

STATE OF ALABAMA
DEPARTMENT OF REVENUE,

§

STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

§

v.

§

DOCKET NO. INC. 86-248

DAVID J., JR. & CAROL R. EVANS§
P. O. Drawer N
Boaz, AL 35967,

§

Taxpayers.

§

ORDER

This case concerns a preliminary assessment of income tax entered by the Revenue Department against David J., Jr. and Carol R. Evans (Taxpayers) for the calendar year 1983. A hearing was conducted in the matter on November 26, 1986 at the Revenue Department Taxpayer Service Center in Huntsville, Alabama. The Taxpayer, David J. Evans, Jr., was present and represented both himself and his wife. The Revenue Department was represented by assistant counsel Adolph Dean. Based on the facts as established at said hearing, the following findings of fact and conclusions of law are hereby made and entered.

FINDINGS OF FACT

The Taxpayer, an attorney, was employed by the First National Bank of Boaz to give a title opinion on a parcel of property. In reliance on the Taxpayer's title opinion, the Bank accepted the property as collateral for a loan to a third party (loan mortgagor).

In 1983, the loan mortgagor declared bankruptcy and the Bank foreclosed on the subject property. However, during foreclosure it

was discovered that the loan mortgagor's 83 year old mother had a valid life estate in the property which had not been disclosed in the Taxpayer's title opinion. As a result, the Bank required the Taxpayer to assume liability for the loan mortgagor's outstanding loan balance of approximately \$26,544.00. The Taxpayer signed a note payable to the Bank for the amount due, amortized over ten years at eleven percent interest. Title to the property remained with the Bank, but the evidence at the hearing indicated that both the Bank and the Taxpayer consider the property to be owned by the Taxpayer, and that the Taxpayer would receive any proceeds from the sale of the property over and above the loan balance due the Bank. The Taxpayer, with the Bank's assistance, is currently trying to sell the property.

Relative to the above transaction, the Taxpayers took a "damage claim" business loss of \$18,578.00 on their 1983 return, Schedule C. The deduction amount was arrived at through a complicated formula by which the projected value of the property in 8.3 years (life expectancy of the life estate holder) was determined by applying an eleven percent interest rate (arbitrarily determined) to the present value of the property of \$17,700.00 (determined, according to the Taxpayer, by a recent appraisal). Thereby, the present market value of the property, in consideration of the outstanding life estate, was determined to be approximately \$7,971.00. The Taxpayer subtracted that amount from the loan amount of \$26,544.00 to arrive at a loss or damage claim of

\$18,573.00. In short, the Taxpayer claims that in return for assuming the liability of \$26,544.00, he received the right to property presently worth \$7,971.00, which consequently, resulted in a deductible loss of \$18,573.00

The Department audited the Taxpayer's 1983 return and disallowed the claimed loss. Based thereon, the preliminary assessment in issue was entered, from which the Taxpayers properly protested to the Administrative Law Division.

CONCLUSIONS OF LAW

The burden is on the taxpayer to establish and verify all claimed deductions. In the present case, the Taxpayer's position, presumably, is that the "damage claim" is deductible under Code of Ala. 1975, §40-18-15(4), which allows a deduction for business losses sustained during the tax year. That section is modeled after the federal statute on the subject, 26 U.S.C. §165, and accordingly, federal authority should be followed in interpreting the Alabama statute. State v. Gulf Oil Corporation, 256 So.2d 172.

Under federal case law, a loss is sustained when evidenced by a completed, closed transaction, from which its amount can be accurately determined. Higgins v. Smith, 60 S.Ct. 355, 308 U.S. 473; Meyer v. C.I.R., 243 F.2d 262, cert. denied, 78 S.Ct. 94, 355 U.S. 864.

In the present case, because of the erroneous title opinion, the Taxpayer was required to purchase the property in question from

the Bank for the amount of the outstanding loan balance. While title to the property remained with the Bank, both the Bank and the Taxpayer are in agreement that the Taxpayer is the owner of the property and would receive any proceeds from its sale that exceeds the outstanding loan balance due from the Bank. Title remained with the Bank only because it would facilitate the sale of the property. Thus, the mere purchase of the property by the Taxpayer is an open transaction and no loss (or gain) would be recognizable for tax purposes until the property is sold. Only then, after the closed of the transaction, could the amount of the gain or loss be accurately determined.

The above considered, it is hereby determined that the preliminary assessment in issue, which is based on the disallowance by the Department of the claimed deduction by the Taxpayers, is correct and should be made final as entered, with applicable interest as required by law.

Done this 8th day of January, 1987.

BILL THOMPSON
Chief Administrative Law Judge