

STATE OF ALABAMA
DEPARTMENT OF REVENUE,

§

STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

§

v.

§

DOCKET NO. INC. 87-184

JERRY D. STONE
P.O. Box 8
Albertville, AL 35950,

§

§

Taxpayer.

§

ORDER

This case involves two disputed income tax preliminary assessments entered by the Revenue Department ("Department") against Jerry D. Stone ("Taxpayer") for the calendar years 1984 and 1985. A hearing was conducted in the matter on September 10, 1987.

Mr. Wallace Lyons was present and represented the Taxpayer. Assistant counsel Nancy I. Cottle appeared on behalf of the Department. Based on the evidence submitted by the parties, the following findings of fact and conclusions of law are hereby made and entered.

FINDINGS OF FACT

The Department audited the Taxpayer for the years 1984 and 1985 and disallowed the following deductions: (1) A bad debt deduction claimed in both years relating to an aborted business venture known as Wire Road Development; (2) employee business expenses (traveling expenses) relating to the Taxpayer's employment with the Tennessee Valley Authority ("TVA"); and (3) professional entertainment expenses also relating to the Taxpayer's TVA employment.

In 1978, the Taxpayer and three other individuals began plans for a housing development near Auburn, Alabama, to be known as Wire Road Development. The developers incurred various start-up costs, mostly in 1980, including payment of engineering fees, interest on a pre-existing mortgage on the subject property so as to prevent foreclosure, and various miscellaneous expenses.

To finance the start-up costs, the developers jointly borrowed \$25,000.00 in 1980 from an area bank. The evidence establishes that at least \$21,000 of the loan was used to pay the various start-up expenses referred to above.

In 1981, the development was abandoned, and the bank subsequently required the Taxpayer and one of the other three developers to personally assume the entire \$25,000.00 debt. The Taxpayer became personally liable for \$13,700.00. Since 1981, the Taxpayer has made numerous interest and principal payments on the loan. No attempt to collect from the other two developers has ever been made.

The Taxpayer paid \$3,000.00 in principal on the above-referenced debt in 1984, and \$4,000.00 in 1985. The Taxpayer did not claim a deduction for the principal payment on his original 1984 return, but later amended said return and thereon claimed a \$3,000.00 bad debt deduction. A \$4,000.00 bad debt deduction was claimed by the Taxpayer on his 1985 return.

Relating to the disallowed travel and entertainment expenses, during the years in question the Taxpayer was employed by the TVA

as program coordinator for the coal gasification plant in Marshall County, Alabama. The Taxpayer's duties were not specifically enumerated, but entailed general personal relations and lobbying work, including both formal and informal meetings with various government officials, legislators, civic groups, etc. on behalf of the TVA.

The Taxpayer kept a daily log of his travel mileage. On those occasions when the Taxpayer was specifically required by the TVA to attend some scheduled event, public meeting or otherwise meet with various groups or individuals, the Taxpayer was reimbursed by the TVA and the travel log showed the exact destination and miles traveled. Those miles were allowed by the Department. The Taxpayer's job also required extensive unspecified travel at his discretion, for which he was not reimbursed. In those instances, the travel log indicated total miles traveled only. The expenses relating to those expenses were denied because the travel was not specifically required by the TVA and also because of inadequate substantiation.

The professional expenses claimed by the Taxpayer were for meals and lodging. The Taxpayer paid for the expenses with his personal credit card. No contemporaneous records were maintained, aside from credit card receipts. The expenses were thus disallowed for lack of substantiation. However, subsequent to the initial audit, the Taxpayer compiled a list of individuals that he had entertained, along with the specific time, date, amount spent and

general synopsis of the business reason for the meeting.

CONCLUSIONS OF LAW

The payments of \$3,000.00 and \$4,000.00 made by the Taxpayer in 1984 and 1985, respectively, have been claimed by the Taxpayer as either a bad debt or a loss in a transaction entered into for profit. For the following reasons, the payments are not deductible under either theory forwarded by the Taxpayer.

The Taxpayer and his co-developers spent at least \$21,000.00 of the total \$25,000.00 borrowed in 1980 on expenses relating to the Wire Road Development project. The Department concedes that the development was a business venture entered into with the intent of making a profit. Consequently, any expenses (or loss) relating thereto would have been deductible under Code of Ala. 1975, §40-18-15(5) in the year incurred. Because the developers were not incorporated, any deductible expenses (or loss) would have filtered pro rata to the four developers in the year in which the expenses (or loss) occurred, 1980. Any subsequent repayment of the loan used to finance the expenses would not be deductible.

As to whether the Taxpayer is entitled to a bad debt deduction, the only amount that could possibly be considered a bad debt is that portion of the \$25,000.00 loan which was assumed by the Taxpayer in 1981 for which he was not already liable. The Taxpayer's initial pro rata liability for the loan was \$6,250.00 (\$25,000.00 divided by 4), his total liability after assumption in

1981 was \$13,700.00. Thus, only \$7,450.00 could arguably be characterized as a debt owed to the Taxpayer by the other co-developers.

A bad debt deduction is allowable only for a bona fide debt arising from an enforceable obligation to pay a set amount. Wortham Machinery Company v. U.S., 521 F.2d 160; Zimmerman v. U.S., 318 F.2d 611, and the burden of establishing a bad debt deduction is on the one claiming it. Wilson v. U.S., 376 F.2d 280; Wortham Machinery Company v. U.S., supra. While it is not an absolute requisite that legal action for collection must be taken, as a general rule the creditor must exhaust every reasonable means of collection before a bad debt deduction is allowable. Bell v. U.S., 120 F.Supp. 931. At the least, in the absence of a suit for collection, the creditor must prove that any action to collect the debt would have been unsuccessful. Dustin v. C.I.R., 467 F.2d 47. further, a bad debt is allowable only in the year in which the debt becomes worthless or uncollectible. Wilson v. U.S., supra; Herskovits v. C.I.R., 110 F.2d 272.

In the present case, the Taxpayer made no attempt to obtain a judgment or otherwise collect from the co-developers. Further, there is no evidence that any such suit would have been unsuccessful or that the co-developers were insolvent. Finally, even if the debt was uncollectible, it was uncollectible, or "bad", at the time it arose in 1981. No subsequent event in 1984 or 1985 made the debt uncollectible. To be deductible, the debt must

become worthless during the year in question. Wilson v. U.S., supra. Thus, even assuming arguendo that a deductible bad debt existed, it would have been allowable only in 1981, and not in the years in issue.

Concerning the disallowed travel expense, an expense is considered "necessary" if it is appropriate in conducting a trade or business, and doesn't have to be essential, absolutely necessary or specifically required by the taxpayer's employer. Welch v. Helvering, 290 U.S. 111; Levitt and Sons, Inc. v. Nunan, 142 F.2d 795. However, the expenses must be properly verified, and in the present case the Taxpayer's log book contained total miles traveled only with no destinations or business purpose indicated. The only other evidence presented was the Taxpayer's testimony that all unspecified daily travel was done in furtherance of his employment.

The Taxpayer has the burden of proving that the deductions in question are proper, Showell v. C.I.R., 238 F.2d 148; Great Lake Pipeline Company v. U.S., 352 F.Supp. 1159; Masat v. C.I.R., 784 F.2d 573. While no specific method of proof or bookkeeping is required, and a taxpayer is not obligated to conclusively prove a deduction, Bechelli v. Hufferbert, 111 F.Supp. 631; Showell v. C.I.R., supra, it is necessary that specific proof is submitted to establish that the expenses claimed were (1) paid or incurred during the taxable year, (2) involved in a trade or business, (3) constituted an expense, (4) were necessary, and (5) were ordinary. Great Lakes Pipeline Company v. U.S., supra. Further, the verbal

assertions of a taxpayer, without substantiating records, are insufficient to verify a deduction. State v. Ludlum, 384 So.2d 1089.

In the present case, the Taxpayer failed to carry the burden of establishing that the unspecified mileage traveled was in the ordinary course of business. While it is reasonable to assume that the nature of the Taxpayer's business required him to travel, without specific destinations and a specific business purpose for the travel, the business purpose cannot be verified and any deduction must be disallowed.

Concerning the "professional entertainment" expenses, the Taxpayer did keep a record of credit card receipts showing that the expenditures were in fact made. That evidence alone however, which was all that the Taxpayer originally presented to the Department's auditor, is insufficient to establish a business purpose for the expenses.

However, subsequent to the audit, the Taxpayer submitted a list setting out the specific dates, individuals involved, and business purpose for each of the various entertainment activities claimed.

That detailed list, by which the Department could, if necessary, verify the business nature of the expenses, in conjunction with the corresponding credit card receipts kept by the Taxpayer, is sufficient to establish that the expenses claimed by the Taxpayer were incurred for a business purpose, and are thus deductible.

The Revenue Department is hereby directed to adjust the

preliminary assessment so as to conform with the findings and conclusions set out herein. Thereafter, the assessment, as adjusted, should be made final, with applicable interest.

Done this 30th day of October, 1987.

BILL THOMPSON
Chief Administrative Law Judge