

RONALD L. & CAROLYN S. MCELROY §  
214 HICKORY VALLEY ROAD  
TRUSSVILLE, AL 35173, §

STATE OF ALABAMA  
DEPARTMENT OF REVENUE  
ADMINISTRATIVE LAW DIVISION

Taxpayers, §

DOCKET NO. INC. 05-965

v. §

STATE OF ALABAMA §  
DEPARTMENT OF REVENUE.

### **OPINION AND PRELIMINARY ORDER**

The Revenue Department assessed Ronald L. and Carolyn S. McElroy (together “Taxpayers”) for 2000 and 2001 Alabama income tax. 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 April 19, 2005 in Birmingham, Alabama. Ronald McElroy (individually “Taxpayer”) represented the Taxpayers. Assistant Counsel Keith Maddox represented the Department.

The Taxpayer worked until 1999 on an offshore oil rig. When not working offshore, the Taxpayer performed minor home repairs.

The Taxpayer was laid off from his offshore job in 1999. In 2000, the City of Trussville Airport Authority took the Taxpayers’ home by eminent domain to make way for a runway extension. The Taxpayer drew unemployment benefits for several months. He subsequently decided to build two houses on some property he had purchased in 1999.

The Taxpayer claims that he initially intended to sell the two houses. He claims that he took the name Native American Construction Company, and that he opened bank accounts and obtained permits in that name. He started on the first house in the Spring of 2000, and completed it in mid-2001. The Taxpayer ran into financial troubles while constructing the house. Consequently, his son loaned him \$40,000 to complete the house.

The son subsequently decided to purchase the house himself.

The Taxpayer had started on the second house while the first was being completed. He completed the second house in the Spring of 2002. He claims he also wanted to sell that house, "but my wife loved the house and wanted to be close to our son, so we in essence purchased the house ourselves." Taxpayers' Notice of Appeal at 1.

The Taxpayers filed 2000 and 2001 Alabama returns on which they claimed Schedule C income of \$77,432 in 2000 and \$21,566 in 2001. They also claimed the expenses incurred in building the two houses on the Schedule Cs, which resulted in a loss of \$47,124 in 2000 and a net profit of \$3,692 in 2001.

A Department examiner audited the Taxpayers and disallowed the Schedule C expenses because she determined that the expenses were personal in nature, and thus not incurred in a business venture. She also reclassified the income reported on the Schedule Cs as "other income." The examiner's audit report reads in part as follow:

Schedule C-Native American Construction

The taxpayer claimed a Schedule C business loss of \$(47,124.00) in 2000 and a net profit of \$3,692.00 in 2001 on "Native American Construction", a home construction venture. The taxpayer started construction on two houses, on side-by-side lots, in the year 2000. The taxpayer deducted expenses associated with building of the houses. The taxpayer moved into one of the homes, 214 Hickory Valley Road. In 2002, his son moved into the house next to it. According to the tax preparer, the taxpayer original intention was to build and sell the houses as a business venture. No evidence was presented to establish that a legitimate business venture existed. All evidence indicates that the homes built by the taxpayers were personal in nature, and not business. The taxpayers sold their previous personal residence in 2000, and started building the two houses that same year. The two houses were never placed on the market. No business license was presented. The gross receipts reported on the Schedule C were received from the son, but it is unclear in what capacity. Because the evidence establishes that no business existed, the Schedule C's have been disallowed. The gross receipts reported have been reclassified as other income.

### Other Income

The taxpayers received income of \$77,432.00 in 2000 and \$21,566.00 in 2000, reporting the amounts as gross receipts on the Schedule C. The Schedule C has been disallowed because no business existed. However, the gross receipts received are taxable absent records to verify the type of income and in what capacity received. The gross receipts reported have been reclassified as other income. It is unclear in what capacity the income was received, but a transaction occurred in which the monies were received. Absent complete records the entire amount received is taxable.

The Taxpayer testified that he and a cousin were in business as Native American Construction. However, they apparently operated independent of each other. The Taxpayer claimed that the cousin had the business incorporated in about 1996, and that the cousin was responsible for filing the appropriate tax returns. However, the Alabama Secretary of State has no record of a corporation in the name of Native American Construction, Inc., nor have any corporate income tax or other returns been filed with the Department under that name.

The Taxpayer testified that he intended to build and sell the houses as a business. However, he did not conduct his activities in a businesslike manner. Importantly, he did not obtain a business license for his alleged business; nor did the business ever file any income tax returns. There also is no evidence the Taxpayer intended to ever build anymore houses other than the two in which his family and his son's family now live. Under the circumstances, the examiner's finding that the Taxpayer's construction of the two houses was personal in nature is affirmed. See generally, Treas. Reg. §1.183-2(b) and *Dudewicz v. State of Alabama*, Inc. 02-367 (Admin. Law Div. O.P.O. 1/6/03). The Schedule C deductions were correctly disallowed.

The Taxpayer also argued at the April 19 hearing that he should not be taxed on the proceeds he received from the house that he sold to the City of Trussville. He claims that

the \$77,432 reported on the 2000 Schedule C constituted those sales proceeds.

I agree that the proceeds from the sale of the Trussville house were not taxable. Any loans from the Taxpayers' son also were not taxable. It is unclear, however, as to the source of the Schedule C income reported on the returns. The examiner not unreasonably assumed that the income was taxable, and thus recharacterized it as other income.

The Taxpayers or their tax preparer should notify the Administrative Law Division by May 27, 2005 as to the source of the Schedule C income reported on the Taxpayers' 2000 and 2001 returns. An explanation as to why the income was reported should also be provided, unless the information is self-explanatory. Appropriate action will then be taken.

This Opinion and Preliminary Order is not an appealable Order. The Final Order, when entered, may be appealed to circuit court within 30 days from the date of this Order pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered April 27, 2005.

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BILL THOMPSON  
Chief Administrative Law Judge