ALABAMA TAX TRIBUNAL

LAIRD COLE,	§	
Taxpayer,	§	DOCKET NO. INC. 18-102-JP
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

OPINION AND FINAL ORDER

Following an audit, the Alabama Department of Revenue entered a final assessment of individual income tax against Laird Cole (Taxpayer) for the year 2013. The assessment totaled $51,753.04, and included tax, a late-payment penalty, a negligence penalty, and interest. The Taxpayer timely appealed to the Alabama Tax Tribunal.

Question Presented

During the audit and assessment process, the Revenue Department increased the amount of "Other Income" that the Taxpayer had reported on his 2013 Alabama return, most notably "Farm Income" on Schedule F. The Farm-Income adjustment resulted from the submission of two Forms 1099 that reported litigation proceeds payable to a limited liability company of which the Taxpayer was a member. The Taxpayer reported none of the Forms 1099 proceeds on his return. Thus, the Revenue Department entered the final assessment at issue.

The question presented is whether the Taxpayer proved that the proceeds at issue constituted non-taxable income.

Facts

After the Taxpayer's appeal was filed, followed by the Revenue Department's Answer and a few responsive filings, the appeal was held in abeyance at the request of the parties to allow them to conduct informal discovery. The Order Holding Case in Abeyance directed the parties to notify the Tax Tribunal of the status of the case by a certain date. On that date, the Revenue Department's attorney notified the Tax Tribunal that the Taxpayer had not objected to, nor responded to, the Revenue Department's discovery request. Therefore, the case was set for hearing.

Near the end of the nearly 4-hour hearing, the Tax Tribunal stated that the case should have been better developed prior to the hearing. Therefore, the Tax Tribunal remanded the case to the Revenue Department to allow the parties additional time to attempt to resolve, or at least narrow, some or all of the issues. At the request of both parties, the remand period was extended. At the end of the extended remand period, the Revenue Department informed the Tax Tribunal that the parties had discussed a settlement, with the Revenue Department making an offer, but that there had been no further communication between the parties. Thus, the Revenue Department requested a status conference.

At the status conference, the Taxpayer's attorney agreed to ask his client about the client's willingness to accept the Revenue Department's settlement offer; to submit a request to the Revenue Department's attorney concerning a confidentiality agreement; and to speak with the Revenue Department's attorney in an attempt to define the issues. Subsequently, the Taxpayer's attorney notified the Tax Tribunal that an agreement between the parties was not possible. The Tax Tribunal then set a briefing schedule.

During the hearing, the Revenue Department's auditor testified that the final assessment resulted from three adjustments that were made to the Taxpayer's 2013 return.

First, the Taxpayer claimed a loss of $108,951 on Schedule E relating to two rental properties and a limited liability company. After audit, the Revenue Department allowed a loss of only $16,105. The disallowance of the remainder of the claimed loss resulted in an increase in "Other Income" of $92,846.

The second adjustment involved Schedule F, which relates to profit or loss from farming. The Taxpayer reported no such income or expenses on Schedule F of his 2013 return. However, the Revenue Department included $807,077 in Schedule F income resulting from a Form 1099 in the amount of $790,198.37 and a separate Form 1099 for $16,878. Both amounts apparently were paid to Foundation Farms, LLC, and both payments apparently represented proceeds from litigation involving dairy milk. The Revenue Department then allowed fertilizer and lime expenses of $35,624, which resulted in an increase in Other Income of $771,453.

Third, the Revenue Department increased the Taxpayer's Other Income by $10,179, which also was reported on a Form 1099 and which related to dairy-milk litigation. The Taxpayer had not reported the $10,179 amount on his return.

The three adjustments increased the Taxpayer's Other Income by $874,478. The Taxpayer's deductions were reduced by $2,131, and the Revenue Department calculated additional income tax on the result. Interest, a late-payment penalty, and a negligence penalty were added, and the final assessment was entered for the total amount of these changes.

The Taxpayer testified that he already had been in the dairy business, but that he expanded by acquiring additional dairy cows between 2007 and 2009 and placing them on a farm in Dallas County, Alabama, that he had leased. To acquire these cows, the Taxpayer borrowed money and contracted with investors. He stated that a few of the cows died immediately, but that the business still was profitable in 2008. As time went on, though, more cows died, and the Taxpayer learned that the farm was non-compliant with certain environmental standards. Between 2007 and 2010, more than 200 cows died from what the Taxpayer suspected was arsenic. The last milking of the cows occurred in December 2010.

Multiple lawsuits ensued, and the Taxpayer testified that he resolved matters with the investors, banks, and others in approximately 2012. A lawsuit involving the owner of the Dallas County farm was resolved through mediation, and the Taxpayer testified that the owner made a payment for the cattle that had died and for damaged and repossessed equipment. He also testified that, although he had costs associated with acquiring the cows, the Revenue Department did not make any allowance to the Taxpayer for these costs. According to the Taxpayer, his Exhibits 3 and 4 showed his purchases of cows between 2007 and 2010, as well as the amount paid for each purchase.

At the hearing, the Taxpayer admitted Exhibit 5, which was a contract between the Taxpayer, signing on behalf of Foundation Farms, LLC, and an individual (referred to as an investor) concerning an investment in a dairy cow. The contract stated that the parties "have determined that a Buy/Sale Contract is necessary to address the investment opportunity as offered by Foundation Farms.... The parties agree and contract that the investor shall purchase one milk cow for $2,000.00 ...." The term of the contract was 5 years, and it entitled the investor to receive an interest payment at an annual rate of 15%.

The contract also stated that the investor held the cow as collateral on the contract. If the cow died within the 5-year contract term, Foundation Farms was responsible for replacing the cow.

Despite the language of the contract, the Taxpayer testified that the $2,000 payment by an investor "was meant to be an investment all along [as opposed to a purchase], because I was paying them interest payments on their money. They never actually physically took their cow.... And then at the end of the 5 years, I was responsible for paying them their money back." Taxpayer's Exhibit 5 made no mention of the Taxpayer being required to repay the $2,000 to the investors at the end of the term, although the contract was subject to Foundation Farms's authority to "call the contract due and pay each investor the original contract price of $2,000.00 at the time of the call. In the event said contact is called and the purchase price is paid to the investor, all monthly interest payments shall cease."

Following the death of the cows and the litigation that followed, the Taxpayer testified that he paid back the investors for their losses. Concerning one lawsuit in which the Taxpayer was the defendant, he stated that the suit was settled by transferring money to the plaintiff that had been obtained from a court-ordered sale of the remaining cows and by the payment to the plaintiff of a certain amount of insurance proceeds. The Taxpayer then sued the owner of the farm for losses arising from the death of the cows. That suit was settled, and the settlement amount was disbursed to the attorney, to the Taxpayer's dad, to the Taxpayer (in the name of Foundation Farms, LLC), and to creditors and other claimants. The Taxpayer also testified that Foundation Farms, LLC, was a single-member limited liability company and that he was the sole member.

Law and Analysis

The pertinent statutes regarding the Revenue Department's audit and assessment functions read as follows:

> (1) In addition to all other recordkeeping requirements otherwise set out in this title, taxpayers shall keep and maintain an accurate and complete set of records, books, and other information sufficient to allow the department to determine the correct amount of value or correct amount of any tax, license, permit, or fee administered by the department. . .
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> (2) The department may examine and audit the records, books, or other relevant information maintained by any taxpayer or other person for the purpose of computing and determining the correct amount of value or correct amount of any tax, license, or fee administered by the department. . .

Ala. Code § 40-2A-7(a)(1) – (2)

> (b) *Procedures governing entry of preliminary and final assessments; appeals therefrom.*
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> (1) ENTRY OF PRELIMINARY ASSESSMENT; FINAL ASSESSMENT OF UNCONTESTED TAX; EXECUTION OF PRELIMINARY AND FINAL ASSESSMENTS.
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> a. If the department determines that the amount of any tax as reported on a return is incorrect, or if no return is filed, or if the department is required to determine value, the department may calculate the correct tax or value based on the most accurate and complete information reasonably obtainable by the department. The department may thereafter enter a preliminary assessment for the correct tax or value, including any applicable penalty and interest.

Ala. Code § 40-2A-7(b)(1)a

If a taxpayer does not contest the preliminary assessment, or if the Revenue Department contends that the taxpayer owes additional tax nonetheless, the Revenue Department may enter a final assessment for tax, interest, and/or penalties. Ala. Code § 40-2A-7(b)(4)b. "On appeal to the circuit court or to the Alabama Tax Tribunal, the final assessment shall be prima facie correct, and the burden of proof shall be on the taxpayer to prove the assessment is incorrect." Ala. Code § 40-2A-7(b)(5)c.3.

Here, as noted, the assessment resulted from three adjustments that the Revenue Department made to the Taxpayer's 2013 return – the reduction of a loss claimed on rental properties; the inclusion of Schedule F income that had been reported to the Revenue Department on two Forms 1099; and the inclusion of other income that also had been reported on a Form 1099. However, in his post-hearing brief and reply brief, the Taxpayer addressed only the inclusion of $790,198.37 in settlement proceeds that had been reported to the Revenue Department on Form 1099. The Revenue Department allowed the Taxpayer a Schedule F deduction of $35,624 relating to fertilizer and lime expenses. Thus, the Taxpayer disputes only the amount of tax due on approximately $755,000. Specifically, the Taxpayer argues that the amount subjected to tax also should have been reduced by the amounts that the Taxpayer paid to acquire the cattle that died. In other words, the Taxpayer argues that the Revenue Department's assessment is too high because the Revenue Department did not recognize that the Taxpayer had a basis in the cattle whose deaths resulted in the settlement proceeds.

The facts concerning the Taxpayer's argument were not proven, however. The agreement between the Taxpayer and an "investor" (Taxpayer's Exhibit 5) referred to the document as a "Buy/Sale Contract." It further stated that the "parties agree and contract that the investor shall purchase one milk cow…" The agreement was executed on May 15, 2009. There was no evidence presented to prove how the Taxpayer still had basis in a cow in 2013 that he had sold in 2009. To the contrary, the sale by the Taxpayer of a cow in

2009 would have triggered its own tax consequences for which the Taxpayer's basis in the cow should have been taken into account. Despite the Taxpayer's characterization of the transaction as an investment, the wording of the agreement (which the Taxpayer drafted) states that it was a sale. Even if the Taxpayer had argued that subsequent restitution payments to the investors somehow created basis in the cows he sold, he did not prove the amounts of such restitution. And he testified that he resolved matters with the investors in 2012, not 2013. Further, he testified that the restitution payments were made by an insurance company on the Taxpayer's behalf.

Also, the Taxpayer was unsure if the cows had been depreciated on tax returns prior to 2013. He acknowledged, though, that depreciating the cows would have affected his basis in them. Again, no proof was provided concerning this question.

Conclusion

Suffice it to say that the Taxpayer did not meet his burden of proving the final assessment incorrect. Ala. Code § 40-2A-7(b)(5)c.3. Therefore, the final assessment is affirmed in full. Judgment is entered against the Taxpayer and in favor of the Revenue Department in the amount of $51,753.04. Additional interest is due from the date of the final assessment. Ala. Code § 40-1-44.

It is so ordered.

This Opinion and Final Order may be appealed to circuit court within 30 days, pursuant to Ala. Code § 40-2B-2(m).

Entered April 13, 2021.

/s/ *Jeff Patterson*
JEFF PATTERSON

Chief Judge
Alabama Tax Tribunal

jp:cm

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