

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
WESTERN OUTDOOR MARKETS)

Appearances:

For Appellant: Anthony J. Quigley
Attorney at Law

For Respondent: Ben F. Miller
Counsel

O P I N I O N

This appeal is made pursuant to section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Western Outdoor Markets against proposed assessments of additional franchise tax in the amounts of \$2,211.04 and \$2,168.12 for the taxable years 1962 and 1963, respectively.

The questions presented are whether appellant Western Outdoor Markets was doing business during the taxable year 1962 and whether \$43,745 received by appellant in 1962 constituted income which should have been reported in that year.

Appellant was incorporated in California on September 18, 1962, and its board of directors met for the first time on October 1, 1962. At the second meeting of the board on October 16, 1962, corporate officers were elected, bylaws were adopted, and it was resolved that corporate funds would be deposited with a San Francisco branch of the Bank of America. Appellant's president and its secretary-treasurer were authorized to sign checks on appellant's behalf, and the president was authorized to obligate appellant for short-term borrowing not to exceed \$30,000.

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Appellant is a trade association which was created by certain independent billboard owners to serve as a central selling agent of billboard space in the western United States. Similar services had previously been provided by Outdoor Advertising Institute (OAI), but that organization planned to terminate its western operations on January 1, 1963. Since most of appellant's prospective members had contracts with OAI until that date, appellant did not intend to begin its selling operations until then. In anticipation of commencing operations in 1963, appellant began in 1962 to sign contracts with the billboard owners participating in the venture. These contracts were identical in form and provided that appellant would receive for its services an annual fee measured by the annual gross poster and bulletin space sales of the particular billboard owner. The fee for the first six months was payable in advance and thereafter the fee was payable quarter-annually in advance. By January 1, 1963, appellant had received \$40,745 in advance fees. These funds were deposited in appellant's general bank account, along with an additional \$3,000 which three billboard owners had contributed on September 18, 1962, to cover appellant's organizational expenses.

During 1962, appellant also reached agreement with the employees of OAI's western offices to come to work for appellant beginning January 2, 1963. In cases where OAI possessed long-term leases on its western offices, appellant agreed to assume those leases effective January 2, 1963. Where OAI rented offices on a month-to-month basis, appellant attempted to secure less costly offices. In Seattle appellant agreed to sublet certain office space and made a rent deposit with the sublessor on December 4, 1962.

Based on all of the above facts, respondent determined that appellant was "doing business" in 1962 within the meaning of Revenue and Taxation Code section 23101 and that the \$43,745, which appellant received and deposited in 1962, was income that should have been reported in its return for that year. Accordingly, respondent issued two notices of proposed assessment: one for the income year 1962, taxable year 1962, including the \$43,745 in appellant's income; the other for income year 1962, taxable year 1963, covering appellant's prepayment for the 1963 taxable year. Appellant protested these assessments and appeals from respondent's denial of its protests.

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Revenue and Taxation Code section 23151 imposes on every corporation doing business in this state a franchise tax measured by the corporation's net income. As defined in Revenue and Taxation Code section 23101, "doing business" means actively engaging in any transaction for the purpose of financial or pecuniary gain or profit. In the Appeals of Kleefeld & Son Construction Co., Inc. and Don Ja Ran Construction Co., Inc., Cal. St. Bd. of Equal., June 9, 1960, we had before us two solely-owned corporations which had been organized to take part in a five-corporation joint venture to build a large housing project. We there held that the following activities, engaged in by each sole incorporator for and on behalf of his corporation, "clearly constituted 'doing business'" within the meaning of section 23101: "actively conducting negotiations, assembling plans, data, etc., preparatory to the execution of formal agreements with the other participating corporations, suppliers, contractors and the bank."

We find here that the activities of appellant in 1962 constituted "doing business." Not only did appellant actively negotiate to obtain members, new employees and office space, but it actually executed formal contracts with 37 billboard owners and received advance fees from 16 of them. Appellant's attempt to distinguish Kleefeld and Don Ja Ran on the grounds that the financing negotiations and construction planning were begun before the appellant corporations were formed has no discernible merit.

Having found that appellant was "doing business" in 1962, we now turn to the question of whether appellant should have reported the \$43,745 in its income for 1962. Appellant keeps its books and files its tax returns using an accrual method of accounting. Under its accounting system appellant deferred reporting the \$43,745 in prepaid fees until 1963,^{1/} the year in which it was obligated to

^{1/} In view of this fact, we do not understand appellant to argue seriously that the prepaid fees were not income at all. Clearly, advance payments received in return for a commitment to render income-producing services in the future must be income at the time of receipt, at the time the services are performed, or perhaps partially at both times. Be that as it may, if we have misunderstood appellant, there is in any event absolutely no basis in the record for a finding that appellant was a "trustee" with respect to the prepaid fees. Likewise, the existence of an alleged contingency that the fees would have to be returned if appellant did not commence operations does not alter the nature of those fees as income. (Brown v. Helvering, 291 U.S. 193 [178 L. Ed. 725].)

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render the services for which the fees had been paid. By determining that these fees were properly reportable in 1962, respondent has implicitly determined under Revenue and Taxation Code section 24651, subdivision (b), that appellant's accrual method of accounting did not clearly reflect its income for 1962, (see Automobile Club of New York v. Commissioner, 304 F.2d 781, 783-784), and has substituted its judgment that the cash receipts and disbursements method does clearly reflect appellant's income for that year.

In order to overturn respondent's determination, appellant must show that its accounting method did clearly reflect its 1962 income. No such showing has been made. Indeed, the record is totally lacking in evidence on the accuracy of appellant's accrual accounting method. No doubt this is due mainly to the fact that this appeal was briefed and argued under the theory that the controlling question was the applicability of the so-called "claim of right" doctrine, but that is no help to appellant since it is well established that a taxpayer's failure to prove the accuracy of his accrual accounting method provides an independent ground for decision in prepaid income cases. (Automobile Club of Michigan v. Commissioner, 353 U.S. 180 [1 L. Ed. 2d 746]; American Automobile Association v. United States, 367 U.S. 687 [6 L. Ed. 2d 1109]; Schlude v. Commissioner, 372 U.S. 128 [9 L. Ed. 2d 633].) We are basing our decision on this theory rather than on the "claim of right" doctrine because recent federal decisions have cast considerable doubt on that doctrine's continuing applicability to prepaid income situations. (See, e.g., Automobile Club of New York v. Commissioner, supra; Artnell Co. v. Commissioner, 400 F.2d 981; Hagen Advertising Displays, Inc. v. Commissioner, 407 F.2d 1105.)

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,

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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 the protest of Western Outdoor Markets against proposed assessments of additional franchise tax in the amounts of \$2,211.04 and \$2,168.12 for the taxable years 1962 and 1963, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 4th day of January, 1972, by the State Board of Equalization.

John W. Lynch, Chairman
Raymond J. ..., Member
Paul ..., Member
..., Member
William W. ..., Member

ATTEST: W. W. ..., Secretary