BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
EBEE CORPORATION, TAXPAYER, AND)
EDWARD BACCIOCCO, ASSUMER AND/OR)
TRANSFEREE)

Appearances:

For Appellants: Richard L. Greene
Attorney at Law

For Respondent: Marvin J. Halpern
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 Ebee Corporation, taxpayer, and Edward Bacciocco, assumer and/or transferee, against a proposed assessment of additional franchise tax in the amount of $37,514.92 for the Income year ended July 31, 1970.

The issue for determination in this appeal is whether Ebee Corporation, hereinafter referred to as appellant or the corporation, was a commencing

corporation during Its entire existence. Ifitwas, appellant may not obtain the benefits of the nonrecognition of gain provisions contained in section 24512 of the Revenue snd Taxation Code and the proposed assessment is correct. If on the other hand appellant was not a commencing corporation, it is entitled to the benefits of the nonrecognition provisions snd respondent's determination is incorrect.

On January 10, 1964, Edward Bacciocco and his sister each acquired an undivided one-half interest in property located at 620 Montgomery Street in San Francisco. The property was advertised for lease from the date of acquisition. However, with the exception of a brief rent-free occupation by a charitable organization the property was not occupied prior to the inception of the Transamerica Title Insurance Company lease discussed below.

On July 12, 1960, Mr. Bacciocco snd his sister received sn offer from Transsmerica to lease the property. Immediately thereafter Mr. Bacciocco sought legal advice concerning the offer. After discussions with his attorneys It was concluded, on July 17, 1968, that it would be advisable for Mr. Bacciocco to form a corporation of which he was to be the sole shareholder, snd to transfer his one-half interest in the property to that corporation. Mr. Bacclocco testified, under oath, that after this date it was his understanding that all his negotiations were for and on behalf of appellant.

Appellant's articles of incorporation were submitted to the Secretary of State on August 9 and filed on August 12 at which time the corporation officially came into existence. However, intensive negotiations with Transsmerica concerning the proposed lease had commenced on July 19 and continued until the execution of a final letter of intent on August 27. During these negotiations Mr. Bacciocco was represented by his attorney, John H. Painter, who stated, in an affidavit, that it was his understanding that all negotiations, discussions, and meetings regarding the lease were conducted on behalf of appellant.

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Daily, from August 13 until August 19, Mr. Painter had discussions concerning the terms of the lease with Mr. Bacciocco, Transamerica's attorney Jim Haynes, snd Joseph Mahoney, a vice president of Milton Meyer and Company, Transamerica's leasing agent. Mr. Mahoney also stated in an affidavit that he understood that Mr. Bacciocco was acting on behalf of appellant. On the 12th and 13th Mr. Painter had telephone conversations with officers of Milton Meyer and Company concerning the lease. On the 14th, 15th, 19th, and 20th he also worked on the lease, discussing it and his proposed changes with Mr. Bacciocco and Mr. Haynes, the attorney for Transamerica. These negotiations resulted In a letter from Mr. Painter to Mr. Haynes, dated August 20, summarizing the proposed changes to the letter of intent. A revised letter of intent, initiated by Transamerica, was dated August 22 while the final letter of intent containing the basic terms of the lease was dated August 27.

On August 28, 1968, the first meeting of appellant's directors was held. At that meeting the by-laws and the corporate seal were aaopted, officers elected, and the location of the principal place of business designated. The corporation also adopted a fiscal year ending July 31, authorized a bank account, and adopted a plan to issue stock pursuant to section 1244 of the Internal Revenue Code of 1954.

On August 29, the directors met to accept Mr. Bacciocco's offer to transfer his one-half interest in the property, subject to the terms of Transamerica's August 27 letter of intent, in exchange for all the stock to be issued by the corporation. A permit to issue stock was granted to appellant by the Commissioner of Corporations on September 6 authorizing the corporation to issue 20,000 shares of $10.00 par value stock to Edward Bacciocco, the sole shareholder in exchange for his undivided one-half interest in the property.

The final lease with Transamerica, which was dated September 1, was delivered to escrow on September 23. The escrow closed on September 24 after recording appellant's interest in the property and delivering the signed lease and the first year's rent to the corporation.

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On December 23, 1969, the corporation adopted a plan of complete liquidation within a 12-month period. The property was sold to Transamerica on December 24 and the proceeds of the sale were distributed to Mr. Bacclocco pursuant to the plan. All the remaining assets were distributed, or made available for distribution, to Mr. Bacciocco within the 12-month period from December 23, 1969, to December 22, 1970.

Appellant's first franchise tax return, for the year ended July 31, 1969, indicated that the corporation began business on September 1, 1968.[1] Appellant's second franchise tax return also indicated that it commenced doing business on September 1, 1968.

On its franchise tax return for the income year ended July 31, 1970, appellant claimed the benefits of the provisions of section 24512 of the Revenue and Taxation Code pertaining to the nonrecognition of gain on the sale of its assets. However, respondent determined that appellant was a commencing corporation described in sections 23222 and 23222a of the Revenue and Taxation Code and not entitled to the benefits of the nonrecognition provisions. It is this determination which forms the basis for this appeal.

Section 24512 of the Revenue and Taxation Code provides:

> If-
>
> (a) A corporation, other than a corporation described in Section 23222 or 23222a, adopts a plan of complete liquidation on or after December 31, 1954; and

1/ Actually, the date on the return was September 1, 1969; however, the parties agree that this was a typographical error and should have read September 1, 1968.

> (b) Within the U-month period beginning on the date of the adoption of such plan, all of the assets of the corporation are distributed in complete liquidation, less assets retained to meet claims;
>
> then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within such 12-month period.

There is no question that appellant meets the requirements of subdivision (b) regarding the distribution of its assets and liquidation within a U-month period. We are only concerned with whether appellant was a *corporation described in Section 23222 or 23222a", and excluded from the nonrecognition benefits by the operation of section 24512, subdivision (a).

A corporation described in section 23222 includes one whose first taxable year constitutes a period of less than 12 months, or one that does business for a period of less than 12 months during its first taxable year. Appellant's first taxable year was the period August I, 1968, to July 31, 1969. If appellant was "doing business" for a full 12 months during this period, then appellant was not a corporation described in section 23222. Pursuant to respondent's regulations, a period of more than one-half a calendar month may be treated as a full month. (Cal. Admin. Code, tit. 18, reg. 23221023226, subd. (b).) Therefore, if appellant commenced "doing business" on or before August 16, 1968, it was not a commencing corporation. Section 23101 of the Revenue and Taxation Code defines "doing business" as "actively engaging in any transaction for the purpose of financial or pecuniary gain or profit."

Although respondent takes inconsistent positions in its brief, it apparently maintains that in order to determine whether the activities of an incorporator conducted prior to the transfer of assets to a corporation constitute "doing business" by the corporation, one looks only at the activities carried on between the date of

incorporation and the crucial date for tax purposes. In other words, respondent argues that no **preincorporation** activities may be considered even if they would **otherwise** amount to **"doing** business@'; only those activities occurring after incorporation may be considered. In support of this position respondent relies on Anneal of Kleefeld **&** Son Construction Co., Inc., et al., decided by this board on June **919960, and it**s own regulations. However, nothing in the **regulations** or in Kleefeld compel this conclusion,

Respondent's regulations provide, in pertinent part:

> 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 preincorporation activities are ratified at the first meeting of the board end 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.** 23221023226, subd. **(c).)**

In determining when **a** corporation has commenced **"doing** business", preincorporation activities when not ratified at the first meeting of directors are deemed immaterial in **the** typical multishareholder corporation. **(Appeal** of Lakehurst Con**struction Co., et al., Cal. St. Bd. of Equal., Oct. 5, 1965; Appeal of Acme Acceptance Corporation, Cal. St. Bd. of Equal., Dec. 11, 1963.) However, where there is only a single shareholder in** complete control of the corporation, preincorporation

activities of the sole shareholder-incorporator, acting on behalf of his corporation, may be considered even if not formally ratified at the first meeting of directors in view of the futility of requiring such an act. This exception was recognized in Kleefeld where we stated:

> 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.)

Thus if the preincorporation activities of the sole shareholder-incorporator acting on behalf of the corporation constitute "doing business", the corporation will be deemed to be doing business as of the date of incorporation but not before that date. (Cal. Admin. Code, tit. 18, reg. 23221-23226, subd. (c); cf. Appeal of Kleefeld & Son Construction Co., et al., supra.)

In Kleefeld there was sufficient post incorporation activity conducted by the corporations' sole shareholders to justify a conclusion that the corporations had commenced doing business prior to the crucial date. It was not necessary to consider any preincorporation activity in order to reach this conclusion. Kleefeld does not stand for the proposition that preincorporation activities can never be considered in determining when a

corporation has commenced doing business. Therefore, in line with respondent's regulations and prior decisions of this board, we conclude that the preincorporation activities of appellant's sole shareholder, Edward Bacciocco, may be considered if the activities constitute "doing business", and if they were conducted for, and on behalf of, the corporation and not in Mr. Bacciocco's capacity as an individual.

Next, respondent maintains that the only activities occurring prior to the critical date of August 16, 1968, were negotiations between Transamerica and Edward Bacciocco In his capacity as an individual. However, Mr. Bacclocco testified, under oath, that it was his understanding that at all times after deciding to form a corporation on July 17, 1968, he was negotiating on behalf of appellant. John Painter, Mr. Bacciocco's attorney, submitted an affidavit stating that he also believed that all negotiations and discussions regarding the lease were conducted on behalf of appellant. Furthermore, Joseph Mahoney, a vice president of Milton Meyer and Company, Transamerica's agent in the transaction, also stated in an affidavit that he understood that Mr. Bacciocco was acting on behalf of appellant. In support of its position respondent merely offers a hypertechnical argument based on a single paragraph contained in the letter of intent. . .In view of the evidence, we conclude that from and after July 17, Mr. Bacciocco was acting on behalf of the corporation.

In arguing that appellant did not commence "doing business" until after August 16, respondent also relies on the fact that appellant's franchise tax returns stated that the corporation commenced doing business on September 1, 1968. However, appellant's accountant, Robert Berry, submitted an affidavit stating that he was unaware of the status of, and the extent of, the lease negotiations and arbitrarily entered September 1 on the corporation's first franchise tax return since this was the date that appeared on the lease. He also stated that had he been aware of the status and extent of the negotiations he would have entered the date of August 1, 1968, on the return as the date on which the corporation commenced doing

business. It is obvious, as appellant points out, that the September 1 date appearing on the second return was merely copied from the first return without an independent investigation.

Finally, respondent maintains that even if the negotiations were conducted on behalf of appellant they would still not constitute "doing business" since the negotiations were merely preliminary to appellant's only business activity, that of being a lessor. Therefore, respondent concludes, the only business which appellant would ever do would be to collect the rental income from the property. Appellant, on the other hand, maintains that negotiating a lease was the only activity that appellant was ever going to conduct; therefore, the negotiations were not preliminary to doing business.

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 Company, Cal. St. Bd. of Equal., Feb. 16, 1971.) However, we believe that both parties miss the mark in describing appellant's business activity. Appellant's business of being a lessor required an agreement with the lessee, which in turn required pragmatic bargaining between realistic businessmen, and the reduction of the essential terms to writing, resulting in the final lease. Thereafter, the business of being a lessor required the implementation of the terms of the lease and the supervision of the lessee's conduct within the parameters set forth in the lease. It cannot be questioned that the collection of rent is an integral element of appellant's business. However, it is no more important then the other elements mentioned above. Therefore, we conclude that negotiating the terms of a lease is an integral part of the business activities of a lessor, and does not constitute activity preliminary to doing business.

In line with the facts and conclusions set forth above, we find that from and after July 17, 1968, Edward Bacciocco, appellant's sole shareholder, was negotiating for and on behalf of appellant; and that

the activities constituted "doing business" as that term is used in section 23101 of the Revenue and Taxation Code and were not preliminary to doing business. Therefore, we hold that appellant was "doing business" prior to the critical date of August 16, 1958,2/ and is entitled to the benefits of the nonrecognition of gain provisions set forth in section 24512 of the Revenue and Taxation Code. Accordingly, respondent's action in this matter must be reversed.

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,

2/Since we have concluded that appellant was "doing business" for the entire 12 months during its first taxable year and, therefore, not a commencing corporation as described in section 23222 of the Revenue and Taxation Code, it follows that appellant could not have been a commencing corporation described in section 23222a during its second taxable year.

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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 **Ebee** Corporation, taxpayer, and **Edward Bacciocco,** assumer and/or transferee, against a proposed assessment of additional franchise tax in the amount of **$37,514.92** for the income year ended July **31,** 1970, be and the same is hereby reversed.

Done at Sacramento, California, this 19th day of February, **1974, by the State Board of Equalization.**

_____, **Chairman**

_____, **Member**

_____, **Member**

_____, Member

_____, **Member**

ATTEST: _____, Secretary