PAUL S. & CONNIE B. BISHOP 60 Cross Creek Drive Birmingham, Alabama 35213,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayers,	§	DOCKET NO. INC. 95-256
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

FINAL ORDER

The Revenue Department partially denied a refund of 1994 income tax claimed by Paul S. and Connie B. Bishop ("Taxpayers"). The Taxpayers appealed to the Administrative Law Division, and a hearing was conducted on August 14, 1995. CPA Richard H. Phillips represented the Taxpayers. Assistant Counsel Jeff Patterson represented the Department.

The issue in this case is whether the Department properly disallowed a loss claimed by the Taxpayers on their 1994 Alabama income tax return. The loss occurred when accounts receivable held by the Taxpayers became uncollectible in that year. The Taxpayers had reported the fair market value of the receivables as income in the year received, 1987. The issue thus is whether the Taxpayers properly reported the receivables as income in 1987. If so, the loss was properly claimed in 1994. If not, the 1994 loss must be denied.

The facts are undisputed.

The Taxpayer, Paul Bishop, sold his stock in Emack Slate Company, Inc. in 1987. The Taxpayer received cash of $208,993.00, and was assigned accounts receivable by the company of $172,254.00.

The Taxpayer reported the cash and the fair market value of the receivables as income in 1987.

In 1994, a portion of the receivables totaling $51,993.00 owed by Babco Roofing Company became uncollectible. The Taxpayers accordingly claimed that amount as a loss on their 1994 Alabama return. The return as filed showed a refund due of $2,666.00. The Department reviewed the return, disallowed the loss, and accordingly reduced the Taxpayers' refund to $94.00. The Taxpayers subsequently appealed to the Administrative Law Division.

The Department argues that the Taxpayers, as cash basis taxpayers, should not have reported the uncollected accounts receivable in 1987. Consequently, they cannot now claim a loss for the receivable that became uncollectible in 1994.

The Taxpayers argue that the cash and the accounts receivable were both properly reported in the year received, 1987. The Taxpayers cite Department Reg. 810-3-7-.01(1)(c)(1), which provides that the amount realized from the sale of property must include any money received plus the fair market value of any other property received. The Taxpayers argue that the accounts receivable were "property" received, and thus correctly reported in 1987. The Taxpayers also argue that the installment method of reporting was not applicable because more than 40 percent of the sale price was received in the initial year. See, Dept. Reg. 810-3-44-.01.[1]

[1]Reg 810-3-44.01 does provide a 40 percent maximum first year payment, but only for years prior to 1985. For 1985 and later years, the 30 percent rule followed by the IRS is also applicable

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in Alabama.

The Department, in its response dated September 14, 1995, argued that under the installment method, the unpaid receivables should have been reported only when paid, not in the year of receipt. Consequently, because any unpaid account should not have been initially reported as income, it cannot later be allowed as a loss.

The controlling question is whether the fair market value of the accounts receivable should have been reported as income in 1987.

Initially, I agreed that because the receivables had not been paid in 1987, the cash basis Taxpayers should not have reported them in that year. However, after a review of the relevant authority, I now agree with the Taxpayers that the receivables constituted income that was properly reported in 1987.

The amount realized from the sale of property is all money received plus the fair market value of any other property, other than money, received. Code of Ala. 1975, §40-18-7 and Dept. Reg. 810-3-7-.01(3)(a). The receivables in issue constituted property received, and thus were properly reported by the Taxpayers in 1987.

The 1987 sale also could not have been reported under the installment method. Code of Ala. 1975, §40-18-44 provides that income derived from an installment sale may be reported for Alabama purposes in the same manner as allowed for federal purposes at 26 U.S.C. §453.

Under §453, a taxpayer is required to report as income in any taxable year only that proportion of the installment payments received in that year which the gross profit to be realized bears to the total contract price. The installment method cannot be used, however, if payments in the initial year exceed 30 percent of the selling price. "Payments" as used in §453 includes cash and other property, but does not include evidences of indebtedness of the purchaser. IRC Reg. 1.453-1(c)(1) and 1.453-4(b). The receivables in issue are third-party indebtedness, not indebtedness of the purchaser, and thus constituted "payments" under §453. Those payments exceeded 30 percent of the total sales price, and thus were properly reported as income in the year received. In any case, the actual cash received by the Taxpayer in 1987, $208,993.00, exceeded the 30 percent limit so as to bar use of the installment method.

In Holmes v. Commissioner, 55 TC 53 (1970), the Tax Court held that a promissory note given in consideration for the sale of property was taxable in the year received.[2]

> Petitioners further argue that to treat the Smith note as a payment in the year of sale would be contrary to the intention of Congress. They maintain that Congress certainly did not intend for a taxpayer to have to pay a

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[2]The issue in Holmes was stated by the Tax Court as follows: "The narrow issue for our decision is whether the Smith (promissory) note, otherwise being the equivalent of cash, is an evidence of indebtedness of the purchaser so as not to constitute a payment to petitioners in the year of sale in ascertaining the profit to be reported in that year".

> tax on money he has not received. In response to this argument, we need only point out to petitioners that it is the receipt of income which triggers a Federal income tax and that it is well established that the term "income" as used in the revenue statutes is not limited to cash income. Indeed, where section 453 for some reason is inapplicable, as for example where more than 30 percent of the sales price is received in the year of sale, the entire gain on the sale is taxable in the year of sale even though the balance of the purchase price is represented by property that is not readily convertible to cash.

The Taxpayer in this case received the entire purchase price of the stock in 1987, either in cash or as other property, the accounts receivable. The cash and the receivables were thus properly reported as income in that year. Having properly reported the entire amount in 1987, and paid tax thereon, the Taxpayers should now be allowed a loss for the receivable that became uncollectible in 1994.

The above considered, the entire refund of $2,666.00 claimed by the Taxpayers for 1994 should be allowed.

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

Entered October 19, 1995.

BILL THOMPSON
Chief Administrative Law Judge