STATE OF ALABAMA DEPARTMENT OF REVENUE,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
v.	§	DOCKET NO. INC. 91-146
THOMAS E. & MINNIE H. RAST 3901 Hillock Drive Birmingham, AL 35213,	§	
Taxpayers.	§	

FINAL ORDER

The Revenue Department assessed income tax against Thomas E. arid Minnie H. Rast (Taxpayers) for the year 1989. The Taxpayers appealed to the Administrative Law Division and a hearing was conducted on October 1, 1991. Beth Acker appeared for the Department. William Dow represented the Taxpayers.

FINDINGS OF FACT

The issue in this case is whether a stock loss incurred by Thomas E. Rast (Taxpayer) on the liquidation of Johnson, Rast and Hays Insurance, Inc. in 1986 constituted a business or nonbusiness loss for purposes of computing the net operating loss (NOL) deduction allowed at Code of Ala. 1975, §40-18-15(16).

A nonbusiness loss is limited to a taxpayer's nonbusiness income whereas a business loss is allowed in full, see subsection (16)f.3.

The Taxpayer founded Johnson-Rast and Hays Company, Inc. in 1955. The Taxpayer was an officer of and received a salary of over $379,000.00 from Johnson-Rast and Hays in 1986.

In the late 1970's and early 1980's, the Taxpayer formed and was sole stockholder in at least fifteen separate corporations

engaged in the insurance business in Alabama. The Taxpayer also formed Jaybird Aviation, Inc. (Jaybird) in 1978 which owned an airplane chartered by the various insurance companies.

The record is not specific, but apparently the numerous corporations (not including Johnson-Rast and Hays, Inc.) were merged in the early 1980s into one or several remaining corporations. Jaybird was merged into Johnson-Rast and Hays Insurance, Inc. in 1983. That company was dissolved in late 1986 and as a result the Taxpayer suffered the stock loss in issue of $1,287,960.00. The Taxpayer received no salary or other compensation from Johnson-Rast and Hays Insurance during 1986.

The Taxpayer treated the stock loss as a business loss for NOL purposes and carried the loss forward as a deduction to his 1989 Alabama return. The Department denied the carryforward and entered the assessment in issue based on its claim that the loss was a nonbusiness loss and thus should be limited to nonbusiness income pursuant to subsection (16)f.3. If the loss is a nonbusiness loss, as argued by the Department, then the assessment is correct and should be upheld.

The Taxpayer argues that the stock loss was a business loss because he actively managed the corporation. The Department counters that the Taxpayer was an investor only. As discussed below, a loss on stock held as an investment constitutes a nonbusiness loss for NOL purposes. The Department also argues that

the Taxpayer failed to prove at the administrative hearing that he actively managed the corporation.

CONCLUSIONS OF LAW

A stock loss is a business loss for NOL-purposes only if the taxpayer is a stock trader or broker or is in the business of promoting corporations for profit. A loss on stock held as an investment is nonbusiness. see, Purvis v. C.I.R., 530 F.2d 1332; Whipple v. C.I.R., 83 S.Ct. 1168, 373 U. S. 193.

To begin, the Department is correct that the Taxpayer failed to prove that he actively managed the corporation in question. The Taxpayer submitted affidavits to that effect subsequent to the administrative hearing which were properly objected to by the Department. However, even if the Taxpayer had been actively involved with the corporation, the stock loss would still be a nonbusiness loss because it was attributable to the corporation's trade or business and not to the Taxpayer's trade or business.

A corporation and its shareholders are separate and distinct for tax purposes. Dalton v. Bowers, 53 S.Ct. 205, 278 U.S. 404; Burnet v. Clark, 53 S.Ct. 207, 278 U.S. 410. Thus, a shareholder does not engage in a trade or business when he invests in a corporation. Betson v. C.I.R., 802 F.2d 365. This is true even if the taxpayer is actively engaged in the overall management of the corporation. Whipple v. C.I.R., supra. As stated in Betson v. C.I.R., supra, at page 368:

> As a general rule, the trade or business of a corporation is not that of its shareholders. See Whipple v. Commissioner, 373 U.S. 193, 202, 83 S.Ct. 1168, 1174, 10 L.Ed.2 288 (1963). Shareholders, unless they are traders, do not engage in a trade or business when they invest in the stock of a corporation.
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> These rules are consistent with the principle that if a taxpayer chooses to conduct business through a corporation, he will not subsequently be permitted to deny the existence of the corporation if it suits him for tax purposes. (cites omitted).

In Whipple v. C.I.R., supra, the court stated as follows, at page 1174:

> Devoting one's time and energies to the affairs of a corporation is not of itself and without more, a trade or business of the person so engaged. Though such activities may produce income, profit or gain in the form of dividends or enhancement in the value of an investment, this return is distinctive to the process of investing and is generated by the successful operation of the corporation's business as distinguished from the trade or business of the taxpayer himself. When the only return is that of an investor, the taxpayer has not satisfied his burden of demonstrating that he is engaged in a trade or business since investing is not a trade or business and the return to the taxpayer, though substantially the product of his own services, legally arises not from his own trade or business but from that of the corporation.
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> To be sure, the presence of more than one corporation might lend support to a finding that the taxpayer was engaged in a regular course of promoting corporations for a fee or commission, see Ballantine, Corporation, 102, or for a profit on their sale, see Giblin v. Commissioner, 227 F.2d 692 (5th Cir.),, but in such cases there is compensation other than the normal investor's return, income received directly for his own services rather than indirectly through the corporate enterprise, and the principles of Burnet, Dalton, duPont, and Higgins are therefore not offended. On the other hand, since the Tax

> Court found, and the petitioner does not dispute, that there was no intention here of developing the corporations as going businesses for sale to customers in the ordinary course, the case before us inexorably rests upon the claim that one who actively engages in serving his own corporations for the purpose of creating future income through those enterprises is in a trade or business. That argument is untenable in light of Burnet, Dalton, duPont and Higgins, and we reject it.

The Taxpayer in this case was not in the business of organizing and developing corporations for sale in the ordinary course of business, as discussed in the above Whipple quote, and received no salary or other benefits from the corporation in question. Thus, even if he was actively involved in the affairs of the corporation, the Taxpayer held the stock individually as an investor and thus the loss was a nonbusiness loss for NOL purposes.

The Taxpayer correctly argues that the loss would have been a business loss if he had operated as a sole proprietorship. However, the Taxpayer elected to operate in corporate form and cannot now ignore the corporate entity because it is advantageous for tax purposes. Betson v. C.I.R., supra. Accordingly, the carryforward was properly denied and the assessment in issue is correct and should be made final, with applicable interest.

Entered on December 18, 1991.

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BILL THOMPSON
Chief Administrative Law Judge