STATE OF ALABAMA, DEPARTMENT OF REVENUE,

vs.

ROBERT M. COSBY
1130 Ford Avenue
Birmingham, AL 35217,

Taxpayer.

§ § § § § §

STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

DOCKET NO. INC. 92-180

FINAL ORDER

The Revenue Department denied two petitions for refund of income tax filed by Robert M. Cosby (Taxpayer) for the years 1986 and 1988. The Taxpayer appealed to the Administrative Law Division and a hearing was conducted on September 24, 1992. The Taxpayer represented himself. Assistant counsel Mark Griffin appeared for the Department.

FINDINGS OF FACT

The Taxpayer lost money in the stock market in 1987 and as a result reported a net loss on his 1987 Alabama return. The Taxpayer carried the 1987 loss back to 1986 and forward to 1988. The Department disallowed the carryback and carryforward, and as a result assessed the Taxpayer for additional tax in those years. The Taxpayer paid the assessments and then filed the petitions for refund in issue. The Department denied the refunds and the Taxpayer appealed to the Administrative Law Division.

The issue in this case is whether the 1987 stock loss was a business loss or nonbusiness loss. A business loss can be allowed in full in computing a NOL carryback or carryforward. However, a nonbusiness loss can be used only up to the amount of nonbusiness income. See, Code of Ala. 1975, §40-18-15(16)f.3. Whether the stock loss was business or nonbusiness turns on whether the Taxpayer was in the "trade or business" of trading stocks in 1987. The relevant facts are undisputed.

The Taxpayer is a doctor and began practicing medicine in Birmingham in 1972. The Taxpayer's medical practice started to decline in 1979, and he averaged only $16,000 - $18,000 per year from the practice of medicine from 1983 through 1988. As discussed below, during those same years the Taxpayer spent considerable time researching and investing in stocks.

The Taxpayer started investing in stocks through a stockbroker in 1972. The Taxpayer slowly gained confidence, and in 1983 or 1984 moved his accounts to a discount brokerage house and began making his own buy and sell decisions.

The Taxpayer continued to practice medicine, but also spent a good deal of time at both his medical office and at home studying investment periodicals, long-term market trends, tracking particular stocks, and making trades. The Taxpayer was also personally involved with two or three companies in which he owned stock.

The Taxpayer initially invested only money on hand, but started buying on margin in the early 1980s and also borrowed and invested $300,000.00 from two area banks. The Taxpayer's portfolio as of April 15, 1987 showed $3,913,000.00 in stocks, $1,888,000.00 in stock mutual funds, and a small amount in bonds. $2,580,000.00 of the above amount was on margin and $300,000.00 represented money borrowed from the two banks. The portfolio included 13 separate stocks or stock mutual funds.

The Taxpayer made a total of 50 trades in 1987. Thirty-one of the trades occurred from October 28 to December 10, following the stock market crash of October 27. The Taxpayer lost $786,222.53 in the market during 1987.

The Taxpayer argues that his stock activities reached the level of a trade or business because of the time he spent studying stocks, his personal involvement with several companies in which he held stock, and the amount of money involved in his stock activities versus the income from his medical practice.

## CONCLUSIONS OF LAW

Whether an individual's stock trading and investment activities constitutes a "trade or business" turns on whether the individual is a "trader" or an "investor". A trader is in a trade or business, whereas an investor is not. Purvis v. C.I.R., 530 F.2d 1332; Higgins v. Commissioner, 61 S.Ct. 475. Whether an individual is a trader or an investor must be decided on the particular facts of each case.

A trader is involved in high volume, short-term trading and buys and sells primarily to take advantage of the market's short-term swings. On the other hand, an investor is someone primarily interested in preserving his assets and achieving long-term gains. As stated in Moller v. U.S., 721 F.2d 810, at pages 814 and 815:

> A taxpayer who merely manages his investments seeking long-term gain is not carrying on a trade or business. This is so irrespective of the extent and continuity of the transactions or the work required in managing the portfolio, Higgins v. Commissioner, 312 U.S. 212, 61 S.Ct. 475, 85 L.Ed. 783 (1941). The fact that the Mollers spent much time managing a large amount of money is not determinative of the question of whether they were engaged in a trade or business.
>
> *　　　　*　　　　*
>
> In the instant case, the taxpayers were not engaged in a trade or business. They were active investors in that their investment activities were continuous, regular, and extensive. However, this is not determinative of the issue and it is not the correct test. What is determinative is the fact that the taxpayers' return was that of an investor: they derived the vast majority of their income in the form of dividends and interest; their income was derived from the long-term holding of securities, not from short-term trading; and they were interested in the capital appreciation of their stocks, not short-term profits. Merely because taxpayers spent much time managing their own sizeable investments does not mean that they were engaged in a trade or business.

In this case, the Taxpayer actively and regularly engaged in studying and trading stocks. However, the Taxpayer was admittedly conservative and cautious and had as his primary goal the long-term appreciation of his portfolio. Accordingly, the Taxpayer must be considered an investor and not a trader of stocks.

The above conclusion is supported by the fact that the Taxpayer made only 50 trades in 1987. Of that total, 31 occurred from October 28 to December 10 and were precipitated by the market crash of October 27. Those 31 trades were out of the ordinary and do not represent the Taxpayer's normal level of activity. A better guide is that the Taxpayer made only 19 trades during the balance of the year.

In Levin v. U.S. 597 F.2d 760, and Fuld v. Commissioner, 139 F.2d 465, both cases in which the taxpayers were found to be traders, the taxpayers were engaged in almost daily transactions.[1] In Moller, supra, the taxpayer made 124 and 106 trades in the two years in issue and the court found that level of activity to be below the normal level of a trader. The same is true of the Taxpayer's 50 trades during 1987 in this case.

The fact that the Taxpayer continuously practiced medicine, albeit sparingly, is further evidence that the Taxpayer was in business as a doctor and not a stock trader. Also, while the Taxpayer did on occasion become involved in companies in which he held stock, the level of involvement was well below the level of activity in Levin, supra.

[1]In Levin, the taxpayer made 332 transactions in the subject year. Fuld involved a brother and sister. The brother made 347 transactions in one year and the sister 318.

The above considered, the Taxpayer's stock market activities did not reach the level of a trade or business, and consequently, the 1987 loss could not be carried back to 1986 or forward to 1988. The refunds in issue were thus properly denied by the Department.

This Final Order may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered on December 15, 1992.

BILL THOMPSON
Chief Administrative Law Judge