

STATE OF ALABAMA  
DEPARTMENT OF REVENUE,

§

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DEPARTMENT OF REVENUE  
ADMINISTRATIVE LAW DIVISION

§

v.

§

DOCKET NO. INC. 92-179

AUBURN ELECTRIC, INC., ET AL, §  
c/o Mr. Jimmy A. LaFoy, CPA  
P.O. Box 790 §  
Opelika, AL 36801,

§

Taxpayers.

OPINION AND PRELIMINARY ORDER

The Revenue Department assessed Peter D. and Vilate D. Lanier for income tax for the years 1986 through 1990, Cheryl A. Lanier Strickland for the years 1988 through 1990, Robert S. and Becky B. Pruitt for the years 1989 and 1990, Don H. and Renee Gardner for the years 1988 through 1990 and Donald Gregg and Mary A. Lanier for the years 1988 through 1990. The above Taxpayers appealed to the Administrative Law Division and a hearing was conducted on November 5, 1992. CPA Jimmy LaFoy represented the Taxpayers. Assistant counsel Dan Schmaeling represented the Department.

The issue in this case is whether numerous adjustments by the Department to the returns of the above Taxpayers for the years in issue should be upheld.

Auburn Electric Company, Inc. (corporation) was an Alabama Subchapter S corporation during the years in question. The above Taxpayers were all shareholders of the corporation.

The Department audited the corporation and made adjustments to the corporation's returns for the subject years, which in turn caused adjustments to the pass-through liabilities of the various

shareholders. The assessments in issue are based on those adjustments.

A hearing was conducted by the Administrative Law Division on November 5, 1992. At the hearing, the Taxpayers' representative, CPA Jimmy LaFoy, requested additional time to obtain more information relevant to the case. The information was finally provided and the Department subsequently issued a revised audit report on September 16, 1993. The revised audit was submitted to the Taxpayers' representative, who was directed to identify which, if any, issues were still disputed. The representative did so by letter dated November 18, 1993. Those issues in dispute are discussed below.

(1) The corporation deducted interest paid for a condominium in Florida. The Department denied the deduction because the condo belonged to Peter D. and Vilate D. Lanier, not the corporation.

The Taxpayers argue that the corporation actually owned the condominium, as evidenced by the minutes of a meeting by the corporation's board of directors. However, a pronouncement by the board of directors does not and cannot establish that the corporation owned the condominium. The Laniers had legal title to the condominium, not the corporation. Thus, the corporation could not deduct interest paid on the corporation as an expense.

(2) The Department estimated several of the factors used in apportioning the corporation's income to Alabama during the subject years. The Taxpayers contend that the required data had been

provided to the Department and that estimates were unnecessary.

No evidence has been submitted from which I can decide this issue one way or the other. Thus, without evidence to the contrary, the Department's prima facie correct findings are upheld.

(3) The Department disallowed interest deductions claimed by Peter and Vilate Lanier because they failed to provide records to substantiate the expense. The Taxpayers claimed that they lost their bank statements and are unable to obtain cancelled checks showing that the interest was paid.

All taxpayers are required to keep adequate records to verify all deductions, and in the absence of proof, a deduction must be disallowed. U. S. Wodtke, 627 F.Supp. 1034. The Taxpayers admit that they cannot provide sufficient records to establish or verify the interest payments. Accordingly, the deduction was properly denied by the Department.

(4) The Laniers also claim that they invested/loaned over \$739,000.00 to Seville Entertainment Complex, a Florida Subchapter S corporation, from 1985 through 1990. The corporation apparently filed for bankruptcy in 1986. The Laniers argue that "the amount of the investment should be allowed as a capital loss in the years the losses were incurred or in the year that the bankruptcy was final".

The Department has characterized the above transactions as loans by the Laniers to the corporation. The Department argues

that the loss on the loans can be deducted as a nonbusiness loss up to the amount of nonbusiness income. The Department is willing to allow a \$31,000.00 loss because that is the only amount verified by the Laniers.

The facts relating to this issue are unclear. If the amounts advanced to the corporation were loans, then the Laniers should be allowed to deduct the amounts as losses incurred in a transaction entered into for profit, although not connected with a trade or business. See, §40-18-5(5). The loss should be allowed in the year the loans became uncollectible, but only up to the amount verified by the Taxpayers, \$31,000. No evidence was submitted showing losses in excess of that amount.

(5) The Laniers have raised a new issue relating to insurance premiums paid by the corporation on the life of Peter D. Lanier.

The Laniers claim that the Department initially included the premiums as income to them, but later agreed to remove the amounts from the assessment. The Laniers contend that the amounts are nevertheless still included in the assessments and should be removed.

Again, the Administrative Law Division is without sufficient facts to decide this issue one way or the other. If the Department agreed to remove the amounts from the audit, then the amounts should be removed. The Department should submit in writing its

position as to whether the premiums should be included as income.

The Department should also submit to the Administrative Law Division the adjusted amounts due relating to each of the Taxpayers in question. A Final Order will then be issued after the receipt of the above information.

Entered on January 31, 1994.

BILL THOMPSON, Chief Administrative Law Judge