

STATE OF ALABAMA,
DEPARTMENT OF REVENUE,

vs.

JIANYUN DONG and DANHER WANG
5400 10th Avenue, South
Birmingham, AL 35222,

Taxpayers.

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STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

DOCKET NO. INC. 92-289

OPINION AND PRELIMINARY ORDER

The Revenue Department assessed 1989 Alabama income tax against Jianyun Dong and Danher Wang (hereinafter jointly "Taxpayers" or individually "husband" or "wife"). The Taxpayers appealed to the Administrative Law Division and a hearing was conducted on February 3, 1993. The Taxpayers represented themselves. Assistant counsel Beth Acker represented the Department.

The Department audited the Taxpayers for 1989 and made the following adjustments:

- (1) Educational expenses of \$4,200.00 were disallowed;
- (2) A scholarship or stipend of \$14,864.48 received by the husband was included as taxable income;
- (3) Employee business expenses of \$6,024.00 were disallowed, and;
- (4) Three dependent deductions totalling \$900.00 were disallowed.

(1) Educational Expenses.

The Taxpayers are both doctors and received medical degrees in China before moving to Birmingham in the mid-1980s. The Taxpayers

both attended the University of Alabama at Birmingham (UAB) as post-doctorial chemistry or biology students during the years in issue. The husband subsequently graduated and is now teaching at UAB. The wife is still a student.

The Taxpayers claimed \$4,200.00 as educational expenses on their 1989 return. The Taxpayers claim that they each paid \$2,400.00 in tuition in 1989 (\$600.00 per quarter each for 4 quarters). They also claim that they should be allowed to deduct the cost of the books required for their courses. Unfortunately, the Taxpayers either failed to keep or destroyed their receipts for the expenses and provided only a single \$600.00 tuition check in support of the claimed expenses.

The Department denied the educational expenses in full because (1) the on-going education did not maintain or improve the Taxpayers' skills in their existing field, but rather qualified them for a new trade or business, and (2) the expenses were not properly substantiated.

Educational expenses may be deducted if primarily for the purpose of maintaining or improving the taxpayer's skills in his present employment. However, such expenses must be denied if the education qualifies the student for a new trade or business or allows for substantial advancement in a present position. Carroll v. C.I.R., 51 T.C. 213, 418 F.2d 91; see also, Department Reg. 810-3-15-.10.

The Taxpayers in this case were both medical doctors prior to attending UAB. Although I am not clear what the Taxpayers studied or exactly what it qualified them to do, clearly the UAB education has allowed the husband and will allow the wife to enter new fields they were previously not qualified to enter. Certainly the husband was not qualified to teach at UAB before attending school there. Consequently, the claimed educational expenses must be disallowed.

Also, even if allowable, the Taxpayers failed to substantiate all but \$600.00 of the claimed expenses. The burden was on the Taxpayers to keep good records verifying all claimed deductions, and in the absence of adequate records the deductions must be disallowed. U. S. v. Wodtke, 627 F. Supp. 1034.

(2) The \$14,864.48 scholarship.

The husband received \$14,864.48 as a scholarship or stipend from UAB in 1989. The examiner considered the amount to be taxable income because as a condition to receiving the money the husband was required to conduct research and his work product was controlled by the university.

The husband concedes that he was required to do research work but argues that the research was necessary for his studies and all other students in the program were subject to the same requirements. The Taxpayers provided letters from two UAB administrators stating that the husband was subject to the same requirements (research work) demanded of all students in the

graduate program. Taxpayers' Exhibits 1 and 2.

Money received as a true scholarship or grant is nontaxable, but only if the amount is not compensation for services performed by the recipient for the grantor.¹ The recipient may be required to perform some services, but the money still qualifies as a tax-free scholarship if all other students must perform the same services. The amount received is not taxable if the primary purpose for the payment was to further the education of the recipient rather than as compensation for services rendered. Logan v. U.S., 518 F.2d 143.

In this case all other students in the husband's program were required to do research and were subject to the same restrictions and guidelines as the husband. The school retained control over and could have benefited from the husband's research, but the primary purpose for the scholarship was to advance the husband's studies and not for the benefit of the school. Consequently, the money paid by UAB qualifies as a tax-exempt scholarship and should be removed from the audit. Contrast Sebberson v. C.I.R., 781 F.2d 1034, in which a stipend received by a teaching assistant was taxable because it primarily benefited the university.

(3) Employee Business Expenses.

¹The non-taxability of scholarships is governed for federal purposes at 26 U.S.C. §117. Alabama has no similar provision but treats a "no strings" scholarship as an exempt gift. See, Dept. Reg. 810-3-14-.02. Generally speaking, the federal guidelines are also applicable for Alabama purposes.

The Taxpayers do not contest this adjustment.

(4) Three Dependent Deductions.

The husband's mother and father and the wife's father are from China but lived with the Taxpayers in Birmingham in November and December, 1989. The Taxpayers claim that they provided all of their parents' support during that period. However, the Taxpayers must prove that they provided more than half of their parents' support during the entire year, not just the 2 months they lived with the Taxpayers. Code of Ala. 1975, §40-18-19(a)(7). The Taxpayers failed to do so in this case. Accordingly, the dependent deductions were properly disallowed.

The Department examiner in this case conducted a thorough audit and I appreciate her efforts and her help in explaining the audit at the administrative hearing. The fact that I disagree with her conclusions concerning the taxability of the scholarship received by the husband is a difference in interpretation only and should not reflect on her work.

The Department is directed to recompute the Taxpayers' liability as set out above and thereafter inform the Administrative Law Division of the adjusted amount due. A Final Order will then be entered from which either party may appeal.

Entered on February 19, 1993.

BILL THOMPSON

Chief Administrative Law Judge