

method of accounting. See section 706(a) and paragraph (a) of §1.706-1. Guaranteed payments are considered as made to one who is not a member of the partnership only for the purposes of section 61(a) (relating to gross income) and section 162(a) (relating to trade or business expenses). For a guaranteed payment to be a partnership deduction, it must meet the same tests under section 162(a) as it would if the payment had been made to a person who is not a member of the partnership, and the rules of section 263 (relating to capital expenditures) must be taken into account. This rule does not affect the deductibility to the partnership of a payment described in section 736(a)(2) to a retiring partner or to a deceased partner's successor in interest. Guaranteed payments do not constitute an interest in partnership profits for purposes of sections 706(b)(3), 707(b), and 708(b). For the purposes of other provisions of the internal revenue laws, guaranteed payments are regarded as a partner's distributive share of ordinary income. Thus, a partner who receives guaranteed payments for a period during which he is absent from work because of personal injuries or sickness is not entitled to exclude such payments from his gross income under section 105(d). Similarly, a partner who receives guaranteed payments is not regarded as an employee of the partnership for the purposes of withholding of tax at source, deferred compensation plans, etc. The provisions of this paragraph may be illustrated by the following examples:

Example 1. Under the ABC partnership agreement, partner A is entitled to a fixed annual payment of \$10,000 for services, without regard to the income of the partnership. His distributive share is 10 percent. After deducting the guaranteed payment, the partnership has \$50,000 ordinary income. A must include \$15,000 as ordinary income for his taxable year within or with which the partnership taxable year ends (\$10,000 guaranteed payment plus \$5,000 distributive share).

Example 2. Partner C in the CD partnership is to receive 30 percent of partnership income as determined before taking into account any guaranteed payments, but not less than \$10,000. The income of the partnership is \$60,000, and C is entitled to \$18,000 (30 percent of \$60,000) as his distributive share. No part of this amount is a guaranteed payment. However, if the partnership had income of

\$20,000 instead of \$60,000, \$6,000 (30 percent of \$20,000) would be partner C's distributive share, and the remaining \$4,000 payable to C would be a guaranteed payment.

Example 3. Partner X in the XY partnership is to receive a payment of \$10,000 for services, plus 30 percent of the taxable income or loss of the partnership. After deducting the payment of \$10,000 to partner X, the XY partnership has a loss of \$9,000. Of this amount, \$2,700 (30 percent of the loss) is X's distributive share of partnership loss and, subject to section 704(d), is to be taken into account by him in his return. In addition, he must report as ordinary income the guaranteed payment of \$10,000 made to him by the partnership.

Example 4. Assume the same facts as in example 3 of this paragraph, except that, instead of a \$9,000 loss, the partnership has \$30,000 in capital gains and no other items of income or deduction except the \$10,000 paid X as a guaranteed payment. Since the items of partnership income or loss must be segregated under section 702(a), the partnership has a \$10,000 ordinary loss and \$30,000 in capital gains. X's 30 percent distributive shares of these amounts are \$3,000 ordinary loss and \$9,000 capital gain. In addition, X has received a \$10,000 guaranteed payment which is ordinary income to him.

[T.D. 6500, 25 FR 11814, Nov. 26, 1960, as amended by T.D. 7891, 48 FR 20049, May 4, 1983]

§ 1.707-2 Disguised payments for services. [Reserved]

§ 1.707-3 Disguised sales of property to partnership; general rules.

(a) *Treatment of transfers as a sale—(1) In general.* Except as otherwise provided in this section, if a transfer of property by a partner to a partnership and one or more transfers of money or other consideration by the partnership to that partner are described in paragraph (b)(1) of this section, the transfers are treated as a sale of property, in whole or in part, to the partnership.

(2) *Definition and timing of sale.* For purposes of §§1.707-3 through 1.707-5, the use of the term sale (or any variation of that word) to refer to a transfer of property by a partner to a partnership and a transfer of consideration by a partnership to a partner means a sale or exchange of that property, in whole or in part, to the partnership by the partner acting in a capacity other than as a member of the partnership, rather than a contribution and distribution to which sections 721 and 731,