

STATE OF ALABAMA  
DEPARTMENT OF REVENUE,

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STATE OF ALABAMA  
DEPARTMENT OF REVENUE  
ADMINISTRATIVE LAW DIVISION

§

v.

§

DOCKET NO. INC. 89-155

HORACE M. & MILDRED F. DAY  
301 North Pratt Street  
Centre, AL 35650,

§

§

Taxpayer.

§

FINAL ORDER

The Revenue Department assessed income tax against Horace M. & Mildred F. Day (Taxpayers) for the year 1987. The Taxpayers appealed to the Administrative Law Division and a hearing was conducted on February 21, 1990. Mitchell Williams appeared for the Taxpayers. Assistant counsel Duncan Crow represented the Department. This Final Order is entered based on the evidence and arguments presented by the parties.

FINDINGS OF FACT

Horace M. Day (Taxpayer) is in the business of buying and selling real estate and timber. The Taxpayer purchases timberland, cuts and sells the timber, and then either resells the land or holds it as rental property. In some instances it is important for the Taxpayer to cut and remove the timber from the property as quickly as possible.

The Taxpayer personally guaranteed several bank loans for J. R. Timber Company (Timber Company). The Timber Company was owned and operated by the Taxpayer's son and daughter-in-law. The Taxpayer had no ownership interest in the Timber Company and was

not involved in the management of the business.

The Taxpayer's son died in 1987. The Timber Company could not repay the bank loans, and the bank subsequently demanded payment from the Taxpayer. The Taxpayer satisfied the loans in the amount of \$66,203.06 in October, 1987. The issue in dispute is whether the loans paid by the Taxpayer can be deducted as a business bad debt.

The Taxpayer argues that he guaranteed the loans to keep the Timber Company in business so that he would have access to a timber operator that would cut his timber on short notice. In that respect, significant amount of timber for the Timber Company was not under exclusive contract. However, the Timber Company was not under exclusive contract with the Taxpayer, and the Taxpayer occasionally used other timber operators when the Timber Company did not have a crew available.

#### CONCLUSIONS OF LAW

A business-related bad debt can be fully deducted under Alabama law, see Code of Ala. 1975 §40-18-15(a)(7). However, a nonbusiness or personal bad debt cannot be deducted, see Department Reg. 810-3-15-.07(9).

The business or nonbusiness nature of a debt must be decided on the particular facts of each case. The U. S. Supreme Court has determined that to be a business bad debt, the debt must have a dominate rather than only a significant business motivation, see

U.S. v. Generes, 92 S. Ct. 827; Alsobrook v. U. S., 566 F.2d 628.

The Taxpayer argues that he guaranteed the loans for the Timber Company to insure that he would have a lumber company available to cut his timber on short notice. However, while keeping the Timber Company in business may have in some respects benefited the Taxpayer's business and allowed the Taxpayer to realize more profit on some transactions, the Taxpayer has failed to prove that the Timber Company was essential to his business or that he would not have been successful but for the existence of the Timber Company.

Given that the Taxpayer's son owned and operated the Timber Company, and that the Timber Company was not essential or necessary for the successful operation of the Taxpayer's business, it must be determined that the large unsecured loan guaranties were primarily motivated by the Taxpayer's personal desire to help his son, and were not primarily or dominantly business motivated. Accordingly, the amount paid by the Taxpayer to satisfy the loans cannot be deducted as a business bad debt.

The above considered, the assessment in issue should be made final as entered, with applicable interest.

Entered this 29th day of March, 1990.

BILL THOMPSON  
Chief Administrative Law Judge