

BETTY V. LEE	§	STATE OF ALABAMA
2801 HIGHWAY 150, STE. T		DEPARTMENT OF REVENUE
HOOVER, AL 35244-4007,	§	ADMINISTRATIVE LAW DIVISION
Taxpayer,	§	DOCKET NO. INC. 06-835
v.	§	
STATE OF ALABAMA	§	
DEPARTMENT OF REVENUE.		

FINAL ORDER

Betty V. Lee (“Taxpayer”) appealed to the Administrative Law Division pursuant to Code of Ala. 1975, §40-2A-7(c)(2) concerning a denied refund of 2005 income tax. A hearing was conducted on April 20, 2007. CPA Matt Turpin represented the Taxpayer. Assistant Counsel David Avery represented the Department.

It was agreed at the hearing that a Department examiner would review the Taxpayer’s records. The Department responded in December 2007 that the review of the Taxpayer’s records had not changed its position that the refund should be denied. A Final Order affirming the denial of the refund was entered on December 10, 2007.

The Taxpayer timely applied for a rehearing, and a second hearing was conducted on January 18, 2008. CPA Matt Turpin again represented the Taxpayer. Assistant Counsel Mark Griffin represented the Department.

The Taxpayer has a successful dental practice in Hoover, Alabama. The Taxpayer’s husband (now ex-husband) owned an S corporation that opened and operated two restaurants in the Birmingham area in 2003 and 2004. Because of her husband’s lack of funds and bad credit rating, the Taxpayer provided the money to start-up and operate the restaurants in both years. The money came from her dental practice, an inheritance from her mother, and bank loans.

The Taxpayer and her husband filed joint Alabama returns for 2003 and 2004. The returns reported substantial losses that were passed-through from the husband's S corporation. The couple separated in 2004. The husband agreed in early 2005 that if the Taxpayer filed a joint 2004 Alabama return with him, she could carryover to future years half of the losses that the S corporation incurred in 2003 and 2004. The couple consequently filed a joint 2004 Alabama return.

The Taxpayer continued paying the restaurants' debts in 2005 because she was either obligated to pay the amounts or she wanted to protect her good business reputation. She paid a total of \$56,300 in restaurant-related debts in 2005.

The Taxpayer filed a married, filing separate Alabama return for 2005 on which she carried over part of the losses from the couple's 2003 and 2004 joint returns. (She did not deduct the \$56,300 she had paid in restaurant-related debts in 2005.) The NOL carryover offset the Taxpayer's substantial dental practice income, which resulted in a refund due for the year.

The Department disallowed the NOL carryover, and the resulting refund, based on Department Reg. 810-3-15-.27(6). That regulation provides in substance that if a married couple incurs an NOL and later divorces, only the spouse that actually incurred the loss can carryover the NOL to subsequent years. Consequently, because the 2003 and 2004 NOLs related to the husband's Subchapter S restaurant business, the Taxpayer could not carryover the losses to her 2005 married, filing separate return. (The couple divorced in 2006.)

The Department correctly disallowed the NOL carryover because, as indicated, the prior years' losses were attributable to her ex-husband's business. The Taxpayer

contends, however, that even if the NOL loss cannot be allowed, she still should be allowed to deduct the \$56,300 she paid in restaurant-related debts in 2005.

The \$56,300 appears to be nondeductible personal loans by the Taxpayer to her then husband. But the Administrative Law Division does not have jurisdiction to decide the deductibility of those payments based on the Court of Civil Appeals holding in *Rheem Manufacturing Company v. Alabama Dept. of Revenue*, ____ So.2d ____, decided February 27, 2009.

The Court held in *Rheem* that the Administrative Law Division only has jurisdiction to review an issue or issues previously addressed by the Department. That is, the Administrative Law Division can only review and decide the legality or propriety of the Department's actions relating to the taxpayer/appellant. Consequently, concerning refunds, the Administrative Law Division can only address an issue raised by the taxpayer in the refund petition.

In this case, the Taxpayer's 2005 Alabama return constituted her refund petition. The only issue involving the petition that was addressed by the Department was the allowability of the NOL carryovers. The Taxpayer did not deduct the \$56,300 on the return. Consequently, because that issue was not raised by the Taxpayer and addressed by the Department, it cannot be addressed on appeal by the Administrative Law Division.

The Department's denial of the Taxpayer's 2005 refund is affirmed.

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

Entered March 18, 2009.

BILL THOMPSON
Chief Administrative Law Judge

bt:dr

cc: Lionel C. Williams, Esq.
Matt E. Turpin, CPA
Kim Peterson