

## 2010 U.S. Master Tax Guide, 421. Guaranteed Payments to Partners

<http://prod.resource.cch.com/resource/scion/document/default/%28%40%40MTQ01+P421%29mtq0109013e2c85895478?cfu=Legal>

Any fixed payments to partners for services or for the use of capital made without regard to partnership income are treated as though paid to a nonpartner for purposes of computing partnership gross income and business expense deductions (see ¶432). Thus, guaranteed payments are regarded as ordinary income to the recipient and are deductible by the partnership as ordinary and necessary business expenses (assuming they are, in fact, ordinary and necessary) (see ¶902) (Code Sec. 707(c); Reg. §1.707-1(c)).<sup>53</sup>

This rule applies only to the extent that the amounts paid are in fact guaranteed payments determined without regard to the income of the partnership (Code Sec. 707(c); Reg. §1.707-4).<sup>54</sup> The partner must report the payments on his return for the tax year within or with which ends the partnership year in which the partnership deducted the payments as paid or accrued under its method of accounting.

### Example 1

In the AB partnership, Ann is the managing partner and is entitled to receive a fixed annual payment of \$100,000 for her services, without regard to the income of the partnership. Her distributive share of partnership profit and loss is 10%. After deducting her guaranteed payment, the partnership has \$300,000 ordinary income. Ann must include \$130,000 (\$100,000 guaranteed payment plus \$30,000 distributive share) as ordinary income for her tax year within or with which the partnership tax year ends. If the partnership had shown a \$100,000 loss after deduction of Ann's guaranteed payment, her guaranteed payment (\$100,000) would be reported as income and her \$10,000 distributive share of the loss, subject to the loss limitations of Code Sec. 704(d) (see ¶425), would be taken into account by her on her return.

If a partner is entitled to a minimum payment and the percentage of profits is less than the minimum payment, the guaranteed payment is the difference between the minimum payment and the distributive share of the profits determined before the deduction of the minimum payment (Reg. §1.707-1(c)).<sup>55</sup> Only the amount of the guaranteed payment may qualify as a deductible business expense of the partnership.

### Example 2

The AB partnership agreement provides that Ann is to receive 30% of partnership income before taking into account any guaranteed payments, but not less than \$100,000. The income of the partnership is \$600,000, and Ann is entitled to \$180,000 (30% of \$600,000) as her distributive share. Because her distributive share exceeds the minimum amount that was guaranteed, no part of the \$180,000 is a guaranteed payment. If the partnership had income of only \$200,000, Ann's distributive share would have been \$60,000 (30% of \$200,000), and the remaining \$40,000 payable to Ann would have been a guaranteed payment.

A partner who receives a guaranteed salary payment is not regarded as an employee of the partnership for the purpose of withholding of income or Social Security taxes or for pension plans. The guaranteed salary is includible in self-employment income for the purpose of the self-employment tax along with the partner's share of ordinary income or loss of the partnership (Reg. §1.707-1(c); Rev. Rul. 56-675).<sup>56</sup>

*Fringe Benefits.* The value of fringe benefits provided to a partner for services rendered in the capacity as a partner is generally treated as a guaranteed payment (Rev. Rul. 91-26).<sup>57</sup> As such, the value of the benefit is generally deductible by the partnership as an ordinary and necessary business expense; the value of the benefit is included in the partner's gross income, unless a Code provision allowing exclusion of the benefit specifically provides that the exclusion applies to partners.

Thus, a payment of premiums by a partnership for a partner's health or accident insurance is generally deductible by the partnership and included in the partner's gross income. As an alternative, a partnership may choose to account for premiums paid for a partner's insurance by reducing that partner's distributions;

in this case the premiums are not deductible by the partnership and all partners' distributive shares are unaffected by payment of the premiums ([Rev. Rul. 91-26](#)).<sup>58</sup> A partner can deduct 100 percent of the cost of the health insurance premiums paid on his behalf ([Code Sec. 162\(l\)](#)).<sup>59</sup>

<b>Footnotes</b>
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- 53 FED¶25,180, FED¶25,181
- 54 FED¶25,180, FED¶25,181C
- 55 FED¶25,181
- 56 FED¶25,181, FED¶25,183.30
- 57 FED¶25,183.16
- 58 FED¶25,183.16
- 59 FED¶8500, FED¶25,183.16