

JIM AND ELIZABETH DRAIN
4 Sycamore Lane
Albertville, Alabama 35950,

Taxpayers,

v.

STATE OF ALABAMA
DEPARTMENT OF REVENUE.

STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

DOCKET NO. INC. 97-192

FOURTH PRELIMINARY ORDER

This case involves 1994 and 1995 final assessments entered against the above Taxpayers. The issue, as stated in the Opinion and Preliminary Order entered in the case on March 17, 1998, is as follows:

The Taxpayers suffered a net operating loss ("NOL") in 1990. They carried over the NOL to their 1994 and 1995 Alabama returns. The issue in this case is whether the 1990 NOL must first be offset by income attributed to the Taxpayers from debt discharged in a 1992 bankruptcy action.

The Opinion and Preliminary Order held that the 1990 NOL should not be offset by any debts of the Taxpayers that were reaffirmed or that could have been deducted if paid. The Order further held that a \$1,000,000 debt to Citicorp was a contingent liability of the Taxpayers, against which the 1990 NOL should not be applied. The Taxpayers were directed to provide evidence showing which debts were reaffirmed or could have been deducted if paid.

The Taxpayer provided the above evidence in June 1999. Subsequent to that date, the Department attorney that was handling the case left the State service. The case was reassigned to Assistant Attorney General Troy King in the Attorney General's Office. Mr. King responded for the Department in a well-written letter dated December 28, 1999.

The Department's letter raised two issues. First, the Department claims it must have the Taxpayers' 1987, 1988, and 1989 returns so it can compute how much of the 1990 NOL should first be carried back to those years. Second, the Department claims it needs further information concerning the contingent nature of the \$1,000,000 Citicorp debt. The Taxpayers responded with a concise and equally well-written letter dated January 27, 2000.

The Taxpayers are correct concerning the inapplicability of the 1987, 1988, and 1989 tax years. Federal law has consistently required taxpayers to first carry an NOL back to prior years. See, 26 U.S.C. ' 6511(d)(2). Before 1990, the Alabama NOL statute, Code of Ala. 1975, ' 40-18-15(a)(16)b., also required an NOL to be first carried back to the three preceding years. The Taxpayers are correct, however, that the three year carry back requirement was deleted from the statute by Act 90-583, effective for all years after December 31, 1989. The Alabama NOL statute thus did not require or allow a carryback during the year in issue, 1990. Consequently, the Taxpayers' entire 1990 NOL must be carried forward.¹

The Administrative Law Division and others in the Revenue Department were aware

¹The carryback provision was reinserted in the NOL statute by Act 98-502, effective December 31, 1997.

that the 1990 amendment had deleted the carryback provision from the statute. The Administrative Law Division has never addressed the issue because it was never raised in a case. The Department, to its credit, continued to allow taxpayers the benefit of the carryback even though it was not in the statute. That does not, however, require the Taxpayers in this case to carry back their 1990 NOL to prior years where the statute did not require or allow such a carryback.

The Opinion and Preliminary Order found that the NOL should not be offset by the Citicorp liability because it was contingent. That finding is affirmed.

The Department is directed to recompute the Taxpayers= 1994 and 1995 liabilities in accordance with this and prior Orders entered by the Administrative Law Division, and in consideration of the information submitted by the Taxpayers in June 1999. A Final Order will then be entered, from which either party may appeal pursuant to Code of Ala. 1975, ' 40-2A-9(g).

Entered January 31, 2000.

BILL THOMPSON
Chief Administrative Law Judge

BT:dr

cc: Troy King, Esq.
JoClaudia Mitchum, Esq.
Kim Herman (418-54-4087)