BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
THOR ELECTRONICS OF)
CALIFORNIA, INC.)

Appearances:

For Appellant: Theodore H. Cominos
Attorney at Law

For Respondent: Karl F. Munz
Counsel

OPINION

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 Thor Electronics of California, Inc., for refund of franchise tax in the amount of $18,297.64 for the income and taxable year ended June 30, 1968.

Appeal of Thor Electronics of California, Inc.

The sole issue for determination in this appeal is whether appellant was doing business for a full twelve months prior to the end of its first taxable year on June 30, 1967.

Appellant, a California corporation, manufactures electronic parts; It was incorporated on July 29, 1966, and adopted an accounting period ending on June 30 of each year, Appellant's sole shareholder is also the sole shareholder of Triangle Electronic Manufacturing Co., Inc., a New York corporation (hereafter Triangle), and Thor Electronics Manufacturing Co., Inc., also a New York corporation (hereafter Thor of New York). The New York corporations were in existence prior to appellant's incorporation.

'Appellant maintains that preincorporation activities on its behalf commenced on or about May 25, 1966, when an industrial plant was leased in Salinas by Thor of New York; supplies, materials, and equipment were assembled, and the necessary personnel were hired. According to appellant, actual production at the Salinas location commenced in the latter part of June 1966. In support of its position, appellant submitted' the following documents:

(1) copy of a lease dated May 25, 1966, between Salinas-Market Street Building Corporation, as lessor, and Thor of New York, as lessee;

(2) copies of payroll journals for the periods ending July 15 and August 5, 1966, for employees of the Salinas plant;

(3) copies of checks drawn on the account of Triangle reflecting the payments entered in the payroll journals;

(4) certified copy. of a portion of the minutes of a meeting of appellant's directors held on August 5, 1967, purporting to be the first meeting of directors, held to ratify and adopt the alleged preincorporation activities reflected by the above documents.

In an audit of appellant's first two franchise tax returns, respondent determined that appellant had not been doing business for a full twelve months prior to the end of its first accounting period on June 30, 1967, since it was not incorporated until July 29, 1966. Therefore, respondent concluded that, pursuant to section 23222 of the Revenue and Taxation Code, appellant's return for its second income year ended June 30, 1968, should have included a tax due for its second taxable year ended June 30, 1968, measured by the income for that year. The additional tax, penalty and interest were assessed and paid. Thereafter, appellant filed a claim for refund which was denied. This appeal followed.

Section 23222 of the Revenue and Taxation Code provides, in substance, that if a corporate taxpayer was doing business for a full twelve month period during its first taxable year, the tax for its second taxable year is measured by the net income for its first taxable year. If, on the other hand, a corporate taxpayer was not doing business for a full twelve month period during its first taxable year, its tax for the second taxable year is measured by the net income for that year.

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 applicable regulations provide:

> 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 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, reg. 23221~23226, subd. (c).) (Emphasis added.)

Subdivision (b) of the same regulations 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 is to prevail, it must establish that it commenced doing business on or before July 16, 1966.

Appellant contends that it was "doing business" for a full twelve month period during its first taxable year because its preincorporation activities, not the date of incorporation, established the date it commenced "doing business" within the meaning of section 23101 of the Revenue and Taxation Code. Appellant argues that a corporation should be considered to have commenced "doing business" when it actively engages in any transaction for the purpose of financial gain, and should be allowed to include preincorporation activities in determining when it commenced its first taxable year. Appellant concludes that its first taxable year commenced on or about May 25, 1966, the time that business activities on its behalf began, notwithstanding its failure to first complete formal corporate organizational procedures.

Appellant's argument must be rejected since it ignores the clear language of the regulations cited above and a long line of decisions by this board contrary to appellant's position. (Appeal of Devmar, Inc., Cal. St. Bd. of Equal., Feb. 6, 1973; Appeal of Jerry Lewis Pictures Corp., Cal. St. Bd. of Equal., Oct. 6, 1966; 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; Appeal of Kleefeld & Son Construction Co., et al., Cal. St. Bd. of Equal., [redacted]9, 1960; Appeal of Edward M. Ornitz and Co., Cal. St. Bd. of Equal., May 17, 1950.) It has been specifically

held by this board that if preincorporation activities which would normally constitute "doing business" are ratified at the first meeting of the board of directors, the taxable year will be deemed to have commenced from the date of incorporation, but not prior to that date. (Appeal of Edward M. Ornitz & Co., supra; Appeal of Jerry Lewis Pictures Corp., supra;)

In support of its position appellant relies on Appeal of Kleefeld & Son Construction Co., et al., supra. However, appellant's reliance on Kleefeld is misplaced. In Kleefeld this board held that 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. Thus, if the preincorporation activities of a 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. (Cf. 'Appeal of Ebee Corp., Taxpayer, and Edward Bacciocco, Assumer and/or Transferee, Cal. St. Bd. of Equal., Feb. 19, 1974; see also Cal. Admin. Code, tit. 18. reg. 23221-23226, subd. (c).) Kleefeld did not hold, as appellant argues, that a corporation will be found to have commenced "doing business" at the time preincorporation activities on its behalf began. (Appeal of Ebee Corp., Taxpayer, and Edward Bacciocco, Assumer and/or Transferee, supra.)

As another theory in support of the position that it was "doing business" on or before the critical date of July 16, 1966, appellant argues that prior to the date of its formal incorporation it was, a de facto corporation. Since it had a de facto existence prior to the critical date, appellant concludes that it was "doing business" for a full twelve month period prior to the end of its first taxable year.

Under California law a de facto corporation will result where three factors exist: (1) a law under which a corporation may be organized; (2) a good faith attempt to organize under such law; and (3) an actual use of the corporate franchise. (Midwest Air Filters- Pacific, Inc. v. Finn, 201 Cal. 587 [258 P. 382];

Westlake Park Investment Co. v. Jordan, 198 Cal. 609 [246 P. 807]; Appeal of Jerry Lewis Pictures Corp., supra.) The goodfaith attempt to organize which is required to establish that a de facto corporation was formed must be a colorable attempt to comply with the statute authorizing the formation of such a corporation followed by an actual exercise of the corporate franchise in good faith. (Westlake Park Investment Co. v. Jordan, supra, 198 Cal. at 614; Appeal of Jerry Lewis Pictures Corp., supra.) Here, appellant has made no showing that it made any good faith attempt to organize under the appropriate law prior to the critical date of July 16, 1966. On the contrary, the record indicates that the only attempt appellant made at organizing was the successful one when it filed its articles of incorporation with the Secretary of State on July 29, 1966. Furthermore, there is no evidence that appellant ever attempted to utilize the corporate franchise prior to the date of its incorporation.

A common thread throughout appellant's argument is that it engaged in certain activities which constituted "doing business" prior to the critical date of July 16, 1966. The fatal, flaw in this argument is that appellant attributes to itself certain activities conducted by its corporate promoters, Triangle and Thor of New York. All the evidence submitted indicates that it was these organizations, not appellant, that conducted the activities **prior to July 16 on which appellant relies. Appellant did not exist until its articles of incorporation were filed with the Secretary of** State. (Corp. Code, § 308; Brodsky v. Seaboard Realty Co., 206 Cal. App. 2d 504, 515-16 [24 Cal. Rptr. 61]; Appeal of Two Pine Street Co., Cal. St. Bd. of Equal., Feb. 16, 1971.) The case of Judelson v. American Metal Bearing Co., 89 *Cal. App. 2d 256 [200 P. 2d 836] relied upon by appellant, is not contrary to this proposition. 6 Judelson the court pointed out that a corporation which does not exist has no capacity of any kind. (89 Cal. App. 2d at 262.)

In summary, even if the activities relied on by appellant would otherwise constitute "doing business", a point we need not determine, appellant cannot prevail for two reasons. First, the **activities relied on by appellant to establish that it commenced "doing business" prior to the critical date of July** 16, 1966, were

not performed by appellant, but, in reality, were undertaken by separate entities. Second, in no event could appellant have been "doing business" prior to July 29, 1966, when the articles of incorporation were filed and appellant's existence commenced.

Appellant has also directed three constitutional challenges at section 23222 of the Revenue and Taxation Code; 1/

1/ Section 23222 of the Revenue and Taxation Code provides:

> If a taxpayer commences to do business in this state during its first taxable year its tax for that year shall be adjusted upon the basis of the net income received during that taxable year, at the rate applicable to that year, a credit being allowed for the prepayment of the minimum tax. The return for the first taxable year, which shall be filed within 2 months and 15 days after the close of that year, shall also be the basis for the tax of said taxpayer for its second taxable year, if its first taxable year is a period of 12 months. In every case in which the first taxable year of a taxpayer constitutes a period of less than 12 months, or in which a taxpayer does business for a period of less than 12 months during its first taxable year, said taxpayer shall pay as a prepayment of the tax for its second taxable year a tax based on the income for the first taxable year computed under the law and at the rate applicable to the second taxable year, the same to be due and payable at the same times and in the same manner as if that amount were the entire amount of its tax for that year; and upon the filing of its tax return within 2 months and 15 days after the close of the second taxable year it shall pay a tax for said year, at the rate applicable to that year, based upon its net income received during that year, allowing a credit for the prepayment; but in no event, except as provided in Section 23332, 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 taxpayer for its third taxable year, if the second taxable year constitutes a period of 12 months. (Emphasis added.)

First, appellant maintains that section 23222 contains a classification which is arbitrary, capricious, and bears no rational relationship to a legitimate state purpose, and, therefore, violates, the equal protection clause of the Fourteenth Amendment to the United States Constitution.

We do not agree. In fact, we are unable to find any classification of corporations in section 23222. The statute merely establishes a method for computing the tax of all commencing corporations; it does not create different classes of corporations and apply different standards to them. The statute merely provides that in order for the first taxable year to be the 'basis for the tax for the succeeding taxable year it must be a period of twelve months. No special tax treatment or exemption from tax is created or conferred by the statute.

Even if we were to assume that section 23222 does set up a classification, we fail to find any denial of the equal protection of the laws 'occasioned thereby. It is well settled that the power to make classifications for the purpose of taxation is very broad. A statute is presumed to be constitutional until the contrary appears. (F. S. Royster Guano Co. v. Virginia, 253 U. S. 412 [64 L. Ed. 989]; Associated Home Builders of the Greater East Bay, Inc. v. City of Newark, 18 Cal. App. 3d 107 [95 Cal. Rptr. 648J.) When a statute is attacked as violative of the equal protection clause, if facts can reasonably be conceived that would sustain it, their existence is presumed, and the burden of showing arbitrary action rests upon the one who assails the classification. (Burks v. Poppy Construction Co., 57 Cal. 2d 463, 475 [20 Cal. Rptr. 609, 307 P. 2d 313 J; Associated Home Builders of the Greater East Bay, Inc. v. City of Newark, supra; see also Stevens v. Watson, 16 Cal. App. 3d 629 [94 Cal. Rptr. 190].) A m-owing of a potential difference in the amount of tax payable by two corporations, as appellant offers in its brief, is not sufficient to carry the burden of showing that. section 23222 is arbitrary, capricious, and bears no rational relationship to a valid state purpose.

The section establishes an orderly scheme for commencing corporations to prepay their franchise tax in accordance with the overall plan' envisioned by the Bank and Corporation Tax Law.

Section 23222 establishes a reasonable method of imposing the tax from year to year in a manner which does not discriminate among corporations. As respondent maintains, the statute poses a reasonable method for achieving reasonable ends,

Next, appellant argues that section 23222 is void for uncertainty. Appellant's primary concern is that the section does not state what acts will be deemed to constitute the commencement of "doing business" in the first taxable year. Appellant maintains that the statute is so vague and uncertain that it must guess whether the net income from its first taxable year or its second taxable year should be used to measure the tax for the second taxable year. Hence,, appellant concludes that since. section 23222 is neither definite nor certain it should be declared void for vagueness.

It is true that the due process clauses of both the California and federal constitutions require civil as well as criminal laws to provide a standard for uniform application. (Morrison v. State Board of Education, 1 Cal. 3d 214, 231 [82 Cal. Rptr. 175 461 P. 2d 375]; Fletcher v. Western National Life Insurance Co., 10 Cal. App. 3d 376, 405 [89 Cal. Rptr. 78].) However, all that is required is reasonable certainty. A statute will not be held void for vagueness if any reasonable and practicable construction can be given its language or if its terms may be made reasonably certain by reference to other definite sources. (American Civil Liberties Union v. Board of Education, 59 Cal. 2d 203, 218 [28 Cal. Rptr. 700, 379, P. 2d 4]; Fletcher v. Western National Life Insurance Co., supra.)

Appellant's argument presupposes that section 23222 exists in a vacuum. Of course, it does not. When section 23222 is read in conjunction with the regulations and the numerous decisions which have construed that section, many of which have been cited above, it is readily apparent that the statute contains a reasonably clear and readily ascertainable standard. Therefore, appellant's argument that section 23222 is void for vagueness must fail.

Finally, appellant assails section 23222 as imposing a double tax in contravention of article XIII, section 1 of the California Constitution. Specifically, appellant asserts that it was required to pay two franchise taxes in the sake year, for the same purpose, upon property owned by the same corporation, imposed by the same taxing authority.

Although the state Constitution does not expressly forbid double taxation, article XIII, section 1 does provide that all property in the state not expressly exempt shall be taxed in proportion to its value, This language has been construed to prohibit double taxation of property.' (See, e. g. , Flynn v. San Francisco, 18 Cal. 2d 210, 215 [115 P. 2d 3] and the cases cited therein.) Forbidden double taxation occurs only when two taxes of the same character are imposed on the same property for the same purpose, by the same taxing authority within the same jurisdiction during the same taxing period. (Associated Home Builders of the Greater East Bay, Inc. v. City of Walnut Creek, 4 Cal. 3d 633, 642 [94 Cal. Rptr. 630, 484 P. 2d 606].)

It has also been held that excise taxes are free from this limitation. (Ingels v. Riley, 5 Cal. 2d 154, 164 [53 P. 2d 939]; see also Fox Bakersfield Theatre Corp. v. City of Bakersfield, 36 Cal. 2d 136 [222 P. 2d 879].) However, so called double taxation may pose a question of substantive due process if its imposition assumes confiscatory characteristics. (Fox Bakersfield Theatre Corp. v. City of Bakersfield, supra, 36 Cal. 2d at 140.)

The initial flaw in appellant's double taxation argument is its improper characterization of the franchise tax as a tax on property or income. It has long been held that the franchise tax is an excise tax imposed on the privilege of exercising the corporate franchise which is measured by the corporation's net income. The franchise tax is a tax imposed upon a corporation for the right or privilege of being a corporation or doing business in a corporate capacity. (See, e.g. , Rosemary Properties v. McColgan, 29 Cal. 2d 677 [177 P. 2d 757]; West Publishing Co. v. McColgan, 27 Cal. 2d 705 [166 P. 2d 861]; Edward Brown & Sons v. McColgan, 53 Cal. App. 2d 504 [128 P. 2d 186]; Rev. & Tax. Code, §§23151.)

Appellant is correct in its assertion that it was required to pay two franchise taxes during the same year, and that the tax was imposed by the same taxing authority. However, the tax was paid for two separate taxable periods, appellant's second and third taxable years, although the tax for both years was measured by the income for appellant's second income year. Furthermore, the tax was imposed upon two separate privileges, the privilege of doing business or exercising the corporate franchise for appellant's second and third taxable years. Accordingly, we conclude that the scheme of computing the tax of commencing corporations contained in section 23222 does not constitute invalid double taxation.

In accordance with the views expressed herein it is our conclusion that respondent's action 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 Thor Electronics of California, Inc. , for refund of franchise tax in the amount of $18,297.64 for the income and taxable year ended June 30, 1968, be and the same is hereby sustained.

Done at Sacramento, California, this 4th day of February, 1975, by the State Board of Equalization.

John W. Lynch, Chairman

William M. Bennett, Member

Geo. R. Reilly, Member

Paul Carpenter, Member

_____, Member

ATTEST: W. W. Dunlop, Secretary