

1999-011  
October 4, 1999  
Attachment 1

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GKMatuszeski

### **ACTION ON DECISION**

**Subject:** James J. and Sandra A. Gales v. Commissioner,  
T.C. Memo. 1999-27

**Issue:** Whether advance commissions received on insurance written by taxpayer husband were income at the time paid or were loans such that income was reportable only as the commissions were subsequently earned.

**Discussion:** Taxpayer husband, an insurance agent, received advance commissions under a contract, which characterized the amounts as loans and required the payment of interest on the advance commission account. It also stated that, if the actual earned commissions were not sufficient to pay off the advance commissions, the balance of the account was payable by taxpayer upon demand. Taxpayer's advance commission account was credited by the amount of commissions he subsequently "earned" as the insured paid the premiums on the insurance sold. The insurance company treated the amount of advance commissions paid each year as income to taxpayer and deducted them. Taxpayer treated the advance commissions as loans.

The issue of whether the advance commissions are income when paid or are loans is a factual issue to be determined from all the surrounding circumstances. Warden v. Commissioner, T.C. Memo. 1988-165; Beaver v. Commissioner, 55 T.C. 85, 91 (1970). A number of factors should be considered. Haag v. Commissioner, 88 T.C. 604, 616 n.6 (1987), aff'd without published opinion, 855 F.2d 855 (8th Cir. 1988); Reed v. Commissioner, T.C. Memo. 1994-611. For an advance to constitute a bona fide loan, there must be a good-faith intent on the part of the recipient to make repayment and a good faith intent on the part of the person advancing the funds to enforce repayment. Fisher v. Commissioner, 54 T.C. 905, 909-10 (1970). Such intent is determined at the time the advance is made. See Beaver, 55 T.C. at 91-92. In Rev. Rul. 83-12, 1983-1 C.B. 99, the Service held that when repayment of insurance commission advances is expected by no other means than subsequently earned commissions, the advances are income when paid.

The present case is distinguishable from the revenue ruling in that the agreement at issue arguably contemplated some means of repayment other than the earned commissions. If personal liability is merely conditional at the time the loan is made the advances are income rather than loans. Warden v. Commissioner, T.C. Memo. 1988-165, citing, James v. United States, 366 U.S. 213, 219 (1961). See Brown v. Helvering, 291 U.S. 193 (1934), holding that insurance commissions were income even though they were repayable in the event the policy lapsed or was canceled. Thus, if personal liability arises only when the earned commissions fail to cover the advances, the advances are still income. See Security Associates Agency Insurance Corp. v. Commissioner, T.C. Memo. 1987-317; George Blood Enterprises, Inc. v. Commissioner, T.C. Memo. 1976-102; Warden. This is true even if subsequent repayments from the recipient are actually made. See Beaver, 55 T.C. at 92. That the advances were originally intended to be repaid through commissions earned is evidence that any personal liability was contingent. Security Associates; Beaver, 55 T.C. at 91. Whether the company normally required other repayment and whether other repayments were in fact made is relevant. See Morgan v. Commissioner, T.C. Memo. 1997-132; Security Associates; Warden. In addition, the deduction of the amounts by the company indicates they were never intended to be loans. See Beaver, 55 T.C. at 92.

In the present case, the Tax Court found that the advance commissions were loans rather than income in the year received, specifically finding that on occasion repayment was demanded of taxpayer and that he personally repaid some of the advance commissions. The court relied upon Dennis v. Commissioner, T.C. Memo. 1997-275, where advance commissions were found to be loans because the taxpayer was personally liable for repayment at the time of the advances. Although, in the present case, the Service viewed the advances as income because personal liability was contingent upon future events, the factual findings of the court provided a sufficient basis for concluding that the amounts were loans.

In light of the court's findings, the Service will not assert that an advance commission is income to an insurance agent when the transaction is: 1) structured as a loan requiring the payment of interest, 2) under the agreement, there is personal liability for repayment at the time the advance is made and 3) the payor in practice or in fact demands and receives repayment of the advances if the commissions earned are not sufficient for repayment. Furthermore, the Service will challenge the payors' deductions for advance commissions paid to their agents where the transaction is structured as a loan.

**Recommendation:** Acquiescence.

**Reviewers:**

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