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**INDIVIDUAL INCOME TAX -
TAXABILITY OF PARTNER'S GUARANTEED PAYMENTS**

(Replaces Income Tax Bulletin 1984-3)

RAB-88-31. The purpose of this Bulletin is to describe the income characterization of a "guaranteed payment" paid to a partner in a partnership and the subsequent income tax treatment of the amount distributed. This Bulletin supersedes Income Tax Bulletin 1984-3, dated April 2, 1984. There are no substantive or technical changes to report in this revision.

Federal Treatment

Definition of a Guaranteed Payment

A payment made by a partnership to a partner for services performed or for the use of capital is generally deemed a guaranteed payment if the payment is made without regard to partnership income. [See the Internal Revenue Code of 1986 (IRC), Section 707(c)]

Tax Treatment by the Partnership

For the purpose of deducting the payment as a trade or business expense, the partnership treats the guaranteed payment as though it is made to a taxpayer who is not a partner. An amount that does not qualify as a guaranteed payment is not deductible by the partnership as a trade or business expense.

Tax Treatment by the Partner

A partner includes a guaranteed payment in gross income as ordinary income in the taxable year the payment is constructively or actually received.

Minimum Payment

When a partnership agreement stipulates that a partner is to receive a minimum payment of partnership income, the guaranteed payment is the amount by which the minimum guarantee exceeds the partner's share of the partnership income before considering the minimum guaranteed payment.

Applicability of Guaranteed Payment

Payments made to a partner are guaranteed payments only for the purposes of determining gross income of the partner and deductibility as business expenses to the partnership. For all other federal tax purposes, guaranteed payments are treated as a partner's distributive share of ordinary income from the partnership.



Michigan Income Tax Treatment

A guaranteed payment as defined under the Internal Revenue Code of 1986 Section 707(c) which is determined to be compensation for services rendered or for the use of capital is not considered a distributive share of the partnership's profits. The payment, to the extent included in federal adjusted gross income, is characterized as compensation or interest on the individual's return.

Resident

To the extent a "guaranteed payment" is includable in a resident partner's gross income, the amount is fully taxable to Michigan. The Michigan Income Tax Act, MCL 206.110(1), states "[i]n the case of a resident individual, estate or trust all taxable income from any source whatsoever, except that attributable to another state under the provisions of Sections 111 to 115 and subject to the credit provisions of Section 255, is allocated to this state."

A credit is allowed under Section 206.255 to a resident of Michigan for income tax imposed on this income by another state of the United States or a political subdivision of another state of the United States, the District of Columbia, or a Canadian province. The Department of Treasury Income Tax Rules, 1979 AC, R 206.16, limit the credit to the smaller of: (1) the Michigan tax on such income, or (2) the tax imposed by the other state. The credit is that portion of the Michigan income tax that the income which is subject to tax in both states bears to total taxable income.

Nonresident

A nonresident partner is taxed on a guaranteed payment to the extent the payment is includable in federal adjusted gross income and is for compensation received for personal services performed in this State. A guaranteed payment for the use of capital is allocated to the nonresident partner's state of domicile.

A nonresident is not allowed to claim a credit for tax paid to another state on the Michigan income tax return except as provided in MCL 206.256. This provision allows a nonresident a credit against, but not in excess of, the Michigan tax otherwise due for the amount of any income tax imposed by the taxpayer's state of residence or subdivision thereof on income from Michigan sources which is also subject to tax under the Income Tax Act.

However, the Michigan Income Tax Act, MCL 206.256(2), provides that ". . . [t]he credit shall be allowable only if the laws of the state of residence contain a reciprocal provision which allows credits to residents of this state under similar circumstances." Presently, Michigan has reciprocal agreements with New Mexico and West Virginia allowing a nonresident to claim a credit on the nonresident's Michigan income tax return for tax paid to the nonresident's state of domicile.

Withholding Tax

A guaranteed payment characterized as compensation is not subject to a withholding tax at the source. The partner in this case is not treated as an employee of the partnership.