

STATE OF ALABAMA §
DEPARTMENT OF REVENUE, §

STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

v. §

DOCKET NO. INC. 86-220

JAMES R. & VIRGINIA BLACKMON §
811 Ridgecrest Drive §
Luverne, AL 36069, §

Taxpayers. §

FINAL ORDER

An initial hearing was conducted in this matter on June 11, 1987. A second hearing was conducted on December 10, 1987. The parties were represented at both hearings by Charles J. Kettler, Jr., for the Taxpayers, and assistant counsel Mark Griffin, for the Department.

The second hearing involved three items: (1) loan proceeds of \$22,000.00 that were used in the Taxpayers' business during the subject year 1983; (2) installment loan payments made by the Taxpayers during the subject year 1983; and (3) bad debts of \$4,702.00 claimed by the Taxpayers during the subject year 1983.

FINDINGS OF FACT

(1) The Taxpayers borrowed \$22,000.00 which was subsequently deposited into their business account. The Taxpayers operated a small gas station/grocery store during the year in question. The Taxpayers argue that their basis in the business should be adjusted to reflect the \$22,000.00 in additional capital. The Department contends that the money was used to pay for deductible business expenses and thus was (or should have been) claimed on Schedule C

as ordinary business expenses. The Taxpayers deducted numerous business expenses on their 1983 return. However, no evidence was presented indicating whether the \$22,000.00 was used to pay for said deductible items.

(2) The Taxpayers produced nine checks representing payments for three months on three separate installment loans. The Department allowed credit (a deduction for the interest and adjustment to basis for the principal) for the nine checks. However, the Taxpayers claim that further credit should be allowed for payments that were made during the remaining months of the year. The Taxpayers contend that no records are available concerning the remaining months because the payments were made in cash. The Taxpayers were allowed an opportunity to submit evidence from the banks in question indicating that payments had been made, but no further evidence was provided.

(3) The Taxpayers presented numerous records at the hearing which, according to the Taxpayers, represented uncollectible accounts receivable totaling \$4,702.00. although testimony concerning the bad debts was inconclusive, apparently the Taxpayers never reported the receivables as income. Further, the Taxpayers admit that no attempt was made to collect the amounts owed.

CONCLUSIONS OF LAW

(1) Amounts expended as ordinary and necessary business expenses must be deducted in the year incurred. See Code of Ala.

1975, §40-18-15(a)(1) and corresponding federal statute 26 U.S.C. §162.

In the instant case, the Taxpayers contributed \$22,000.00 to the operation of their business. The Taxpayers claim that their basis in the business should thus be adjusted to reflect the contribution to capital.

However, the Taxpayers also claimed various business related expenses on the 1983 return. The Department contends that here should be no adjustment of basis if the Taxpayers had already deducted the \$22,000.00 in the form of business expenses. Thus, the question is whether the \$22,000.00 was used to pay all or part of the business expenses already claimed by the TAXPAYERS. If the money was used to pay such deductible expenses, then no adjustment to basis should be allowed.

No records or other evidence was provided by which the \$22,000.00 could be properly traced. The Taxpayers were required to keep proper records by which their proper liability can be computed. U.S. v. Wodtke, 627 F.Supp. 1034. In light of the Taxpayer's failure to prove that the \$22,000.00 had not been used to pay deductible business expenses, the amount cannot be used to pay deductible business expenses, the amount cannot be allowed as an adjustment to the Taxpayers' basis in the business.

(2) As stated, the Taxpayers were required to produce adequate records by which all claimed deductions could be verified.

U.S. v. Wodtke, supra. The Taxpayers' oral testimony is insufficient to support a deduction unless corroborating records are produced. State v. Ludlum, 384 So.2d 1089.

In the instant case, the Taxpayers provided cancelled checks for three months only. NO checks or other evidence was offered concerning note payments made during the remainder of the year. Consequently, the Taxpayers can be allowed credit for only the three months for which records were provided.

(3) A bad debt deduction must be established from adequate proof by the taxpayer. Wilson v. U.S., 376 F.2d 280. Further, a taxpayer must establish that the debts are in fact worthless, and also must either exhaust every reasonable means of collection or prove that any attempt to collect would be fruitless. Bell v. U.S., 102 F.Supp. 931, affirmed 217 F.2d 646; Dustin v. C.I.R., 467 F.2d 47.

In the instant case, the Taxpayers presented records relating to the alleged uncollectible accounts. However, the Taxpayer testified that he made no attempts to collect the debts, other than to informally discuss the matter with some of the debtors. Further, the Taxpayers failed to present evidence indicating that the accounts had become worthless in the subject year, which is necessary for a deduction to be allowed. Wilson v. U.S., supra.

Consequently, the bad debt deduction was properly disallowed by the Department.

The above considered, the Taxpayers should be allowed no

further adjustments to their 1983 liability. Accordingly, the preliminary assessment in issue should be made final as entered, with applicable interest as required by statute.

Entered this 17th day of August, 1988.

BILL THOMPSON
Chief Administrative Law Judge