MICHAEL K. & MARIBETH C. BEDSOLE 115 Walden Pond Road Headland, Alabama 36345,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayers,	§	DOCKET NO. INC. 94-410
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

FINAL ORDER

The Revenue Department assessed income tax against Michael K. and Maribeth C. Bedsole (together "Taxpayers") for the years 1990 and 1991. The Taxpayers appealed to the Administrative Law Division, and a hearing was conducted on March 20, 1995. The Taxpayers were represented by CPA Harold Ingram. Assistant Counsel Claude Patton represented the Department.

The Taxpayers incurred a loss in 1989. The issue in this case is whether the Taxpayers should be allowed to carry the loss over as a net operating loss ("NOL") to the years 1990 and 1991. That issue turns on whether the loss was a "business" loss or a "non-business" loss. Code of Ala. 1975, §40-18-15(16)f.3. provides that only "business" losses, i.e. losses incurred in a trade or business, may be used in computing a NOL carryback or carryforward. If the NOL is allowed, a second issue is whether the loss must first be carried back to years prior to 1989.

Michael Bedsole ("Taxpayer") and five other investors formed two corporations, Garden Grove, Inc. and Oak Landing, Inc., for the purpose of constructing and selling an apartment complex and homes to be developed by the corporations. The investors, including the Taxpayer, invested approximately equal amounts in the two corporations.

The Taxpayer, operating through a separate corporation, Bedsole Corporation, also contracted with the above corporations to construct the buildings for the projects. The Taxpayer's duties included site preparation, actual construction, and overall management of the projects. The Taxpayer received $25,000.00 "up-front" money, and was to be paid a profit of $3.00 per square foot.

The projects were not successful, and when one of the investors refused to invest more money in 1989, the two corporations went out of business in that year. The Taxpayer and the other investors consequently lost their total investment in the corporations in that year.

The Taxpayers claimed the loss on their 1989 Alabama return. However, they failed to elect to forego the carryback of the loss to prior years. The Department agrees that the loss could be deducted in full in 1989 as a loss incurred in a transaction entered into for profit.

The Taxpayers subsequently attempted to carry the NOL over as a loss to 1990 and 1991. The Department disallowed the carryover because (1) the loss was not a "business" loss and thus could not be used for NOL purposes pursuant to §40-18-15(16)f.3., and (2) the Taxpayers had failed to elect to forego the carryback of the loss to prior years.

Section 40-18-15(16)f.3. provides that "The deductions allowable by this chapter which are not attributable to a taxpayer's trade or business (non-business), . . . , shall be allowed only to the extent of the amount of the gross income not derived from such trade or business". As stated, the issue here is whether the 1989 loss in issue was incurred in the Taxpayer's trade or business.

An individual that invests in a corporation is not engaged in a trade or business, unless the individual is a stockbroker or is otherwise regularly engaged in the business of investing in corporations. Whipple v. C.I.R., 87 S.Ct. 1168 (1963); Betson v. C.I.R. Service, 802 F.2d 365 (9th Cir. 1986). Devoting one's time and energy to a corporation in which the individual has invested also does not constitute a trade or business. 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 services, legally arises not from his own trade or business but from that of the corporation. Even if the taxpayer demonstrates an independent trade or business of his own, care must be taken to distinguish bad debt losses arising from his own business and those actually arising from activities peculiar to an investor concerned with, and participating in, the conduct of the corporate business.

The Taxpayer in this case is not a stockbroker and is not regularly engaged in the business of investing in corporations. Consequently, although he was a managing investor in the two corporations in question, those activities did not constitute the Taxpayer's trade or business.

The Taxpayer argues that the amounts contributed by him to the two corporations were loans made for the purpose of protecting his employment with the corporations.

I agree that a loan to a corporation by an employee that is made for the dominant purpose of protecting the employee's job is a business transaction. U.S. v. Generes, 92 S.Ct. 827 (1972). However, the Taxpayer in this case was not an employee of either

Garden Grove, Inc. or Oak Landing, Inc. Rather, he was an investor only in those corporations. He conducted business and was an employee of a separate corporation, Bedsole, Inc.

The losses in question, whether they are characterized as an investment or as loans to protect an investment, were not incurred in the Taxpayer's trade or business and thus cannot be recognized for NOL purposes.

In light of the above, the second issue concerning whether the losses should first be carried back to years prior to 1989 is moot.

The final assessments in issue are affirmed, and judgment is entered against the Taxpayers for 1990 income tax in the amount of $2,922.27, and 1991 income tax in the amount of $111.46, plus applicable interest.

This Final Order may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered November 13, 1995.

BILL THOMPSON
Chief Administrative Law Judge