A. LARRY & CAROLINE M. MERRILL '
2129 Garland Drive
Birmingham, AL 35216, '

Taxpayers, '

v. '

STATE OF ALABAMA '
DEPARTMENT OF REVENUE.

STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

DOCKET NO. INC. 98-517

FINAL ORDER

The Revenue Department assessed 1994 income tax against A. Larry and Caroline M. Merrill (ATaxpayers@). The Taxpayers appealed to the Administrative Law Division pursuant to Code of Ala. 1975, '40-2A-7(b)(5)a. A hearing was conducted on February 23, 1999. A. Larry Merrill (individually ATaxpayer@) appeared at the hearing. Assistant Counsel David Avery represented the Department.

The issue in this case is whether the Taxpayers should be allowed to carry over a 1991 net operating loss (ANOL@) to 1994.

The Taxpayers claimed a net operating loss carryover from 1991 on their 1994 Alabama income tax return. The NOL reduced the Taxpayers= 1994 income to zero. The Department audited the return and disallowed the carryover because the 1991 loss was not substantiated.[1] The disallowed NOL resulted in the final assessment in issue. The Taxpayers appealed.

---

[1]The Taxpayers also failed to elect to forego the NOL carryback when they filed their 1991 return. But even if the 1991 loss was first carried back to prior years, the amount available to carry forward to 1994 would still be sufficient to fully offset

the Taxpayers= 1994 income.

The Taxpayer argues that he incurred a $317,000 loss when his business closed in 1991. The Taxpayer contends that the IRS audited him in 1991 and determined that his business records were good and that no additional tax was due. The Taxpayer claims he kept his business records for several years, but eventually threw them away in mid-1996 because he thought they were no longer relevant.

All taxpayers are required to keep accurate records from which their correct liability can be computed. Code of Ala. 1975, '40-2A-7(a)(1). A common misconception is that records must be kept for only three years. That is generally a sufficient period because the Department usually has only three years in which to assess additional tax due. Code of Ala. 1975, '40-2A-7(b)(2). There is, however, no fixed statutory period for which records must be maintained. Rather, a taxpayer should maintain records for as long as the tax period to which they pertain is open and subject to audit by the Department.

In this case, the Taxpayers carried over the 1991 loss as a deduction in 1994. The Taxpayers were thus under a duty to maintain records concerning the 1991 loss so that the 1994 deduction could be verified.

The IRS reviewed the Taxpayer=s business records in 1991 and found them acceptable. Most likely, however, that review related to the Taxpayer=s withholding and other business-related taxes. In any case, the federal audit could not have verified the amount of the 1991 loss in issue because it was conducted in mid-1991, before the Taxpayers= 1991 tax liability could have been computed.

The burden was on the Taxpayers to substantiate that they incurred a loss in 1991. They failed to do so. Consequently, the NOL carryover to 1994 was properly disallowed by the Department.

The final assessment includes a penalty. Under the circumstances, reasonable cause exists to waive the penalty pursuant to Code of Ala. 1975, '40-2A-11(h). The final assessment, less the penalty, is affirmed. Judgment is entered against the Taxpayers for 1994 income tax and interest of $2,233.74, plus additional interest from the date of entry of the final assessment, October 29, 1998.

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

Entered March 12, 1999.

____

BILL THOMPSON
Chief Administrative Law Judge

BT:ks

cc: David E. Avery, III, Esq.
A. Larry & Caroline M. Merrill
Kim Herman (423-52-2760)