

STATE OF ALABAMA  
DEPARTMENT OF REVENUE,

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STATE OF ALABAMA  
DEPARTMENT OF REVENUE  
ADMINISTRATIVE LAW DIVISION

§

v.

§

DOCKET NO. INC. 91-177

RITA TUCKER  
2069 Wood Meadow Circle  
Birmingham, Alabama 35216,

§

§

Taxpayer. §

#### FINAL ORDER

The Revenue Department assessed income tax against Rita Tucker (Taxpayer) for the year 1988. The Taxpayer appealed to the Administrative Law Division and a hearing was conducted on September 11, 1991. Barry Tucker appeared for the Taxpayer. Assistant counsel Dan Schmaeling represented the Department. This Final Order is based on the evidence and arguments presented by the parties.

#### FINDINGS OF FACT

The Taxpayer suffered a stock loss in 1988 and filed amended returns on March 30, 1989 carrying the net operating loss (NOL) back to 1985, 1986 and 1987. The Taxpayer also carried the NOL forward to 1989.

The Department treated the loss as a "business" loss and accordingly allowed the NOL in full and issued refunds to the Taxpayer for all four years on April 27, 1990. The Department's position at the time was that a loss from the sale of any asset, including stock, constituted a "business" loss for purposes of computing an NOL carryback or carryforward. A "business" loss is

any loss derived from a trade or business and is allowed in full in computing an NOL, whereas a "nonbusiness" loss is a loss not derived from a trade or business and is allowed only to the extent of "nonbusiness" income. See, Code of Ala. 1975, §40-18-15(16)f.3.

The Department changed its position in late 1990 and now recognizes a stock loss as a business loss for NOL purposes only if the taxpayer is actively engaged in business as a stockbroker. Any loss on stock held as an investment is treated as a nonbusiness loss subject to the subparagraph (16)f.3 limitations. The Department's change in position was based in part on a Recommended Order issued by the Administrative Law Division in September, 1990. See, Docket No. INC. 88-201.

The Department applied its new position retroactively and determined that the Taxpayer's 1988 stock loss was a nonbusiness loss and therefore allowable only to the extent of the Taxpayer's 1988 nonbusiness income. The NOL was consequently disallowed in full because the Taxpayer had no nonbusiness income during 1988.

The Department billed the Taxpayer to repay the refunds she had previously received as a result of the NOL. The Taxpayer objected and the Department entered the preliminary assessment in issue.

The first issue is whether the Taxpayer's stock loss was a business or nonbusiness loss for purposes of applying the subsection (16)f.3. modification.

The Taxpayer is employed full-time with the State of Alabama

and inherited the stock in question from her husband in 1985. The stock was in a closely held corporation owned and operated primarily by the husband. The Taxpayer had earlier been an officer and had financially helped the corporation, but was not involved in the corporation after her husband's death in 1985. The stock became worthless when the corporation bankrupted in 1988.

The second issue is whether the Department can retroactively apply its change in position to the Taxpayer's 1988 stock loss. The Taxpayer argues that the Department's initial examination and allowance of the refunds constituted a "final assessment" of the tax that cannot now be reopened. The Taxpayer also contends that the Department's subsequent investigation and disallowance of the NOL was an unlawful second examination of her records.

A third issue raised by the Taxpayer is whether the Department correctly computed interest on the preliminary assessment. The Department included the interest that was refunded to the Taxpayer and added interest from the date of the refund to the date of the preliminary assessment.

#### CONCLUSIONS OF LAW

Alabama's NOL statute is modeled for the most part after the federal NOL statute, 26 U.S.C. §172. Consequently, federal case law should be followed in construing the Alabama statute. Best v. State, Department of Revenue, 417 So.2d 197 (1981).

Under federal case law, a stock loss is recognized as a

business loss for NOL purposes only if the taxpayer is engaged in a regular trade or business as a stockbroker. A loss on stock held as an investment does not constitute a business loss. See, Purvis v. C.I.R., 530 F.2d 1332; Chaing Hsiao Liang, 23 T.C. 1040, 1043 (1955).

In this case, the Taxpayer inherited the stock in 1985 and thereafter held the stock as a passive investment. The Taxpayer is not a stockbroker and did not otherwise use the stock in a trade or business. Consequently, the 1988 stock loss must be treated as a nonbusiness loss for NOL purposes.

The Taxpayer argues that the Department should be bound by its initial treatment of the loss as a business loss and cannot now retroactively change its position and deny the NOL. However, the Department cannot be estopped from correctly treating the loss as nonbusiness because of a prior erroneous interpretation. Maddox Tractor and Equipment Company v. State, 69 So.2d 426.

Also, the Department has not previously assessed tax for the subject years and is not otherwise barred from entering the assessment in question. Rather, the Department properly assessed tax due within three years from when the amended returns were filed on March 30, 1989. See, Code of Ala. 1975, §40-18-45.

Nor did the reopening of the Taxpayer's file violate Code of Ala. 1975, §40-18-56 as an unnecessary second examination of the Taxpayer's records. That section allows the Department to

reinvestigate a taxpayer if there is reasonable cause, as in this case.

Finally, the Taxpayer argues that the Department incorrectly computed interest on the preliminary assessment. However, the Department included the interest that had been refunded to the Taxpayer and then added interest from the date of the refunds to the date of the preliminary assessment. The Department's calculation of interest is correct and should be upheld.

The above considered, the preliminary assessment in issue is correct and should be made final, with applicable interest.

Entered on September 30, 1991.

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BILL THOMPSON  
Chief Administrative Law Judge