

STATE OF ALABAMA  
DEPARTMENT OF REVENUE,

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STATE OF ALABAMA  
DEPARTMENT OF REVENUE  
ADMINISTRATIVE LAW DIVISION

§

v.

§

DOCKET NO. INC. 89-180

WENDELL SAWYER FURNITURE  
204 South Wilson Avenue  
Prichard, AL 36610,

§

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Taxpayer.

§

FINAL ORDER

The Revenue Department assessed income tax against Wendell Sawyer Furniture Co. Inc. (Taxpayer) for the fiscal years ending 2/28/86 and 2/28/87. The Taxpayer appealed to the Administrative Law Division and the case was submitted on a joint stipulation of facts. Assistant counsel Mark Griffin represented the Department.

CPA G. Marshall Burden represented the Taxpayer.

FINDINGS OF FACT

This case involves the bad debt deduction allowed for corporations at Code of Ala. 1975, §40-18-35(5). As will be discussed, prior to 1985 §40-18-35(5) allowed a deduction for only bad debts actually incurred during the tax year. However, that section was amended effective 1/1/85 to allow corporations to also use the federal reserve method for computing bad debts. The Taxpayer in this case elected to convert to the reserve method for Alabama purposes beginning the fiscal year ending 2/28/86. The issue in dispute is how the deduction should be computed in that year of conversion. The facts are undisputed.

The Taxpayer reported federal net income of \$4,603.53 on line

1 of its Alabama return for the fiscal year ending 2/28/86. The federal net income amount included (excluded) a federal bad debt deduction computed using the reserve method in the amount of \$42,147.07.

In addition, the Taxpayer also claimed an additional bad debt deduction on the Alabama return in the amount of \$68,124.20. The additional deduction was for the Taxpayer's bad debt reserve balance at the end of the prior fiscal year. As a result, the 1986 return showed a net loss of \$64,211.00. The Taxpayer subsequently carried the 1986 loss forward as a NOL carryover to 1987.

The Department disallowed the additional bad debt deduction on the 1986 return, and as a consequence also disallowed the carryover loss to 1987. The preliminary assessments in issue are based on the above adjustments.

#### CONCLUSIONS OF LAW

Prior to 1985, for Alabama purposes a corporation was allowed by §40-18-35(5) to deduct only actual bad debts incurred during the tax year. Consequently, a corporation computing its bad debt deduction using the reserve method for federal purposes was required to first add back the federal deduction to the federal net income amount reported on line 1 of the Alabama return, and then deduct its actual bad debts incurred during the tax year.

Section 40-18-35(5) was amended effective 1/1/85 to allow corporations the same "reasonable addition to a reserve for bad

debts" as provided by the federal bad debt provision, 26 U.S.C. §166.<sup>1</sup>

The Taxpayer claims that it should be allowed to deduct the entire bad debt reserve in the year of conversion in addition to a reasonable allowance for an addition to the reserve. The Taxpayer argues that the additional deduction is necessary to bring the Alabama bad debt reserve in line with the federal reserve. I disagree.

The federal bad debt deduction is already built into the federal net income amount reported on line 1 of the Alabama return.

Consequently, by making no adjustment to the line 1 amount, a corporation opting for the reserve method in Alabama is allowed the same reserve method bad debt deduction as allowed under federal law. That was the intent of §40-18-35(5) as it read during the subject year. No additional deduction is necessary to conform the Alabama deduction to the federal deduction.

The above considered, the Department properly disallowed the additional bad debt deduction claimed by the Taxpayer on the 1986

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<sup>1</sup>The federal government discontinued use of the reserve method in 1987. Alabama followed suit in 1990.

return. As a result, the loss carryover to 1987 was also properly disallowed. The preliminary assessments in issue are correct and should be made final, with applicable interest.

Entered on May 28, 1992

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BILL THOMPSON  
Chief Administrative Law Judge