



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
SERIAL PRODUCING CORPORATION)

Appearances:

For Appellant: Oscar Moss, Attorney At Law

For Respondent: W. M. Walsh, Assistant Franchise Tax
Commissioner

O P I N I O N

This appeal is made pursuant to Section 25 of the Bank and Corporation Franchise Tax Act (Chapter 13, Statutes of 1929, as amended) from the action of the Franchise Tax Commissioner in overruling the protest of the Serial Producing Corporation to his proposed assessment of additional tax in the amount of \$1727.43 for the taxable year ended October 31, 1934.

On November 7, 1932, Appellant was incorporated under the laws of the State of California. From the record before us it appears that prior to filing its **articles of** incorporation with the Secretary of State as required by law, Appellant prepaid the minimum tax of \$25, pursuant to the provisions of Section 4 of the California Bank and Corporation Franchise Tax Act. Appellant determined to keep its books on the basis of fiscal years ending October 31 of each year, and as required by Section 13 of the Act, within two months and fifteen days after October 31, 1933, it filed its return for its first taxable year, disclosing a net income for franchise tax **purposes of \$5618.59.** This amount it used as the measure of the tax which it self-assessed for both its first and its second taxable years. The correctness of this action is not disputed so far as the first taxable year is concerned, but Appellant's authority to use this amount as a measure of its tax for the second taxable year is challenged by respondent, who has reassessed the tax upon the basis of Appellant's income for the year ending October 31, 1934. The propriety of this action is the sole question present by this appeal.

The provisions governing the computation of Appellant's tax for the second taxable year are contained in Section 13 of the the Act as the same read immediately after the 1933 amendment. This section read in part as follows:

"In every case in which the first taxable year of a . . . corporation constitutes a period of less than twelve months, said . . . corporation shall pay as a prepayment of the tax for its second taxable year an amount equal to the tax

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.. for its first taxable year ... and upon the filing of its tax return within two months and fifteen days after the close of its second taxable year it shall pay a tax for said year based upon its net income received during that year, allowing a credit for the prepayment; but in no event shall the tax for the second taxable year be less than the amount of the prepayment for that year, and said return for its second taxable year shall also . . . be the basis for the tax of said ... corporation for its third taxable year."

It is apparent from the above provisions that the **return** for the first taxable year was properly used as the basis of the tax for the second taxable year only if the first taxable year constituted a period of twelve months. It appears from the record that Appellant did not commence operations until some time in 1933 and the Commissioner contends that by reason of this fact the period ending October 31, 1933, upon the basis of which its first return was filed, was a period of less than twelve months, so that under the above quoted provisions the tax for the **second taxable** year must be computed upon the net income for that year. We think this contention must be sustain

-Appellant denies that its taxable year ending October 31, 1933, was a period of less than twelve months, and seeks to support its position by reference to the definition of "doing business" contained in the Act at the time of the incorporation, and to the requirement contained in Section 13 of the Act that it prepay the minimum tax at the time it "commenced to do business." At that time Section 5 of the Act read in part as follows:

"The term 'doing business', as herein used, means any transaction or **transactions** in the course of its business by a corporation created under the laws of this state . . . and shall include the right to do business through such incorporation . . ."
(Emphasis added.)

Briefly stated, Appellant's contention is that by the term of Section 5 it began doing business when it acquired the right to do business, that it became subject at that time to the tax measured by net income provided for by Section 4, so that its first taxable year began at that time and was therefore a period of twelve months. Appellant also contends that by the terms of Section 13 it is to be regarded as commencing business at the time of its prepayment of the minimum tax.

The difficulty with Appellant's position is that it is impossible of reconciliation with the definition of "**taxable year**" contained in the Act prior to 1935 and with the following provision of Section 13, as said section read prior to 1933:

"...in no case may the term '**doing** business' as defined in Section 5 hereof be so construed

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as to enable a ... corporation to pay a less amount of tax that it would be required to pay were the last clause of Section 5 omitted therefrom."

The term "taxable year" was defined by Section 11 of the Act as the period "upon the basis of which the net income is computed herein." Inasmuch as Appellant, under Section 4 of the Act, was subject to the tax measured by net income only if it was doing business within the meaning of the Act, it follows that there would be no computation of its net income under the Act and that consequently its first taxable year would not begin until it started "doing business." In determining when it started doing business consideration must be given to the above quoted sentence from Section 13.

The obvious purpose of this provision was to prevent a corporation that filed its articles long prior to the time it actually commenced business operations from measuring its tax for its second taxable year by the income from activities extending over only a fraction of a year and thereby avoiding payment of a fair tax as compared to other corporations. Upon the deletion of the last sentence of Section 5 by the 1933 Legislature, this provision was no longer considered necessary; and it was, accordingly, likewise deleted. It is to be noted, however, that the 1933 amending act expressly provided that it should be applied in the computation of taxes accruing subsequent to December 31, 1932 (Cal. Stats, 1933, p. 708). Consequently, in determining the amount of Appellant's accrued tax liability under the Act up to December 31, 1932, the provisions of the 1931 Act must be followed. Under the above quoted provision of Section 13 the conclusion is compelled that during the period prior to the commencement of operations the Appellant was not doing business and that it was, accordingly, not subject to the tax measured by net income, but only to the minimum tax provided by Section 4, and that, therefore, its first taxable year had not yet commenced. A holding that the Appellant was doing business during that time would be possible only by applying the last clause of Section 5 and this could be done only by violating the plain mandate of Section 13, since it would enable the corporation to pay a less amount of tax for its second taxable year.

W R W E R

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

IT IS HEREBY ORDERED, ADJUDGED AND DECREED that the action of Chas. J. McColgan, Franchise Tax Commissioner in overruling the protest of the Serial Producing Corporation to a proposed assessment of an additional tax in the amount of \$1727.43 for the taxable year ended October 31, 1934, be and the same is hereby sustained.

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Done at Sacramento, California, this 15th day of November, 1939, by the State Board of Equalization.

Fred E. Stewart, Member
George R. Reilly, Member
Harry B. Riley, Member

ATTEST: Dixwell L. Pierce, Secretary