

STATE OF ALABAMA,  
DEPARTMENT OF REVENUE,

vs.

THOMAS W. AND NEVA STUBBS  
3485 Helena Road  
Helena, AL 35080,

Taxpayers.

§

§

§

§

§

§

STATE OF ALABAMA  
DEPARTMENT OF REVENUE  
ADMINISTRATIVE LAW DIVISION

DOCKET NO. INC. 93-199

FINAL ORDER

The Taxpayers, Thomas W. and Neva Stubbs, claimed a \$922,482 business loss on their 1991 Alabama return. The Taxpayers also filed an amended 1988 return and attempted to carry part of the 1991 loss back to that year. The Department reduced the 1991 business loss to \$488,797 and also disallowed the attempted NOL carryback to 1988. The Taxpayers appealed to the Administrative Law Division and a hearing was conducted on June 8, 1993. Thomas W. Stubbs appeared for the Taxpayers. Assistant counsel Mark Griffin represented the Department.

The issues are (1) what part of the Taxpayers' 1991 loss, if any, should be allowed as a NOL carryback, and (2) even if a NOL carryback is available, can it be used to reopen a year in which a final assessment was entered and not appealed.

The Taxpayers were the sole shareholders and Mr. Stubbs was president of Stubbs Foundry Company, Inc. during the years in issue. The corporation started losing money in 1985. Mr. Stubbs subsequently advanced or loaned the corporation over \$1,400,000

from 1985 through 1991 for necessary capital improvements and to pay the corporation's operating expenses. Mr. Stubbs received a salary of \$20,000 from the corporation in early 1985, but nothing after that time.

The Taxpayers filed a 1988 Alabama return but failed to pay the tax due of \$12,491. The Department, after crediting the Taxpayers for a subsequent \$5,000 payment, entered a final assessment for the remaining tax due plus penalty and interest on November 12, 1991. The Taxpayers failed to appeal the final assessment within 30 days as then required by Code of Ala. 1975, §40-2-22.

The Taxpayers filed a 1991 return and declared a portion (\$922,482) of the unrepaid loans to the corporation as a business loss. The Taxpayers also filed an amended 1988 return and carried a part of the 1991 loss back to offset the tax (final assessment) owed in that year. As stated, the Department reduced the 1991 business loss to \$488,797, and also disallowed the NOL carryback to 1988.

The first issue is whether the Taxpayers' 1991 loss was a business or non-business loss for purposes of computing an NOL carryback under Code of Ala. 1975, §40-18-15(16). Under subsection f.3 of the above statute, a non-business deduction can be used in computing a NOL carryback or carryover only to offset the taxpayer's non-business income in the loss year. Consequently, if

the 1991 loss is considered non-business, it cannot be carried back as a NOL deduction to 1988.

To constitute a business loss, there must be some connection between the loss and the taxpayer's trade or business. The Taxpayer's trade or business in this case was as an employee of the corporation. Consequently, the loans were business transactions only if the Taxpayer's primary motive in making the loans was to protect his job and salary. See generally, United States v. Generes, 92 S.Ct. 827; B. B. Rider Corp. v. C.I.R., 725 F.2d 945.

The Taxpayer claims that he made the loans to the corporation to protect his salary. I disagree. The Taxpayer received only \$20,000 in salary in early 1985 and no salary from mid-1985 through 1991. A reasonable businessman would not risk over 1.4 million in unsecured loans to protect a salary he was not receiving to begin with.

In both Generes, supra, and B. B. Rider Corp., supra, the court ruled that employee/shareholder loans to a corporation were non-business because of the difference between the large loan amounts versus the relatively small salary to be protected. The same is true in this case. The Taxpayer's primary motive was not to protect his non-existent salary, but rather to allow the corporation to continue operating. While the loans were transactions entered into for profit and thereby deductible in full

in 1991,<sup>1</sup> they were non-business in nature and therefor subject to the subsection f.3 limitation.

The Department examiner treated the loans from 1985 through 1987 as business transactions. While I can see no significant difference between the loans in 1985 through 1987 and those in later years, I will not question the examiner's decision to allow the first three years as business losses. Consequently, the loss relating to the 1985-1987 loans (\$488,797) should be recognized as a business loss for NOL purposes.

The next issue is whether the NOL can be carried back to 1988 to offset or reduce the final assessment previously entered for that year.

The Alabama Supreme Court has ruled that an unappealed final assessment constitutes a final liability owed the State which cannot be reopened by use of the NOL carryback provision. Alabama Education Association v. Grayson, 382 So.2d 501.

---

<sup>1</sup> The Department does not question that the loans became bad or uncollectible in 1991.

The 1988 final assessment was entered against the Taxpayers on November 12, 1991 and was not appealed within 30 days as then required by Code of Ala. 1975, §40-2-22. Consequently, the 1991 NOL cannot be carried back to reopen the closed year of 1988.<sup>2</sup> However, the loss should not be reduced and is available in full for carryback or forward to any open year.

The above considered, the Department properly reduced the 1991 loss for NOL purposes, and also disallowed the attempted carryback of the remaining loss for a refund to 1988.

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

---

<sup>2</sup> If the events in issue had occurred after the October 1, 1992 effective date of the Uniform Revenue Procedures Act, the Taxpayers could pay the 1988 assessment in full and then file an amended return and carry the 1991 NOL back for a refund of the tax paid. Unfortunately for the Taxpayers, the Uniform Act cannot be used to reopen a period (1988) already closed prior to the effective date of the Act, as in this case.

Entered on July 28, 1993.

---

BILL THOMPSON  
Chief Administrative Law Judge