

STEPHEN M. BRICKLEY
1827 RIDGE AVENUE, APT. 3
MONTGOMERY, AL 36106-1865,

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STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

Taxpayer,

§

DOCKET NO. INC. 06-1203

v.

§

STATE OF ALABAMA
DEPARTMENT OF REVENUE.

§

FINAL ORDER

The Revenue Department denied a 2004 income tax refund requested by Stephen M. Brickley ("Taxpayer"). The Taxpayer appealed to the Administrative Law Division pursuant to Code of Ala. 1975, §40-2A-7(c)(5)a. A hearing was conducted on May 23, 2007. CPA James Hodgson represented the Taxpayer. Assistant Counsel David Avery represented the Department.

The Taxpayer worked as the chief operating officer for Wolff System Technology, Inc. in Atlanta, Georgia until 1996. Wolff System was purchased in 1996, and the new owners brought in their own executive officer. The Taxpayer was thereafter unemployed, and unsuccessfully looked for a new executive position in Atlanta for almost one year.

In mid-1997, the Taxpayer learned of a graphic arts company, Atlanta Prepaid Service, Inc. ("APS"), that needed new management. The Taxpayer formed a corporation, Rockcreek Wells Group, Inc. ("Rockcreek"), for the purpose of buying the assets of APS. Rockcreek subsequently purchased the assets of APS for \$550,000 in late 1997.

The Taxpayer personally loaned Rockcreek \$250,000 toward the purchase price. The corporation borrowed the remaining \$300,000 from a bank in Atlanta. The bank required the Taxpayer to personally guarantee the loan.

The Taxpayer worked for and managed Rockcreek for an annual salary of \$67,000. The business struggled, and Rockcreek filed for Chapter 7 bankruptcy in October 2001. The Taxpayer filed a claim in bankruptcy court concerning his \$250,000 loan to the corporation. He subsequently received \$14,000 from that claim. He did not, however, file a claim concerning the \$300,000 loan guarantee.

The Taxpayer was forced to sell his residence in Georgia in early 2002 to pay off the loan guarantee. He subsequently moved to Alabama in May 2002.

The Taxpayer claimed the \$300,000 loan repayment as a business-related net operating loss ("NOL") on his 2002 Alabama return. He subsequently carried the loss forward and claimed a refund on his 2004 Alabama return. The Department determined that the loss was a nonbusiness investment loss. It consequently disallowed the carryover to 2004, and also the resulting refund.

Alabama law allows that a business-related NOL may be carried back two years and forward fifteen years. Code of Ala. 1975, §40-18-15.2. However, nonbusiness losses can only be deducted in the loss year, and cannot be carried back or forward to other years. Code of Ala. 1975, §40-18-15.2(5)c.

The issue in this case is whether the Taxpayer's loss resulting from his loan guarantee was a personal loss or a business loss. If the loan constituted an investment in or contribution of capital to the corporation, the loss was nonbusiness. If, however, the Taxpayer's dominant motive was to protect his employment with the corporation, the loan guarantee was business-related, and the loss can be carried over to the year in issue. See generally, *United States v. Generes*, 92 S.Ct. 827 (1972).

The Taxpayer contends that he guaranteed the \$300,000 loan so that Rockcreek could purchase the assets of APS and he could thereafter have a job running the business. He thus argues that his dominant motive in making the guarantee was to be employed by the corporation.

An employee's job is the employee's trade or business. Consequently, if an employee loans money to his or her employer primarily to protect his or her job, the loan is business-related, and any subsequent loss concerning the loan can be considered in computing an NOL carryover. Conversely, a loan or loan guarantee is nonbusiness if it serves to protect the employee's equity interest in a corporation, or is in substance a contribution of capital to the corporation. See, *Healey v. United States*, 228 B.R. 332 (ND Ga. Atl. Div. 1998); *Betson v. C.I.R.*, 802 F.2d 365 (9th Cir. 1986); *Piggy Bank Stations, Inc. v. Comm. of Internal Revenue*, 755 F.2d 450 (5th Cir. 1985).

The Department argues in this case that the \$300,000 loan was in substance a contribution of capital to Rockcreek. I must agree. The loan constituted a necessary infusion of capital into Rockcreek that allowed Rockcreek to purchase the assets of APS. The Taxpayer's ultimate goal may have been to be employed by Rockcreek, but he first had to capitalize Rockcreek so that it could buy the assets of APS. His loan guarantee secured that needed capital. And importantly, the Taxpayer was unemployed when he made the loan guarantee, and thus at the time did not have a trade or business, i.e., a job, to protect, as required for the loan guarantee to be business-related.

Finally, even if the loan guarantee was business-related, the loss relating to the transaction occurred when the Taxpayer paid off the loan in early 2002, before he moved to

Alabama in May 2002. Consequently, the loss occurred in Georgia, not Alabama, and thus was not reportable on the Taxpayer's part-year 2002 Alabama return.

The Department's denial of the Taxpayer's 2004 refund is affirmed.

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

Entered August 29, 2007.

BILL THOMPSON
Chief Administrative Law Judge

bt:dr

cc: David E. Avery, III, Esq.
James C. Hodgson, CPA
Kim Peterson