



Agent Advances – Loans or Compensation?

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Whether agent advances are loans, or compensation, is an important question for insurance companies and agents. If an advance is compensation, the insurance company can deduct it for tax purposes and the agent must pay tax on receipt. Conversely, if the advance is a loan, the insurance company cannot deduct it and the agent is not required to pay tax on it. Agents typically repay the loans through future commission offsets and pay tax on the commissions in the year they are earned.

The law in this area has been relatively well-settled since 1999, when the IRS formally acquiesced in the result of a Tax Court case that it lost. In *Gales v. Commissioner*, TC Memo. 1999-27, the Tax Court held that certain agent advances were loans. In AOD 1999-011 (Action on Decision) (Oct. 6, 1999), the IRS stated that it would no longer assert that an agent advance is compensation if (1) the advance is structured as a loan requiring the payment of interest; (2) there is personal liability for repayment at the time of the advance; and (3) the payor in practice or in fact demands repayment of the advance if commissions earned are not sufficient for repayment. Two years later, the IRS released Revenue Procedure 2001-24, 2001-1 C.B. 788, which provides similar rules for the insurance company tax side.

Although the basic rules are well settled, issues of fact still arise for the agent. In most cases there are proper legal documents that structure the advances as loans repayable on a date or dates certain with adequate interest. However, questions regarding personal liability can arise, in spite of what the documents say, if the company does not seek to collect past due balances or if it routinely forgives loan balances. In other words, attention should be paid not only to the documents, but to the company's actual practices, in order to ensure loan treatment.