ALABAMA TAX TRIBUNAL

DYLAN L. & REBECCA J. PHILIP BLUNT,	§	
Taxpayers,	§	DOCKET NO. INC. 24-0220-JP
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

OPINION AND FINAL ORDER

This appeal involves the entry of a final assessment of income tax for 2022. A trial was held on November 20, 2024. The Taxpayers were represented by Norman Blunt, the father of Taxpayer Dylan L. Blunt. Andrew Gidiere represented the Alabama Department of Revenue, and Yeteva Johnson, a manager in the Revenue Department's audit and appeals section, appeared and testified.

At trial, the parties agreed that the only remaining issue was the disallowance by the Revenue Department of all expenses claimed on the Taxpayers' 2022 Schedules C related to their business, Weevil Run, LLC. Specifically, the Taxpayers argued they were entitled to claim a deduction for startup expenses they incurred in organizing Weevil Run. In response, the Revenue Department argued that the Taxpayers were not entitled to deduct those expenses because Weevil Run did not become an active trade or business until the following year. After the trial, the parties submitted legal arguments to the Tax Tribunal regarding when a business could claim a deduction for startup costs.

Alabama Code § 40-18-15(a)(22) adopts by reference the deduction allowed by

26 U.S.C. § 195 for start-up expenditures. Sub-section (a) of 26 U.S.C. § 195 clarifies that the only allowable deductions for start-up expenditures are those identified within that section. Sub-section (b)(1) then allows a taxpayer to claim a limited deduction "*for the taxable year in which the active trade or business begins*[,]" and any remaining start-up expenditures not captured by the initial deduction are then "allowed as a deduction ratably over the 180-month period beginning with the month in which the active trade or business begins."

The Tax Tribunal's predecessor, the Administrative Law Division of the Alabama Department of Revenue, previously recognized that "[s]tart-up expenses incurred before a business opens cannot be currently deducted." *Vickers v. State Dep't of Revenue*, No. INC. 13-487, 3 (Ala. Dep't of Revenue Admin. L. Div. Mar. 5, 2014). *See also Miles v. State Dep't of Revenue*, No. INC. 12-1129 (Ala. Dep't of Revenue Admin. L. Div. Jan. 28, 2014) (Op. and Preliminary Order); *Bailey v. State Dep't of Revenue*, No. INC. 99-265 (Ala. Dep't of Revenue Admin. L. Div. Nov. 19, 1999). Therefore, the issue here is whether Weevil Run became an active trade or business in 2022 or 2023.

The Taxpayers assert that Weevil Run became an active trade or business in 2022 because that is when they began incurring expenses related to the business. The Revenue Department argues, however, that Weevil Run did not become an active trade or business until 2023 because Weevil Run, a retail business, did not begin selling items until February of 2023. The Tax Tribunal agrees with the Revenue Department that the Taxpayers were not entitled to claim a deduction in 2022 for the startup expenses incurred that year because Weevil Run did not become an active trade or business until 2023. The Administrative Law Division's rulings in *Vickers*, *Miles*, and *Bailey*, cited *supra*, as well as the decision of the Eleventh Circuit Court of Appeals in *Provitola v. Commissioner*, No. 20-12615, 859 F. App'x 474 (11th Cir. June 11, 2021), are instructive in making this determination.

The taxpayers in *Bailey* incurred expenses in 1981, 1982, 1983, 1984, and 1988, relating to a coal mining venture in Peru, that they sought to deduct as deferred start-up expenses in 1993 under Ala. Code § 40-18-15(a)(22). No. INC. 99-265, at 1. The Baileys incurred over $300,000.00 in expenses between 1981 and 1984 to start their mining venture, before beginning to produce and sell coal in 1984 and 1985. *Id.* The Administrative Law Division noted that Ala. Code § 40-18-15(a)(22), in adopting by reference 23 U.S.C. § 195, required a taxpayer to "begin deducting the business-related expenses in the year the business begins." *Id.* at 2. The Division then stated that the coal mining venture became an active trade or business in 1984 when it began selling coal, thus requiring the Baileys to begin deducting their start-up expenses on their 1984 return. *Id.* at 2-3. Discussing the ruling of the United States Tax Court in *Pino v. Commissioner*, 52 T.C.M. (CCH) 1388 (1987), the Division further opined that, if a taxpayer never starts a business, expenses cannot be deducted as business-related start-up expenses. *Id.* at 3-4.

Similar to its discussion of *Pino* in *Bailey*, the Division ultimately ruled that the taxpayers in *Miles* were not entitled to a deduction for expenses incurred in their attempted start-up of a doughnut business. There, Mr. Miles sought to convert his substantial experience in the doughnut industry into a wholesale doughnut business of his own. *Miles*, No. INC. 12-1129 at 4. He began constructing a building in 2008 to house his wholesale doughnut business, but ultimately abandoned the project by 2012 before selling any doughnuts. *Id.* Because the wholesale doughnut business never actually started, the Division ruled that the Mileses were not entitled to deduct any of the expenses incurred in Mr. Miles's attempts to start the business. *Id.* at 5.

In *Vickers*, the taxpayers purchased several vehicles in April of 2009 so that they could lease the vehicles to another individual who supposedly had an agreement to lease vehicles to the federal government. No. INC. 13-487 at 1-2. The Vickerses then executed a lease agreement concerning the vehicles in June of 2009 before purchasing and leasing additional vehicles to the same individual in October 2009. *Id*. at 2. Unfortunately, the Vickerses never received any lease payments for any of the vehicles. *Id.* They then claimed both bonus and regular depreciation on their 2009 Alabama tax return. *Id.* The Revenue Department disallowed the depreciation, arguing that the Vickerses had never started a leasing business. *Id.* The Administrative Law Division ruled differently, though, finding that the Vickerses had entered into the business of leasing the vehicles when they purchased and delivered the vehicles to the proposed lessee in 2009, and that the fact they never received any payments from the lessee did not preclude them from claiming depreciation of a business they had successfully initiated. *Id.* at 3-4.

Finally, in *Provitola*, the taxpayers claimed business deductions on their 2013 and 2014 federal income-tax returns for expenses incurred by their company, Viovision Ventures, LLC ("Viovision"). No. 20-12615, slip op. at 2. The Provitolas formed Viovision in 2007 to develop, manufacture, and market a device Mr. Provitola invented that employed a visual system allowing viewers to see two-dimensional television images as three dimensional. However, Viovision did not report any income or expenses until 2013, and did not produce its first inventory until 2015. *Id.* Nevertheless, the Provitolas claimed deductions for Viovision's expenses on their 2013 and 2014 income tax returns. *Id.* at 4. The Internal Revenue Service ("IRS") disallowed the deductions because the Provitolas had not established that "the business expenses were paid or incurred during the taxable year or that they were 'ordinary or necessary.'" *Id.* The Provitolas then petitioned the U.S. Tax Court for review of the IRS's deficiency notices. After a bench trial, the Tax Court held that the Provitolas could not deduct the expenses in issue because "expenses for a business that is still in the start-up phase are not 'ordinary and necessary' expenses to the business[,]" and that Viovision "had not yet engaged in an active trade or business in 2013 and 2014 because it had not 'attempted to market or sell a product,' 'made any sales,' or 'made its website public.'" *Id.* at 5.

On appeal to the Eleventh Circuit, the Provitolas received a similar result. The Eleventh Circuit discussed the treatment of expenses incurred before the actual beginning of a business, as follows:

> Section 162 of the Internal Revenue Code allows as a deduction "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business." 26 U.S.C. § 162(a). "The phrase 'trade or business' presupposes an existing trade or business." *Stanton v. Comm'r of Internal Revenue*, 399 F.2d 326, 329 (5th Cir. 1968).2 So § 162(a) "does not allow current deductions for expenses

> incurred by a taxpayer prior to beginning business operations." *Sorrell v. Comm'r of Internal Revenue*, 882 F.2d 484, 486 (11th Cir. 1989) ("[P]rior to the business's beginning to operate as a going concern, the taxpayer is not engaged in carrying on any trade or business." (quotation marks omitted)).
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> Moreover, such "pre-opening" or "start-up" expenses are not "ordinary" expenses because they are considered "capital in nature, given that they spring from the taxpayer's efforts to create or acquire a capital asset." *Id.* at 488; *see Comm'r of Internal Revenue v. Tellier*, 383 U.S. 687, 689-90 (1966) ("The principal function of the term 'ordinary' in § 162(a) is to clarify the distinction, often difficult, between those expenses that are currently deductible and those that are in the nature of capital expenditures, which, if deductible at all, must be amortized over the useful life of the asset."). This understanding is reflected in 26 U.S.C. § 195, which provides that "no deduction shall be allowed for start-up expenditures," except through amortization once "the active trade or business begins." See 26 U.S.C. § 195(b).

Id. at 8-9.

According to the Eleventh Circuit, "[t]he determination of when a trade or business begins presents a question of fact[,]" and "[a]n active or existing trade or business is generally one that is performing those activities for which it was organized, not simply taking steps in preparation to perform those activities." *Id.* at 9 (internal quotations and citations omitted). The Eleventh Circuit found ample support for the Tax Court's conclusion that the Provitolas were not carrying on a trade or business through Viovision in 2013 or 2014 because Viovision was still engaged in the process of creating a manufacturable item in 2014, did not produce its first units until 2015, did not have a website until 2015, and had not sold any products as of 2019. *Id.* at 9-10. Therefore, the Eleventh Circuit concluded, "whether viewed as a manufacturing business or a marketing or retail business, or both, Viovision had not begun 'to operate as a going concern' in 2013 and 2014 because it had not yet manufactured or sold any of the devices, the purposes for which it was organized." *Id*. at 10.

Here, the facts establish that Weevil Run, like Viovision in *Provitola* and the doughnut wholesale business in *Miles*, had not become an active trade or business during the 2022 tax year in issue. (The Taxpayers' representative explained at trial that Weevil Run is a retail business organized to sell running apparel and equipment.)

Both *Bailey* and *Provitola* establish that a business designed to sell a specific product does not become an active trade or business until it begins selling that product. In 2022, the Taxpayers here were still preparing Weevil Run to begin selling running merchandise, and they had yet to establish a physical or digital storefront from which they could do so. Although the Taxpayers signed a lease for a physical storefront in November of 2022, the lease term did not begin until February 1, 2023. The Taxpayers also represented in correspondence with the Revenue Department that they did not complete shopfitting until 2023. Therefore, Weevil Run could not have performed the activities for which it was organized; *i.e.*, selling running merchandise rather than merely leasing property, before 2023 because it did not have a conduit through which it could sell any running merchandise until 2023. Consequently, Weevil Run did not become an active trade or business until 2023, and the Revenue Department correctly disallowed all startup expenses claimed by the Taxpayers on their 2022 Alabama income tax return regarding Weevil Run. (Subsequent to the entry of the final assessment, the Revenue Department argued that previously-allowed expenses should be disallowed for the same reason discussed herein. The Taxpayers do not disagree with the mathematical calculations concerning those similar expenses.)

The Revenue Department's final assessment, as increased, is upheld. Judgment is entered against the Taxpayers in the amount of $2,476.52, consisting of $2,326.00 in tax and $150.52 of interest,[1] plus additional interest that continues to accrue from the date of entry of the final assessment until the liability is paid in full.

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

Entered May 1, 2025.

/s/ *Jeff Patterson*
JEFF PATTERSON
Chief Judge
Alabama Tax Tribunal

jp:thb
cc: Norman Blunt
Andrew P. Gidiere, Esq.

1 The Revenue Department stated that it received a payment by credit card of $2,389.86 on March 13, 2024, from the Taxpayers, and that this payment has been applied to the relevant period as of the date posted. The application of this payment will be reflected in the actual balance owed by the Taxpayers, rather than the final assessment amount stated here because the final assessment, dated February 27, 2024, was entered before the payment was made.