

STATE OF ALABAMA	§	STATE OF ALABAMA
DEPARTMENT OF REVENUE,		DEPARTMENT OF REVENUE
	§	ADMINISTRATIVE LAW DIVISION
v.	§	DOCKET NO. INC. 91-205
MICHAEL & JANE GRAFFEO	§	
1131 10th Street, South		
Birmingham, AL 35205,	§	
Taxpayers.	§	

FINAL ORDER

The Revenue Department assessed income tax against Michael and Jane Graffeo for the year 1989. The Taxpayers appealed to the Administrative Law Division and a hearing was conducted on October 30, 1991. Darrell L. Cartright, Esq. appeared for the Taxpayers. Assistant counsel Dan Schmaeling represented the Department.

FINDINGS OF FACT

Michael Graffeo (Taxpayer) was elected to the Birmingham City Council for a four-year term in October, 1987.

The City Council passed an ordinance in March, 1989 changing the city's at-large elections to single-member district elections.

The ordinance also required the Taxpayer and all other council members elected to a four-year term in 1987 to run again in 1989.

The Taxpayer challenged the ordinance as unconstitutional in circuit court. The circuit court ruled for the Taxpayer but the Alabama Supreme Court reversed and upheld the ordinance. See, City of Birmingham v. Michael G. Graffeo, 551 So.2d 357.

The Taxpayer subsequently ran in the special election in October, 1989 and lost. As a consequence, the Taxpayer's term of

office as a city councilmen ended in November, 1989.

The issue in dispute is whether the Taxpayer's legal expenses incurred in challenging the city ordinance constitutes deductible ordinary and necessary business expenses within the purview of Code of Ala. 1975, §40-18-15(a)(1).

CONCLUSIONS OF LAW

Section 40-18-15(a)(1) allows a deduction for all ordinary and necessary expenses incurred in carrying on a trade or business. The deduction is modeled after 26 U.S.C. §162 and federal case law and authority should be followed in construing the Alabama statute. Best v. State, Department of Revenue, 423 So.2d 859.

The Department argues that the legal fees were personal in nature because they were not related to the discharge taxpayer's duties as a city councilman. I disagree.

"Trade or business" includes the performance of the functions of an elected public office. See, 26 U.S.C. §7701(a)(26). The expenses of running for election or re-election are not deductible business expenses. McDonald v. Commissioner, 323 U.S. 57. The reasoning is that election to public office constitutes a new "trade or business", even if the expenses are for re-election, see, Martino v. C.I.R., 62 T.C. 840.

However, this case presents a third scenario. The legal fees were incurred to retain a seat to which the Taxpayer had already been elected. The expenses are deductible because they were

incurred to protect an existing or on-going "trade or business".

See, Rev. Rul. 71-470, 1971-2 C.B. 121; Rev. Rul. 74-394, 1974-2 C. B. 40; Carey v. C.I.R., 56 T.C. 477.

In Rev. Rul. 71-470, a judge was elected to office and subsequently incurred expenses in fighting a recall. The IRS allowed the expenses as follows:

However, the taxpayer in the instant case was not a candidate for public office, and was not seeking a new term. He was merely defending his position for his current term, and the Supreme Court of the United States has held that the ordinary and necessary of defending one's business are deductible. Commissioner v. S. B. Heininger, 320 U.S. 467 (1943), Ct.D. 1956, C.B. 1944, 484.

The above considered, the assessment should be reduced and made final showing no additional tax due by the Taxpayers.

Entered on November 26, 1991.

BILL THOMPSON
Chief Administrative Law Judge