

Appeal of Craft International Travel, Inc.

The sole issue for determination is whether appellant was doing business for a full twelve months during the first year of its existence.

Appellant, a calendar year taxpayer, was incorporated on January 16, 1970. On its franchise tax return for its first year of operations appellant reported a net loss and paid the \$100.00 minimum tax for its first year. At the same time, appellant pre-paid \$100.00 for the privilege of doing business in California during its second year. For appellant's second year of operations it reported net income and paid a tax of \$244.44. Respondent determined that appellant had not been doing business for a full twelve month period during 1970, its first year in existence, and proposed the assessment in controversy. ^{1/} Appellant protested the assessment and this appeal followed.

Normally, the franchise tax is for one year measured by the income of the preceding year, Section 23222 of the Revenue and Taxation Code provides the method by which a commencing corporation computes its tax. During the year in issue, a commencing corporation had to pay a tax for its first taxable year based upon the income for that

^{1/} Since respondent determined that appellant' had not done business for a full twelve month period during its first year in existence, respondent concluded that the income for the second year, appellant's purported first full twelve month period, was the appropriate measure for the third year's tax. Thus, respondent determined that \$244.44 was to be prepaid for the privilege of doing business in the third year.

The computation of the proposed deficiency was as follows:

Tax due for second year	\$244.44
Tax to be prepaid for third year	244.44
Total Tax due	\$ 4 8 8 .

Less:

Prepayment for second year	\$100.00
Amount paid with second year's return	<u>244.44</u>
Total tax paid	\$344.44
Proposed deficiency	<u>\$144.44</u>

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year. If the first year was for a full twelve months of operation, the income for the first year was used to measure the tax for both the first and second taxable years. Where the first taxable year was less than twelve months, the corporation, in addition to paying a tax for the first taxable year based on the income for that year, was also required to prepay the tax for its second year based on the first year's income. If the corporation's income for the second year was larger than the first year's income, the tax for the second year was based on the income for the second year. The income, as disclosed by the second year's return, was also used to measure the tax for the third taxable year. ^{2/}

In determining when a corporation commences doing business, the regulations provide:

The first taxable year begins when the corporation commences to do business, which may be at any time after the articles of incorporation are filed and generally subsequent to the time the first board of directors meeting is held. Since the corporate powers are vested in the board of directors under the Corporations Code, it is rarely true that a corporation will be doing business prior to the first meeting of the board. However, if pre-incorporation activities are ratified at the first meeting of the board and the activities would normally constitute doing business, the taxable year will be deemed to have commenced from the date of incorporation, but not prior to that date. Each case must be decided upon its own facts. (Cal. Admin. Code, tit. 18, reg. 23221-23226, subd. (c).)

^{2/} In 1972, an amendment to section 23151.1 of the Revenue and Taxation Code greatly simplified the calculation of franchise tax for a commencing corporation. For corporations which commence doing business in California after December 31, 1971, the tax for the first taxable year, whether or not a full twelve month period, is the minimum franchise tax, generally \$200.00.

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In determining whether a corporation was doing business for a full twelve month period, the regulations provide that periods of one-half month or more shall be considered a full month for the purpose of determining whether a taxpayer commenced to do business during that month. (Cal. Admin. Code, tit. 18, reg. 23221-23226, subd. (b).) Thus, for an initial part of a month to be considered a full month, a corporation must commence doing business, in the case of a 31-day month, on the 16th or before. (See FTB Legal Ruling No. 310.) "Doing business" means actively engaging in any transaction for the purpose of financial or pecuniary gain or profit. (Rev. & Tax. Code, § 231.01.) Therefore, if appellant is to prevail, it must establish that it commenced doing business on or before January 16, 1970.

Although appellant was incorporated on the critical date, January 16, it did not formally open its place of business to the public until February 2. However, for many weeks prior to January 16, appellant, through its officers and employees, was searching for suitable office space, purchasing furniture and supplies, designing and printing graphics, opening bank accounts, acquiring licenses, installing telephone equipment, and actively soliciting clients. For example, appellant executed a lease for the business premises on January 9. Two months' rent was paid to the lessor on January 16. The corporate bank account was opened and in use prior to January 16. Necessary telephone equipment had been installed on or before the critical date.

Appellant submitted a copy of the minutes of the first meeting of directors which was held on February 24, 1970. The minutes specifically provide that all preincorporation activities undertaken on behalf of the corporation were ratified at that meeting.

We recognize the proposition that, in determining whether a corporation was "doing business" within the meaning of section 23101 of the Revenue and Taxation Code, activities which are preliminary to doing business are disregarded. (See, e.g., Appeal of Two Pine Street Co. , Cal. St. Bd. of Equal. , Feb. 16, 1971.) However, we believe that this case

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is more closely analogous to the Appeal of Western Outdoor Markets, decided by this board January 4, 1972, and affirmed on rehearing, October 7, 1974.

Here, prior to the critical date, appellant had leased its business premises and paid rent in advance, purchased furniture and other assets, contracted for the design and printing of graphics and other advertisements, and had actively solicited clients. All these activities, taken on behalf of the corporation, were ratified at the first meeting of the board of directors held on February 24, 1970. It is apparent that appellant actively engaged in these transactions solely for the purpose of securing financial gain or profit.

We conclude that appellant had commenced doing business on January 16, 1970, so that its first year was a full twelve month period. Accordingly, respondent's action in this matter must be reversed.

ORDER

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

