

STATE OF ALABAMA
DEPARTMENT OF REVENUE,

§

STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

§

v.

§

DOCKET NO. INC. 89-152

WILLA C. ROBERTS
189 Lime Quarry Road, #101
Madison, AL 36758,

§

§

Taxpayer.

§

FINAL ORDER

The Revenue Department assessed income tax against Willa C. Roberts (Taxpayer) for the years 1985 and 1986. The Taxpayer appealed to the Administrative Law Division and a hearing was scheduled for August 9, 1989. The hearing was continued at the request of the Taxpayer's representative, Mr. Carl Fallin, until September 21, 1989. The hearing was continued a second time until October 4, 1989, again at the request of the Taxpayer's representative. However, the Taxpayer failed to appear at the October 4th hearing. The hearing proceeded, with assistant counsel Duncan Crow appearing for the Department. The following Final Order is entered based on the evidence submitted at the hearing, and in consideration of the arguments submitted by both parties.

FINDINGS OF FACT

The Taxpayer claimed a non-business bad debt of \$245,000.00 in 1984 and attempted to carry the loss over on her 1985 and 1986 Alabama return.¹

¹The loss was first carried back to 1981 and 1982, and based thereon a refund was issued for those years by the Department. The Department now argues that the refunds were improperly issued, but

concedes that the refunds cannot be recovered because the statute of limitations has run for those years.

The loss carryovers reduced the Taxpayer's liability for 1985 and 1986 to zero. The Department audited the Taxpayer, rejected the carryovers, and consequently entered the assessments in dispute.

The relevant facts upon which the Department's position is based are as follows:

The Taxpayer and her husband were sole shareholders in a corporation that operated a motel in Hartselle, Alabama. The Taxpayer had borrowed approximately \$190,000.00 from a bank and had put that money into the operation of the motel.

The motel was destroyed by fire in 1981. The Taxpayer filed an insurance claim for the damage caused by the fire, but the claim was never paid. The Taxpayer subsequently filed for personal bankruptcy in U. S. Bankruptcy Court in 1984. The Taxpayer's residence was foreclosed on as a result of her bankruptcy.

The Taxpayer argues that she incurred a deductible loss of \$190,000.00 in 1984 based on the money she had invested in the motel and never recovered. In addition, the Taxpayer also claims a \$55,000.00 loss on the foreclosure sale of her personal residence. The total amount of \$245,000.00 was claimed as a "non-business bad debt" on the Taxpayer's 1984 Alabama return.

CONCLUSIONS OF LAW

Code of Ala. 1975, 540-18-15(a)(7) allows a deduction for bad debts sustained in the conduct of a regular trade or business. However, a non-business bad debt is not deductible under Alabama

law. Consequently, the Taxpayer's non-business bad debt claimed in 1984 should be disallowed, and thus no carryover loss can be allowed in the subject years. Also, even assuming that the Taxpayer had incurred a deductible loss in 1984, the Bankruptcy Code at 11 U.S.C.A. §346 provides that if any debt is discharged in bankruptcy, then such debt cannot be the basis for a net operating loss carryover. That is, the loss must be reduced to the extent that the debt is forgiven or discharged in bankruptcy, see subsection 346(j). Consequently, the loss incurred by the Taxpayer in 1984 could not have been carried over to the subject years 1985 and 1986 because the Taxpayer's liability for the bank loan of \$190,000.00 that was the basis for the loss was discharged when the Taxpayer filed for bankruptcy in 1984. In addition, the alleged \$55,000.00 loss resulting from the sale of the Taxpayer's personal residence was also a non-business loss and thus cannot be allowed under Alabama law.

The above considered, the assessments in issue are correct and should be made final, with interest running to the date of entry of the final assessments.

Entered this 3rd day of January, 1990.

BILL THOMPSON
Chief Administrative Law Judge