

W. E. & NELL BAILEY
1398 Co. Road 735
Cullman, AL 35055,

Taxpayers,

v.

STATE OF ALABAMA
DEPARTMENT OF REVENUE.

STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

DOCKET NO. INC. 99-265

FINAL ORDER

The Revenue Department assessed 1995 income tax against W. E. and Nell Bailey (together **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 August 25, 1999. Charles Bence, Jr. represented the Taxpayers. Assistant Counsel Mark Griffin represented the Department.

W. E. Bailey (individually **ATaxpayer@**) incurred expenses in 1981, 1982, 1983, 1984, and 1988 relating to a coal mining venture in Peru. The issue in this case is whether the Taxpayer can deduct those expenses in 1993 as deferred start-up expenses pursuant to Code of Ala. 1975, ' 40-18-15(a)(22). That section adopts by reference the federal deduction at 26 U.S.C. ' 195. If the expenses can be deducted in 1993 pursuant to ' 195, then the Taxpayers should be allowed to carryover the resulting net operating loss (**ANOL@**) to 1995.

The Taxpayer started a coal mining business in Alabama in 1975. He became interested in a Peruvian coal mining venture in 1981. The Taxpayer claims he intended to mine coal in Peru for export to Asia, Europe, and North America. He traveled to Peru and incurred over \$300,000 in expenses from 1981 through 1984 in an effort to get the venture started. The mining operation actually produced and sold coal in 1984 and 1985. The coal was sold to a steel mill and several small foundries in Peru. Those sales earned enough money to pay the mine's operating expenses.

The Taxpayer and his wife both suffered various illnesses beginning in 1985. Consequently, the Taxpayer was unable to travel to Peru from 1985 until 1988. He did, however, stay in regular contact with several individuals he had hired to operate the mine in Peru.

The mine closed in the late 1980's due to terrorist activity in the area. The Taxpayer returned to Peru in October 1988 to determine the status of the venture. The trip was inconclusive. In the early 1990's, three individuals in Peru involved in the venture died, including the person who maintained the Taxpayer's records. Because of the negative political climate in Peru, and the fact that his Peruvian contacts had died, the Taxpayer abandoned the venture in 1993.

The Taxpayer deducted his Peru-related expenses incurred from 1981 through 1984, and in 1988, on his 1993 Alabama income tax return as deferred start-up expenses pursuant to § 40-18-15(a)(22). He also carried the excess over as a business-related NOL to 1995. The Department allowed the expenses as a non-business investment loss in 1993, but disallowed the NOL carryover to 1995. The Taxpayers appealed.

As indicated, § 40-18-15(a)(22) adopts by reference 26 U.S.C. § 195. Section 195 allows a taxpayer to elect to defer expenses incurred before starting a trade or business. The taxpayer must begin deducting the business-related expenses in the year the business begins. The expenses must then be deducted over a period of not less than 60 months. If the taxpayer sells or closes the business before the start-up expenses are fully deducted, the remaining expenses may be deducted as a loss under 26 U.S.C. § 165.

The Taxpayer claims his expenses can be deducted as accrued start-up expenses in 1993 because he gave up on the Peruvian venture in that year. He claims that because he never exported coal outside of Peru, he never started the business. Consequently, he was never required by § 195 to elect to amortize the start-up expenses in any year before 1993. I disagree.

First, the Taxpayer's business started when the venture sold coal to Peruvian customers in 1984 and

1985. The Taxpayer was thus required by ' 195 to begin deducting the start-up expenses on his 1984 return. He failed to do so. It is irrelevant that the venture never exported coal. The Taxpayer was in the business of mining and selling coal. That business started in 1984.

Even if the Taxpayer never started his business, as he claims, ' 195 still does not apply. For expenses to be deducted under ' 195, a taxpayer must actually begin a business. This is illustrated in H. Pino, 52 TCM 1388 (T.C. Memo. 1987-28).

In H. Pino, the taxpayer, an airplane pilot, intended to start an import-export business. He incurred start-up expenses, but never started the business. The taxpayer argued that the expenses should be allowed as accrued start-up expenses pursuant to ' 195. The Tax Court disagreed:

APetitioner contends, in the alternative, that if we find that his expenses were start-up or pre-opening expenses, he is entitled to amortize those expenditures under section 195.

Section 195 permits a taxpayer to elect to amortize certain start-up expenditures over a period of not less than 60 months commencing with the month in which business begins. The legislative history of section 195 provides that--Expenditures must relate to the investigation or creation of an active trade or business (within the meaning of Code sec. 162). * * * Therefore, no deduction is allowed under the provision with respect to items incurred incident to a trade or business which actually is not commenced or acquired by the taxpayer.

Any expenditures incurred by petitioner during 1981 in an effort to organize an import-export business would be ineligible for amortization under section 195 because petitioner was never engaged in an active trade or business. By his own admission, petitioner's efforts never materialized into a business and he never made any purchases or sales before he ran out of money. Petitioner's attempts to organize a business went no further than his giving a sample of ginger to some growers in Florida in January 1982. Because petitioner never commenced or acquired an active trade or business, he is not entitled to amortize his expenses under section 195. Petitioner also failed to elect to amortize start-up expenditures as is required under sec. 195(c)(1), see H. Rept. No. 96-1278 (1980), 1980-2 C.B. 709, 714, and for this reason, also, fails to qualify for an amortization deduction for 1981. @

As illustrated, if the Taxpayer never started his business, his expenses cannot be deducted pursuant to § 195 as business-related start-up expenses. Consequently, the Department properly disallowed the NOL carryover to 1995.¹ The final assessment in issue is affirmed. Judgment is entered against the Taxpayers for \$2,125.16, plus applicable additional interest from April 7, 1999.

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

Entered November 19, 1999.

¹Technically, the expenses also should not have been allowed even in 1993. The Department apparently allowed the expenses in that year in an attempt to settle the audit. This appeal involves only 1995. Consequently, the Taxpayers' liability for 1993 will not be addressed.