultural labor per 3 months during the preceding calendar year, excluding the employer's spouse and other members of the immediate family in the same domicile. | Compulsory | No | No | Yes | Yes |
| Iowa | All, if the farm employer's total cash wage payments during the preceding year amount to at least \$1,000. | Compulsory | Yes | No | Yes | Yes |
| Maine | All, except seasonal or casual. However, an employer of 4 or fewer farmworkers may secure the payment of compensation by obtaining an employer's liability insurance policy (total limit not less than \$25,000 and medical payment coverage of not less than \$1,000). | Compulsory | Yes | No | Yes | Yes |
| Maryland | All, if the farm employer has 3 or more full-time employees or a yearly payroll for full-time employees of \$25,000. Office workers and migratory workers not operating machines are exempt from coverage. | Compulsory | Yes | Competitive ¹ | Yes | Yes |
| Minnesota | All, except those who work for a "family farm"—defined as any farm operation that paid less than \$4,000 in cash wages, exclusive of machine hire, to farm laborers for service rendered during the preceding calendar year. | Compulsory | No | No | Yes | Yes |

See footnotes at end of table.

Continued—

**Table 7—Workers' compensation requirements in 19 States with special provisions
for agricultural employment, 1979—continued**

| State | Farmworkers covered | Type of coverage | Waivers permitted | Insurance required or permitted through: | | |
|--------------|---|------------------|-------------------|--|-----------------|----------------|
| | | | | State fund | Private company | Self-insurance |
| Missouri | Farm laborers whose employer elects to accept the provisions of the act by the purchase of a valid compensation policy. Members and officers of a family farm corporation may be covered under a policy of workers' compensation insurance if approved by a resolution of the board of directors. | Elective | No | No | Yes | Yes |
| New York | Farm laborers to be covered for 12 months from April 1, if the farmer's total cash wage payments during the preceding calendar year amounted to \$1,200 or more; farmworkers supplied to a farmer by a farm labor contractor are deemed to be employees of the farmer. | Compulsory | No | Competitive ¹ | Yes | Yes |
| Oklahoma | All workers employed in agriculture or horticulture by an employer who had a gross annual payroll, including money paid to independent contractors, in the preceding calendar year of \$25,000 or more (increased to \$100,000 in 1981). | Compulsory | No | Competitive ¹ | Yes | Yes |
| Pennsylvania | All, if an employer pays one agricultural worker wages of \$150 or more or furnishes employment to one employee in agricultural labor on 20 or more days during a calendar year. | Compulsory | No | Competitive ¹ | Yes | Yes |
| South Dakota | Workers engaged commercially in operating threshing machines, grain combines, corn shellers, corn huskers, shredders, silage cutters, and seed hullers. | Compulsory | Yes | No | Yes | Yes |
| Utah | All except: employees who are family members; those working for employers whose cash payments to one or more employees amounted to less than \$2,500 during the preceding calendar year; or those working for employers who do not employ at least 4 persons for 40 hours or more per week for 13 consecutive weeks during any part of the preceding 12 months. | Compulsory | No | Competitive ¹ | Yes | Yes |

See footnotes at end of table.

Continued—

Table 7—Workers' compensation requirements in 19 States with special provisions for agricultural employment, 1979—continued

| State | Farmworkers covered | Type of coverage | Waivers permitted | Insurance required or permitted through: | | |
|---------------|---|------------------|-------------------|--|-----------------|----------------|
| | | | | State fund | Private company | Self-insurance |
| Vermont | All except those working for an employer whose aggregate payroll is less than \$1,000 in a calendar year. | Compulsory | Yes | No | Yes | Yes |
| Virginia | All working for an employer who, during the previous calendar year, had a payroll of \$15,000 or more per year, or who regularly employs more than 4 full-time employees. | Compulsory | Yes | No | Yes | Yes |
| Washington | All except those who earn less than \$150 per calendar year from one employer, or any child under 18 employed by parents in agricultural activities on the family farm. | Compulsory | No | Exclusive ² | No | Yes |
| West Virginia | Employees of an employer who has 6 or more workers in agricultural service. | Compulsory | No | Exclusive ² | No | Yes |
| Wisconsin | All who work for employers subject to the Act (employers become subject to the Act 10 days after they have employed 6 or more employees), whether in one or more locations on 20 or more days during the calendar year. | Compulsory | No | No | Yes | Yes |
| Wyoming | Workers engaged in power farming when one or more are employed for an average of 6 months on a farm, livestock ranch, or poultry farm, which uses in connection with its operation any power-driven equipment, such as a pickup truck, feed grinder, stacking machinery, tractor, mower, baler, or road grader. | Elective | No | Exclusive ² | No | No |

¹Employer may insure with a State fund or private company.

²Employer may only insure with a State fund or self insure.

Source: Unpublished tables: "Coverage for Agricultural Workers," and "Type of Law Insurance Requirements for Private Employment," Division of State Workers' Compensation Standards, Employment Standards Administration, U.S. Dept. of Labor, January 1, 1980.

who are members of the National Council on Compensation Insurance (NCCI). Generally, in States where the NCCI files its rate changes with a State insurance commissioner on behalf of private insurance carriers who write coverage in the State, the commissioner uses the information as an input into the rate approval process. In States where the NCCI does not operate (like California), the State has its own rating board.

Classification of Firms and Workers. The NCCI classifies firms and types of activity by main industry groups similar to Standard Industrial Classifications provided by the Federal Government's Office of Management and Budget. Additional

classifications are provided at a more detailed level based in part on the nature of the activity and the employees' risks of disability (special classification developed for the exclusive use of designated States). Under the agricultural classification, the following national classifications are made:

1. Animal raising (fur bearing) and drivers
2. Berry farm or vineyard and drivers
3. Cattle or livestock raising (not otherwise classified) and drivers
4. Dairy farm and drivers
5. Field crops and farm (not otherwise classified) and drivers

Table 8—Workers' compensation requirements in the 18 States not requiring coverage of agricultural workers, 1979

| State | Type of coverage | Waivers permitted | Number of workers | Insurance required or permitted through: | | |
|-----------------------|------------------|-------------------|-------------------|--|-----------------|------------------|
| | | | | State fund | Private company | Self-insurance |
| Alabama | Compulsory | No | 2 | No | Yes | Yes |
| Arkansas ¹ | do. | Yes | 2 ¹ | No ² | Yes | Yes |
| Delaware ³ | Elective | No | 0 | No | Yes | Yes |
| Georgia | Compulsory | Yes | 2 | No | Yes | Yes |
| Idaho | do. | No | 0 | Competitive ⁴ | Yes | Yes |
| Indiana | do. | No | 0 | No | Yes | Yes |
| Kansas | do. | Yes | 0 ⁵ | No | Yes | Yes |
| Kentucky | do. | Yes | 0 | No | Yes | Yes |
| Mississippi | do. | No | 4 | No | Yes | Yes |
| Nebraska | do. | Yes | 0 | No | Yes | Yes |
| Nevada | do. | No | 0 | Exclusive ⁶ | No | Yes ⁷ |
| New Mexico | do. | Yes | 2 ⁸ | No | Yes | Yes |
| North Carolina | do. | Yes | 3 ⁹ | No | Yes | Yes |
| North Dakota | do. | No | 0 | Exclusive ⁶ | No | No |
| Rhode Island | do. | No | 3 | No | Yes | Yes |
| South Carolina | Elective | Yes | 3 ¹⁰ | No | Yes | Yes |
| Tennessee | Compulsory | Yes | 4 | No | Yes | Yes |
| Texas | Elective | No | 0 ¹¹ | No | Yes | No |

¹ Contractor engaged in building or building repair work is covered if he or she employs 2 or more employees at any one time. Provision also applies if contractor subcontracts any portion of the work.

²Harl shows Arkansas as having a competitive State fund (3, Vol. 3, 20.02, page 20-14).

³Coverage is not required unless an employer carries insurance to insure the payment of compensation to farm laborers or their dependents.

⁴Employer may insure with a State fund or private company.

⁵Employers are exempt if they had a total gross annual payroll for the preceding year of less than \$10,000 and anticipate the same or lower payroll expenses for the current year.

⁶Employer may only insure with a State fund or self-insure.

⁷Harl shows Nevada permitting self-insurance (3, Vol. 3, 20.02, page 20-14).

⁸Exemption does not apply if injury occurs upon any structure 10 feet or more above the ground.

⁹The State statute exempts sawmill and logging operations with fewer than 10 employees, operating less than 60 days in 6 consecutive months and whose principal business is unrelated to sawmills.

¹⁰Exemption does not apply if employer had a total annual payroll during the previous calendar year of less than \$3,000.

¹¹Provides for mandatory workers' compensation coverage under Title 25 of State Statutes regarding rules and regulations for "Carriers" (Article 911-A, Sec. 11 Motor Bus Transportation and Regulations by the Railroad Commission).

Source: Unpublished table: "Type of Law Insurance Requirements for Private Employment," Division of State Workers' Compensation Standards, Employment Standards Administration, U.S. Department of Labor, January 1, 1980.

6. Fish hatchery and drivers
7. Florist (cultivating or gardening) and drivers
8. Gardening market or truck and drivers
 - a. Vegetable farm and drivers
9. Nurserymen, including incidental landscape, gardening, and drivers
10. Orchards and drivers
11. Poultry or egg producers and drivers
 - a. Hatchery and drivers

12. Sheep or goat raising and drivers
13. Landscape gardening and drivers
14. Logging or lumbering and drivers
 - a. Timber or brush cutting and drivers
15. Tree pruning, spraying, and drivers

In addition to the national subclassifications, many special subclassifications are made for agriculture and horticulture for individual States (appendix III).

Table 9—Standard premium basis for field crops, farm and cattle or livestock raising for States where the National Council on Compensation Insurance provides ratings or qualified as an advisory organization, 1979

| State | Field and farm ¹ | | | Cattle or livestock raising ⁴ | | |
|----------------------------|-----------------------------|-----------------|------------------------------------|--|-----------------|------------------------------------|
| | Rate per \$100 ² | Minimum premium | Policy writing charge ³ | Rate per \$100 ² | Minimum premium | Policy writing charge ³ |
| <i>Dollars</i> | | | | | | |
| Alabama | 3.90 | 275 | 11 | 3.90 | 275 | 11 |
| Alaska | 10.09 | 706 | 0 | 10.09 | 706 | 0 |
| Arizona ⁵ | 6.27 | 172 | 0 | NA | NA | NA |
| Arkansas | 5.64 | 320 | 0 | 5.64 | 320 | 0 |
| Colorado | 9.15 | 500 | 5 | 9.15 | 500 | 10 |
| Connecticut ⁶ | 6.54 | 373 | 3 | 6.54 | 373 | 3 |
| Delaware | NA | NA | NA | NA | NA | 10 |
| District of Columbia | 26.25 | 500 | 10 | 26.28 | 500 | 0 |
| Florida | 6.74 | 249 | 3 | 6.74 | 249 | 5 |
| Georgia | 4.80 | 236 | 10 | 4.80 | 236 | 0 |
| Hawaii | 10.98 | 394 | 0 | 10.98 | 394 | 0 |
| Idaho | 7.81 | 445 | 5 | 7.81 | 445 | 5 |
| Illinois ⁷ | 9.30 | 429 | 0 | 9.30 | 429 | 0 |
| Indiana | 3.26 | 222 | 0 | 3.26 | 222 | 0 |
| Iowa | 7.84 | 500 | 5 | 7.84 | 500 | 5 |
| Kansas | 4.76 | 276 | 4 | 4.76 | 276 | 4 |
| Kentucky | 8.65 | 493 | 7 | 8.65 | 493 | 7 |
| Louisiana | 8.51 | 396 | 3 | 8.51 | 396 | 3 |
| Maine | 12.18 | 500 | 3 | 12.18 | 500 | 3 |
| Maryland | 6.64 | 314 | 5 | 6.64 | 314 | 5 |
| Massachusetts | 4.74 | 191 | 10 | 4.74 | 191 | 10 |
| Michigan ⁸ | NA | NA | NA | NA | NA | NA |
| Minnesota ⁹ | NA | NA | NA | NA | NA | NA |
| Mississippi | 4.28 | 255 | 10 | 4.28 | 255 | 10 |
| Missouri | 5.75 | 284 | 15 | 5.75 | 284 | 15 |
| Montana ¹⁰ | 10.26 | 500 | 3 | 10.26 | 500 | 3 |
| Nebraska | 4.45 | 215 | 5 | 4.45 | 215 | 5 |
| New Hampshire | 7.32 | 271 | 5 | 7.32 | 271 | 5 |
| New Jersey ¹¹ | NA | NA | NA | 9.30 | 182 | 6.03 |
| New Mexico | 9.23 | 500 | 10 | NA | NA | NA |
| New York ¹² | NA | NA | NA | NA | NA | NA |
| North Carolina | 3.67 | 189 | 9 | 3.67 | 189 | 9 |
| Oklahoma ¹³ | NA | NA | NA | NA | NA | NA |
| Oregon | 14.50 | 250 | 0 | 14.50 | 250 | 0 |
| Rhode Island ¹⁴ | 6.41 | 303 | 5 | 6.44 | 303 | 5 |

See footnotes at end of table.

Continued—

Field Crops and Livestock Rates. Insurance rates for two of the most common types of agricultural employment on a national basis (field crops and farms and cattle or livestock raising) are illustrated in table 9. A number of States that use the NCCI's rates use different subclassifications; those that appeared closest to the national classifications for crops and livestock are shown in the table.

The NCCI cautions that conclusions should not be drawn from rate comparisons between States because many factors, which cannot be measured separately in each State, contribute

to the rate level and an individual firm's rate classification. The factors vary markedly from State to State and firm to firm. The following are among the more important factors considered by the Council:

- The benefit levels required by each State are different, as are payroll limitations for premiums and wage rates (which are reflected in benefit levels).
- Administration of workers' compensation laws among States is different. In addition, attorneys

Table 9—Standard premium basis for field crops, farm and cattle or livestock raising for States where the National Council on Compensation Insurance provides ratings or qualified as an advisory organization, 1979—Continued

| State | Field and farm ¹ | | | Cattle or livestock raising ⁴ | | |
|-------------------------|-------------------------------|-----------------|-----------------------|--|-----------------|-----------------------|
| | Rate per \$100 ^{2,3} | Minimum premium | Policy writing charge | Rate per \$100 ^{2,3} | Minimum premium | Policy writing charge |
| <i>Dollars</i> | | | | | | |
| South Carolina | 4.61 | 264 | 0 | 4.61 | 264 | 0 |
| South Dakota | 3.73 | 262 | 10 | 3.73 | 262 | 10 |
| Tennessee | 5.34 | 357 | 0 | 5.34 | 357 | 0 |
| Texas ¹⁵ | NA | NA | NA | NA | NA | NA |
| Utah | 6.75 | 391 | 10 | 6.75 | 391 | 10 |
| Vermont | 6.49 | 436 | 4 | 6.48 | 436 | 4 |
| Virginia | 6.20 | 418 | 5 | 6.20 | 418 | 5 |
| Wisconsin ¹⁶ | NA | NA | NA | NA | NA | NA |

NA = Not available.

No rate information available for California, Nevada, North Dakota, Ohio, Pennsylvania, Puerto Rico, Virgin Islands, West Virginia, and Wyoming.

¹The full classification is Field Crops and Farm Not Otherwise Classified and Drivers.

²Rate includes disability.

³The official classification is loss construction.

⁴The full classification is Cattle or Livestock Raising Not Otherwise Classified and Drivers.

⁵Field crops and farm classification not available. Rates quoted for specialty crops were \$6.27 per \$100, \$172 minimum premium.

⁶State law prohibits a rating organization from having a rule requiring members to adhere to its filings. Therefore, any member may make other filings.

⁷The National Council on Compensation Insurance has qualified as an advisory organization but not as a rating organization. The rates shown have not been filed with the State Insurance Department.

⁸Field crops and farm, and cattle or livestock raising classifications rates not available. Rates quoted for farm not otherwise classified were \$12.56 per \$100, \$500 minimum premium. Special rules apply to rates for various classifications of farmworkers.

⁹Field crops and farm, and cattle or livestock raising classifications rates not available. Rates quoted for farm and drivers were \$13.20 per \$100, and \$100 special minimum premium. Special rules apply to rates for various classifications of farmworkers.

¹⁰State law allows the National Council on Compensation Insurance to file rates on behalf of members and subscribers. However, manual rates must be filed on an advisory basis.

¹¹Field crops and farm classification not available. Rates quoted for farm not otherwise classified and drivers were \$9.30 per \$100, \$182 minimum premium, and \$6.03 policy writing charge.

¹²Field crops and farm classification, and cattle or livestock raising classification not available. Rates quoted for farm and not otherwise classified were \$9.77 per \$100, \$100 minimum premium, and \$31 policy writing charge.

¹³Field crops and farm classification, and cattle or livestock raising classification not available. Rates quoted for farm—all employees other than servants, including drivers classification—were \$8.06 per \$100, \$302 minimum premium, and \$10 policy writing charge. Special rules apply for private residences, estates, and farms.

¹⁴The National Council on Compensation Insurance has qualified as an advisory organization but not as a rating organization.

¹⁵Field crops and farm, and cattle or livestock raising classification rates not available. Certain general farm classifications were discontinued.

¹⁶Field crops and farm, and cattle or livestock raising classification rates not available. Rates quoted for farm and drivers classification were \$7.25 per \$100, \$269 minimum premium, and \$5 policy writing charge. A special meaning is described for farm broadly defined.

Sources: (1) Classification Code; (2) Workmen's Compensation and Liability Insurance Manual, with inserts available February 1, 1980 (some State data updates latest dates ranged from May 21, 1979 to February 1, 1980) both published by the National Council on Compensation Insurance, One Penn Plaza, New York, N.Y. 10001. States where no information is shown are not rated by the National Council on Compensation Insurance.

in some States are more litigious about workers' compensation cases than in others. This has been particularly true in recent years as questions have evolved about the cause and effect relationship of the workplace to lung diseases, radiation sickness, cancer, and other non-traumatic ailments.

- Substantial differences probably exist among States in the quality of labor, an occupation's tendency to injuries, and the overall level of industrialization.
- Differences exist in intensity and success of safety programs and in the availability of and rates charged by physicians and medical and hospital facilities.
- The large differences in minimum policy premiums among the States increase substantially the effective rate per \$100 of coverage in States with large minimum premiums.

In addition to the general factors that influence rates in a State, certain characteristics separate agricultural employment from other types of employment. There are also differences in agricultural employment by areas of the country and by size of farm or firm. At the national level, agricultural employment has long been one of the most hazardous occupations, given the nature of farm animals, machines, and equipment, the inherent characteristics of certain manufactured chemicals that are increasingly used in crop and livestock production (4), and the general nature of farmwork. Farm firms with a large work force can generally spend more on safety equipment and provide employee training, since such fixed costs would be a smaller proportion of the wage bill. Finally, certain types of agricultural production are more readily adaptable to automation and safety than others—for example, automated cattle feedlots versus open-lot bunk feeding and open-lot care versus range care of cattle and sheep.

Experience Rating. Premiums are generally set on a group basis, but over time an individual firm's history over a 3-year period may be used. The NCCI considers two factors of importance in setting rates for a firm: (1) size of firm in terms of number of employees and their salaries—a schedule of premium discounts is used when an employer's premiums exceed \$1,000—and (2) premium costs (many carriers pay dividends based on good experience).

Effects on Employers. Several coverage requirements and cost situations exist that may determine an employer's methods of operation. Many States have minimum policy premiums, which can add substantially to the premium rate of an employer with a small total hired labor bill. For example, an employer who pays \$1,000 annually for labor, who is required to provide coverage, and who is in a State with a \$500 minimum premium would effectively pay \$50 in insurance premiums for every \$100 of payroll. This, of course, is extremely regressive, adding 50 percent to the basic labor wage rate. If no minimum premium were imposed and the rate were 7 percent, the employer would pay only \$70 for workers' coverage.

Employers who hire few workers may pay high minimum premiums in order to protect themselves from major lawsuits. However, in States with no mandatory coverage or where employers can get mandatory workers' compensation coverage waived, employers may purchase employers' liability insurance, which provides more limited coverage but at a lower cost than workers' compensation.¹² Some employers may be able to reduce the amount of hired labor used to the point where they are not required to provide insurance coverage. They can do that by reducing the size of the operation, doing more work themselves, mechanizing to replace the hired labor, or contracting the work out. Other employers may instead expand the size of their operations to employ more labor. In the above example, the employer could pay up to \$7,143 in hired labor costs to meet the \$500 minimum premium cost at the \$7 rate per \$100 of coverage.

In addition to the minimum premiums, high workers' compensation premiums, when compared with other employee fringe program costs, can encourage farm firms of any size to mechanize to reduce their labor needs. This is particularly the case if the workers' compensation rate for workers using machines and equipment is not substantially higher than that for workers doing hand labor. In situations where the rate increases substantially with mechanization, the rate structure may encourage the farmer not to mechanize or even to reduce the level of mechanization and to increase the number of workers doing the work by hand.

Differences in coverage requirements and costs among States can also influence where a firm will operate or expand, especially firms that operate in more than one State. For example, other variables being the same, an Iowa farm firm paid more for workers' compensation in 1979 than a similar farm in Missouri or Nebraska.¹³ Nebraska's rate per \$100 was over \$3 lower and coverage was voluntary.

The differences in requirements and costs, if undisturbed, may make some difference in the amount of labor used among States to produce the same farm commodity. States with low rates and with rates that do not increase greatly with mechanization will probably have more mechanization and production. Where rates increase greatly with mechanization, any expansion in output will probably be due to a rise in the use of hand labor. Some farmers may try to operate in two States if part of their operation has to be in a high-cost State. They may try to operate and insure their workers in the low-cost State and use their workers in the high-cost State on only a limited basis to avoid the premium cost there. This may no longer be feasible, however, if the courts decide that injured workers are entitled to the benefits of either State, whichever are higher.

¹²Employers' liability insurance, which is written by private companies, generally covers losses up to \$25,000 per incident as contrasted with unlimited liability protection under workers' compensation policies (18). Electing employers' liability coverage in lieu of workers' compensation is permissible only where all employees of an employer are excluded from a workers' compensation law or have elected not to be subject to the law and where there is no law or regulation that makes issuance of such a policy illegal (18, pp. R-2, rule II B 5.b, reference 6).

¹³The minimum premium in Iowa was subsequently lowered in 1980.

Corporations and Partnerships. As with social security and unemployment insurance, self-employed individuals become employees if they form a corporation or general partnership and continue to do agricultural work, as defined in workers' compensation laws. State laws vary greatly on whether corporate officers are required to be covered. In general, officers and directors who are not actively engaged in the business do not have to be covered, but those who are may have to be covered.

Where mandatory coverage is not required, voluntary coverage is generally permitted. In some cases, shifting from a sole proprietorship to a corporation in a State where coverage is required may so increase the firm's number of employees or size of payroll that coverage becomes mandatory. In States where the minimum premium rate is high, forming a corporation and covering the former sole proprietor may actually reduce the average premium per \$100 of coverage.

Linkage to Other Programs. At present, there are no offsets in workers' compensation benefits as exist in unemployment insurance, or disability and survivor benefits coverage under social security. In the future, workers' compensation costs may be reduced through offsets in social security coverage and by health and accident insurance coverage. However, in worker negotiations where minimum levels of compensation are required by State law and coverage is voluntary, the linkage can be important. Workers have an opportunity to balance one type and level of fringe insurance coverage against another. For example, increases in employer contributions to a pension fund may be more desirable to some agricultural employees than workers' compensation coverage where pension fund benefits start immediately upon disability rather than at normal retirement age.

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Life Insurance

Life insurance coverage is not required in most farm businesses by State or Federal law but is often included as a fringe benefit for employees and by sole proprietors to provide family protection. Life insurance policies are usually either ordinary life policies, which cover an individual for the remainder of his or her life, or term policies, which cover a person for a specific number of years. Life insurance policies may vary greatly: They can provide savings features with cash surrender values; they can be paid up at age 65; and they can provide decreasing amounts of coverage over time with level premiums throughout the life of the policy. In addition to providing immediate cash for an estate, such as loan (credit) protection and funding for children's education, many other farm business and family uses have evolved.

Payment of premiums takes cash away from the farm business. The emphasis in this report is on those coverages and uses that are most directly related to the farm business and on incentives for employees and their employers to include coverage as a condition of employment. Key person and term life coverage for employees are discussed, since Federal tax law provides incentives for their use in specific circumstances. There are no direct Federal income tax cost reductions from premiums paid by sole proprietors for policies on their own and family members' lives. Their heirs, however, can receive estate benefits if they owned the policy, that is, if the insured's estate does not receive the proceeds of the policy and cannot change the beneficiaries. In such cases, heirs can receive the proceeds free of estate taxes.

Key Person Coverage

Key person coverage (until recently called keyman insurance) is used primarily to provide immediate cash to continue the farm business in the event that a key person dies upon whom the business had been heavily dependent for survival or for attaining business objectives. Key person coverage may also be used by a farm business to provide the surviving spouse or other heirs with immediate income or an annuity so that survivors are not forced to sell the farm business. A surviving partner or stockholders may likewise carry the coverage (be named beneficiary) so that they have sufficient money to buy out a surviving spouse or other heirs of the deceased partner or stockholders.

The premiums for key person coverage may be tax deductible provided that they meet the rather rigid guidelines imposed by the Internal Revenue Service: (1) the premium must be an ordinary and necessary business expense in the nature of additional compensation to the employee; (2) the total amount of all compensation, including insurance premiums, paid to the key person should not be unreasonable; and (3) the policy does not directly state that the business is the beneficiary.

Where the three guidelines are met, the farm business can deduct the cost of the premiums but they are considered taxable income for the key person. If a spouse (or other heir) is the beneficiary, the policy proceeds are excluded from Federal taxes and need not be included in the probate of the estate.

Premiums are not tax deductible to the farm business if the farm business names itself as the beneficiary or is assigned the right to surrender the policy or to exercise any and all options, rights, and privileges without the consent of the insured. However, the premiums paid are not considered taxable income to the person whose life is insured nor are the proceeds included in his or her estate.

The Internal Revenue Service regulations also specifically address partnership situations. Premiums are not tax deductible if a key partner takes out a life insurance policy on himself (herself), pays the premium, and names other partners as the beneficiaries. Such a situation might arise in an effort to induce the other partners to retain their investments in the farm business. A similar situation exists where each partner takes out a life insurance policy in favor of the other partners. In this situation, the premiums are not tax deductible, regardless of whether the partnership pays the premiums or whether each partner pays his or her own premiums. If the partners retain no ownership in the policies on themselves, the insurance proceeds are not included in their estates.

Tax-Deductible Group Term

Group term life insurance is sometimes referred to as a "perfect" fringe benefit. While most commonly used by incorporated businesses, it can also be used by sole proprietorships and partnerships. The Internal Revenue Code permits the employer to deduct the premium costs as a business expense for qualified plans that provide up to \$50,000 of term coverage for each employee. The premium payment is not considered as taxable income to the employee and the policies can usually be set up so that the proceeds are not subject to inheritance and estate taxes.

Certain criteria must be followed to qualify for the favorable income tax treatment. The coverage may be provided under a master policy or a group of individual policies. The policies must be life insurance contracts, form part of a plan of group insurance arranged by an employer for employees, and be for a fixed period of time.

An employer may be able to restrict coverage to certain employees. To restrict coverage, there must be a bona fide group, class, or classes of employees such as executives, other upper echelon employees, or tractor drivers. Coverage cannot be limited to stockholder employees and covered employees cannot be selected individually. The group(s) can be designated on criteria such as officers, kind of work, salary, position, or years of service. In addition, most States require that the group consist of at least 10 full-time employees and that all be covered.

Some life insurance companies offer plans for firms with fewer than 10 employees. The Internal Revenue Service may approve a group plan covering fewer than 10 employees if the amount of insurance for employees is computed either as a uniform percentage of salary, or on the basis of coverage brackets under which no bracket exceeds 2½ times the next lower bracket and the lowest bracket is at least 10 percent of the highest bracket. If evidence of insurability beyond a medical questionnaire is involved, the plan may not be approved by the IRS.

If a policy includes more than group term life insurance such as permanent insurance, a paid-up value, a cash surrender value, or an equivalent benefit, the policy must specify the portion of the premium that is allocated to the group term life insurance and must provide that no part of the term policy premium paid by the employer is used for permanent policies. If the employer's payment includes part of the premium not allocated by the policy to the group term life insurance and exceeds the amount properly allocable to group term life insurance, the entire premium payment is included in the employee's gross income for tax purposes. If the employer's payment does not exceed the amount allocated by the policy to group term life insurance, but does exceed the portion allocable to group term insurance, only the excess is included in the employee's gross income.

In either case, the premium payment made by the employer is tax deductible if the employer either directly or indirectly is not the beneficiary of the policy. If the amount of term coverage does not exceed \$50,000, the employer's payment is not taxable income to the employee. Likewise, employees need not include employer's premium payments in their gross income when the sole beneficiary is a charitable organization, even though such premiums are not deemed to be charitable deductions for either the employee or employer.

If an employee wants more than \$50,000 of term life insurance, there are tax incentives for the employee to have the employer make the coverage available through the group term program. The employee is taxed on the cost of insurance coverage in excess of \$50,000. For this purpose, the aftertax "cost" of the insurance can be figured from the data in table 10.

Table 10 shows that costs are substantially below the actual group term insurance costs paid by the employer. In the case of a 40-year old, the rate is \$2.76 per \$1,000 of protection while the employer would probably pay approximately \$4 per \$1,000. Where the employer pays for \$150,000 of group term coverage, he or she is able to deduct the estimated full \$600 of premium cost (\$150,000 x \$4 per \$1,000), while the employee need report only \$276 as income (\$100,000 of extra coverage x \$2.76 per \$1,000). Depending on the Federal income tax brackets of the employer and employee, a net tax savings can be achieved. In addition, the employer is generally able to get a better rate per \$1,000 of coverage through a group program than the employee could obtain by purchasing an individual term life insurance policy plan offered by a fraternal or professional group that the employee associates with.

If an employee has more than one employer, each employer may provide up to \$50,000 of group term insurance for the employee and the employee need not include any of the employers' contributions in his or her taxable income so long as no employer provides more than \$50,000 of group term coverage.

Federal Tax Incentives

Life insurance premiums are tax deductible for the employer in two situations:

- Group term life insurance where the premiums are deductible to the employer and are not considered as taxable income to the employee.
- Other situations, where the premiums are deductible to the employer but constitute taxable income to the employee.

In the latter situation, the net tax benefit is greatest when the employer is in a high Federal income tax bracket and the employee is in a low bracket even with the premium considered as income. For instance, assume that the employer (a farm corporation) is in the 46-percent bracket, the employee (the farm operator) is in the 16-percent bracket, and the annual premium is \$500. The employer reduces its Federal tax cost by \$230 while the employee pays an additional \$80 in taxes for a net tax savings of \$150, which translates into a net policy cost of \$350. If the employer is in the 17-percent bracket and the employee is in the 32-percent bracket, the employer will save \$85 in tax costs while the employee will pay an additional \$160 in taxes from having the employer pay the premium. In that case, the net cost of the policy is \$575.

Linkage to Other Programs

Since life insurance is not a required fringe benefit unless it is required in an employment contract, its linkage to other fringe benefits largely rests with employees' choosing it as a high-priority fringe in their bargaining with employers. Since premium costs may provide Federal income tax benefits to the employer, life insurance may be as important to employees as retirement programs, if not more so. In some cases, policies with cash value may provide retirement program funding as well as insurance during an employee's working years. Certain policies also permit the purchase of a disability rider, which pays off the policy if the employee is no longer able to work. Policies with such riders may help to reduce employee demands for high workers' compensation benefits.

Table 10—Insurance cost per \$1,000 of protection

| Age | Cost per month | Annual Cost |
|---|----------------|-------------|
| <i>Dollars</i> | | |
| Under 30 | 0.08 | 0.96 |
| 30 through 34 | .10 | 1.00 |
| 35 through 39 | .14 | 1.68 |
| 40 through 44 | .23 | 2.76 |
| 45 through 49 | .40 | 4.80 |
| 50 through 54 | .68 | 8.16 |
| 55 through 59 | 1.10 | 13.20 |
| 60 and over and employment not terminated | 1.63 | 19.56 |

Source: U.S. Dept. of the Treasury, Internal Revenue Service Publication 17 (Rev. November 1980).

Medical and Hospitalization Insurance

Health and accident insurance, while not required by Federal or State laws, has become a necessity in many farm businesses since medical and hospital costs are among the most rapidly increasing items in the Consumer Price Index. Since agricultural production is among the most hazardous types of employment, more farm businesses have been purchasing coverage in recent years. This is particularly the case where workers' compensation coverage is not required or voluntarily taken and where self-employed farmers and farm employees want protection against accidents and illness unrelated to their jobs.

Many private insurance companies provide various types of individual and group medical, hospital, and nursing home coverage. Some policies provide all coverages with small annual deductions and very high lifetime maximums, while other policies cover only one expense such as a limit on daily hospitalization costs. Most carriers provide policies that cover only the employee or the employee and family members. Large farm firms are able to obtain group policies designed by private companies and agents for their specific farm situations.

Individual Coverage

Private insurance companies write individual medical and hospitalization policies for farmers and their families as well as group policies that individual farmers can obtain through farm organizations, their church, and other groups. The group policies should cost less since administrative and sales overhead costs are lower for insurance companies and agents.

Older farmers, age 65 and over, are generally able to obtain Federal medicare coverage, which is administered by the Social Security Administration. Medicare is limited in covering expenses of major prolonged illness and usually needs to be supplemented by other coverages. Some farmers are able to carry over existing medical and hospital policies into their retirement as supplements to medicare and more are likely to purchase policies in their younger years that have carryover provisions. A few special medicare supplemental policies are available for retirees who do not have policies that carry them past age 65.

Individual policies are generally paid for by the individual farmer, whether as a sole proprietor or as an employee of a farm corporation or farm partnership that does not provide coverage for its employees. In these cases, half of the premium, up to a maximum of \$150, is tax deductible for the individual. The balance of premium cost is added to other medical expenses, which are tax deductible only to the extent that they exceed 3 percent of adjusted gross income. Premiums are not tax deductible for hospitalization policies that guarantee a specified dollar amount each week for a specified number of weeks while hospitalized. Farmers who selected coverage under part B of the Federal medicare program were able to deduct \$8.70 per month for Federal income tax purposes from June through December of 1979.

The deductible amount is adjusted as the coverage cost changes, every 6 or 12 months, for example. Coverage costs for the basic medicare (part A) are deductible if the farmer voluntarily pays for the coverage and is not eligible for social security benefits. The premiums, however, are not deductible if they are paid as part of the social security tax.

Group Coverage

A farm business employing several people may be able to establish its own group plans. Such plans can cost as little as or less than conventional group plans, and they offer some tax advantages that are not available to the sole proprietor or the farmworker whose employer does not provide group coverage. The farm business is able to deduct the cost of the group coverage from Federal taxable income and the premiums paid are not taxable income to the employee.

Certain rules must be followed, however, for the employer to be eligible for the tax deduction. The rules in effect in 1980 were written to prevent discrimination in favor of the five highest paid officers, shareholders owning more than 10 percent of the company stock or those among the highest paid 25 percent of employees. Thus, a plan must benefit at least 70 percent of all employees or at least 80 percent of all employees eligible to participate in the plan. Employees who have not completed 3 years of service, who are under age 25, who are part-time and seasonal employees, who are covered by a labor union medical plan, or who are nonresident aliens need not be included for compliance with the discrimination rules. Plans that discriminate require that highly compensated employees include part of the premium as personal income. When the highly compensated individual receives a reimbursement not available to other employees, the full amount is taxable income.

In cases where the employee is eligible for medicare coverage, the premium payment is not taxable income to the employee if the farm business pays the premium. However, if the employee, upon retirement, elects to receive a lump sum payment rather than to continue coverage under the employer's group medical plan, the employee must include the lump sum payment as taxable income for that year.

Tax Deductibility

A Federal income tax advantage exists where the farm business can buy group medical and hospitalization coverage and stay within the antidiscrimination guidelines. Where this is done, the employee receives coverage and does not have to report the premium cost as income and the employer can deduct the cost of the insurance against other taxable income.

The tax system also provides some, if limited, incentive for individuals to purchase basic medical and hospitalization coverage since individuals can deduct half of the premiums (up to \$150) from other taxable income. The remainder can be included with other medical expenses and deducted if the total exceeds 3 percent of adjusted gross income.

The relative financial importance of the use of a group policy depends on policy provisions, cost, the cost of comparable individual coverage, and the tax brackets of the employee and employer. For instance, assuming that a farmer can purchase a family policy for \$600 and is in the 32-percent tax bracket, a savings of \$48 is realized (32 percent of \$150). But if the farmer is an employee of a farm corporation or other farm business, and if the business is in the 46-percent tax bracket and can purchase the same coverage for the farmer for \$500, the net savings is \$230. Thus, the employer's net cost of the policy is \$270, while the employee's cost is \$552. Savings are less in the lower tax brackets: for example, an employer in the 17-percent tax bracket would have a net cost of \$425 and an employee in the 14-percent tax bracket would have a net cost of \$579.

Linkage to Other Programs

Health insurance, while not a required fringe program, nonetheless is becoming an increasingly important farm business expenditure. Employees and self-employed farmers place such insurance high on the list of fringe benefits required in their total wage and fringe bargaining with employers. Many accidents and illnesses occur other than at the workplace or in vehicles, such as heart attack, stroke, and gallstones, which are not generally associated with the workplace coverage and are not covered by workers' compensation insurance.

Health insurance is most directly linked to disability benefits and medicare coverage for those 65 and older under social security and workers' compensation. Many illnesses and associated expenses may not be covered by the other programs so that health insurance is essential for the financial protection of workers and their families. Medicare protection is very limited for prolonged illnesses and workers' compensation covers only accidents or diseases arising out of and in the course of employment in the workplace.

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Retirement Programs

Three major tax-shelter retirement programs are covered in this section: Individual Retirement Accounts (IRA's), Self-Employed HR-10 (Keogh) Plans, and corporate programs.¹⁴ Variations on the programs are also covered. Where a farmer can arrange business affairs to participate in the programs, and especially in the recently broadened programs, substantial sums of money can be sheltered. Each program has specific characteristics that make it uniquely applicable to certain types and sizes of farm firms. Each program contains a number of specific requirements. Keoghs were created for self-employed persons, and IRA's for individuals whose employers do not provide retirement programs, and corporate programs for employees of businesses that are incorporated. The Economic Recovery Tax Act of 1981 removed that restriction for IRA's making them available to all wage earners.

In recent years, certain provisions of the IRA and Keogh programs have been broadened so that employees can (and in some cases must) be covered. Consequently, the earlier distinctions between individual and corporate programs are no longer so clear cut.

Each program was designed to provide retirement income, in some cases as a major source and in others as a supplement to social security. However, the Federal income tax features that permit current deductions for contributions to the programs may override the uncertain purchasing power of the funds at time of retirement. This in part has resulted from rising incomes, and consequently the rise in income taxes, of some farmers.

However, not all such farmers are interested in retirement programs or making the maximum tax-sheltered contributions, for to do so in some cases will mean that they will have to include employees in their programs, thereby raising their farm labor costs, the costs of their own retirement programs, or both.

Some farmers can also shelter their income from income taxes more effectively by investing their funds in their farm businesses where they have more control. For other farmers whose taxable incomes are low, retirement fund investing may not be economically justified, especially where funds are needed in the farm business.

Even if a retirement program is set up, farmers need not contribute the maximum permitted amount each year to most programs or contribute anything every year. Criteria permitting the tax sheltering of income must be met each year. Income earned on funds in a sheltered program continues to be free of taxes as long as the rules are followed.

Income Tax Savings from Retirement Program Contributions

The tax benefits available from contributing to retirement programs are usually small at the start of the program, but increase over time as the tax-free earnings from additional contributions accumulate. One can earn substantially more with an IRA, because of its tax deferral features, over a number of years than with a conventional investment, as the following two situations show.

Situation A. The taxpayer is in the 40-percent tax bracket and has \$1,500 before taxes to invest. The Federal income tax takes \$600, leaving \$900 to put in a tax-sheltered annuity program (the accumulated earnings are not taxed annually). Thus, over a 15-year period the taxpayer has placed \$13,500 in the annuity. At a compound interest rate of 8 percent, it is worth about \$19,000 at the end of 15 years.

Situation B. The same taxpayer (40-percent tax bracket, \$1,500 before taxes to invest) invests it all in an IRA. No Federal taxes are due on the \$1,500. Future annual contributions and accumulated earnings are not taxed annually. Thus, over a 15-year period, the taxpayer has placed \$22,500 in the IRA. At a compound interest rate of 8 percent, the IRA account is worth about \$40,000 at the end of 15 years.

Thus the taxpayer in Situation B has an account that will have accumulated about twice as much equity at the end of 15 years as that accumulated by the taxpayer in Situation A. When funds are withdrawn, the shelter planholder will presumably be in a lower income tax bracket. While the annual tax benefits may be quite small, they may be worthwhile to farm people who are unable to find aftertax investments in their farm businesses or other nonfarm investments that can do better than the shelter.

The potential tax savings and consequent net equity accumulation are much greater for the other programs. A Keogh program can shelter up to \$15,000 annually and a defined benefit program can, in some cases, shelter much more. Those programs are discussed later.

Standard Individual Retirement Accounts

Individual Retirement Accounts (IRA's) generally permit the smallest tax shelters among the three major types of retirement programs and offer the most limited retirement benefits. An IRA is a savings program with Federal income tax advantages, and as such is a trust or custodial account created or organized in the United States for the exclusive benefit of an individual or designated beneficiaries. The standard IRA is discussed here, while the more complex SEP-IRA (Simplified Employee Pension plan) is discussed in the section of this report dealing with corporate retirement plans.

Types of Plans. An IRA must be created in writing. IRA's may be purchased from or set up through several sources such as a bank, credit union, savings and loan association, life insurance company, stock brokerage firm, employer (or employee) association that establishes an Individual Retirement Trust Account, and the like.

¹⁴Many other types of retirement programs, not usually available to farmers, are not covered here.

IRA's

Individual Retirement Accounts can be opened by any wage earner, whether self-employed or not. By opening an IRA, one can shelter from Federal taxes up to 100 percent of compensation up to a maximum of \$2,000 per year (\$2,250 if an unemployed spouse is also included in the IRA). If both spouses are employed, each can open an IRA and contribute up to \$2,000 per year to it. Earnings on the IRA funds are also free of annual taxation. The contributions plus the accumulated earnings are withdrawn upon retirement and are fully subject to taxation then as ordinary income. While the annual permitted tax-free shelter is small, the compounded earnings can, over a long period of time, provide a sizable retirement fund.

Plan Eligibility Requirements. Any person with earned income in a tax year can establish an IRA. While small in annual shelter dollars, an IRA can be used at least as a marginal incentive to attract and keep full- and part-time help. Farm operators and farm laborers can set up their own IRA's; farm operators can also set up an IRA for their farm employees. Many farm operators and laborers with off-farm employment may also set up an IRA from that income.

Participation in other retirement plans is permissible without jeopardizing one's eligibility for an IRA. Retired individuals who are receiving benefits from social security, Railroad Retirement, Civil Service Retirement, or any other type of retirement plan may also establish an IRA.

Corporations and Partnerships. An IRA can be set up by an owner-employee of a closely held corporation (25 or fewer shareholders). Presumably, personal services income from a partnership qualifies for an IRA. Partnership income derived solely from investments in a partnership apparently does not qualify for tax-deductible contributions to an IRA.

Maximum Tax Deductions and Additional Contributions.

Once an IRA is set up, annual contributions need not be made. The maximum annual tax-deductible contribution permitted for an approved IRA is 100 percent of compensation or farm profit up to \$2,000. A married taxpayer with an unemployed spouse, however, as an alternative, can deduct up to \$2,250 for contributions made to separate IRA's for each or to a single IRA with separate sub-accounts. If a husband and wife are both employed, each can start an IRA and contribute up to \$2,000 annually (\$4,000 total). The filing of joint or separate income tax returns has no bearing on the maximum amount that can be sheltered from taxes. No deduction is allowed for contributions made during or after the tax year that the taxpayer becomes age 70½.

To qualify for the unemployed spouse deduction, the spouse cannot have any compensation during the taxable year

ending with or within the taxpayer's taxable year.¹⁵ This includes compensation otherwise exempt from taxes as foreign source earned income. Community property laws are not taken into account, that is, one spouse is not considered to have compensation just because the other does and they live in a community property jurisdiction.

Payments made by one spouse for another into an IRA after December 31, 1976, are not considered gifts of a future interest in property. Thus, such payment is allowable as a deduction for income tax purposes under provisions for IRA's for noncompensated spouses. Therefore, the amount of the contribution for the benefit of a spouse may be treated as part of the permitted \$3,000 annual gift exclusion to a spouse.

Where a trust account is established by an employer or employee association, contributions are included in the employees' gross income and are subject to income tax and the Federal Unemployment Act. Earnings from the contributions over the years, however, are not annually taxable to the employee until he or she withdraws the funds.

Holders of an IRA can contribute more than the allowable deductible limit, but such contributions are not tax deductible and a 6-percent tax is imposed on them. When the excess is withdrawn, it is included in the taxpayer's income even though no tax benefits were received when the contribution was made. However, if the excess plus the income earned on it are withdrawn by the due date of the Federal income tax return, the 6-percent penalty does not apply.

Distributions. Provisions for withdrawal of funds during retirement may make a difference in how long and with what degree of intensity an older self-employed farm operator continues to operate the farm. The provisions may also make a difference in the availability of older farmworkers for further farmwork and in the wages they require.

When funds are withdrawn at retirement, they are considered ordinary income and are fully taxable at regular rates, but any funds not withdrawn may not be subject to an estate tax on payment to a beneficiary unless the beneficiary takes a lump sum payout and does not waive special income tax provisions.

Contributions must be kept in an IRA until an employee or self-employed taxpayer attains age 59½, becomes disabled,

¹⁵Compensation is wages, salaries, or professional fees and other amounts received for personal services actually rendered including, but not limited to, commissions, tips, and bonuses. Compensation also includes earned income from self-employment, but only with respect to a trade or business in which the personal services of the individual creating the program are a material income-producing factor. A partner's distributive share of partnership income for services actually rendered is considered compensation for IRA purposes. Unearned income such as interest, rents, and dividends does not qualify. Income not included in gross taxable income, such as earned income from outside the United States, is not treated as compensation in determining the maximum limitation for the IRA deduction. Compensation for purposes of a spouse's eligibility for a noncompensated spouse plan includes income from sources outside the United States.

dies, or separates from service of an employer (not applicable to an owner-employee or self-employed individual).

Funds cannot be left in an IRA indefinitely. Partial or complete distribution must begin in the year that an individual reaches age 70½. The penalty for failing to accept distribution is a nondeductible excise tax of 50 percent of the underdistribution called for by the plan. The penalty may be waived by the Internal Revenue Service if the IRA holder can demonstrate a "reasonable cause" for not making the required distributions.

Funds in an IRA at the death of the owner are not included in an estate if they are paid out under an annuity contract or if arrangements were made that provide for a series of substantially equal periodic payments to a beneficiary, other than an executor, for his or her life or for a period extending for at least 36 months after death. However, if the balance is withdrawn as a lump sum payment, there is no avoidance of estate taxes.

The penalty for premature distributions is stiff. The amount of the distribution is taxed as ordinary income and is added on top of taxable income the taxpayer may have. In addition, a 10-percent penalty is assessed on the amount withdrawn.

Loan Collateral. Self-employed farmers and employees may need to use their IRA's for loan security or to borrow from the accounts. Such transactions incur Federal income tax penalties. If money is borrowed from an IRA or if an IRA is used as security for a loan, the IRA ceases to be an IRA as of the first day of the tax year that it is so used. The IRA owner must include in gross income for that year the fair market value of the IRA. If a portion of an IRA is used as security for a loan, that portion is treated as a distribution to the taxpayer and taxed as ordinary income along with a 10-percent penalty on the amount of the distribution.

Standard Self-Employed HR-10 or Keogh Plans

In 1962, Congress recognized that self-employed people, including farmers, needed to be able to shelter income from current taxes for retirement purposes. House of Representatives Bill No. 10, whose primary sponsor was Representative Keogh, was the first tax shelter legislation for the self-employed.

Types of Plans. A self-employed Keogh plan, like a standard IRA, is primarily a savings program with wide options on how the funds are invested. Since a plan has Federal income tax advantages, it is a trust or custodial account created or organized in the United States for the exclusive benefit of an individual or group of individuals or their beneficiaries. A Keogh plan must be in writing. A Keogh plan may be set up by a custodial account administered through, for example, a bank, federally insured credit union, industrial loan company, or savings and loan association. A qualified annuity plan may purchase an annuity contract that provides incidental life insurance coverage for the participants. Face-amount certificates, which are treated as annuity contracts, may be purchased by the employer directly from an issuing company

or by a trust or custodial account. A plan may also be funded by U.S. Retirement Plan Bonds. In addition, a trust may be established to administer the funds. A trust agreement may permit others, including an owner-employee, to direct investments of the trust.

Plan Eligibility Requirements. Standard Keogh plans are designed to provide tax shelter retirement income for individuals who have net earnings from self-employment. Such individuals may set up a Keogh plan even if they are covered by an employer pension or profit-sharing plan. Thus, unincorporated self-employed farmers may set up a plan, as may farmers who have off-farm jobs at which they are covered by their employers' plans. The law specifies that if self-employed individuals establish plans for themselves, their employees must also be enrolled in the plans.

A self-employed individual is defined as a person who has earned income in any tax year or would have had earned income if there had been profits. Earned income is defined as net earnings from self-employment, but only from a trade or business in which the personal services of the individual are a material income-producing factor. Services performed by a tenant sharecropper for a farmowner constitute a trade and income from such services is eligible for a Keogh plan. Directors of corporations are considered independent business executives, and their directors' fees are considered net earnings and are eligible for a Keogh plan.

Keogh regulations exclude holders of public office, newspaper carriers, and services performed as employees. Interest income derived from the investment of capital is not eligible for a Keogh plan.

Net self-employment income is defined as gross income less all allowable deductions, which includes contributions made to a retirement plan for "common law" employees in a trade or business. A common law employee is any individual who, under common law, would have the status of an employee. A common law employee for purposes of Keogh plans excludes any self-employed individuals.

Keoghs

Standard Keogh-type retirement programs have been developed for self-employed individuals. Such individuals can annually tax shelter up to 15 percent of their *net* taxable income up to a maximum contribution of \$15,000. Future earnings on the funds left in a program are also free of annual taxation. Annual contributions plus accumulated earnings are withdrawn upon retirement, when the individual is supposedly in a lower tax bracket. Should funds be withdrawn before retirement age, they are subject to taxation as ordinary income plus an additional penalty. A self-employed individual who has employees must also include them under certain situations when the individual sets up a Keogh retirement program.

The definition of employment differs between social security and Keogh regulations. A spouse is not necessarily an employee for social security purposes even if he or she is an employee for Keogh purposes. Thus, a spouse can be put on a payroll as an employee, paid a salary for services, and be covered as a common law employee. Fifteen percent of the spouse's salary can be contributed to the plan and deducted for tax purposes even though the combined contribution exceeds the maximum permitted contribution discussed later.

Employee Requirements. A plan that includes self-employed individuals must provide benefits for employees on a non-discriminatory basis. When a plan includes self-employed individuals, none of whom are owner-employees, the applicable qualification requirements of corporate employee plans, discussed later, apply. The more important features for both the Keoghs and the corporate plans are that the plan must be funded and provide for the benefit of employees or their beneficiaries. In addition, the plan must benefit a stipulated percentage of employees or, as an alternative, the employer may establish a category of employees that does not discriminate in favor of highly paid employees. A plan including self-employed individuals does not qualify if the compensation of the employee is reduced at or about the time the plan is adopted. If a plan includes an owner-employee, it must meet the requirements for an employee program plus additional requirements that apply exclusively to plans that include owner-employees.

A plan must benefit each employee having 3 or more years of service, with a year of service meaning a 12-month period during which the employee has worked for at least 1,000 hours. If an employee incurs a 1-year break in service prior to completing the eligibility requirements of the plan, the plan may disregard whatever service was completed prior to the break in service. (A 1-year break in service is a 12-month period in which an employee works for fewer than 500 hours. Thus, a sole proprietor farmer needs to consider not only the tax benefits to be derived from setting up a Keogh plan but the added aftertax cost of having to include employees).

Certain employees may be excluded from coverage under a Keogh plan. For instance, nonresident alien employees who do not have earned income from a U.S. source need not be covered. Likewise, employees who are included in a unit covered by a collective bargaining agreement need not be covered if the retirement benefits were excluded from the agreement made between employee representatives and the employer.

Corporations and Partnerships. A Keogh plan can also be set up by an owner-employee of a closely held corporation (25 or fewer shareholders). The setting up and use of a closely held corporation may allow an individual owner to contribute a greater percentage of earnings than under a sole proprietorship. Likewise, Keogh provisions may be used for a retirement program in a regularly taxed (subchapter C) corporation. More specific details are in the section on corporate programs.

Contributions to a Keogh plan based on partnership income can be made only if personal services are performed. Individuals who derive their partnership income solely from investments are not eligible to set up or contribute to a Keogh plan. IRS regulations place an individual in a partnership as a partner if he or she owns more than 10 percent of either the capital interest or profit interest. If a Keogh plan is established by the partnership, the partnership is considered the employer of the partners, and an individual partner cannot establish a separate plan for himself or herself alone. Each owner-employee of a partnership can decide whether or not to be covered under the partnership plan.

Maximum Tax Deductions and Additional Contributions. Once a Keogh plan is set up, contributions need not be made each year, even though most planholders will probably want to contribute to it each year. The meaning of earned income for low-income individuals was expanded: Individuals whose adjusted gross income from all sources (interest, dividends, salary, self-employment income, etc.) is \$15,000 or less may contribute to a Keogh plan the lesser of \$750 or 100 percent of self-employed income.

The maximum deductible contribution that can be made annually to a Keogh plan is 15 percent (up to \$15,000) of net earnings from self-employment. In addition to tax deductible contributions, a limited amount of voluntary non-deductible contributions can be made to a Keogh. The owner-employee of a Keogh plan can make voluntary contributions of up to 10 percent (up to \$2,500) of earned income. Such contributions can be made only if there is at least one non-owner-employee covered in the year in which the voluntary contributions is made by the owner-employee. The added contribution is not currently tax deductible but all earnings on it are, and if earnings are paid out as part of a lump-sum payout, they qualify for 10-year special averaging (discussed later).

Distributions. At age 70½, a Keogh owner has to make a decision to distribute the entire amount accrued, or start taking payments over a longer period. When funds are withdrawn upon retirement, they are viewed as earned or personal services income and subject to the maximum income tax of 50 percent. Upon death, any unpaid balance in the account is generally not subject to an estate tax on payment to a beneficiary unless the beneficiary takes a lump sum payout and does not waive special payout income tax provisions.

As an alternative to an annual payout, the entire amount may be withdrawn if the owner-employee dies, becomes disabled, or reaches 59½ years of age. If the entire fund assets are withdrawn and the sum is less than \$40,000, an income exemption is granted on 50 percent of the lump sum amount if it is \$20,000 or less. If the lump sum is over \$20,000, the tax exemption is reduced by 20 percent of the excess over \$20,000. This eliminates all exemptions if the lump sum is over \$70,000. For example, if the lump sum is \$50,000 the exemption is 50 percent of \$20,000 (= \$10,000) less 20 percent of \$30,000 (= \$6,000). The total amount

exempted therefore is \$4,000 (\$10,000-\$6,000), leaving a balance of \$46,000 (\$50,000-\$4,000) to be taxed as follows.

The taxable portion of the lump sum payment is not taxed at regular rates, and bears no relationship to marital status, number of dependents, other taxable income, or deductions. The tax is called a special 10-year averaging tax. It is arrived at by calculating the tax as though the individual were single with a taxable income equal to 10 percent of the lump sum payment. The tax is then multiplied by 10. In the foregoing example, the taxable portion of the \$50,000 lump sum payment is \$46,000. The tax on \$4,600 (10 percent of the payment) for a single person is \$816; multiplying that by 10 equals a total tax of \$8,160 on the entire \$50,000 lump sum withdrawal.

A distribution to an owner-employee is not considered a lump sum distribution until he (she) has been a participant in a plan for at least 5 taxable years before the year of distribution. A distribution on account of death qualifies without regard to the 5-year rule.

Premature Distributions. If a planholder withdraws funds from the plan before it matures, the distribution is added to the individual's gross taxable income and a penalty of 10 percent of the distribution is imposed. In addition, no contribution can be made to the plan for 5 tax years after the premature distribution. A planholder may withdraw voluntary contributions from a plan without the 10-percent penalty.

Distribution to Employees. Where employees are involved, a plan must provide that an employee will receive benefits no later than the 60th day after the close of the tax year in which the latest of the following occur: termination of employment, attainment of normal retirement age, attainment of age 70½ in the case of an owner-employee, or the later of age 70½ or termination of employment in the case of any other employee. A qualified plan that includes owner-employees must contain an affirmative restriction against premature distributions.

Loan Collateral. Some self-employed farmers and employees may want to use their equity in Keogh plans for loan security or to borrow from the accounts. Such transactions are prohibited or if made are considered as a premature distribution. The assets in the fund are then taxed the same as a premature distribution.

Corporate Retirement Programs

Regulations dealing with corporate retirement plans are among the most complex sections of the Internal Revenue Code. The complexity of the rules has spawned a consulting industry on actuarial and employee benefits. Fiduciary standards, types of investment permitted, layoffs, disability, and similar conditions are similar to those for individual programs discussed earlier and are not covered again here.

Corporate Programs' Background

Company pension programs were begun in this country soon after companies started hiring large numbers of employees, long before the development of the individual retirement programs. In more recent decades, the company programs have taken on more formal status as the corporate form of legal business organization has become more extensive. Tax shelter incentives have also become more important to employees, and unions have frequently been able to bargain for substantial employee retirement benefits.

Many irregularities developed around company pension programs. Exclusion of employees, lack of funding, and unduly long periods for vesting of benefits (that is, when the employees become assured of benefits upon separation or retirement) were among the important issues. Congress held extensive hearings on such topics and passed in 1974 a major reform, the Employee Retirement Income Security Act (ERISA). The act provides protection of the interests of participants in employee benefit programs and is considered benchmark legislation on which many of the current provisions for both corporate and individual programs rest. Frequent but less major legislative changes have since been made.

Employees and their beneficiaries under corporate retirement programs are not taxed on employer contributions, accumulated earnings, or capital appreciation until distributions are made. This is the case regardless of whether employee rights to program benefits are forfeitable or nonforfeitable. Most of the tax benefits that can be obtained by corporations and their employees can also be obtained by sole proprietorships, partnerships, and their employees. There are, however, some unique corporate provisions. Corporations, for instance, have employee-employer status and boards of directors and officers that may be covered by retirement programs. Shares of stock can be used in tax-sheltered retirement programs or as profit-sharing and bonus incentives. Also, tax-sheltered contributions can be as much as 25 percent of compensation under profit-sharing programs, whereas 15 percent is the maximum permitted under Keoghs (and much less under IRA's). Consequently, the maximum dollar amount that can be sheltered from taxes each year under corporate programs is greater. Owners of closely held corporations can set up more than one corporation for retirement purposes. Contributions to employee retirement programs may be avoided or reduced for certain employees. In some cases, corporations can use some retirement funds for other uses if the funds are not fully vested in employees.

Even though the number of farm businesses operating as corporations nearly doubled between 1974 and 1978, farm corporations still account for only about 2 percent of all

U.S. farms. Fewer than 10 percent of the farm corporations have more than 10 shareholders; that is, most are closely held family operations. Such incorporated farmers may not be in high income tax brackets and may not be interested in using retirement programs as tax shelters for large amounts of money. They may also want to concentrate their sheltered contributions for parents who will gradually phase out of the business. A corporation can provide a retirement program to support parents, who may then not have to depend on income from the farm corporation. In some cases, use of a corporate form of business organization permits the owner to set his (her) compensation level higher than the level of taxable income that is used as a basis for tax sheltering under a sole proprietorship.

The large agricultural corporations with many employees are, for the most part, involved in land intensive activities: cattle feeding, broilers and eggs, fruits and vegetables. Some corporations use large amounts of seasonal help and may have frequent turnover of employees other than supervisors, management, and ownership personnel. The interest in tax-sheltered retirement programs for such firms probably rests with owner-employers, directors, and full-time permanent personnel.

Retirement programs are generally grouped in two major types: defined benefit and defined contribution programs. Such programs can also be used by the more complex IRA and Keogh programs described in later sections. Some additional details about these programs are provided in those sections.

Defined benefit program provisions most closely follow those of programs formerly called fixed-benefit pension programs. An employer makes a fixed annual contribution (payments) to a retirement program and the retirement outcome is fairly reliable or fixed in amount. The amount of the employer's contribution is negotiable. The maximum tax-deductible contribution permitted in 1980 was that which was necessary to provide a retirement income not to exceed 100 percent of the highest 3-year average compensation of an employee, computed under a straight interest rate annuity or \$110,625 maximum. This was increased to \$124,500 in 1981 to account for the rise in the cost of living. There is no specified cost of living limit on an employer's contribution for an employee other than that the compensation must be reasonable in relation to the employee's responsibilities.¹⁶

Defined benefit employer tax shelter regulations allow flat, fixed, off-set, and unit benefit plans. Under each of these

plans, the employer need not agree to contribute the maximum tax-sheltered amount but minimum funding programs require specified annual contributions each year to meet ERISA criteria. When investment results are better than assumed, an employer can reduce annual contributions to the plan. Since the contribution levels are tied to expected outcome, a funding standard account must be maintained and an actuarial service certification is required.

Defined contribution programs are usually referred to as profit-sharing plans where up to 25 percent of an employee's compensation can be sheltered from taxes in a plan with a maximum contribution in 1980 of \$36,875 (raised to \$41,500 in 1981 for increase in cost of living). Since variations in profit will change the level of actual contributions, the outcome is less certain upon retirement than with a defined benefit program.

Employees and employers have considerable flexibility in setting up various types of defined contribution plans. Under profit-sharing arrangements, the employer can contribute cash or company stock. If the company has no profit in an accounting period, no contributions need to be made. The contributions and accumulated earnings of former employees who left a company before all contributions were vested in their accounts may be used to reduce contributions for current employees or they may be allocated among current employees in addition to current contributions. Employees and employers each supposedly benefit from profit-sharing programs. Employees have incentive to help the company do well at present as well as in the future since their current retirement account is affected. When stock is involved, future employee benefits are tied to the value of the stock.

Fixed contribution money purchase plans as well as target plans may be developed under defined contribution regulations. Both types of plans generally require the employer to make specified contributions based on payroll cost. Thus, the employer is required to make specified annual contributions and the employee is thereby assured that money is placed in the plan.

Employee Stock Option Plans. One of the objectives of ERISA was to encourage employee stock ownership. Current regulations designate employee stock option plans (ESOP's) as defined contribution plans which have a stock bonus plan, or a stock bonus along with a money purchase plan designed to invest primarily in qualifying employer securities. ESOP's may form a portion of a retirement plan which includes a qualified pension, profit-sharing, or stock bonus plan that is not an ESOP. Regulations for ESOP's, including how to handle employer securities, rights of first refusal, put options, and valuation, are detailed in (5).

Congressional interest in ESOP's was quite strong in the seventies. The Senate Finance Committee chairman stated that "just as in 1862, when Congress passed a law to allow Americans who had very little money to own and develop up to 160 acres of land, we should now give Americans the opportunity to become owners of our growing frontier of new capitalism. The way to do this is through laws which encourage the development of programs like ESOP's" (5).

¹⁶Specific provisions for retirement programs sponsored by subchapter S corporations are not discussed but in general are similar to the provisions for subchapter C corporations. However, under subchapter S, a profit-sharing plan that benefits an officer or employee owning directly or indirectly more than 5 percent of the corporate stock must provide that forfeitures attributable to employer contributions cannot benefit shareholder employees. In addition, to the extent that contributions exceed 15 percent of an employee's compensation or \$7,500 (whichever is less), the amount is included in the employee's gross income.

The general idea is that a plan's assets are used to buy employer stock, and as stock ownership increases, the value of employees' benefits increases. This supposedly provides added incentives for employees to contribute more to the company's success.

Several additional advantages are cited for ESOP's. In most cases, companies make tax-deductible contributions of stock directly to an ESOP. ESOP's can also help a company raise cash where a trust is used to buy company stock. The trust borrows money to make the purchase and the company then makes annual cash payments to the trust to repay the loans. The payments, like the direct contributions of stock, are tax deductible. A company can name the ESOP trustee and thus retain effective control over stock contributed to a plan, even though the shares are technically owned by the employees. Retiring owners of closely held corporations, by selling their stock to an ESOP, may be taxed on the sale at the capital gains rate instead of the higher unearned income rate that would apply if the stock were sold. One disadvantage mentioned for both employers and employees is that ESOP's are relatively expensive to set up and maintain, a result of the uncertain nature of company fortunes.

For the most part, ESOP's are successful where the corporation is successful and the amount of stock contributed is meaningful. When company profits are not increasing, the value of the stock to the employee may decline substantially. Employers may be able to overvalue stock contributed to an ESOP to the employees' detriment. In addition, when employees retire and want the proceeds from their ESOP accounts, the stock price may be low; or a privately held company, without a public market for its shares, may be unable to buy the stock back. Such a problem may in part be corrected by requiring companies to establish sinking funds (funds set aside from other uses) to buy the shares.

The number of companies with ESOP's is still modest. During a 9-month period ending September 30, 1979, the IRS approved (with favorable determination letters) 45,553 plans with an average of 37 employees per plan. Companies with large investments in depreciable or amortizable property (such as aviation, lumber, oil, and public utilities) that qualify for an investment credit may find ESOP's to be useful.¹⁷

Few land-based independent farms can be expected to have large depreciable and amortizable property. Closely held family corporations, where labor and management are provided by the owners, are not likely to have strong incentives to dilute their shareholder base. Some large farm producers, like specialized livestock or poultry operations, which may be part of other corporate activities, may have interest in ESOP's.

Eligibility Requirements. Employee eligibility requirements for corporate tax-sheltered retirement plans are similar to those required of sole proprietorships and partnerships. Such a plan must satisfy the participation requirements either by covering a certain percentage of employees or a nondiscriminatory class of employees.

To meet percentage requirements, a plan must cover at least 70 percent of all employees, or 80 percent or more of all employees who are eligible to benefit under the plan if at least 70 percent are eligible. To meet the nondiscriminatory classification, the plan must benefit a nondiscriminatory class of employees, that is, a class that does not discriminate in favor of employees who are officers, shareholders, or highly compensated. If the classification is found to be non-discriminatory by the IRS, the employer can exclude some individual employees because of age or service. Employees who have not attained a minimum age of 25 with 1 year of service (or 3 years for full vesting) may be excluded from participating in the plan.

Vesting Standards. The 1974 ERISA requires that employees be granted nonforfeitable rights to retirement benefits and to the accrued benefits derived from their own contributions upon reaching normal retirement age.¹⁸ Employees are guaranteed their benefits under any of three vesting schedules as follows:

- A plan may provide for 100-percent vesting in an employee's accrued benefits derived from employer contributions upon completion of 10 years of service (10-year vesting).
- A plan may provide for 25 percent vesting upon completion of 5 years of covered service, 5 percent for each additional year thereafter through the 10th year and an additional 10 percent for each of the following years—for example, full vesting at the end of 15 years (5- to 15-year vesting).
- A plan may provide that an employee who has not separated and has completed at least 5 years of covered service be granted vested rights to at least 50 percent of his or her accrued benefit if the sum of the employee's age and years of service equals or exceeds 45. Vested rights must increase by 10 percent for each additional year of service, resulting in 100 percent vesting after 10 years service when the age and service factor total 55. However, an employee who has completed at least 10 years of service must be vested in at least 50 percent of his or her accrued benefits and receive an additional 10 percent for each year of service after the 10th year (Rule of 45).

¹⁷The Tax Reduction Act of 1975 established an investment credit of up to 11 percent for employers who establish and contribute to a plan. Such plans are sometimes referred to as TRASOP's (Tax Reduction Act Stock Option Plan). ESOP's and TRASOP's qualify for a further one-half percent credit for matching employee contributions.

¹⁸Normal retirement age is the earlier of the time specified in the plan, the time the participant attains age 65, or the 10th anniversary on which participation commenced.

As with eligibility requirements, vesting requirements, along with minimum funding discussed in the next section, must not discriminate in favor of employees who are officers, shareholders, or highly compensated personnel.

Minimum Funding Standards. Under the 1974 ERISA, a pension or annuity plan must maintain sufficient funds so that there is no accumulated funding deficiency at the end of a plan year. This essentially requires that an employer deposit into a plan each year a portion of the benefits that are expected to accrue to an employee as years of service increase, even if they are not yet vested in the employee. In the absence of such deposits, a participant might be fully vested under a plan, but only a small part of the benefits would be available.

Portable Retirement Benefits. Full and immediate vesting rights in a plan would let employees take their interest along when transferring employment. Such provisions have generally not been widely developed in private retirement plans, since an employer's objective when setting up a plan is to attract and retain good employees. Social security coverage and certain other State and Federal plans have nearly complete portability. A State or Federal employee, however, cannot transfer benefits to the private sector.

In the absence of complete and immediate vesting rights, a number of plans have been developed by unions so that employees do not lose all plan benefits when changing employers. Such plans may be developed as farmworkers become unionized and transfer among employers. Industrywide plans allow an employee to transfer from one employer to another within an industry. Area-wide plans are similar to industrywide plans except that a plan is limited to employment in a particular geographic area.

Keogh Defined Benefit or Plus Plans

Special types of Keogh plans allow annual tax shelters larger than \$15,000. The greater amount is permitted when a defined benefit pension plan is established. The potential annual tax shelter is even greater when a self-employed person incorporates (see the corporate retirement program section). The following is a general interpretation of the IRS regulations. IRS regulations on the plus plans, issued in 1978, are complex and probably subject to further interpretation.

The defined benefit concept is to permit an individual to shelter annual income in a large enough amount, given certain restrictions, to assure that pension funds will be available to meet prespecified annual pension income goals, generally starting at age 65. The pension income goal is influenced by the age when the program is started, the level of earned income, and assumptions about the rate of return the retirement fund will earn. The maximum annual benefit was set at \$124,500 in early 1981. The larger amounts of money involved in the defined benefit plans make them most likely to be formed by corporations, although such plans are also available to individuals.

More specifically, under a defined benefit plan, an individual can contribute whatever amount is necessary to fund a pension payable under a straight-life annuity up to a specified percentage of the individual's current compensation or net earnings from self-employment. The excess tax-deductible contribution permitted depends on the individual's age when plan participation starts. The maximum statutory percentages are 6.5 percent at age 30 or under, 4.4 percent at age 40, 3 percent at age 50, and 2 percent at age 60 or over.

To illustrate, assume that a self-employed farmer earns \$50,000 and at age 50 sets up a defined benefit program. Further assume that the plan provides that at age 65, the farmer will receive a lifetime pension equal to 3 percent of \$50,000, or \$1,500 for each year from age 50 to 65. Therefore, the pension would come to \$22,500 annually after age 65. If the farmer sets the plan up with a life expectancy of 80 years and a 6-percent earnings factor on the Keogh contributions, an annual contribution of \$9,400 would be needed to fund a \$22,500 annual pension after age 65. Thus, the farmer can annually contribute \$1,900 more to a defined benefit plan than to a standard Keogh plan (whose maximum contributions were \$7,500 in 1981). At age 40, with \$50,000 in annual earnings, the farmer could incorporate and shelter about \$21,000 annually.

The amount that can be deducted (percentage of earned income) may be adjusted periodically during the life of the plan to account for changing interest rates earned on funds already in the plan and changing mortality rates. The maximum deductions may have to be reduced if interest rates should increase and the Keogh funds begin to exceed what is necessary to fund the defined benefit. In some years this may reduce the allowable deductions below contributions allowed in a regular Keogh. Since a defined benefit Keogh is considered a pension plan, contributions have to be made even when earnings are low, while contributions for a regular Keogh can drop with earnings. The benefits must be set up to begin at the latter of age 65 or the day 5 years after the day the participant's current period of participation began.

To date, a few banks, brokers, and mutual funds offer the Keogh-plus plans. Self-employed plans are offered for age 65 retirement, while corporate plans can be based on retirement at age 55, or in some cases, even younger. Generally, the Keogh-plus plans are most useful in terms of current shelters for those over age 35 and will likely have high incomes to shelter from taxes through age 65. The "plus" plans could appeal to farmers with high net earned incomes who do not want to incorporate their farm businesses or reinvest their income in the farm business, or to a family where one of the spouses has a high off-farm income that is not needed for family consumption or for investment in the farm business. Table 11 shows the annual amounts that can be sheltered from taxes at various income levels, the increase allowed over standard Keogh plans, and minimum yearly pension starting at age 65, as determined by one sponsor of a plan.

Rollover of Proceeds from Retirement Plans and Deferred Compensation to IRA's

Individuals who are nearing retirement and are about to receive a lump sum distribution from some types of pension, profit-sharing, stock bonus, or annuity plans may be able to roll over the distributions tax free into an IRA. The tax-free rollover of a retirement program was also designed to permit individuals changing jobs to transfer funds to their new employer's plan or transfer them to an IRA. A tax-free rollover to an IRA can also be used where an employee receives a distribution because the plan in which he or she was participating is terminated by the employer. Tax-free rollovers to IRA's must be accomplished within 60 days of receipt of distribution.

Receipts from plans such as other IRA's, Keoghs, and other employee benefit plans are taxed immediately, if not put in an IRA, by a special 10-year averaging program in figuring

the tax due on the lump sum. The tax rates are as follows:

| Amount | Tax Rate |
|-----------|----------|
| \$ 20,000 | 7 % |
| \$ 50,000 | 15.4% |
| \$ 75,000 | 17.9% |
| \$100,000 | 19.2% |

The rate is not cumulative, that is, the tax on a \$100,000 payout is \$19,200.

The 10-year averaging method is not available for (1) U.S. retirement plan bonds distributed with the lump sum; (2) any distribution made before the planholder had been a participant in the plan for 5 years, except distributions made because of the employee's death; (3) distributions to an owner-employee that exceed the benefits provided under a plan's formula; (4) the capital gains portion of a lump sum distribution unless the recipient elects to treat pre-1974 participation (capital gains) as post-1973 participation (ordinary income); and (5) the current actuarial value of an annuity included in a lump sum distribution.

When the distribution is rolled over into an IRA, the recipient avoids any immediate tax on the distribution. However, the opportunity of benefiting from the special 10-year averaging tax provisions are not available for lump sum distributions from an IRA rollover program. Offsetting this for some farmers may be the opportunity to avoid estate taxes on assets held in an IRA, especially where they do not need the assets for personal living or they do not have other investment uses for the assets. In some cases, the tax costs under the 10-year averaging provisions of the other programs may be so large that the IRA alternative is better.

Table 11—Keogh-plus plan (illustration)

| Annual self-employment income and age when plan is started | Maximum yearly Keogh-plus contribution | Increase over maximum contribution to standard Keogh plan | Yearly pension, age 65 |
|--|--|---|------------------------|
| <i>Dollars</i> | | | |
| \$24,000: | | | |
| 35 | 3,800 | 200 | 24,000 |
| 40 | 5,160 | 1,600 | 22,982 |
| 45 | 5,000 | 1,400 | 15,360 |
| 50 | 5,000 | 1,400 | 9,828 |
| 55 | 5,000 | 1,400 | 5,592 |
| \$40,000 | | | |
| 35 | 6,400 | 400 | 40,000 |
| 40 | 8,600 | 2,600 | 38,300 |
| 45 | 8,400 | 2,400 | 25,600 |
| 50 | 8,400 | 2,400 | 16,380 |
| 55 | 8,500 | 2,500 | 9,320 |
| \$50,000 | | | |
| 35 | 8,000 | 500 | 50,000 |
| 40 | 10,800 | 3,300 | 47,875 |
| 45 | 10,500 | 3,000 | 32,000 |
| 50 | 10,500 | 3,000 | 20,475 |
| 55 | 10,600 | 3,100 | 11,650 |
| \$70,000: | | | |
| 35 | 11,100 | 3,600 | 68,850 |
| 40 | 10,800 | 3,300 | 47,875 |
| 45 | 10,500 | 3,000 | 32,000 |
| 50 | 10,500 | 3,000 | 20,475 |
| 55 | 10,600 | 3,100 | 11,650 |

Simplified IRA Employee Pensions

The purpose of Simplified IRA Employee Pensions (SEP-IRA) was to combine the larger deductions of Keogh programs and the simplicity of the standard IRA. For tax years beginning in 1979, employers have been able to set up simplified employee pension plans and make contributions to their employees' IRA accounts. Sole proprietors, partnerships, subchapter S corporations, and regular corporations can use SEP-IRA's.

SEP-IRA's supposedly provide for more simplicity than pension plans. Many of the Federal regulations that may impose a financial burden, especially for administrators of small corporate pension plans, supposedly are relaxed for the SEP-IRA's. Most of the employer's fiduciary liability is removed, which should eliminate the highly specialized reporting and filing requirements that add to pension plan costs. The permitted contribution is not taxable income to the employee until the employee withdraws the funds from the SEP-IRA.

Under the Revenue Act of 1978, which established SEP-IRA's, an employer can make tax-deductible contributions of up to 15 percent of an employee's compensation to an annual maximum of \$7,500 per employee. The employer can increase or reduce yearly contributions without amending a SEP-IRA; thus, in effect a SEP-IRA can be used as a

profit-sharing plan. A SEP-IRA does not permit additional tax-deductible voluntary contributions beyond the SEP-IRA limit. Contributions made by an employer to a simplified pension plan are deductible by the employer for the tax year within which the calendar year ends. Contributions in excess of 15 percent can be deducted in succeeding years. Contributions for a calendar year may be made up to 3½ months after the close of the calendar year. All the employer's contributions immediately vest in the employee. An employee may withdraw funds at any time, but in doing so, forfeits the tax benefits. If the employer's contribution is less than \$2,000 (regular IRA provisions), the employee can contribute the difference and take a deduction of the amount contributed.

Although an employer can sponsor a SEP-IRA, the employee must open the account personally. The employer, however, is not required to let the employee direct the investment. The IRS regulations indicate that employers cannot direct employees in setting up IRA accounts or specify which institution the employees should use. Permitting employees to direct the contribution can free the employer of much of the fiduciary liability and responsibility. When employers make contributions, they must not discriminate among employees; they must make them in like proportion for all eligible employees with the exception of those under 25 years of age, those who have not worked for the employer for any part of 3 of the preceding 5 calendar years, and some union members. Part-time and seasonal employees 25 years of age or older must be included. Employers must also make proportional contributions for any former employees who left their employment within the calendar year and worked for them in 2 of the previous 4 years. The employer's formula for allocating funds to each employee may provide that contributions are reduced by the employer's share of social security taxes.

SEP-IRA's can have specific application for self-employed farmers who do business as sole proprietorships or partnerships. This is particularly the case where the self-employed cannot afford, or are unwilling to assume the costs of covering their employees under a Keogh program.

The self-employed owner of the business can contribute up to \$7,500 for himself, which is fully tax deductible, and can do the same in each employee's individual retirement account. However, the employer's contribution to employees' programs can be at a rate lower than 15 percent of compensation, while the employer contributes \$7,500 to his or her own program. The contribution can be reduced by the employer's social security payments for the benefit of employees (a maximum of \$1,587.67 for 1980 or 6.13 percent on the first \$25,900 of earnings). The same provision applies to the Federal Unemployment Tax (FUTA) on employers' liability on their payments to a SEP-IRA.

Some employers may use payments to employees' SEP-IRA's as a substitute for pay raises or bonuses. By channeling the raises or bonuses into a SEP-IRA, the employer has obtained the same level of tax deduction as would be available if the money had been paid as salary or bonuses, but SEP-IRA contributions are not subject to payroll taxes. The employee can benefit the most, however, since the employer's SEP-IRA

contribution is not subject to income taxes until the employee withdraws it from the retirement account. Of course, if the employee needs the money and prematurely or in the absence of disability withdraws the money, the withdrawal is subject to a 10-percent nondeductible penalty in addition to the ordinary income tax due.

There are apparently a number of problems that can make a SEP-IRA difficult to establish or maintain. For example, if one eligible employee in the group refuses the plan, all others who are eligible will lose the plan's tax benefits. While the Internal Revenue Service states that an employee can be dismissed for refusing to take part in a SEP-IRA, many employment contracts appear to bar dismissals for such a reason. However, participation can apparently be made a condition of employment for new employees. In addition, eligible employees who quit their jobs during the initial year must agree to open another IRA account (with the contribution from their former employer) in order for the employer's SEP-IRA to qualify for the plan's income tax advantages; for example, the employer must convince the former employee to set up an IRA.

An employer who has another retirement plan or defined benefit plan may not participate. As of October 1979, the IRS had not clarified employees' reporting requirements, employers' fiduciary responsibilities, and eligibility of plans that allow contributions for a nonworking spouse, as well as a working spouse, to qualify for the simplified plan.

Other Retirement Program Considerations

Social Security and Retirement Program Coverage for Spouse Employees of Sole Proprietors. As noted in the social security section, a sole proprietor need not pay social security taxes (FICA) on a spouse's wages. Social security taxes paid by the proprietor (the husband, for example) will provide benefits for his wife as well. However, social security coverage of an employed spouse by a sole proprietor owner may be required if the owner spouse sets up a retirement program. In 1979, the Internal Revenue Service ruled that a retirement plan that benefits the owner of a sole proprietorship and its employees must also include the proprietor's spouse if he or she is a bona fide employee with more than 3 years of service.

A self-employed owner and spouse must decide on a level of wages and salary to set for the employed spouse within the bounds of reasonable compensation for services rendered. This involves determining a breakeven point between Federal income taxes saved and the cost of the retirement program. For instance, a self-employed farmer filing a joint return who had \$29,900 of taxable income in 1980 would have paid \$6,201 in Federal income taxes. But if she paid her husband \$15,000 in wages or salary, their joint Federal tax bill would be reduced to \$2,304 a savings of \$4,167. Of that amount, \$2,250 would be paid into a retirement program which would be tax deductible to the farmer's husband, reducing their joint Federal tax bill by \$472 more. If the wages and salary of the farmer's husband were \$20,000 instead of \$15,000, the Federal tax savings would have been \$5,157 and the retirement program costs would have been \$3,000. The

contribution to the retirement program would have further reduced Federal income taxes by \$576.

Corporations and Partnerships for One or Several Persons.

A major advantage of incorporating a one-person sole proprietorship or a partnership with two or more partners is the higher pension plan deductions permitted for corporate employees. This is particularly the case where Keogh-plus plans or defined benefit plans can be used.

In a Keogh-plus plan (see table 10), a self-employed person at age 50 with \$40,000 in annual earnings could shelter \$8,400; in a corporate plan, the individual could shelter over \$20,000. Under a corporation, the major restriction on the maximum contribution is that the plan cannot provide for pension benefits larger than the employee's salary for any 3 consecutive years; the maximum benefit in 1981 was \$124,500.

The Internal Revenue Service requires that the salary on which the retirement program is based be reasonable. In some cases the IRS has successfully challenged corporations that paid salaries and directors' fees too high in relation to dividends, on the grounds that the salaries or fees were not justified and that part of the amount should be taxed as dividends. A sole owner of a farm corporation with high net farm income in the form of salary would need to make a strong case that, as sole owner-employee of the corporation, he is the source of the corporation's net earnings. The owner's position would probably be strongest if the salary is set and recorded at the beginning of the year.

Farm Costs or Benefits from Self-Directed Pension Plans.

Farmer owners of some pension plans have an option of whether to manage the plans themselves, to purchase into a plan that includes management, or to acquire the services of a firm that will provide individual plan management. Where the farmer planholder chooses to manage the plan alone, the time that is used has an opportunity cost in its alternative uses in the farm or other investment businesses. However, the farm business may benefit from knowledge obtained and the contacts established as the farmer explores alternative pension plans and analyzes financial outcomes.

To direct a plan himself (herself), a farmer will usually appoint a bank (or some other equally qualified entity) as custodian of his (her) account. Under such accounts there are generally no restrictions on who makes the investment decisions. Within a "prudent man" rule, the farmer could essentially lose all his (her) equity in an account through deals in real estate, stock, commodity, metals, antiques, etc. Where the farmer also manages the account on behalf of employees, the "prudent man" rule especially comes into play, since employees can bring suits for imprudent account management. Banks, brokerage firms, and other institutions that offer such custodial accounts, generally charge a modest fee (\$25 to \$100 per person) for setting up the plan, plus an annual service fee. The farmer then may direct his (her) investments into stock, bonds, commodities, precious metals, antiques, etc.

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Other Employee Fringe Benefits

Other employee fringe benefits, limited only by the imagination and bargaining power of employers and employees, can directly or indirectly add to the cost of farm labor. They may become more important as farmworkers move into higher Federal income tax brackets and seek to shelter their earnings from higher tax payments. These benefits are particularly attractive where they are not considered as income to an employee but are tax deductible for the employer. In such situations, employees may seek other fringes instead of salary increases. Most have effects on substitution of capital for hired labor in agricultural production, on labor productivity, and on stability. Some of the more common fringes and what seem to be emerging fringes are discussed in this section.

Paid Vacations, Personal Leave Days, and Flexible Work Time

Paid absences from work range from formal policies established through annual bargaining to case-by-case requests as needs arise.

Policies regarding paid absence from farmwork, where they exist, are usual for full-time employees. Two weeks of paid vacation appears to be a common policy, with 3 to 4 weeks offered after longtime employment with the same employer. Employers frequently require that vacations be taken during the non-peak work-load periods. Other paid leave days can include time off for sickness, the deaths of close relatives, Federal and State holidays, birthdays, routine medical examinations, and (even for men) pregnancy and birth.

Most paid days off from work may raise the farm's labor cost. Time off may, however, be necessary to maintain the physical and mental health of the employee and may provide a positive benefit-cost ratio. The employer's costs for both salary and fringe benefits, are tax deductible.

Other industries have been experimenting with flexible work hours in recent years. The general idea is to arrange daily, weekly, monthly, or annual work schedules to benefit both the employee and employer. Four 10-hour days per week, 32 hours of work one week and 48 hours the next, or 48-hour weeks during the winter and 32-hour weeks (with 3-day weekends) during the summer are some of the variations being tried. Farmers have long provided informal time off during slack periods but have expected extra work during peak periods, such as planting, harvesting, and when animals give birth. As farmworkers become better organized and see nonfarm workers arranging flexible schedules, they too may demand flexible hours. Farm employers may benefit from such arrangements by having employees with better physical and mental health.

Employee Training

Increasingly, farm employers are sponsoring additional training and schooling for their employees. Such training ranges from a few hours provided by a local machinery

dealer on proper adjustment, repair, and operation of farm machines and equipment, to several days to learn techniques of artificial insemination of livestock, provided by local schools. Other training, such as engine overhaul, farm recordkeeping, and accounting, may lead to a certificate or academic credit and require several months of part-time day or evening classes. Such training frequently involves tuition costs in addition to travel, meals, and occasionally, lodging. Employers frequently pay all an employee's out-of-pocket costs as well as salary while the employee is absent from farmwork for the training. Employers supposedly receive higher quality, more skilled work in return from their employees. Such training, however, frequently helps to make employees more job-mobile and as such, indirectly further increases employer costs if the farmer has to pay higher salaries to keep employees or has to start with new untrained people.

The employer's costs are usually considered necessary business expenses and are tax deductible. From the employee's perspective, educational expenses beginning after 1978 and before 1983 are tax-free fringe benefits when the employer sets up an educational assistance program. This is most relevant where the schooling is unrelated to an employee's job or qualifies the employee for a new position. Employees generally must report as taxable income tools and supplies that they can keep, meals, lodging, and transportation.

When plans are properly structured, sole proprietors and partners can also participate in training without jeopardizing the tax deductibility. In addition, if the educational courses are required by the employer and are related to the job and the employer either pays the expenses directly to the educational organization or reimburses the employee for the expenses, after a full accounting, the expenses need not be included in the employee's taxable income.

Cash and Noncash Outlays for Housing, Food, Clothing, Transportation, and Other Living Costs

Given the uncertainty associated with climate and livestock cycles, farm employees are frequently required to live next to or on the farm. Farm employers often provide the housing for such employees but utilities and other items of personal living are the employees' expenses. Employees frequently have the use of a farm vehicle to commute to and from the worksite or, in the case of crew-type seasonal workers, employers frequently bus their employees from their living accommodations to the worksite.

In the usual sole proprietorship and partnership farm businesses, housing costs are generally tax-deductible business expenses to the employer while the value of the housing is considered taxable income to the employee. For personal use of a farm vehicle, an employee can reimburse his or her employer at a reasonable rate and neither will have a tax-deductible expense for such use. Where an employer provides an employee with personal use of a farm vehicle as part of the fringe package, the costs are deductible to the employer and the employee must include the value of the use as taxable income. Employers are generally able to deduct the cost of group transport of seasonal workers from living sites and employees need not include the transport costs as income.

Some farmers have incorporated their farm businesses, continued doing required farmwork as they did before incorporation, and deducted such personal living expenses as housing, utilities, food, and clothing (uniforms) as necessary business expenses for tax purposes. Those farmers were not required to include the value of such benefits in their personal income under provisions in the Internal Revenue Code and regulations that were developed for other businesses. Those who were successful in doing that were generally in a livestock business where they could establish that their corporation, as a condition for employment, required them to be at the site and available for 24-hour duty to care for the stock. For food to be a nonincome item to the employee, the food must be provided at the employer's place of business and must be provided for the convenience of the employee. If a cash allowance for either food or lodging is provided, the employee must include the allowance as income.

When special work clothes and equipment are provided and required as a condition of employment and are not suitable for everyday use, the employee need not include their value and upkeep as income. Protective clothing and related gear seem to qualify as special items required for working with and around farm chemicals, and crop and livestock, and certain air pollutants. Uniforms worn to identify an employee to the public also seem to qualify and are most frequently seen on employees of specialty farms such as purebred livestock or seed farms.

Low-Interest Loans

Employers may guarantee loans for employees (which may reduce the interest cost) or may loan directly to an employee at a reduced interest rate. Such loans provide an opportunity for both the employer and employee to save on Federal income tax costs. A low-interest loan may permit an employee's net equity to increase substantially over time if the loan is used to purchase an asset, like a house, that will increase in value. The employer's net taxable income is reduced by the amount of the difference in what the loan would have earned in an alternative investment.

The Internal Revenue Service has generally not sought to tax an employer on the difference between what the loaned funds might have earned in an alternative use. The IRS does, nonetheless, have authority to allocate income and deductions between businesses controlled by the same interests and may try to impose a tax in such situations where the loan would have earned more in an alternative use. If the IRS is successful, the borrower should receive a corresponding deduction for the interest taxed to the employer. The IRS may try to classify the loan advance as taxable compensation or in a corporation as a dividend (even less desirable when taxed like ordinary income). Use of formal loan documents may reduce the likelihood that the IRS will pursue such a situation, especially where a repayment schedule is specified and where a note and loan security are given.

As an alternative, an employer may help an employee obtain a low-interest rate by guaranteeing a loan for an employee with a third party—whether an individual, another company, or a lending institution. This is usually feasible only where the employer has sufficient unencumbered assets that can be used for such purposes. A guarantee might enable the employee, during periods of high interest rates, to receive a discount of several percentage points, thereby making the repayment terms more favorable.

Officers' Liability Insurance

A corporation or partnership can provide insurance to indemnify its officers for expenses arising from wrongful acts, such as breach of duty, acts of omission, or error, misleading statements, or any other matter claimed against them, committed in their official capacities. The employer can deduct the cost of such premiums and they are not taxable to the employee.

Group Prepaid Legal Services

Various types of property settlements, estate settlements, titles, adoptions, wills, and so forth, although usually routine, frequently require legal work. As the work force has become more mobile, claimants have become less likely to settle grievances informally. Some law firms, for a flat annual fee, will handle certain personal legal problems for a firm's employees. For tax years beginning after 1976 and ending before 1982, payments made by an employer to a qualified group prepaid legal service plan, which provides legal services for an employee or an employee's spouse or dependents, are tax deductible to the employer. Employees in turn are not required to report as income either the amount of the employer's payment on their behalf or the value of the services received under the plan.

Dental, Eye, and Child Care, Paid Health Insurance Deductibles, and Auto Insurance

Workers' compensation and health and accident insurance can cover major hospital and medical expenses, but frequently do not cover dental and eye care. Specialized dental policies, frequently offered on a group basis have become more widely available in recent years. Eye care has likewise become of increasing interest, and specialized insurance policies have become available for eye treatment and correction such as glasses and contact lenses. Employers can often provide group policies for such items to employees at less cost than policies purchased by the employees individually.

While medical, hospital, dental, and eye insurance generally cover most of the large expenses employees may incur, the amount of the deductible and excluded costs can add up for employees and they may not save much from being able to deduct them from their own taxable income. If the employer pays such costs, the costs are deductible to the employer and are not income to the employee.

Many health insurance policies do not cover the first \$100 of expenses and do not cover prescriptions, eye examinations,

glasses and contact lenses, and routine medical exams. The employer can offer a plan to pay such costs. Such plans cannot discriminate in favor of any class of employees but may exclude employees who belong to unions, those under 25 years of age, those with less than 3 years of service, and those who are part-time or seasonal. Employers, in addition to receiving Federal income tax benefits, may also benefit by having employees pay closer attention to their physical and mental health and thereby perform better. Even though the marginal cost for first-dollar coverage is small (for example, \$50 to \$2,000), small amounts, especially at the margin of an employee's net income, provide motivation. Knowing that an employer will give an employee ample paid time off from work and even send an employee to good facilities for a medical examination can also boost morale.

Farm employers, like employers in other sectors of the economy, can provide day care for children of their employees. The care may be provided by someone in the farm community or nearby town on an individual or group basis.

Farm employers may also be able to obtain lower rates on automobile insurance by including employees' personal vehicles in the policies with farm vehicles. Employers can either provide the coverage at the reduced rate to the employee or free as part of the total employee compensation program.

Financial Counseling, Stock Appreciation Rights, Deferred Compensation

In recent years, employers have been able to provide the services of financial counselors tax free to employees. Depending on the interest and needs of employees, counselors may work with employees to minimize their tax costs as well as to invest in assets that are secure and have growth potential equal to or exceeding the inflation rate.

Firms have also used programs of stock appreciation rights to attract and keep key people (see the discussion of ESOPs under corporate retirement programs). While the Federal tax laws and regulations in this area have been changing in recent years, such programs can be especially appealing when a firm's stock is appreciating rapidly in market value. The central features of the plan usually involve an employer's granting an employee the right to buy a certain number of the firm's shares at a fixed price, sometimes below the market price at the time the option is granted. If and when the stock sells at a higher price, the employee exercises the option and normally does not pay tax at the time. If the stock is then held at least 3 years, capital gains tax is due on the total appreciation. If the stock is sold sooner than 3 years after the option is exercised, the appreciation between the original option price and the price when the option was exercised is taxed at the same rates as ordinary earned income. Further appreciation is subject to capital gains tax if held for more than 1 year or ordinary taxes if held for less than a year.

Some high-income employees, nearing retirement, may find it to their advantage to defer some of their income until after they retire, when they will have less taxable income and be in a lower tax bracket. Where employers will cooperate with an employee on a deferment program, the employee will want to examine the likely effects closely, especially in periods of high inflation.

The top Federal tax on current earned income is 50 percent. Thus, \$5,000 in Federal taxes could be saved by deferring \$10,000. If an employee receives the \$10,000 while in a 30-percent Federal tax bracket, \$2,000 in Federal taxes will have been saved. However, unless the employer is willing to pay the employee under a shadow or phantom plan for the use of the money, income foregone from not taking the money when it was first due may exceed the income tax savings from the delay. A desirable shadow plan during periods of high inflation would be for the employer to invest the deferment in capital assets that will appreciate in value as much as or more than the rate of inflation and where the long-term capital gains are taxed at capital gains rate to the employee. Careful planning of such an arrangement for tax purposes is necessary for the employer to be able to deduct the amount deferred particularly where the employer is on an accrual accounting system.

Club Memberships and Entertainment

Memberships in clubs and certain entertainment expenses, if they serve a business purpose, are also fringe benefits, not taxable to employees but deductible for employers. Farm employers and employees may increasingly take advantage of such benefits as more farm information gathering and analysis is done in such settings for farm procurement, farm practices, and marketing of farm products. Time pressures on employees may force them to mix business with recreation.

Cafeteria Fringe Offerings

With this relatively new concept, an employer offers an array of fringe benefits beyond those required by Federal and State laws and regulations. Under a cafeteria plan, the employer generally sets a maximum dollar amount paid for employee fringe benefits, but permits the employee to choose from the fringes that the firm offers. These may include, for instance, cash, deferred cash, extra paid vacation, profit sharing, matching retirement funds, company stock on a tax-free basis, medical or disability plans, group term life insurance or legal services, and other programs noted in this section.

To qualify for the potential Federal income tax benefits, cafeteria plans must be in writing. The Revenue Act of 1978 provided that if a cafeteria benefit plan is in writing, and the plan gives employees a choice between taxable and nontaxable benefits, employer contributions are included in the employee's income only to the extent that the employee chooses taxable benefits. Employer contributions to nontaxable benefits are excluded from an employee's taxable income.

An additional provision was included for highly compensated employees. An employer's contributions are included in the employee's gross income to the extent that the employee could have elected taxable benefits unless antidiscrimination standards are met. Congress, for example, singled out discrimination in favor of highly compensated individuals on the basis of eligibility to participate as well as discrimination in terms of contributions and benefits. A highly compensated employee was defined as a participant who is: an officer, a shareholder owning more than 5 percent of the employer's stock, a highly compensated employee, or the spouse or dependent of one of the first three.

Farms with a small number of employees probably cannot offer a very wide cafeteria of choices since the cost of learning about and administering them all would be prohibitive. In addition, the small farm may not have enough employees for group plans particularly if the employees want different

programs. An alternative for the small firm may be to contract with a firm that specializes in managing cafeteria offerings.

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Appendix I. Federal Income Tax Consequences of Program Costs for Sole Proprietors and Corporations¹

Federal income taxes can make a significant difference in the cost of payroll taxes, insurance, and other fringe benefits. Thus, analyses of costs of production and economies of size should analyze the costs on an aftertax basis. Potential Federal income tax savings, given the lower tax rates on corporate income once taxable income reaches the \$35,000 level, is probably more important in a farmer's choice of legal business organization than employee payroll and fringe benefit costs.

The aftertax cost of fringe benefits in relation to other investment alternatives can make a difference in whether a farmer offers the fringe and whether a farmer operates as a sole proprietorship or as a corporation. Tax provisions that make some programs mandatory for a corporation but that are voluntary for a sole proprietorship can influence a farmer's decision on whether to incorporate the farm business and, if so, which parts to incorporate. Thus, throughout this appendix the analysis of program costs is based on comparisons between sole proprietorships and corporations. The corporate farm analysis is based on a farm situation with one owner who is also an employee, and one corporation, much the same as if the owner were a sole proprietor providing most of his or her own labor and management. The analysis is likewise applicable to farm corporations using more than one employee, however, an analysis for farms using more than 1 corporation is not included. Use of more than one corporation is generally most advantageous where there are several family member owners and where total taxable income exceeds \$35,000 or where there are unique estate planning and transfer objectives. Only regularly taxed corporations are analyzed in this appendix; subchapter S corporations are not considered.

Social Security

Social security taxes are higher for a corporation than for a sole proprietorship with the same income even after adjusting for the tax deductibility of the corporate contribution. The 1979 aftertax cost of the corporate contribution (6.13 percent of salaries and wages) is 3.31 percent for a corporation in the 46-percent tax bracket. When added to the owner-employee's contribution of 6.13 percent, the total aftertax cost of social security for such a corporation is 9.44 percent of salaries and wages compared with 8.1 percent for the sole proprietor.

Proper allocations of income between a corporation and owner-employee may result in substantial income tax savings. Appendix table 1 shows the social security taxes due for different levels of income if an income tax minimization

strategy is used to determine the salary of a corporate owner employee. No attempt was made to maximize potential social security benefits by paying the maximum salary possible to the owner-employee; it was assumed that minimizing current taxes was more important than obtaining larger future social security benefits. Furthermore, the earnings subject to social security tax are different for the sole proprietorship and a corporation for a given level of income (appendix table 1). Note that under these conditions, the social security tax as a percentage of earned income is higher for the corporation than for the sole proprietorship for income less than \$16,000, but for incomes between \$16,000 and \$65,000, Social Security payments are lower for the corporation because of the salary allocation. The maximum social security savings of the corporation amounts to approximately \$550 at incomes between \$25,000 and \$35,000. For incomes in excess of \$65,000, social security costs are \$307 to \$672 higher for the corporation than for the sole proprietorship. The expected future social security benefits will be lower with the corporation in these situations because of lower levels of personal earnings.

Unemployment and Workers' Compensation Insurance

The coverage and requirements of workers' compensation vary by State, but in general, sole proprietors are exempt, whereas in many States, owner-employees of a corporation must be included in a workers' compensation program. The cost of coverage, usually incurred in the form of a premium on an insurance policy, may amount to 5 to 8 percent of the employee's salary.

Unemployment insurance requirements also vary by State, but a Federal tax of 3.4 percent on the first \$6,000 of wages is imposed if the employer pays \$20,000 or more in wages in any calendar quarter or employs 10 or more individuals. Owner-employees must be covered if the above conditions are met. Variations in the basic requirements exist. The minimum cost of such insurance is thus \$204 per employee that receives a minimum of \$6,000 in wages. Over time, unemployment insurance rates may decline if the owner refrains from filing many small claims, since a firm's rates are based on its own experience.

Appendix table 2 compares the aftertax cost of social security, unemployment insurance, and workers' compensation for a sole proprietor and an owner-employee of a corporation as well as for regular employees in a sole proprietorship and corporation. The costs presume that participation in workers' compensation, unemployment insurance, and social security is mandatory for all employees. Simulated costs are used in the table for the unemployment insurance and workers' compensation programs. The potential benefits in terms of protection from litigation for injuries or disability and death benefits are not considered in the computation. Even though the employer's contributions to the various benefit programs are tax deductible, the aftertax cost of these programs is substantially higher for the farmer as an owner of a corporation than as a sole proprietor, regardless of the corporate tax brackets.

¹This appendix closely follows Michael Boehlje and Kenneth R. Krause, *Economic and Federal Tax Factors Affecting the Choice of a Legal Farm Business Organization* (AER-468, Economics and Statistics Service, U.S. Department of Agriculture, June 1981), which should be consulted for a more complete analysis of farm incorporation and payroll and fringe benefit program treatment.

Appendix table 1—Social security payroll tax after Federal income tax, sole proprietor versus an individual owner-manager and corporation, by income levels, 1979

| Total income ¹ | After-tax social security cost | | Social security tax cost savings | Social security tax cost as a percent of earned income | |
|---------------------------|--------------------------------|---|---|--|--|
| | Sole proprietor ² | Individual owner-manager and corporation ³ | Individual owner manager versus sole proprietor | Sole proprietor | Individual owner-manager and corporation |
| | Dollars | | | Percent | |
| 4,000 | 324.00 | 490.20 | - 166.20 | 8.1 | 12.3 |
| 8,000 | 648.00 | 930.40 | - 232.40 | 8.1 | 12.3 |
| 12,000 | 972.00 | 1,301.28 | - 339.28 | 8.1 | 10.8 |
| 16,000 | 1,296.00 | 1,301.28 | - 5.28 | 8.1 | 8.1 |
| 20,000 | 1,620.00 | 1,301.28 | 381.72 | 8.1 | 6.5 |
| 25,000 | 1,854.90 | 1,301.28 | 552.62 | 8.1 | 5.2 |
| 30,000 | 1,854.90 | 1,301.28 | 552.62 | 6.2 | 4.3 |
| 35,000 | 1,854.90 | 1,301.28 | 552.62 | 5.3 | 3.7 |
| 40,000 | 1,854.90 | 1,682.69 | 172.21 | 4.6 | 4.2 |
| 45,000 | 1,854.90 | 1,754.41 | 99.49 | 4.1 | 3.9 |
| 50,000 | 1,854.90 | 1,754.41 | 99.49 | 3.7 | 3.5 |
| 55,000 | 1,854.90 | 1,754.41 | 99.49 | 3.4 | 3.2 |
| 60,000 | 1,854.90 | 1,754.41 | 99.49 | 3.1 | 2.9 |
| 65,000 | 1,854.90 | 1,754.41 | 99.49 | 2.9 | 2.7 |
| 70,000 | 1,854.90 | 2,206.90 | - 351.90 | 2.6 | 3.1 |
| 75,000 | 1,854.90 | 2,526.79 | - 671.89 | 2.5 | 3.4 |
| 80,000 | 1,854.90 | 2,386.41 | - 531.51 | 2.3 | 3.0 |
| 85,000 | 1,854.90 | 2,386.41 | - 531.51 | 2.2 | 2.8 |
| 90,000 | 1,854.90 | 2,386.41 | - 531.51 | 2.1 | 2.6 |
| 95,000 | 1,854.90 | 2,386.41 | - 531.51 | 2.0 | 2.5 |
| 100,000 | 1,854.90 | 2,386.41 | - 531.51 | 1.9 | 2.4 |
| 105,000 | 1,854.90 | 2,386.41 | - 531.51 | 1.8 | 2.3 |
| 110,000 | 1,854.90 | 2,386.41 | - 531.51 | 1.7 | 2.2 |
| 115,000 | 1,854.90 | 2,246.03 | - 391.13 | 1.6 | 2.0 |
| 120,000 | 1,854.90 | 2,246.03 | - 391.13 | 1.5 | 1.9 |
| 125,000 | 1,854.90 | 2,246.03 | - 391.13 | 1.5 | 1.8 |
| 130,000 | 1,854.90 | 2,246.03 | - 391.13 | 1.4 | 1.7 |
| 135,000 | 1,854.90 | 2,246.03 | - 391.13 | 1.4 | 1.7 |
| 140,000 | 1,854.90 | 2,246.03 | - 391.13 | 1.3 | 1.6 |
| 145,000 | 1,854.90 | 2,246.03 | - 391.13 | 1.3 | 1.5 |
| 150,000 | 1,854.90 | 2,161.81 | - 306.91 | 1.2 | 1.4 |
| 200,000 | 1,854.90 | 2,161.81 | - 306.91 | .9 | 1.1 |

¹Total income is assumed to be earned income—the amount on which social security tax was calculated for the sole proprietor as well as the amount reported for tax purposes prior to deductions and exemptions. Social security tax costs are not deductible on self-employed earnings.

²In 1979, a sole proprietor was taxed at 8.1 percent of earned income between \$400 and \$22,900. It was assumed that the sole proprietor received no off-farm income subject to social security tax.

³Income was divided between the corporation and the individual in a manner that minimized Federal income tax costs. In 1979, an employee and his or her employer were each taxed at 6.13 percent of wages or salary up to \$22,900. The employer is required to pay social security taxes on wages and salaries paid to an employee, but is able to deduct such taxes from taxable income.

For example, if the farmer receives \$30,000 in income as a sole proprietor, program costs would amount to \$1,855 (6.1 percent of income); if the farmer received \$30,000 in salary from a corporation, the program costs would amount to 11.6 percent of the salary, \$3,330, in a corporation taxed at the 20-percent bracket. If the corporation is in the 46-percent bracket, the costs would amount to 9.0 percent of the salary, or \$2,708. Program costs as a percentage of salary are lower for regular employees than for owner-employees of a corporation because the employees' contributions to social security are deducted from their salary and are not a direct cost to the owner. A similar contribution by the owner-employee is a direct cost to the owner.

For most family farms, where the operator and family provide most of the labor and management, workers' compensation (at least in some States) and unemployment insurance are not mandatory. Appendix table 3 shows the combined Federal income tax and social security tax for a sole proprietor, and corporate-individual combination using a salary allocation procedure that minimizes Federal income taxes and social security taxes for various levels of income, and the total income tax and social security tax savings of the corporate alternative. With an income of about \$16,000, the corporation pays \$672 less in taxes than a sole proprietorship, and at a \$35,000 income, the tax savings from the corporate alternatives exceed \$2,500. Tax savings rise rapidly for corporations

Appendix table 2—Federal income tax cost of payroll taxes for social security, unemployment insurance and workers' compensation, corporate owner-employee and nonowner employee, 1979

| Income or salary of each employee 1 | After-tax cost to sole proprietor 2 3 | Before tax cost of payroll taxes and owners share of social security 4 5 | Owner employee | | | | Nonowner employee | | | | |
|--|--|---|---|------------|------------|------------|---------------------------------------|---|------------|------------|----------|
| | | | Aftertax cost to the owner-employee and corporation | | | | Before tax cost of payroll taxes 4 | Aftertax cost to a sole proprietor or corporation | | | |
| | | | | | | | | | | | |
| | | | Marginal tax bracket ⁶ | | | | Marginal tax bracket ⁶ | | | | |
| | | | 20 percent | 30 percent | 40 percent | 46 percent | 20 percent | 30 percent | 40 percent | 46 percent | |
| | | | ----- Dollars ----- | | | | | | | | |
| \$10,000 | 810.00 | 2,230.00 | 1,906.60 | 1,744.90 | 1,583.20 | 1,486.00 | 1,617.00 | 1,293.60 | 1,131.90 | 970.20 | 873.00 |
| \$15,000 | 1,215.00 | 2,843.50 | 2,458.50 | 2,266.00 | 2,073.60 | 1,958.46 | 1,924.00 | 1,539.20 | 1,346.80 | 1,154.40 | 1,038.96 |
| \$20,000 | 1,620.00 | 3,456.00 | 3,010.00 | 2,727.00 | 2,564.00 | 2,430.20 | 2,230.00 | 1,784.00 | 1,561.00 | 1,338.00 | 1,204.20 |
| \$30,000 | 1,854.90 | 3,811.54 | 3,329.99 | 3,089.21 | 2,848.43 | 2,703.43 | 2,407.77 | 1,926.22 | 1,685.44 | 1,444.66 | 1,300.20 |
| \$50,000 | 1,854.90 | 3,811.54 | 3,329.99 | 3,089.21 | 2,848.43 | 2,703.43 | 2,407.77 | 1,926.22 | 1,685.44 | 1,444.66 | 1,300.20 |
| ----- Percent of income ----- | | | | | | | | | | | |
| \$10,000 | 8.1 | 22.3 | 19.1 | 17.4 | 15.8 | 14.9 | 16.2 | 12.9 | 11.3 | 9.7 | 8.7 |
| \$15,000 | 8.1 | 19.0 | 16.4 | 15.1 | 13.8 | 13.1 | 12.8 | 10.0 | 9.0 | 7.7 | 6.9 |
| \$20,000 | 8.1 | 17.2 | 15.1 | 13.6 | 12.8 | 12.2 | 11.2 | 8.9 | 7.8 | 6.7 | 6.0 |
| \$30,000 | 6.1 | 12.7 | 11.1 | 10.3 | 9.5 | 9.0 | 8.0 | 6.4 | 5.6 | 6.0 | 4.3 |
| \$50,000 | 3.7 | 7.6 | 6.7 | 6.2 | 5.7 | 5.4 | 4.8 | 3.8 | 3.4 | 2.0 | 2.6 |

¹Total income or salary is assumed to be earned income subject only to social security tax for a self-employed proprietor. However, a self-employed sole proprietor may have employees and pay the same rate of social security tax and unemployment insurance and workers' compensation as is paid for corporate employees.

²Social security taxes paid by sole proprietors for themselves are not tax deductible.

³In 1979, a sole proprietor was taxed at 8.1 percent of earned income between \$400 and \$22,900. It was assumed that the sole proprietor received no off-farm income subject to the social security tax.

⁴In 1979, the employee and employer were each taxed at 6.13 percent of wages or salary up to \$22,900. An employer is required to pay social security taxes on wages and salaries paid to an employee but is able to deduct such taxes from taxable income. While there is variation by State in unemployment insurance costs, we assumed that the employer was required to participate and paid the Federal rate of 3.4 percent of the first \$6,000 of salary (including his salary), or \$204 per employee. There is also variation between States in required workers' compensation coverage and costs. It was assumed the employer was required to participate and paid a rate of \$5 per \$100 on \$16,000 of coverage, or \$800 per worker. Costs of unemployment insurance and workers' compensation are tax deductible items to an employer, whether a sole proprietor, partnership, or corporation. The latter two coverages are not required of a sole proprietor even if such a proprietor has sufficient employees to be required to cover them.

⁵The owner manager is not able to deduct the cost of the 6.13 percent of salary that he or she must pay to the Internal Revenue Service for social security coverage.

⁶All the corporate marginal tax brackets are not shown.

at income levels above \$35,000. If net income totals \$100,000, the total tax savings from incorporation amounts to \$18,333. In most cases, additional costs of recordkeeping, filing tax returns, staying up to date on recent changes in tax laws, and an increased potential for tax audits will be incurred with the corporate structure.

Other Programs

Programs such as retirement plans, life insurance, and health and accident insurance receive different tax treatment

depending upon the type of business organization. The flexibility and options available to adopt tax-free programs also vary by legal entity. In general, the programs available to corporations are more flexible and have a lower aftertax cost than those available to sole proprietorships or partnerships.

The tax savings potential of a retirement program depends upon the tax bracket of the farm business. For example, if a corporation has taxable income of between \$50,000 and \$75,000 (30-percent tax bracket), the aftertax cost of con-

Appendix table 3—Federal tax savings after including social security taxes for a corporation and its owner-manager, by income levels, 1979¹

| Total income ² | Sole proprietor | | | | Corporation and its individual owner-manager | | | | | Total tax-saving of corporation and owner-manager versus sole proprietor |
|---------------------------|---------------------|--------------------|------------------------|------------------------------|--|----------------|-----------------|-----------|------------------------------|--|
| | Social security tax | Federal income tax | Total tax ³ | Taxes as a percent of income | Social security tax ⁴ | Individual tax | Corporation tax | Total tax | Taxes as a percent of income | |
| | Dollars | | | Percent | | Dollars | | | Percent | Dollars |
| 4,000 | 324 | 0 | 324 | 8.1 | 490 | 0 | 0 | 490 | 12.3 | -166 |
| 8,000 | 648 | 84 | 732 | 9.2 | 980 | 15 | 0 | 995 | 12.4 | -263 |
| 12,000 | 972 | 702 | 1,674 | 14.0 | 1,422 | 630 | 0 | 2,052 | 17.1 | -378 |
| 16,000 | 1,296 | 1,425 | 2,721 | 17.0 | 1,422 | 630 | 627 | 2,679 | 16.7 | 42 |
| 20,000 | 1,620 | 2,265 | 3,885 | 19.4 | 1,422 | 630 | 1,307 | 3,359 | 16.8 | 526 |
| 25,000 | 1,855 | 3,497 | 5,352 | 21.4 | 1,422 | 630 | 2,157 | 4,209 | 16.8 | 1,143 |
| 30,000 | 1,855 | 4,953 | 6,808 | 22.7 | 1,422 | 630 | 3,007 | 5,059 | 16.7 | 1,749 |
| 35,000 | 1,855 | 6,608 | 8,463 | 24.2 | 1,422 | 630 | 3,857 | 5,909 | 16.9 | 2,554 |
| 40,000 | 1,855 | 8,506 | 10,361 | 25.9 | 1,840 | 1,242 | 4,094 | 7,176 | 17.9 | 3,185 |
| 50,000 | 1,855 | 12,818 | 14,673 | 29.3 | 1,950 | 1,404 | 5,875 | 9,226 | 18.5 | 5,444 |
| 60,000 | 1,855 | 17,718 | 19,573 | 32.6 | 1,950 | 1,404 | 7,875 | 11,229 | 18.7 | 8,344 |
| 70,000 | 1,855 | 22,846 | 24,701 | 35.2 | 2,452 | 2,265 | 9,005 | 13,722 | 19.6 | 10,979 |
| 80,000 | 1,855 | 28,126 | 29,981 | 37.5 | 2,808 | 4,505 | 9,249 | 16,562 | 20.7 | 13,419 |
| 90,000 | 1,855 | 33,420 | 35,275 | 39.2 | 2,808 | 4,505 | 12,249 | 19,562 | 21.7 | 15,713 |
| 100,000 | 1,855 | 39,050 | 40,905 | 40.9 | 2,808 | 4,505 | 15,249 | 22,562 | 22.5 | 18,333 |
| 110,000 | 1,855 | 44,680 | 46,535 | 42.3 | 2,808 | 6,608 | 16,449 | 25,865 | 23.5 | 20,670 |
| 120,000 | 1,855 | 50,541 | 52,396 | 43.7 | 2,808 | 8,162 | 18,508 | 29,478 | 24.6 | 22,918 |
| 130,000 | 1,855 | 56,521 | 58,376 | 44.9 | 2,808 | 8,162 | 22,508 | 33,478 | 25.8 | 24,898 |
| 140,000 | 1,855 | 62,501 | 64,356 | 46.0 | 2,808 | 8,505 | 26,348 | 37,661 | 26.9 | 26,695 |
| 150,000 | 1,855 | 68,481 | 70,336 | 46.9 | 2,808 | 12,720 | 26,268 | 41,796 | 27.9 | 28,540 |
| 160,000 | 1,855 | 74,461 | 76,316 | 47.7 | 2,808 | 12,720 | 30,796 | 46,324 | 29.0 | 29,992 |
| 170,000 | 1,855 | 80,514 | 82,369 | 48.5 | 2,808 | 12,720 | 35,396 | 50,924 | 30.0 | 31,445 |
| 180,000 | 1,855 | 86,774 | 88,629 | 49.2 | 2,808 | 12,720 | 39,996 | 55,524 | 30.8 | 33,105 |
| 190,000 | 1,855 | 93,034 | 94,889 | 49.9 | 2,808 | 12,720 | 44,596 | 60,124 | 31.6 | 34,765 |
| 200,000 | 1,855 | 99,294 | 101,149 | 50.6 | 2,808 | 12,720 | 49,196 | 64,724 | 32.4 | 36,425 |
| 250,000 | 1,855 | 131,022 | 132,877 | 53.2 | 2,808 | 12,720 | 72,196 | 87,724 | 35.1 | 45,153 |
| 300,000 | 1,855 | 163,022 | 164,877 | 55.0 | 2,808 | 12,720 | 95,196 | 110,724 | 36.9 | 54,153 |
| 350,000 | 1,855 | 195,022 | 196,877 | 56.3 | 2,808 | 12,720 | 118,196 | 133,724 | 38.2 | 63,153 |
| 400,000 | 1,855 | 227,022 | 228,877 | 57.2 | 2,808 | 12,720 | 141,196 | 156,724 | 39.2 | 72,153 |
| 450,000 | 1,855 | 259,022 | 260,877 | 58.0 | 2,808 | 12,720 | 164,196 | 179,724 | 39.9 | 81,153 |
| 500,000 | 1,855 | 291,022 | 292,877 | 58.6 | 2,808 | 12,720 | 187,196 | 202,724 | 40.5 | 90,153 |
| 1,000,000 | 1,855 | 611,022 | 612,877 | 61.3 | 2,808 | 12,720 | 417,196 | 432,724 | 43.3 | 180,153 |

¹The procedure used to allocate income between the owner-manager and the corporation was to minimize the total Federal income tax bill. The social security tax was calculated on the sole proprietor's total income subject to tax and on the gross salary of the owner-manager as shown at each income level.

²The amount of income reported for tax purposes prior to social security deductions and exemptions.

³The taxable income above \$60,000 was taxed at the surtax level as was done in table 8.

⁴Total social security tax for both a corporation and the individual owner-manager, each of which paid 6.13 percent of the gross salary. The corporation's contributions were a tax deduction.

tributing \$100 to a qualified retirement plan is \$70, or for each dollar contributed, the corporation obtains a 30-cent reduction in taxes. Likewise a sole proprietor or partner in the 32-percent tax bracket can contribute \$100 to a Keogh or IRA plan at an aftertax cost of \$68. The farmer must also make contributions for all other employees (exceptions are made for part-time and seasonal employees) in a corporation, but need not do so in a sole proprietorship or partnership if contributions are made to an IRA.

If a corporation is formed and the income tax minimizing strategy is used to allocate \$50,000 of income between the owner-manager and corporation, the marginal tax bracket of the corporation is 20 percent, so each dollar contributed to a retirement plan would cost 80 cents. A farmer with \$50,000 of income is in the 49-percent tax bracket as a sole proprietor, so each dollar of retirement contribution will cost 51 cents. In this case, the corporate retirement plan has a higher aftertax cost, but the corporation is obtaining some offsetting savings in Federal income taxes from the division of income between the corporation and owner-manager.

Although a sole proprietor and an owner-employee in a corporation can both participate in tax-deferred retirement plans, the tax treatment of life, health, and accident insurance plans is quite different for the proprietorship and corporation. A corporation can acquire up to \$50,000 of life insurance coverage for each employee with the premiums tax deductible to the corporation and not taxable income to the employee under a qualified group plan. Many States require a minimum of 10 employees. The premium payments on health and accident insurance for employees are also deductible to the corporation under certain conditions. To be tax deductible, insurance programs generally must not discriminate in favor of owner-employees or highly paid employees.

Premiums paid by a sole proprietor on life insurance policies are not deductible but half of the premium on health insurance policies is tax deductible in a sole proprietorship up to a maximum of \$150, if the individual itemizes deductions on her personal return. Because of this difference in the tax treatment of such fringe benefit programs, the aftertax dollars needed to acquire a specified level of benefits can be substantially different in the corporation and sole proprietorship (appendix table 4). For example, if the cost of \$1,000 of term life insurance is \$4, the net cost after Federal income taxes of such coverage for a corporation in the 30-percent tax bracket is \$2.80, assuming the policy cost is tax deductible. In contrast, a sole proprietor must pay for such coverage with aftertax income. A sole proprietor in the 32-percent tax bracket must receive \$5.88 of before-tax income to have sufficient aftertax income to purchase the same coverage. Thus, the cost of the coverage is 52-percent lower for the corporation than for the sole proprietorship. The aftertax costs of programs that are tax deductible to the corporation but must be purchased with aftertax income by the sole proprietor are from 30 to 72 percent less expensive for the corporation, depending upon the marginal tax brackets of the two.

In addition to the insurance fringes, a regularly taxed corporation may be able to deduct depreciation, maintenance, and repairs on a farm residence if the owner-employee is required to live in the residence as a condition of employment. A subchapter S corporation can deduct such expenses only to the extent the residence is used for business purposes. The costs of uniforms and food may also be deductible and are not taxable income to the employee if furnished for the convenience of the employer. However, deductions for such expenses as lodging and food are closely scrutinized by the IRS, particularly if taken on behalf of owner-employees.

Appendix table 4—Tax advantages of a corporation over a sole proprietorship in acquiring fringe benefits¹

| Corporation marginal tax bracket | Sole proprietor marginal tax bracket | | | | | | |
|-------------------------------------|--------------------------------------|---------------|---------------|---------------|---------------|---------------|---------------|
| | 16 percent | 21 percent | 28 percent | 32 percent | 37 percent | 43 percent | 49 percent |
| Percent reduction for corporation | | | | | | | |
| 17 percent | 30 | 35 | 40 | 44 | 48 | 53 | 58 |
| 20 percent | 33 | 37 | 42 | 46 | 50 | 54 | 59 |
| 30 percent | 41 | 45 | 50 | 52 | 56 | 60 | 64 |
| 40 percent | 50 | 53 | 57 | 59 | 62 | 66 | 69 |
| 46 percent | 55 | 57 | 61 | 63 | 66 | 69 | 72 |

¹These relative reductions were calculated by comparing the aftertax cost of purchasing tax deductible fringe benefits in a corporation to the additional aftertax income that a sole proprietor must earn to pay for the same benefits (the costs of which are not tax deductible to the sole proprietor). For example, the payment of \$1 for term life insurance only costs \$0.70 for a corporation in the 30-percent tax bracket if the premium is tax deductible. In contrast, a sole proprietor must pay for such coverage with aftertax income and the premium is not tax deductible; thus, if a sole proprietor is in the 28-percent tax bracket, he must earn \$1.39 of additional income to have \$1 of aftertax income to pay the premium. Consequently, the cost of this insurance policy is 50 percent lower for a corporation ($[(\$1.39 - \$0.70) \div \$1.39]$) than for a sole proprietorship.

Appendix II. Unemployment Insurance

The Federal Government took a renewed interest in coverage of agricultural laborers and employees in the seventies. The interest continued as the National Commission on Unemployment Compensation in 1979 and 1980 undertook the task of formulating additional legislative recommendations regarding agricultural workers. The commission obtained the services of Phillip Booth, a former official in the Unemployment Insurance Office, U.S. Department of Labor, and longtime farm coverage analyst, to analyze and recommend changes in the program at the national level. This appendix briefly summarizes Booth's findings and recommendations. All of Booth's recommendations, however, may not be supported or enacted into law in the exact form suggested to the Congress. Nonetheless, the recommendations indicate the interest in certain quarters to greatly expand coverage in agriculture and the general direction that proposed legislation and regulation may take.

Current Magnitude of Coverage

Appendix table 5 shows, for selected States, the number of crop and livestock units whose workers were covered under unemployment insurance in the second quarter of 1978 and their aggregate wages and rate of change from the same quarter in 1977. The second quarter, April-June, is a meaningful quarter for comparison since much of the seasonal labor force is employed for spring planting and early crop harvest. The most notable phenomenon is the large number of workers covered in the States where agriculture uses large numbers of hired workers, especially California and Florida.

Also noticeable is the large increase in the number of employing units, workers, and amount of wages subject to

unemployment coverage in 1978. This large increase resulted from legislation, discussed earlier, that mandated coverage for agricultural operations that employ a significant number of agricultural workers.

In most of these selected States, the percentage increase in number of covered workers was much greater on crop production units than on livestock farms. This occurred since more of the livestock operations were already covered prior to 1978. California and Minnesota showed little change in number of employers and workers covered from 1977 to 1978, which was expected since their State laws had earlier brought under coverage many of the units and workers that the 1978 Federal provisions brought under coverage. Other States with little coverage prior to 1978 (Ohio and Mississippi, for example) found many farm units and workers coming under coverage in 1978. Iowa, with little specialized fruit and vegetable production and few large livestock units with many employees, showed small percentage changes from 1977 to 1978.

Recommended Extension of Coverage

Research analysts should be aware that more changes may be ahead in unemployment insurance coverage, following Booth's recommendations. Booth categorized his recommendations according to those calling for (1) Federal congressional action, (2) State legislation, and (3) State and Federal administrative action. His recommendations are quoted below; in some cases, comments are added in brackets.

Federal Congressional Action

- a. Students performing services in agriculture should be covered by the Federal Unemployment Tax Act (FUTA). (This recommendation may

Appendix table 5—Crop and livestock employing units, covered workers and wages for selected States, April-June 1978 and percentage change from the same period in 1977

| State | Crop production units | | | | | | Livestock production units | | | | | |
|--------------|-----------------------|----------------|---------|----------------|---------------|----------------|----------------------------|----------------|---------|----------------|---------------|----------------|
| | Employers | | Workers | | Wages | | Employers | | Workers | | Wages | |
| | Number | Percent change | Number | Percent change | 1,000 dollars | Percent change | Number | Percent change | Number | Percent change | 1,000 dollars | Percent change |
| Arkansas | 317 | 645 | 4,430 | 2,048 | 8,379 | 2,254 | 99 | 67 | 2,435 | 122 | 4,617 | 118 |
| California | 18,472 | -4 | 228,210 | 0 | 402,962 | 5 | 4,812 | -4 | 29,843 | 0 | 63,079 | 10 |
| Florida | 1,275 | 240 | 52,678 | 1,341 | 86,378 | 755 | 350 | 296 | 6,803 | 1,099 | 13,935 | 981 |
| Iowa | 117 | 29 | 1,929 | 136 | 4,005 | 133 | 113 | 57 | 1,271 | 70 | 2,479 | 86 |
| Minnesota | 398 | 8 | 4,369 | -8 | 2,473 | 9 | 250 | -7 | 2,523 | 4 | 1,421 | 2.4 |
| Mississippi | 383 | 6,258 | 7,847 | 18,361 | 10,703 | 28,522 | 49 | 533 | 1,896 | 1,483 | 3,912 | 2,369 |
| New York | 522 | 130 | 6,614 | 293 | 13,086 | 323 | 172 | 54 | 2,049 | 173 | 4,210 | 200 |
| Ohio | 230 | 10,350 | 5,560 | 5,429 | 10,133 | 6,283 | 58 | 160 | 960 | 307 | 1,781 | 332 |
| Pennsylvania | 326 | 138 | 7,906 | 539 | 16,471 | 6.7 | 112 | 62 | 2,224 | 217 | 4,031 | 258 |
| Texas | 321 | 287 | 14,071 | 1,595 | 23,732 | 1,272 | 479 | 168 | 10,260 | 456 | 21,720 | 495 |
| Washington | 650 | 1,571 | 19,126 | 2,007 | 25,639 | 1,948 | 82 | 489 | 1,965 | 862 | 4,386 | 812 |

Source: Phillip Booth, "Coverage of Agricultural Workers Under Unemployment Compensation," report submitted to the National Commission on Unemployment Compensation, June 1979.

have the problem of including school children. Some school children in Maine, for example, are dismissed each fall for the potato harvest; in other areas, children harvest apples. Unemployment coverage would be required for such children unless they were excluded.)

- b. The provision for exclusion of wages paid to certain workers under selected sections of the Immigration and Nationality Act should be permitted to expire at the end of 1979. (The provision was extended to 1980 and provided that time and services of agricultural workers so exempted should be counted toward the numerical and quarterly payroll criteria in determining their employer's liability for coverage under FUTA). Wages paid to temporary agricultural workers would not constitute the basis for their own unemployment insurance.
- c. Aliens not legally admitted to the United States with permission to work should be covered if they have resided and worked in the United States the preceding 6 years and have declared their intention to continue to work in the United States permanently.
- d. Farm operators should be regarded as the employer of crew members performing services for them unless the operator and the leader of the crew have agreed in writing that the crew leader is to be regarded as excluded under mandatory coverage.
- e. Unemployment insurance coverage should be extended to agricultural workers on the same basis that nonagricultural workers are presently covered. (This would require most States to change their coverage provisions).

State Legislation

States should adopt broader and, insofar as possible, uniform legislative provisions for extending coverage to farmworkers presently excluded under mandatory coverage.

Federal and State Administrative Action

- a. The U.S. Department of Labor should make resources available to the States to improve and expand counseling, guidance, placement, and followup services, generally available to nonfarm workers, to farmworker claimants, and especially to migrant farmworker claimants. Such farmworkers should be encouraged to ask for the available resources. The Department should work with other governmental and nongovernmental agencies to improve methods of meeting the special readjustment needs of farmworkers displaced by mechanization and other technical changes, and consolidation of farm employing units.
- b. Both levels of government should assure that crew leaders and farm operators inform crew members of their unemployment insurance rights.

(The States would seem to have the greater responsibility since they provide the actual coverage.)

- c. Both levels of government should assure that benefit payments to multistate farmworkers are made on a timely basis called for by Federal administrative standards. Regulations and procedures should be amended where necessary to assure that employers found chronically tardy in responding to requests for wage and employment information be required to submit quarterly wage reports.

Implications

While each recommendation has implications for employers, farmworkers, and farm technology (to replace labor on farms), the most far-reaching recommendation is to extend FUTA and State coverage to all agricultural workers on the same basis that nonagricultural workers are presently covered. Required Federal coverage does not automatically require that States provide actual benefit coverage.

Citing studies made since the thirties on the reasons for the exclusion of agriculture, Booth (and other authors) contends that the earlier reasons for exclusion are no longer valid. Extending mandatory coverage at the Federal level all at once is more desirable, they maintain, than allowing the individual States to decide if coverage should be extended, and if the extended coverage should be phased in over a period of years.

A number of reasons were advanced to exclude agricultural workers from unemployment insurance coverage when the Social Security Act was passed in 1935 and several more have been advanced over the years. However, farm groups may now object to unemployment insurance more firmly than to social security and workers' compensation coverage. With social security, the farm family is a potential recipient of benefits. Workers' compensation protects farmers against negligence suits. They may be against extending unemployment insurance since benefits largely go to unemployed workers. Farm groups may most strongly oppose extending mandatory coverage to students who are not in the labor force on a permanent basis.

Among the more significant observations advanced for opposing unemployment insurance coverage was the initial reluctance of the States to create an unemployment insurance system, believing that if they did so, employers would be at a competitive disadvantage and move to States with no program. The Federal Act, for the most part, removed this problem. In addition, excluding agricultural coverage was justified on the expectation that agriculture would be a deficit industry and more money would be paid out than collected, which could threaten the solvency of the entire compensation system. Most of the agricultural employment was assumed to be seasonal and as such would create insurmountable administrative problems. Most farms were small, had few hired workers, had little experience with the necessary recordkeeping work, and could not absorb the cost

of unemployment insurance out of profit margins. In addition, the observation was advanced that required coverage would create perverse work incentives for short-term agricultural employees.

Over time, the objections to including agricultural workers has diminished. Social security experience has shown that the government can collect payroll taxes from farmers, and farmers have been able to absorb the costs. Unemployment insurance coverage, where available, tends to help farmers minimize worker turnover, which in turn can reduce agricultural labor costs. In addition, when workers can collect insurance benefits, farm operators tend not to keep them on their payrolls during slack periods to insure their availability during peak labor need periods. While agricultural workers covered under unemployment insurance have a higher than average cost of premiums paid to benefit received ratio, it is not as high as for construction workers, who have a longer participation experience. If mandatory coverage is extended to all agricultural workers, fruit and vegetable producers will probably be affected the most since their subsector still requires high labor use.

The basic 1979 coverage criteria for nonagricultural workers that would apply to agricultural workers should Federal legislation require coverage is as follows: Employers employing one or more workers at least 1 day in each of 20 different weeks during the current or immediately preceding calendar year or employers who, during any calendar quarter in the current or immediately preceding calendar year, paid wages of \$1,500 or more. Using this criteria, almost all farms that employ labor, even on a part-time basis, would be covered. For example, a farmer who paid the minimum wage of \$3.10 per hour for thirteen 40-hour work weeks in 1980 to one employee would pay \$1,612 and be covered, as would the farmer who paid as little as \$496 to an employee (twenty 8-hour days at the minimum wage of \$3.10 per hour). Employers who employ relatives only, such as spouse and minor children or parents, would apparently continue to be excluded from coverage except as noted in an earlier section. New York, however, does cover such employed relatives.

Self-employed farmers who use a sole proprietorship form of business organization have not and would not be covered under proposed changes. If they incorporate and become employees of the corporation, they would be covered even though they made no substantial changes in the work performed after they became incorporated. The farm corporation that employs relatives, the same as before incorporation, would have to cover them too.

While Booth admitted to substantial problems in enumerating the number of farm employers and employees currently covered and the number that would be covered under his broader coverage proposal, he nonetheless made estimates. As a summary estimate, he stated that no more than 6 or 7 percent of all agricultural employers were liable for contributions under Federal and State unemployment compensation laws in the late seventies. Reports from the State

Unemployment agencies for the first quarter of 1978 showed a total of 86,543 reporting units. He estimated that between 361,000 and 1,100,000 farms used some hired labor in 1977. The 1974 Census of Agriculture counted 700,000 farm operators using hired labor in 1974, including some who paid less than \$150 in wages during the year. Booth concluded that the size of the underestimation or overestimation of the 1974 census is unknown. The U.S. Department of Agriculture estimated, for the Employment Standards Administration of the U.S. Department of Labor, that 1.1 million farmers employed some hired labor in 1974. No estimate was made of the percentage of the employing units that would qualify under the proposed unemployment coverage for agricultural employers.

Booth estimated that some 2.8 million workers earned wages in agricultural work in 1976; about 57 percent did only hired farmwork during the year and the remaining nearly 1.2 million worked in both farm and nonfarm work. About 1.5 million of the total were not in the labor force during most of the year; about 1.1 million of them were in school. The remainder were keeping house or not looking for work. Thus, Booth concluded that a large number of the Nation's hired farmworkers are students, housewives, retirees, temporarily employed nonfarm workers, and others who are frequently unemployed or not in the labor market most of the year. If that is true, about 68 percent of all work performed in 1976 was done by about 20 percent of all the hired workers, who tend to be regular or year-around employees. About 41 percent of the hired workers worked fewer than 25 days (casual workers) and did only about 5 percent of all farmwork, most of it during peak seasons. Another group of seasonal employees (working 25 to 149 days) did about one-fourth of the 1976 farm labor and constituted about 38 percent of all hired farmworkers.

Booth concluded that exclusion from coverage is the greatest disadvantage for the latter two groups. For many, their covered nonfarm earnings may be too small to enable them to obtain benefits, or, at best, will qualify only for minimum benefits. Thus, on a concrete numbers basis, Booth concluded that about 250,000 workers would benefit from his proposed coverage extension. He did not address the added number of people who would be covered should more farm operators incorporate. Many such operators would probably not collect unemployment benefits where their farms are large enough to provide year-around employment. Booth also estimated that advances in mechanization in production and processing of fruits and vegetable crops, which have been replacing migratory and local agricultural employees, caused the number of migratory workers to decline from about 400,000 in 1965 to 200,000 in 1978. Agriculture surveys showed that the number of migrant workers stabilized during the seventies and suggested that the stabilizing trend would continue into the 1980's for hired farmworkers as a group.¹

¹Smith, Leslie Whitener, and Robert Coltrane. *Hired Farmworkers: Background and Trends for the Eighties*, RDRR-32. Economic Research Service, U.S. Dept. of Agriculture. September 1981.

Appendix III. Workers' Compensation

Impediments to Wider Coverage of Farmworkers

In addition to traditional reasons for not including farmworkers under required coverage of social programs such as workers' compensation, a number of specific impediments remain, which are not likely to be quickly removed. Without mandatory coverage, employers may lack strong incentives to seek coverage for their workers. Sellers enumerated several impediments but observed that since several States provide complete coverage of agricultural workers, the other States may not have investigated the issues thoroughly and that the impediments may not be significant enough to exclude agricultural workers.¹

Sellers's list of impediments included: 1) State laws permit high minimum premiums and charges, 2) Farm employers do not have reliable information on which to rationally allocate safety resources or decide on risk protection, 3) Most workers' compensation insurance for agricultural employers is not experience rated, 4) Premiums are set on a group basis, which blunts incentive to maintain a low accident incidence rating, 5) the probability of an Occupational Safety and Health Administration inspection is now low and even where farms were cited for violation in 1976, the penalty was only \$32.68 or \$0.49 per employee (OSHA restricted inspections in 1976 to establishments with 11 or more employees and known hazardous industries), 6) Too few farm employees are informed about their rights under court tort systems and may be discouraged from litigation because of high court and associated costs and the possibility of losing the case. Such employees may secure social security disability or benefits from other welfare programs which shift the burden to the public.

There may be reasons for employers to try to remove the impediments. Employers as part of good business strategy try to reduce risk of losing money but they probably cannot expect to remove all employee risks in the workplace. Thus employers may try to provide workers' compensation coverage since, in its absence, a court case may be very costly or even put them out of business.

Sellers concludes with seven general recommendations;

1. Initiate a detailed study of accident injury frequency and severity in the agricultural industry.
2. Provide mandatory coverage for all agricultural workers employed by farmers and agricultural service firms with more than three employees and/or a \$5,000 wage bill.
3. Provide mandatory employers' liability insurance for all other agricultural employers.
4. Provide uniform guidelines in assessing insurance premiums for risks in similar pursuits among the States.
5. Reduce minimum premiums to an equitable level or form State insurance pools for smaller farm employers.

6. Encourage passage of laws that are uniform in farm coverage, where premiums are based on experience rating of the individual firm so that farmers will have an incentive to provide a safer work environment.

7. Provide proper mandatory coverage of farmworkers, which will put the cost of accidents as a cost of production and simultaneously reduce the use of Social Security Disability Insurance and other publicly funded programs, which subsidize farm employer's work accidents.

Special Subclassifications of Agricultural Employment for Workers' Compensation by State

The subclassification list is detailed by occupation and subclassification by State. It is useful to use the correct classification for rate determination when doing studies. The list is as follows:

1. Berry farm and drivers (Florida)
2. Berry farm or vineyard (no dairying or raising of livestock or grain) and drivers (New Jersey)
3. Berry picking (Oregon)
4. Cattle or livestock dealer and drivers (New Jersey)
5. Cattle or livestock farm (no collection of waste for food) and drivers, (New Jersey) artificial breeding of cattle (nonprofessional employees and drivers)
6. Clearing land (California)
7. Country forestry cultural operations (all operations), and drivers (Wisconsin)

Appendix table 6—Occupational injury and illness incidence rates, private sector by selected industries, United States, 1978

| Industry | Total cases | Lost workday cases | Lost workdays |
|--------------------------------------|--|--------------------|---------------|
| | Incidence rate per 100 full-time workers | | |
| Agricultural production | 12.8 | 5.8 | 81.3 |
| Agricultural services | 10.3 | 5.0 | 80.2 |
| Oil and gas extraction | 13.9 | 6.9 | 154.4 |
| Special trade contractors | 15.8 | 6.6 | 111.0 |
| General building contractors | 15.9 | 9.3 | 105.3 |
| Food and kindred products | 19.4 | 8.9 | 132.2 |
| Ship and boat building and repairing | 21.3 | 10.8 | 195.5 |
| Wood containers | 21.4 | 10.9 | 162.1 |
| Iron and steel foundries | 24.6 | 11.6 | 169.2 |
| Logging camps | 25.9 | 15.6 | 316.2 |

Note: This list is only a selected few of the industries which have higher injury rates than farming. Some 40 4-digit SIC code industries in the food and kindred products manufacturing sector have higher rates.

Source: U.S. Dept. of Labor, Bureau of Labor Statistics. *Occupational Injuries and Illnesses in 1978: Summary*. Report 586, table 1. March 1980.

¹Sellers, Walter E., "Workers' Compensation in the Agricultural Industry," unpublished, Division of Evaluation and Research, U.S. Dept. of Labor, February 1981.

8. Dairy farm and drivers (New Jersey)
9. Dairy or livestock farm, all employers other than inservants and drivers (Michigan)
10. Dog kennels and drivers (New Jersey)
11. FARMS: (Arizona)
 - a. Animal raising
 - b. Dairy farm
 - c. Field crops
 - d. Gardening, market or truck and vineyards
 - e. Orchard
 - f. Poultry or egg producer
12. FARMS: (California)
 - a. Cotton farms
 - b. Dairy farms
 - c. Field crops
 - d. Orchards
 - e. Potato crops
 - f. Poultry raising, egg production and hatcheries
 1. Sheep raising and hog farms
 - g. Stock farms
 1. Feed yards
 - h. Truck farms
 - i. Vineyards
13. Farm, all employees other than inservants—including drivers (Oklahoma)
14. Farm, market or truck, all operations and drivers (Michigan)
15. Farm and drivers (Minnesota and Wisconsin)
16. Farm, not otherwise classified, all employees other than inservants and drivers (Michigan)
17. Farm, not otherwise classified and drivers (New Jersey)
18. Farm, not otherwise classified and drivers (New York)
19. Fish pond, care and maintenance, and drivers (Hawaii)
20. Fish hatchery and drivers (Hawaii)
21. Fish raising (Oregon)
22. Oyster raising (Oregon)
23. Flower or bulb farm, no dairying or raising of livestock or grain, and drivers (New Jersey)
24. Fruit farm, and drivers (New York)
25. Fruit growers, other than orchards—all operations and drivers (Wisconsin)
26. Tobacco growers, and drivers (Wisconsin)
27. Fruit packing and handling and drivers (Michigan)
28. Fruit picking, by contractor, and drivers (Florida)
29. Fruit picking on ground (Oregon)
30. Nut picking on ground (Oregon)
31. Vegetable picking by hand (Oregon)
32. Hatchery, poultry, and drivers (New Jersey)
33. Chick, squab, or fish hatchery and drivers (New Jersey)
34. Hatchery, no farming operations and drivers (Michigan)
35. Lawn or shrub spraying and drivers (Florida)
36. Logging or lumbering, all operations (North Carolina)
37. Logging or lumbering, pulp wood exclusively, and drivers (Florida, Georgia, Louisiana, Mississippi, North Carolina, South Carolina, Tennessee, and Texas)
38. Logging railroad operation (North Carolina)
39. Orchard and grove owners and operators, all operations, and drivers (Florida)
40. Orchard work, fumigating or spraying (California)
41. Orchard work, pruning (California)
42. Orchards, all employees other than inservants, and drivers (Michigan)
43. Orchard or fruit farm and drivers (New Jersey)
44. Plantation, sugar or pineapple, including cannery and mill employees and drivers (Hawaii)
45. Poultry farms (New Jersey and New York)
46. Private estates, inservants (New Jersey)
47. Private estates, outservants (New Jersey)
48. Rabbit or fur bearing animal farms and drivers (New Jersey)
49. Silviculture, including brush cleaning (New York)
50. Silviculture, not otherwise classified (New York)
51. Sugarcane plantations and drivers (Florida and Louisiana)
52. Tree farming, Christmas tree growing, harvesting and storing (Oregon)
53. Truck farms, orchards, and vineyards and drivers (Texas)
54. Truckmen, hauling of logs, and drivers (Idaho)
55. Vegetable, berry, flower or bulb farms or vineyards, including incidental dairying or general farming and drivers (New Jersey)
56. Vegetable farms, no dairying or raising of livestock or grain, and drivers (New Jersey)
57. Vegetable packing and handling and drivers (Michigan)
58. Vineyards and drivers (Florida)

Appendix IV. National Participation in IRA Programs

National participation in IRA's was assessed in late 1979, about 5 years after Federal legislation permitted the program.¹ A Congressional estimate made in 1974, when the IRA legislation was enacted, suggested that 55 million employees not covered by employer-sponsored pension programs would be eligible to set up IRA's. However, in 1978 only about 6 percent of the eligible employees had set up their own IRA's.

The 1981 tax legislation expanded the eligibility for IRA's to all persons with earned income. Whether or not those changes will increase the rate of participation remains to be seen.

Data were not available for farm operators, employees, or laborers, but there is no reason to hypothesize that the participation rate of people with income from farming is different from that of the general population. This in part results from the fact that self-employed farm people are also eligible to participate in Keogh programs and Keogh provisions have been available for more years than IRA's.

¹*Consumer Reports*, "IRA's: Costs, Benefits and Problems," January 1980, pp. 40-46.

Several reasons were given for the apparently low participation. The Federal Government was first singled out; "though the Government has cautioned citizens against counting solely on social security benefits, it has done very little to promote tax sheltered savings programs such as those permitted by IRA's." The analysts found that the complex rules and regulations often resulted in poor information being available to eligible participants. "Lack of promotion and complex rules have discouraged participation." The \$1,500 maximum annual tax shelter (\$2,000 beginning in 1982) is too low for some taxpayers. In addition, life insurance and annuity companies often set up IRA programs that may be more to their advantage than to that of the IRA participants, particularly where participants need early withdrawal from a particular financial instrument or retirement annuity or want to switch to a higher paying program. The recently expanded pool of eligible participants may modify some of those shortcomings. Financial institutions have begun to advertise IRA's extensively, with some mutual funds offering IRA exchange privileges among the family of funds that they administer.

Financial institutions have contended that the sales commissions on the small amounts permitted by IRA's were not large enough to attract major sales efforts since many potential participants need considerable help in choosing a program. In addition, they contended that the Federal Government kept changing the rules, which were already too complex.

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