



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
DEVMAR, INC.)

For Appellant: 'Thomas E. Smail, Jr.
 Attorney at Law

For Respondent: Crawford H. Thomas
 Chief Counsel

Jack E. Gordon
Counsel

O P I N I O N

This appeal is made pursuant to section 26077 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claim of Devmar, Inc., for refund of franchise tax in the amount of \$5,047.32 for the income year ended March 31, 1965.

The issue for determination is whether appellant commenced doing business on or before April 15, 1963, so that its first taxable year was a full twelve-month period. If it did, the tax for its second taxable year is measured by its net income for its first taxable year. If it did not, its tax for the second taxable year is measured by the net income for that year.

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Appellant was incorporated in California on March 28, 1963. Its stated purpose was to engage in home construction. One-third of appellant's stock was issued to its president, Mr. Joseph M. McDevitt, while the remaining two-thirds was issued to unidentified parties. Appellant initially selected a fiscal year accounting period ending on September 30. However, by letter dated July 25, 1963, appellant requested permission to change to a fiscal year ending on March 31. Respondent granted the requested change. The letter also stated that appellant had not transacted any business between March 28, the date of incorporation, and March 31.

During March 1963, prior to appellant's incorporation, Mr. McDevitt commenced negotiations with Mr. Allan H. Lindsey of Lindsey-Kowall Development Co. The negotiations concerned the purchase of some property which Mr. McDevitt was interested in having appellant develop after its incorporation. During the course of the negotiations, Mr. McDevitt requested an engineering feasibility report on the property, Mr. Lindsey, who had previously retained Robert U. Grant Civil Engineering Co., Inc. to perform feasibility studies on a master **land development plan**, suggested that the Grant Company include the requested feasibility study in that report. It was agreed that the initial costs of the study for McDevitt should be borne by Lindsey-Kowall Development Co. **which** was responsible for the master plan. Thereafter, if the **initial study was favorable, more detailed engineering work would be required** with appellant bearing that cost. The engineering studies commissioned by Lindsey commenced on April 4, 1963. However, the Grant Company did not meet with McDevitt to make arrangements **for the more detailed study until May 1, 1963.**

Appellant's first meeting of directors occurred on April 1, 1963, when by-laws were adopted and officers were elected. The corporate seal and share certificates were also approved, and the issuance of shares was authorized. There was no ratification of any **preincorporation** activity, nor was there any corporate authorization for Mr. McDevitt to conduct any negotiations on behalf of the corporation.

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The second meeting of directors was held July 11, 1963, when the fiscal year was changed and the location of the principal office was established. The lease of an office building commencing May 15, 1963, was also approved. Finally, the directors discussed the terms of a proposed contract pursuant to which, if approved, appellant would purchase the land from Lindsey.

Appellant filed its initial California franchise tax return on June 15, 1964, indicating that the return covered the period extending from March 28, 1963, through March 31, 1964. After audit of the return, respondent determined that appellant had not been doing business in California for a full twelve months during the period ending on March 31, 1964.

Section 23101 of the Revenue and Taxation Code states that "[d]oing business' means actively engaging in any transaction for the purpose of financial or pecuniary gain or profit." The regulations provide :

The first taxable year begins when the corporation commence-s to do business which may be at any time after the article: 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 preincorporation 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, regs. 23221-23226, subd. (c).)

Subdivision (b) of the same regulation provides 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. Therefore, if appellant

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is to prevail, it must establish that it was doing business on or before April 15, 1963.

Appellant contends that during March 1963, Mr. McDevitt was negotiating with Mr. Lindsey for the purchase of property on its behalf. However, as was noted above, appellant's board of directors did not ratify any preincorporation activity at its first meeting on April 1, 1963. Where the first meeting of directors reveals no ratification of any preincorporation promoter activity, such activity, if any, is irrelevant and may not be considered in determining whether or not appellant was "doing business." (Appeal of Lakehurst Construction Co., et al., Cal. St. Bd. of Equal., Oct. 5, 1965; Appeal of Acme Acceptance Corp., Cal. St. Bd. of Equal., Dec. 11, 1963.)

The record indicates that the only corporate activity which occurred between the date of incorporation and April 16, 1963, was the first meeting of directors. The only business conducted at that meeting was the normal administrative chores preliminary to doing business. Nothing took place which rose to the level of "... actively engaging in any transaction for the purpose of financial or pecuniary gain or profit." (Appeal of Two Pine Street Co., Cal. St. Bd. of Equal., Feb. 16, 1971; Appeal of Lakehurst Construction Co., et al., supra; Appeal of Acme Acceptance Corp., supra.)

The minutes of the second meeting of directors further emphasizes the fact that as of the crucial date, April 15, 1963, appellant had not commenced "doing business." The minutes of that meeting, held July 11, 1963, indicate that appellant had done nothing more than enter into activities preliminary to doing business. At the time of the second meeting appellant had purchased no property. Rather, it had merely entered into negotiations for the purchase of the property. Mere negotiation for the purchase of property does not constitute doing business within the meaning of section 23101 of the Revenue and Taxation Code. (Appeal of Two Pine Street Co., supra.)

In support of its position appellant relies on Appeals of Kleefeld & Son Construction Co., et al., Cal. St. Bd. of Equal., June 9, 1960, which concerned five corporations, each of which was wholly owned by one shareholder and was formed for the exclusive purpose of entering

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into a joint venture with the other four corporations. It was there held that the taxpayer had commenced doing business in view of the fact that between the date of incorporation and the crucial date each incorporator was actively conducting negotiations, assembling plans, and compiling data for and on behalf of his corporation, preparatory to the execution of formal documents reflecting the culmination of this activity with the other participants in the building construction venture. It is apparent that the activities relied upon by appellant in this matter are readily distinguishable from those found in Xleefeld to constitute doing business. In the instant matter the only activity which the corporation engaged in between the date of incorporation and the critical date of April 15, 1963, was waiting for the results of a feasibility study commissioned and paid for by someone else.

Accordingly, it must be concluded that respondent properly determined that appellant had not commenced doing business on or before April 15, 1963. Therefore, respondent's action in this matter must be sustained.

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 26077 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claim of Devmar, Inc., for refund of franchise tax in the amount of \$5,047.32 for the income year ended March 31, 1965, be and the same is hereby sustained.

Done at Sacramento, California, this 6th day of February, 1973, by the State Board of Equalization.

William W. Bernick, Chairman
John W. Lynch, Member
Frank K. ..., Member
_____, Member
_____, Member

ATTEST: W. W. ..., Secretary