



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of
KLEEFELD & SON CONSTRUCTION CO., INC., and
DON JA RAN CONSTRUCTION CO., INC.

Appearances:

For Appellants: Nathan Schwartz, Certified Public
Accountant

For Respondent: A. Ben Jacobson, Associate Tax
Counsel

O P I N I O N

These appeals are made pursuant to Section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on protests to proposed assessments of additional franchise tax against Kleefeld & Son Construction Co., Inc., and Don Ja Ran Construction Co., Inc., in the amounts of \$9,671.94 and \$9,262.77, respectively, for the taxable year ended June 30, 1950.

Sidney Kleefeld and J. George Wright have been associated in the building construction business for a number of years. Early in 1948 they negotiated for the purchase of land and began conferences with officials of a bank for the purpose of establishing a line of credit to finance construction of houses on the land. An escrow with respect to the land was opened on June 4, 1948. By then four other individuals had joined in the enterprise.

It was decided to carry out the construction program through a joint venture of five corporations, to be known as The Five Companies (subsequently changed to Associated Builders). Pursuant to this plan Appellant Don Ja Ran Construction Co., Inc., was formed on July 8, 1948, with J. George Wright as its sole stockholder and on July 12, 1948, Appellant Kleefeld & Son Construction Co., Inc., was formed with Sidney Kleefeld as its sole stockholder. Don Ja Ran held the first meeting of its board of directors on July 9, 1948, and Kleefeld held its first meeting on July 19, 1948. The prior acts of the respective incorporators were not formally ratified at either meeting.

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On July 19, 1948, the plans for houses to be constructed by the joint venture were completed and delivered by the firm engaged to design the **structures**. On August 3, 1948, the bank gave final approval to a line of credit for the use of the joint venture in the amount of \$819,000. A written agreement formalizing the joint venture was executed by the five corporations on August 17, 1948.

There is in evidence a letter from the manager of the bank involved in the negotiations which states in part that "we were negotiating with Mr. Wright and Mr. Kleefeld regarding this project as early as February 14, 1948. Of course, it was necessary to have numerous conferences with them between that time and August 3, 1948, when our decision to make the loans was **'formalized.'**" There is also in evidence a memorandum dated July 15, 1948, setting forth information to be included in a letter to be sent to the bank. In addition, there is a letter dated July 16, 1948, to "The Five Companies, c/o Mr. George Wright" from Mr. Kissel, a participant in the venture and a building material supplier. This letter suggests a schedule of partial payments to be made at various stages of construction.

During the year involved, former Section 13(c) of the Bank and Corporation Franchise Tax Act (now Section 23222 of the Revenue and Taxation Code) provided that the tax of a corporation for its second taxable year was to be measured by its net income for its first year unless it did business for less than 12 months in its first year. In the latter case the tax for the second taxable year was to be measured by the net income for the second taxable year. The regulations of the Franchise Tax Board provide that in making the computation a period of less than 15 days shall be disregarded and a period of 15 days shall be treated as one month. (Reg. 23221-23226, Title 18, Calif. Admin. Code.)

Each Appellant adopted a fiscal year ended June 30. Each paid the franchise tax for its first and second taxable years ended June 30, 1949, and 1950, respectively, measured by its net income for the year ended June 30, 1949. On the ground that each Appellant did business for less than 12 months in its first taxable year the Franchise Tax Board determined that the tax for the second taxable year is to be measured by the net income of that year. The Franchise Tax Board concedes that if either Appellant commenced doing business on or before July 16, 1948, it should be considered as having done **business** for a full 12 months in its first taxable year.

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Former Section 5 of the Bank and Corporation Franchise Tax Act (now Section 23101 of the Revenue and Taxation Code) defined "doing business" as "actively engaging in any transaction for the purpose of financial or pecuniary gain or profit." The regulations provide that:

"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." (Reg. 23221-23226(c) Title 18, Calif. Admin. Code.)

Upon the facts before us it is immaterial whether or not preincorporation activities were ratified at the first meeting of the respective boards of directors of Appellants. Each Appellant was organized by its incorporator for the paramount purpose of participating in the construction project. Each Appellant was wholly owned by its incorporator. These circumstances are sufficient to establish the authority of each incorporator to conduct the business of his corporation in furtherance of the corporate purpose without an express authorization to do so by the board of directors. (First National Finance Corp. v. Five-O Drilling co., 209 Cal. 569; San Roque Properties, Inc. v. Pierce, 18 Cal. App. 2d 379.) [Between the date of incorporation of each Appellant and the crucial date of July 16, 1948, each incorporator, for and on behalf of his corporation, was actively conducting negotiations, assembling plans, data, etc., preparatory to the execution of formal agreements with the other participating corporations, suppliers,

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contractors and the bank. Since such activities clearly constituted "doing business" within the meaning of the statute, we have concluded that each Appellant did business prior to July 16, 1948, and, in accordance with the regulations and practice of the Franchise Tax Board, must be regarded as having done business for a full twelve months in its first taxable year.

O R D 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, pursuant to Section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on protests to proposed assessments of additional franchise tax against Kleefeld & Sons Construction Co., Inc., and Don Ja Ran Construction Co., Inc., in the amounts of \$9,671.94 and \$9,262.77, respectively, for the taxable year ended June 30, 1950, be and the same is hereby reversed.

Done at Sacramento, California, this 9th day of June, 1960, by the State Board of Equalization.

John W. Lynch, Chairman

Alan Cranston, Member

Richard Nevins, Member

_____, Member

_____, Member

ATTEST: Dixwell L. Pierce, Secretary