

BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of    )  
CAPRICES DE FEMME, INC.        )

Appearances:

For Appellant:     Henry Helman  
                            Certified Public Accountant

For Respondent:    Kendall Kinyon  
                            Counsel

OPINION

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 Caprices De Femme, Inc. , against a proposed assessment of additional franchise tax in-the amount of \$232,34 for the income and taxable years ended April 30, 1969.

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The question presented is whether appellant did business for a full twelve month period during its first taxable year.

Appellant was incorporated in California on May 5, 1967. All of its stock is owned by three unrelated individuals who are appellant's officers and directors. On May 1, 1967, prior to appellant's incorporation, the incorporators opened a bank account with a deposit of \$4,400.00. They deposited an additional \$1,600.00 to the account on May 8, and submitted a signature authorization card to the bank on May 10. The only check drawn on this account during the first month of appellant's existence was a \$600.00 check issued on May 16, 1967, to pay the legal fees incident to appellant's incorporation.

Appellant's minute books indicate that the first board of directors meeting took place on June 13, 1967, at which time the board adopted bylaws, elected officers, adopted the corporate seal, and authorized appellant to lease its business premises. Although preincorporation activities were not ratified by the board, the minutes of this meeting were amended, subsequent to the time respondent commenced its audit of appellant's returns, to state that the shareholders had met previously on May 10, 1967, and had passed a resolution authorizing the bank account. Appellant also alleges that, both before and after incorporation, its incorporators were engaged in other activities on its behalf. These activities are said to have included looking for suitable business premises and soliciting prospective clientele.

Appellant's first franchise tax return was filed for the period May 10, 1967, through April 30, 1968, indicating that appellant's first taxable year was a full twelve month period. Respondent determined, however, that appellant did not do business in California for a full twelve months prior to April 30, 1968. Therefore, under the provisions of Revenue and Taxation Code section 23222, respondent concluded that the tax due for appellant's second taxable year ended April 30, 1969, must be measured by the income for that year. -That conclusion gave rise to the deficiency assessment which is the subject of this appeal.

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Section 23222 provides in substance that the tax for a corporate taxpayer's second taxable year will be measured by the net income for the corporation's first taxable year, if the taxpayer was "doing business" for a full twelve month period during its first taxable year. If the corporation did not do business for a full twelve months during its first year, however, then the tax for its second taxable year is measured by the net income for that second year.

The term "doing business" is defined by Revenue and Taxation Code section 23101 to mean "actively engaging in any transaction for the purpose of financial or pecuniary gain or profit. " The regulations relating to commencing corporations 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 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.. (Cal. Admin. Code, tit. 18, reg. 23221-23226, subd. (c). )

Subdivision (b) of the same regulation provides that a period of more than one-half of a month may be considered a full month for purposes of determining whether a corporation commenced doing business that month. (See also FTB LR 148, Dec. 5, 1958. ) Thus, if appellant is to prove that it did business for a full twelve months during its first taxable year, it must establish that it commenced doing business on or before May 16, 1967.

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At the outset we observe that preincorporation activities are irrelevant in determining the time at which appellant commenced doing business since those activities were not ratified at the first meeting of appellant's board of directors. The relevant events, therefore, are those that occurred between May 5 and May 16, 1967, inclusive. It is undisputed that appellant did at least three things during this period: it made a deposit to its bank account on May 8; it filed a bank signature card on May 10; and it issued a check for incorporation legal fees on May 16. We believe that these banking transactions clearly were preliminary to doing business and did not rise to the level of active business operations. (See Appeals of Lakehurst Construction Co., et al., Cal. St. Bd. of Equal., Oct. 5, 1965. ) The same may be said for the search for business premises that allegedly took place during the critical period. (See Appeal of Devmar, Inc., Cal. St. Bd. of Equal., Feb. 6, 1973. ) With respect to the asserted solicitation of clientele by the three incorporators, the circumstances indicate that this activity consisted of nothing more than informing people that the incorporators would be going into business for themselves at some unspecified time in the future. To our minds such activity was still preparatory to doing business and did not amount to "actively engaging in any transaction for the purpose of financial or pecuniary gain or profit. "

For the above reasons, we find that respondent correctly concluded that appellant did not do business for a full twelve months during 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,

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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 Caprices De Femme, Inc., against a proposed assessment of additional franchise tax in the amount of \$232.34 for the income and taxable years ended April 30, 1969, be and the same is hereby sustained.

Done at Sacramento, California, this 8th day of March, 1976, by the State Board of Equalization.

*William C. Burnett*, Chairman  
*Richard L. ...*, Member  
*George J. ...*, Member  
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\_\_\_\_\_, Member

ATTEST: *W. W. ...*, Executive Secretary