

ALABAMA TAX TRIBUNAL

JOHN A., JR., & MELINDA A. ROBERTS, §
Taxpayers, § DOCKET NO. INC. 18-802-JP
v. §
STATE OF ALABAMA §
DEPARTMENT OF REVENUE.

OPINION AND FINAL ORDER

This appeal involves final assessments of 2014 and 2015 individual income tax. A trial was held on September 28, 2022. Robert M. Galloway, Esq., represented the Taxpayers, and David M. Folmar, Esq., represented the Revenue Department. John A. Roberts, Jr., one of the Taxpayers, was present and testified. Paula Kouadio, an examiner for the Revenue Department, was also present and testified.

Question Presented

At the trial, the Taxpayers conceded the validity of the final assessment of individual income tax for tax year 2015. With respect to the 2014 assessment, the Taxpayers assert that the Revenue Department erred in subjecting to taxation a certain cancelation of indebtedness that occurred in 2014 (“the debt cancelation”). According to the Taxpayers, they were insolvent at the time of the debt cancelation and, therefore, were not subject to tax on the amount of the debt cancelation. *See* 26 U.S.C. § 108(a)(1)(B). The Revenue Department agrees that, if the Taxpayers were insolvent at the time of the debt cancelation, the amount of canceled debt would not

be subject to taxation. Therefore, the question is whether the Taxpayers were, in fact, insolvent at that time. The resolution of that dispute hinges on the fair market value (at the time of debt cancelation) of certain property (“the Madison property”) owned by The Madison, LLC, which was an entity owned by the Taxpayers. “On appeal to ... the Alabama Tax Tribunal, the final assessment shall be prima facie correct, and the burden of proof shall be on the taxpayer[s] to prove the assessment is incorrect.” Ala. Code 1975 § 40-2A-7(b)(5)(c)3.

Facts

The Taxpayers introduced into evidence an insolvency worksheet on which they represented that the fair market value of their total assets immediately before the debt cancelation was \$1,868,050 and that their total liabilities were \$2,364,499.¹ The Taxpayers calculated their amount of insolvency as \$496,449. The Taxpayers also introduced into evidence a summary of their financial condition as of December 31, 2014 (“the 2014 financial summary”), that Mr. Roberts testified had been prepared by his accountant.² Mr. Roberts stated that his accountant had passed away prior to the trial of this case. The 2014 financial summary stated that the Taxpayers’ real estate assets had been appraised by the county tax assessor at \$1,830,700, and that related debt totaled \$2,346,499. Considering all assets and debts, the financial summary calculated the Taxpayers’ net worth to be a negative amount of \$515,799. The financial summary stated that the county tax appraisal of the Madison property

¹ Taxpayers’ Exhibit 2.

² Taxpayers’ Exhibit 1.

was \$301,500, which Mr. Roberts testified was a fair value of the Madison property in 2014. However, Mr. Roberts, who had worked in real estate for 40 years, admitted that values assigned by the county tax assessor are not a reliable indicator of fair market value and that he had often sold properties for more than the value assigned by the county tax assessor. The Taxpayers introduced a Warranty Deed dated September 15, 2017, indicating that The Madison, LLC, sold the Madison property for \$390,000.³

Ms. Kouadio testified that, based on the information the Revenue Department had reviewed, it could not determine that the Taxpayers were insolvent in 2014. The Revenue Department introduced balance sheets that the Taxpayers had submitted in conjunction with business privilege tax returns for The Madison, LLC, in 2013 and 2015.⁴ Those balance sheets, which are Revenue Department forms titled Worksheet BPT-NWI, reflect net worth computations (assets minus liabilities) of The Madison, LLC, of \$424,927.00 for 2013 and \$796,132.00 for 2015. *See* Ala. Code 1975 § 40-14A-23(c) (providing that, “if the owner of the disregarded entity is an individual, general partnership, or other entity not subject to [the Business Privilege Tax], the net worth of the disregarded entity shall be equal to the assets minus the liabilities of the disregarded entity) (emphasis added). (The 2015 BPT-NWI worksheet showed a value of \$1,189,541.00 for the Madison property.)

Although the Revenue Department asserted that no business privilege tax

³ Taxpayers’ Exhibit 10.

⁴ Revenue Department’s Exhibits 1 and 2.

returns for The Madison, LLC, had been filed in 2014, the Taxpayers submitted a balance sheet for Madison, LLC, dated December 2014 (“the December 2014 balance sheet”).⁵ According to Mr. Roberts, that balance sheet had been prepared by his late accountant. The December 2014 balance sheet listed total assets of \$1,189,654.66 and total liabilities of \$389,693.01 for The Madison, LLC. The December 2014 balance sheet showed a value of \$858,654.00 for the Madison property, plus development costs of \$330,887.43. The sum of those two numbers is \$1,189,541.43, which corresponds to the value of the Madison property reported on the 2015 BPT-NWI worksheet.

Discussion

“[T]he term ‘insolvent’ means the excess of liabilities over the fair market value of assets.” 26 U.S.C. 108(d)(3). As stated, the Taxpayers assert that the key asset for which a value must be determined is the Madison property.

The Taxpayers argue that the value of the assets listed on the BPT-NWI worksheets as well as the value of the assets listed on the December 2014 balance sheet for The Madison, LLC, are not statements of fair market value but, instead, are statements of “book value.” Therefore, they say, the value listed on the BPT-NWI worksheets should not be used to determine the issue of insolvency. The instructions for the BPT-NWI worksheets state that, with respect to the value of land, the Taxpayers should “[e]nter the book value of land reduced by the amount of

⁵ Taxpayers’ Exhibit 9.

amortization.” “Book value” is defined in the Merriam-Webster Dictionary as:

“The value of something as shown on booking records as distinguished from market value:

“a. the value of an asset equal to cost minus depreciation.”

Merriam-Webster.com Dictionary, Merriam-Webster, <https://www.merriam-webster.com/dictionary/book%20value>. Revenue Department regulations in existence prior to 2018 defined book value similarly, *i.e.*, “cost less accumulated depreciation”). *See* Ala. Admin. Code 810-2-6-.05 (repealed eff. 9-24-2018). On the other hand, “fair market value” is defined as “[t]he amount at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of the relevant facts.” *Ex parte Baron Services Inc.*, 874 So. 2d 545, 550 n. 6 (Ala. 2003) (quoting *Black 's Law Dictionary* 597 (6th ed. 1990)). Because “book value” and “fair market value” have distinct definitions, the Taxpayers are correct that the Taxpayers’ reports of the value of The Madison, LLC, on the 2013 and 2015 BPT-NWI worksheets and the December 2014 balance sheet (which also appears to be based on book value) are not determinative of the issue of insolvency.

Having excluded the evidence of book value from consideration of the determination of fair market value of The Madison, LLC, the question is whether the Taxpayers presented sufficient evidence of the fair market value of the Madison property to meet their burden in this case. *See* § 40-2A-7(b)(5)(c)3. First, the Taxpayers presented evidence of the amount for which the Madison property was

sold; however, the date of that sale was three years after the date of the debt cancellation and, thus, is irrelevant for purposes of this decision. Mr. Roberts also introduced an exhibit showing that the tax-appraised value of the Madison property was \$301,500 on December 31, 2014.⁶ Mr. Roberts testified that he thinks that the 2014 tax-appraised value of the Madison property was a fair value of the Madison property at that time; however, as noted, Mr. Roberts also admitted that the values assigned to properties by county tax appraisals are often lower than the fair market value of those respective properties. Indeed, despite § 40-7-62, Ala. Code 1975, requiring the county tax assessor to “have the property of such county appraised at its fair and reasonable market value,” the Alabama Court of Civil Appeals has recognized the following:

““Generally the tax assessing authority's evaluation is not relevant when offered to prove market value. The rationale underlying this general exclusionary rule is that “it is notorious that properties are not assessed at anything like true value or market value.”” Presley v. B.I.C. Constr., Inc., [64] So. 3d [610, 621] (Ala. Civ. App. 2009) (quoting 2 Charles W. Gamble, McElroy's Alabama Evidence § 267.04 (5th ed. 1996)).”

Berry v. Deutsche Bank Nat'l Trust Co., 57 So. 3d 142, 148 (Ala. Civ. App. 2010); *see also Walker v. N. Am. Sav. Bank*, 142 So. 3d 590 (Ala. Civ. App. 2013).

Also, “[t]he general rule is that the owner of real estate is competent to testify as to its value...” *See Alabama Power Co. v. Cummings*, 466 So. 2d 99, 102-03 (Ala.

⁶ Taxpayers' Exhibit 1.

The Taxpayers also introduced copies of county tax assessments for the tax year 2015 that corroborate the value listed on Taxpayers' Exhibit 1.

1985) (quoting *Alabama Power Co. v. Cummings*, 466 So. 2d 99 (Ala. 1985)). Here, however, Mr. Roberts's overall testimony as to the value of the property at the time in question was uncertain at best. That uncertainty may have been attributable to the death of Mr. Roberts's accountant as well as the number of years that have passed since 2014.

Nevertheless, the Taxpayers did not prove the fair market value of the Madison property at the time of the debt cancelation in question. Consequently, the Taxpayers have not met their burden of showing that the final assessment of 2014 individual income tax is incorrect. *See* § 40-2A-7(b)(5)(c)3.

Conclusion

The final assessments of individual income tax for years 2014 and 2015 are affirmed in the amounts of \$20,849.75 and \$3,329.06, respectively, plus additional interest that continues to accrue from the date of the final assessments until the liabilities are paid in full. Judgment is entered accordingly.

This Final Order may be appealed to circuit court within 30 days, pursuant to Ala. Code § 40-2B-2(m).

Entered February 24, 2023.

/s/ Jeff Patterson

JEFF PATTERSON

Chief Judge

Alabama Tax Tribunal

jp:ac

cc: Robert M. Galloway, Esq.
David M. Folmar, Esq.

