STATE OF ALABAMA DEPARTMENT OF REVENUE,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
v.	§	DOCKET NO. INC. 86-143
LEWIS L. & FRANCES M. HICKMAN 2419 Leonida Drive Montgomery, AL 36106,	§	
Taxpayers.	§	

ORDER

This matter involves a preliminary assessment of income tax entered by the Revenue Department (Department) against Lewis L. and Frances M. Hickman (Taxpayer or Taxpayers) for the year 1980. A hearing was conducted in the matter on February 5, 1987. The Taxpayers were present and represented themselves. The Revenue Department was represented by assistant counsel Mark Griffin. Based on the evidence submitted at said hearing, the following findings of fact and conclusions of law are hereby made and entered.

FINDINGS OF FACT

The Taxpayer, Lewis L. Hickman, was a stockholder in Products for Energy, Inc., a business formed for the purpose of developing and marketing various tree or limb cutting apparatus (ZZZ-Cut Device). The Taxpayer had invented said device and obtained the original patents relating thereto.

On July 23, 1980, the Taxpayer and Products for Energy, Inc. entered into the following agreement:

> I promise to pay Products for Energy, Inc. $50,000. This payment to be made by withholding royalties for the next

> sixteen ZZZ-Cut units sold, rented or leased, in accordance with the agreement reached with Dorsey Trailers and Products for Energy, Inc. Payment of the $50,000 to be made date of sale to Dorsey Trailers.

On July 25, 1980, Products for Energy, Inc. and Dorsey Trailers, Inc. entered into a sale and assignment of all Products for Energy, Inc. stock and patent rights (ZZZ-Cut) to Dorsey Trailers, Inc. On that same date, the Taxpayer and Products for Energy, Inc. entered into an assignment agreement whereby the Taxpayer transferred his ZZZ-Cut patent rights to Products for Energy, Inc. In consideration for the assignment, the Taxpayer was to receive the sum of $3,000.00 for each of the first fifty devices sold, leased or used in each contract year, and $2,000.00 for each device thereafter. However, the agreement provided, as did the July 23, 1980 agreement between the Taxpayer and Products for Energy, Inc., that the Taxpayer would receive no compensation or royalties for the first sixteen devices sold, leased or used in the first year.

The July 25, 1980 assignment agreement also included a paying agent agreement whereby Products for Energy, Inc. agreed to pay the aforementioned amounts due the Taxpayer to First Alabama Bank, as paying agent, and that First Alabama Bank would then transfer said payments to the Taxpayer. The evidence indicates that the Taxpayers never received any payment sunder the agreement, other than the $50,000.00 lump sum payment, nor have they ever made or been requested to make any payments for reimbursement of the $50,000.00.

Based on adjustments made by the Internal Revenue Service, the Revenue Department adjusted the Taxpayers' income for 1980 to reflect the $50,000.00 paid to the Taxpayers in that year as income. Various medical and dental expenses were also disallowed. The $50,000.00 was set up as taxable income by the IRS, and subsequently by the Revenue Department, based on a Form 1099 issued by Dorsey Corporation showing $50,000.00 as miscellaneous income paid to the Taxpayers in 1980.

CONCLUSIONS OF LAW

The issue in dispute is whether the $50,000.00 received by the Taxpayers in 1980 constituted taxable income or a loan. The Taxpayers argue that the money was a loan and that the Form 1099 issued by Dorsey Corporation showing the amount as taxable income was a mistake.

The evidence indicates that the Taxpayer received the $50,000.00 in conjunction with this assignment of the ZZZ-Cut patent rights to Products for Energy, Inc., and the subsequent transfer of those rights to Dorsey Trailer. The money was to be "repaid", as set out in both the July 23, 1980 and the July 25, 1980 agreements between the Taxpayer and Products for Energy, Inc., by the Taxpayer not receiving a royalty payment on the first sixteen devices sold, leased or used in the first year. The Taxpayer was not otherwise obligated to repay the money nor did the agreements specify what would happen if the initial sixteen devices were never sold, leased or used. Thus, in effect, the Taxpayer

received the $50,000.00 in 1980 as payment for his assignment of the patent rights to the ZZZ-Cut device. This conclusion is supported by the fact that the Taxpayers have never received any additional money or other information relating to the sale, lease or use of the ZZZ-Cut devices by Dorsey Trailers, nor have they been contacted in any manner concerning repayment of the $50,000.00.

In the alternative, the $50,000.00 could be properly characterized as an unconditional or unrestricted advance on royalties for the first sixteen devices. Such income must be reported in the year received, see generally 1987 C.C.H. U. S. Master Tax Guide, §629.

Code of Alabama 1975, §40-18-14 provides in part as follows:

> (1) Includes gains, profits, or income derived from salaries, wages or compensation for persona services of whatever kind or in whatever form paid . . . or dealings in property whether real or personal, growing out of ownership or use of or interest in such property; also from interest, royalties, rents, dividends, securities or transactions of any business carried on for gain or profit and income derived from any source whatever, included nay income not exempted under this chapter and against which income there is no provisions for a tax . . . The income of such items shall be included in the gross income for the taxable year in which received by the taxpayer unless under the methods of accounting permitted in this chapter any such amounts are to be properly accounted for as of a different period; (emphasis supplied)

Code of Alabama 1975, §40-18-13 governs the computation of net income for individuals and provides in part as follows:

> Net income shall be computed upon the basis of the

> taxpayer's annual accounting period, fiscal year or calendar year as the case may be, in accordance with the method of accounting regularly employed in keeping the books of such taxpayer . . . If the taxpayer's annual accounting period is other than the fiscal year as defined in this chapter, or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year. (emphasis supplied)

The above section is in accordance with the generally accepted principle that a cash basis taxpayer, such as the Taxpayers in the present case, must report all income in the year received. Blitzer v. U.S., 684 F.2d 874, see also, 1987 C.C.H., U.S. Master Tax Guide, §611.

An analogous situation arose in Bouchard v. Commissioner of Internal Revenue, 229 F.2d 703. In that case, a taxpayer entered into an agreement whereby he would seek to develop for profit his ideas relating to various devices. In return, the taxpayer was to be paid money in advance for his living and traveling expenses. The court concluded as follows:

> From the evidence adduced, the Tax Court determined, as a matter of fact, that Bouchard received payments from Juneau because he was or appeared to be performing services as a result of which Juneau hoped to derive a profit; that there was no understanding that the money would be repaid, except to the extent Juneau was reimbursed out of profits; that, while it appears that Mr. Hofmeier, president of Juneau, was anxious to aid Bouchard and his family, who were without money, there is nothing in the record to indicate that the payments were gifts rather than compensation for services; and that there is no indication that Bouchard was restricted i his use of the money received. The court thereupon concluded that the payments were received for services rendered and are, therefore, taxable as ordinary income.

In the present case, the evidence is clear that the $50,000.00

was not intended as a loan, but rather was either reimbursement for assignment by the Taxpayer of his patent rights or an advance payment of royalties. As in Bouchard, the money was paid without restriction as to use, and no provisions were made as to repayment, except that the Taxpayer would receive no royalties on the first sixteen devices sold, used or leased. The Taxpayer's right to retain the money was not contingent on whether the device was ever sold, leased or used by Products for Energy, Inc. or Dorsey Trailers. Such an unrestricted receipt of income is taxable to a cash basis taxpayer in the year received.

The above considered, the Revenue Department is hereby directed to make final the preliminary assessment as entered, with interest computed to the date of final assessment.

Done this 6th day of March, 1987.

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BILL THOMPSON
Chief Administrative Law Judge