

STATE OF ALABAMA,
DEPARTMENT OF REVENUE,

vs.

H. M. & MARY E. HAMILTON
3913 Franklin Drive
Anniston, AL 36201,

Taxpayers.

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STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

DOCKET NO. 89-264

OPINION AND PRELIMINARY ORDER

The Revenue Department assessed income tax against H. M. and Mary E. Hamilton (Taxpayers) for the years 1986 and 1987. The Taxpayers appealed to the Administrative Law Division and a hearing was conducted on September 30, 1992. O. J. Bailey and H. M. Hamilton (Taxpayer) appeared for the Taxpayers. Assistant counsel Gwendolyn Garner represented the Department.

FINDINGS OF FACT

The issue in this case is whether a bad debt deduction claimed by the Taxpayers on their 1987 Alabama return should be allowed. The relevant facts are set out below.

The Taxpayer owned an electronics business and sold the business to a two man partnership in 1983 for \$25,244.73. The Taxpayer's son was one of the two partners. On October 17, 1983, the Taxpayer's son gave the Taxpayer a promissory note for his one-half of the purchase price of \$12,622.37. The other partner paid cash.

Beginning in late October 1983 and continuing until mid-1987, the Taxpayer made numerous loans to his son in an effort to keep

the financially ailing business open. The total amount loaned by the Taxpayer to his son was \$27,290.00 (\$37,912.00 including the original \$12,622.00 note). The son signed a promissory note for each loan promising to repay the loan in five years, or when the partnership ceased to exist. The loans were unsecured and required interest at 8% annually.

The son failed to pay any principle or interest on the numerous loans and the electronics business finally failed in mid-1987. The Taxpayers subsequently claimed the unpaid notes as a business bad debt on their 1987 Alabama return.

The Department denied the deduction based on its position that the loans were personal in nature and not transactions entered into for profit.

CONCLUSIONS OF LAW

Losses sustained in a transaction entered into for profit are deductible pursuant to Code of Ala. 1975, §40-18-15(5). Personal bad debts are not deductible. The burden is on a taxpayer to prove that a loss was incurred in a transaction entered into for profit.

Levin v. U.S., 597 F.2d 760.

In this case, the initial \$12,622.00 note accepted by the Taxpayer for the sale of his electronics business constituted a business related bad debt. The loan was an arms-length debt accepted in conjunction with the sale of the business and the Taxpayer should not be penalized because he sold the business to

his son and not to an unrelated third party. The \$12,622.00 note should be allowed as a bad debt loss on the Taxpayers' 1987 Alabama return.

However, the subsequent loans by the Taxpayer to his son were nonbusiness or personal loans and therefore should not be allowed.

The Taxpayer was not connected with the electronics business after October 1983. The loans by the Taxpayer were personal in nature and were made in an effort to help the son keep the business open.

Certainly the Taxpayer did not expect to profit by the unsecured loans. A prudent businessman would not make over \$27,000.00 in unsecured loans to protect an original investment of \$12,500.00.

The Department is directed to recompute the Taxpayer's liability as indicated above. A Final Order will then be entered by the Administrative Law Division from which either the Taxpayer or the Department may appeal to circuit court pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered on October 22, 1992.

BILL THOMPSON
Chief Administrative Law Judge