BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF,	
MGM HOLDINGS, INC., & SUBSIDIARIES,	OTA NO. 231014548
APPELLANT.	

TRANSCRIPT OF PROCEEDINGS

Cerritos, California

Wednesday, March 11, 2026

Reported by:
ERNALYN M. ALONZO
HEARING REPORTER

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Transcript of Proceedings, taken at 12900 Park Plaza Drive, Suite 300, Cerritos, California, 90703, commencing at 1:10 p.m. and concluding at 3:38 p.m. on Wednesday, March 11, 2026, reported by Ernalyn M. Alonzo, Hearing Reporter, in and for the State of California.

APPEARANCES:

Panel Lead:	ALJ JOSH LAMBERT
Panel Members:	ALJ KENNETH GAST ALJ ASAF KLETTER
For the Appellant:	CHRISTOPHER CAMPBELL DAVID HAN
For the Respondent:	STATE OF CALIFORNIA FRANCHISE TAX BOARD BRIAN BECK DELINDA TAMAGNI

I N D E X

E X H I B I T S

(Appellant's Exhibit 1 was received into evidence at page 6.)

(Department's Exhibits A-K were received into evidence at page 6.)

OPENING STATEMENT

CLOSING STATEMENT

Cerritos, California; Wednesday, March 11, 2026

1:10 p.m.

JUDGE LAMBERT: We are now on the record in the Office of Tax Appeals oral hearing for the Appeal of MGM Holdings, Inc., & Subsidiaries, Case No. 231014548. The date is March 11th, 2026, and the time is 1:10 p.m.

My name is Josh Lambert, and I'm the lead panel member for this hearing. And my co-panelists today are Judge Kenneth Gast and Judge Asaf Kletter.

First, FTB, could you please introduce yourselves for the record by stating your names.

MR. BECK: Hi. I'm Brian Beck, attorney for Franchise Tax Board.

MS. TAMAGNI: Delinda Tamagni, Assistant Chief Counsel with the Multistate Tax Bureau.

JUDGE LAMBERT: Thank you.

And for Appellant, could you please introduce yourselves for the record by stating your names.

MR. CAMPBELL: Chris Campbell, Deloitte Tax for MGM.

MR. HAN: David Han, Deloitte Tax for MGM.

JUDGE LAMBERT: Thank you all for attending.

The issue in this appeal is as follows: When a member of a combined reporting group excludes cancelation

of debt income from gross income pursuant to IRC section 10881; whether the reduction of tax attributes required by IRC section 108(b)(1) as generally incorporated by California pursuant to R&TC section 24307 solely reduces the tax attributes of the member that excluded the cancellation of debt income from gross income or is divided among the members of the combined reporting group in accordance with each member's share of the combined reporting groups California source income.

FTB submitted Exhibits A through K, and Appellant submitted Exhibit 1. There are no objections to the exhibits by either party, and that evidence is now in the record.

(Appellant's Exhibit 1 was received into evidence by the Administrative Law Judge.)

(Department's Exhibits A-K were received into evidence by the Administrative Law Judge.)

JUDGE LAMBERT: First, we'll have Appellant's presentation for 60 minutes.

So, Mr. Campbell, this is your opportunity to explain Appellant's position, and you have one hour for it. You can proceed when ready.

MR. CAMPBELL: Thank you, Judge Lambert.

Could you hear me okay? Louder? Okay.

Good afternoon. Thanks very much. I think

during our presentation David and I will both take parts of this. Okay.

PRESENTATION

MR. CAMPBELL: Good afternoon. We agree with the phrasing of the issue, first of all, that you just read. So, thank you for that.

The answer in our opinion is clear. Under section 108 of the Internal Revenue Code and section 24307 of Revenue & Taxation Code, only MGM Inc's, tax attributes are reduced. As for FTB's determination in this case, which is to reduce a net operating loss carryforwards of all the members in the combined reporting group. There's no statute, no regulation, no other authority, no case law that permits the reduction of attributes, other than MGM Inc. The Franchise Tax Board agrees that the plain language in section 108 applies to MGM Inc, only. This is clear in all their briefs and their visual aids. Their determination letter says that, although section 108 refer to a singular taxpayer, there is, quote, "Strong reason for California purposes to apply the combined reporting method and combine discreet entities where federal law refers to a single taxpayer."

It should go without saying that strong reason is not a valid legal basis for the FTB to make a

determination against the taxpayer. The FTB is charged with applying and enforcing the statutory language enacted by the legislature, not developing and testing new theories on taxpayers in audits and appeals.

In this case, in addition to strong reason, the FTB has cited to its ability to promulgate regulations as the authority for reducing the attributes of corporations other than MGM Inc. We take this as an admission that the FTB is not relying on any law currently in existence to support its determination. At the end of the day, the FTB's arguments here are not unlike the FTB's arguments in the more recent cases of Appeal of Minnesota Beet and Appeal of Microsoft where the OTA ruled against the FTB in part because the FTB's position, quote, "Did not persuasively explain how the relevant statutes or Regulations might be interpreted in the manner it proposed."

That comment applies equally her as we have said in every one of our briefs, every IDR, response, and protest, and audit that there is just no basis. We've asked every time to have a basis and statute or Regulation to support this determination. There is no -- there isn't one. So, again, the issue in this appeal for us is there is no basis for the determination. We followed the plain language of the statute, and the FTB did not, and these

NOA's need to be withdrawn.

At this point, I'll turn it over to David to continue.

MR. HAN: Thanks, Chris.

So, in this case, the facts are not in dispute. This case raises a question of law. In 2010 MGM Inc's debt were discharged in connection with a Title 11 bankruptcy case whereby the creditors received approximately $1.8 billion of stock, which represented approximately 99 percent of the company post-bankruptcy in exchange for approximately $5 billion of debt. As a result, MGM Inc. was relieved of approximately $3.2 billion of debt. And this amount was exclude from gross income, pursuant to section 108(a) of Internal Revenue Code, and MGM Inc. produces tax attributes under section 108(b).

IRC section 108(a) provides gross income does not include any amount which would be includable in gross income by reason of the discharge of indebtedness of the taxpayer if the discharge occurs in a Title 11 case. Section 108(b) provides the amount excluded from gross income shall be applied to reduce tax attributes of the taxpayer in the following order: One, net operating loss carryovers; two, general business credits; three, minimum tax credits; four, minute tax credits, four, capital loss

carryovers; and five, basis and assets. California incorporates section 108(a) and 108(b) and Revenue & Taxation Code section 24307, with modifications not relevant here.

In this case, the only attributes that MGM Inc. had were annual carryovers and basis and assets. As we'll discuss later, the FTB's entire case is premised on treating MGM Inc.'s excluded debt relief as includable COD income. This simply is not the case. There's no dispute that when a taxpayer's debt is canceled or forgiven, the debt relief constitutes income, and this is included in gross income under section 61 of the Internal Revenue Code. However, when debt is discharged in a bankruptcy case, the income is expressly excluded by section 108. Also, the Treasury Regulations goes so far as to say income is not even realized by a taxpayer by virtue of discharge of his debt as a result of an adjudication in bankruptcy. This is in Treasury Regulation 1.61-12 subsection (b), which is also incorporated in California.

MR. CAMPBELL: And we'll pause here for a second because it's -- I want to emphasize -- can't emphasize enough that 108(a) and (b), this is language enacted by Congress and enacted by the legislature. Congress has declared that gross income does not include the amount of a taxpayer's debt that was discharged in bankruptcy. It's

absolute. The language is plain and unambiguous. And the taxpayer here is MGM Inc., it was discharged. It has excludable CODI. Its attributes are reduced. That's what we did.

This is what this case is about. And as we've said before and will continue to say, probably be too repetitive, but we're going to do that anyway. The FTB's position cannot be reconciled with the plain language of the statute. Again, their briefs and IDRs demonstrate that they understand. The government understands that the statute works the way MGM is presenting it, and it continues to advocate for theories that reach a different result. So --

MR. HAN: Thanks, Chris. So turning back to the law. The law applies mechanically. Again, pursuant to section 108(a), MGM Inc. excluded $3.2 billion from gross income. MGM Inc. applied step by step the plain language of section 108(b). MGM Inc. applied the plain language of the relevant statutes, which I will go through now. And this may sound repetitive or redundant as Chris mentioned. We believe it's important to say in the record what the statute say, as they are the only law that applies in this case.

Revenue & Taxation Code section 24274(a) incorporates the federal definition of gross income, which

says section 61 of Internal Revenue Code relating to gross income shall apply, excepts as otherwise provided. Section 61 of the Internal Revenue Code in turn defines gross income as all income from whatever source derived, except when it's excluded under subsection (b) of section 61. Subsection (b) sets forth the code sections that provide exclusions from gross income, which include section 108. Section 108(a)(1)(A) of the code states that gross income does not include any amount which would be includable in gross income by reason of the discharge in whole or in part of indebtedness of the taxpayer if the discharge occurs in a Title 11 case.

Further, Treasury Regulations 1.61-12(b)(1), which California also incorporates, provides that income is not realized by a taxpayer by virtue of the discharge of his indebtedness as a result of an adjudication and bankruptcy. Pursuant to these provisions, $3.2 billion was excluded from gross income. California Revenue & Taxation Code 24307 expressly incorporates IRC section 108 into California law. So applying the law here, the critical starting point is that the amount of MGM Inc.'s debt, the $3.2 billion -- debt relief of $3.2 billion is excluded from income. It is not realized. It is not recognized. It is entirely excluded.

Instead, the excluded $3.2 billion is applied to

reduce MGM Inc.'s tax attributes in the order set forth under section 108(b). Under Section 108(b), annual carryovers are reduced first. The amount of MGM Inc.'s excluded CODI that is applied to reduce its California NOL carryover needs to be adjusted, since in California NOL's are a post-apportioned amount, and would, therefore, be much less than its federal NOL carryover. In 2010, MGM Inc.'s California percentage was zero. As a result, no amount of its excluded CODI is applied to reduce its California NOL carryover. Instead, the entire amount of the excluded CODI, the $3.2 billion, is applied to the basis or to reduce the basis in MGM Inc.'s assets.

At this point, let's all look at the numbers, both under California law and federal law, and compare it to what the FTB is proposing. For California, as shown on the first page of our visual aid, we apply MGM Inc.'s, zero percent California factor to the $3.2 billion amount of excluded CODI.

JUDGE LAMBERT: Excuse me. You said you had a visual aid. What are you referring to?

MR. CAMPBELL: The three pages that we provided last week in response, you know, with -- it was just tables of numbers. We brought additional copies if you don't have them. But you -- we, you know -- you emailed them and post -- after the prehearing conference, we

submitted visual aids.

JUDGE LAMBERT: Okay. I think we have it. I just want to make sure I'm getting it right.

MR. CAMPBELL: We can hand -- I'm mean, there's -- we can hand out some copies. It's just there's three tables on there.

JUDGE LAMBERT: Okay. I see. We just have it digitally. Okay.

MR. CAMPBELL: We didn't want to use a PowerPoint or anything. We just want to refer to it.

JUDGE LAMBERT: Okay. Okay. Thank you.

MR. HAN: Yeah. So, the first would be with the title "Application of IRC Section 108 Incorporated by California."

JUDGE LAMBERT: Okay. We have it. Thanks.

MR. HAN: So, for California, as shown in our visual aid, we applied MGM Inc.'s zero percent California factor to the $3.2 billion amount of excluded CODI. Since 2010 MGM Inc.'s factor was zero and remained zero since 2010, MGM Inc.'s $66 million of NOL carryover is trapped. And so, there is no income to reduce going forward.

Next, the remaining amount, therefore, would be $3.2 billion of excluded CODI to reduce basis in MGM Inc.'s assets. Unlike NOL carryovers in California, basis is not an apportioned amount. Therefore, there's a

significant reduction in MGM Inc.'s basis which results in acceleration of income in the future.

MR. CAMPBELL: Okay. So you have the -- our table in front of you which shows the $3.2 billion at the top and the zero percent factor with the -- and the result being -- as David just said -- that the MGM NOL carryover of $66 million isn't reduced.

I want to point out, at the beginning, that that's slightly different than what was actually done on the return. So, I kind of anticipated. If you look at the -- when we have the briefs and everything, you'll see that MGM reduced some of its return, the $66 million to zero, and then reduced its basis. And then this, we're saying that it says zero percent factor is -- is used against the -- the $66 million.

Having spent the better part of 12 years considering this issue and responding to FTB arguments and going back and forth and looking at the, you know, cases that explain and clarify that UDITPA doesn't even apply to a lot of things that go into taxable income and loss before getting to the apportionment question. It's clear that excluded cancellation of debt income is not even effected by UDITPA. It's not an item of income. It's not includable income. It never gets factored into UDITPA.

Understanding that makes clear that the group's

percentage is not relevant. The excluded CODI belongs to MGM Inc. MGM Inc., is the taxpayer that 108 applies to. The excluded amount is an amount that then is applied to reduce MGM's tax -- MGM Inc.'s tax attributes. So, in this case, the correct factor to use would be MGM Inc.'s factor, not the group's factor since the group's percentage has no relation to MGM Inc.'s excluded CODI.

I'm pointing this out because at the -- at the end of the day in this case it doesn't matter. It actually benefits California because MGM Inc. has a zero factor. It's had a zero factor since 2010. So whether the -- its NOL was reduced, you know, by -- to zero, or it remained at $66 million has no impact. The 66 NOL carryover would be trapped. The correct application of 108, in this case, would be -- you know, you don't reduce NOL -- the California NOL. You just reduce the basis. Basis is not an apportioned amount. So, the same total amount of $3.2 billion of excluded CODI would reduce the basis in MGM's assets by a substantial amount.

And, again, that all is consistent with, at the end of the day, the purpose of all this, which is debtors in bankruptcy get a fresh start. They aren't hit with huge tax liability as a result of the CODI from the discharge. They reduce their attributes and -- and have income going forward. In this case, again, NOL

carryforward in California wouldn't have an impact. MGM doesn't have income here. It has income, in general, from the reduction of basis of its assets causing it to have more income, you know, as a result of that reduction. You know, like, principle payments on a note as received are income now because it reduced the basis in -- in a no receivable. They're not recovered tax free.

So, pointing that out because again, it's slightly different than what is on the return. But, at the end of the day, the only reason we're talking about the percentage, whether it's the group's percentage or MGM Inc.'s percentage, is that NOL carryforwards as a tax attribute are a post-apportioned amount. Everybody agrees with that. There's no dispute on that. In fact, the only authority that we know of in California that ever discussed -- where the FTB ever discussed the application of 108 is a TAM 2015-2, you know, after the year in question here.

But that TAM simply said when you're applying 108 attribute reduction in California, you have to do it on a post-apportioned base, which just means the amount of the taxpayer's excluded CODI here; which is MGM Inc.'s $3.2 billion needs to be adjusted so that you can reduce the MGM Inc.'s NOL in California by an appropriate adjusted amount.

Okay. That's a long way of saying that what we're presenting on the chart is the -- what we believe is, you know, correct application of the statute here, and whether it's -- we're not advocating to change anything we did. We're just saying that whichever percentage you apply, I think zero is right answer because it's -- the combined reporting group doesn't factor in here.

JUDGE LAMBERT: Oh, also, just a reminder for everyone to speak slow enough --

MR. CAMPBELL: Sorry.

JUDGE LAMBERT: -- so Ms. Alonzo can keep up. Thanks.

MR. CAMPBELL: Good? Good enough. I will slow down that was -- okay. Turning it back to you Dave.

MR. HAN: Thanks, Chris.

So going back to our visual aid for federal tax purposes, which would be the following page titled, "MGM Inc.'s Federal Tax Attribute Reduction." The amount of excluded CODI is the same for federal purposes, $3.2 billion. And this amount was used to reduce MGM Inc.'s 2010 carryover to zero, pursuant to section 108(b). Section 108 is the same under California as it is under federal law. Under federal law, MGM reduced only its tax attributes because that's how federal law works. At this point, after reducing MGM Inc.'s annual carryover to zero,

the federal consolidated return regulations would kick in, and applying the remaining excluded CODI of $2 billion to reduce basis in MGM Inc.'s assets.

California expressly does not follow the federal consolidated return regulations, so these rules do not apply in California. And there's no dispute on that point. Our chart shows that for federal purposes, MGM Inc. reduced the basis in a note receivable. The effect of that is, as MGM Inc. receives payment on that note, it has income that otherwise would have been sheltered by basis.

Next, under the federal consolidated return rules, the remaining amount of excluded CODI that is used to reduce basis in subsidiary stock is instead applied to reduce the tax attributes of the subsidiary itself in the same order found under section 108(b). In other words, the amount of the excluded CODI that was applied to reduce the basis in MGM Inc.'s direct subsidiaries was applied to reduce the tax attributes of the subsidiaries themselves. Again, the consolidated return rules do not apply in California.

MR. CAMPBELL: Can I just make a -- reiterate something? So as between our two-pieces of paper, the California application of 108 and the federal. Again, in both cases you are applying 108. You reduce MGM Inc.'s

tax attributes only. And under federal law, when you get to the basis of MGM Inc.'s assets you reduce the basis of the assets. But where one of the assets is stock in a subsidiary, then the basis that otherwise would reduce -- the amount that would otherwise reduce basis in the stock is transferred over to the subsidiary itself and reduce as the attributes there.

That is a function of the consolidated return regulations that we do not have, and it really is -- that's an important point here because we track 108, the statute. And if you just apply the statute, you're just reducing MGM's attributes, including the basis in its assets, which is what we did here. It's purely a function of very detailed rules that were promulgated over a long period of time. A lot of thought went into them to get the federal result. And that's important because it just illustrates that you can't have rules that get to different results, but you need rules.

So I think David will talk about what the FTB did here.

MR. HAN: The FTB's position in this case is that section 108 applies to reduce the attributes of the group, not the MGM Inc. So, if you turn to the last page of our visual aid, titled "FTB's Methodology." So to reduce a tax attributes of the group, FTB first apportions

MGM Inc.'s excluded CODI amount by the group's California apportionment percentage of 34 percent, which is a billion, and treats this as if they were includable in income in 2010. Next, the FTB reduces the California NOLs of all the members of the combined group, which is $980 million to zero. There's no statute authority. In fact, the statute does not permit the reduction of attributes, other than MGM Inc. This is the fatal flaw in the FTB's analysis.

And, by the, way after the $980 million is excluded, there's not much CODI or excluded CODI left. And the FTB doesn't really explain how the remaining CODI income would apply to reduce the other tax attributes, namely, basis and assets. Under their theory, perhaps they were going to reduce the basis and assets of the entire group, but, at the end of the day, it's not clear how they would reduce the basis and assets after reducing the groups NOLs.

So, to wrap up on our visual aid, our understanding of the FTB's argument, which they can show on their visual aid or as depicted in our chart, is that the FTB treats the excluded CODI amount as includable COD income despite the plain language of the statute saying it's not. Here, CODI is excluded and is not factored into UDITPA. Thus, the FTB's method cannot work.

I'll turn it over back to Chris.

MR. CAMPBELL: Yeah. And so just to wrap up our presentation, our opening, I think when the FTB presents its case, and you'll see in the briefs, is they're treating the excluded amount as if it were income. And if you treat it as income, then, you know, as they say, it would be apportionable income. And you would run it through the combined reporting rules and end up apportioning, you know, the entire amount to -- and -- intrastating it back to the members of the group. And if you did that, honestly, you would have -- if you just look at this and say what they're presenting is, if this weren't in bankruptcy and you had income, here's what would happen. Well, I mean, that's fine. We're in bankruptcy.

This isn't income. I think the key point that we're going to keep reiterating is, this isn't income. It's an amount totally outside of the concept of the income that you're using to reduce your attributes, which effects income going forward. Okay. And the way the rules work are they're specific to a particular taxpayer. And the way UDITPA applies -- UDITPA applied in the past with MGM's income and losses, UDITPA is going to apply going forward to MGM Inc.'s income and losses.

But what happens in bankruptcy is the discharge

occurs. Debt relief occurs at MGM Inc. It reduces its attributes. And whatever those attributes are in this reduction in our case, which in California is just going to be $3.2 billion reduction in basis, causing MGM Inc. to have income for the group going forward. That's what happens. And it's not income, and that's the point. So, everything, you know, that we hear going forward I feel like is going to be about how this should be treated as income, but it's not.

So I'll stop there, and we'll turn it to the FTB and then reserve for rebuttal.

JUDGE LAMBERT: Thank you. Thank you, Mr. Campbell and Mr. Han.

So I will turn to the panel to see if there's any questions at this time.

Judge Gast, do you have any questions?

JUDGE GAST: I think my questions probably will relate to both parties. So I will ask those when FTB is done with their presentation. Thank you.

JUDGE LAMBERT: Okay. And, Judge Kletter, do you have any questions?

JUDGE KLETTER: This is Judge Kletter. I feel the same. I'm going to hold my questions until FTB's presentation is done.

JUDGE LAMBERT: Okay. I'll do the same.

So, at this time, we can move to FTB.

So, Mr. Beck, you could proceed with your presentation for one hour. And, also, I think we're supposed to get your visual aid on the monitor.

So can we call in someone now to assist?

Maybe we'll go off the record and let's take a 10-minute break, and then we'll come back and do the presentation. Thanks.

(There is a pause in the proceedings.)

JUDGE LAMBERT: So we are back on the record.

So we can now move onto FTB's presentation. We have the display up, I see.

So, Mr. Beck, you can proceed when you're ready.

MR. BECK: Thank you.

PRESENTATION

MR. BECK: Good afternoon. I'm Brian Beck, attorney for respondent Franchise Tax Board, and with me is Delinda Tamagni, Assistant Chief Counsel of the Multistate Tax Bureau.

California has a detailed system for sourcing corporate income. The linchpin is the unitary business. The unitary business generates business income. The business income is not necessarily attributed to the same legal entity, as under federal tax law. Rather, each

legal entity member of the unitary business is treated as a fractional part of the whole. In this dispute, the dispositive fact is that the cancellation of debt income, CODI, is business income. As business income, it was generated by the unitary business. The entities as treating -- the entity is treated as generating that income for California purposes may not be the same as for federal purposes.

Appellant MGM Holdings, Inc., and subsidiaries assign the CODI to a single member of the combined reporting group, which I'll call group or combined group. It was not treated as generated by the unitary business. This is a separate accounting. Pursuant to the controlling rules set forth under -- in the Regulations promulgated under Revenue & Taxation Code, R&TC section 25106.5, which I'll call the combined reporting Regulations, Appellant should have assigned the CODI to each member of the group according to the member share of California source income.

This assignment is called interest dating. Interest dating is a key part of how California sources unitary business income. The CODI was business income and should have been treated as business income. Appellant did not do so. The ultimate consequence was that by assigning the California source CODI to the wrong entity,

Appellant permanently eliminated $1.1 billion of income for California purposes. That income should have been -- should have been deferred through reduction of California tax attributes of the members who generated the income for California purposes.

There are two issues. Issue 1 is, does Internal Revenue Code, IRC section 108, require a separate accounting; Issue 2, not withstanding IRC section 108, do the combined reporting regulations require that the CODI be interest dated. Among these two issues, Issue 1 -- Issue 2 is paramount. Even if Issue 1 -- even if under Issue 1 the CODI is determined to belong exclusively to single member of the combined reporting group under federal tax law, under California's combined reporting, the same CODI would still have to be interest dated; that is reassigned to the members according to their share of California source income.

Respondent identified two additional issues during briefing, which to save time will not be supplemented here. Respondent does not withdraw those arguments and stands on the merits of the briefing.

The background is as follows: Appellant had a combined reporting group of over 100 members. According to Appellant, in 2005 a member, MGM Inc. -- which we'll call the debtor member -- took out a loan. From 2007 to

2010, Appellant applied about $1.5 billion in interest expense deductions based on payments with respect to this loan which it applied against business income. Due to combined reporting, the interest expense increased the California source net operating losses, CSNOLs, of other members than the debtor member.

In 2010, Appellant had this $5 billion of debt restructured in a bankruptcy. About $3.2 billion was extinguished. This $3.2 billion was CODI. Appellant attributed all the CODI to the debtor member. Now, as we'll see, the CODI was deferred by reduction in tax attributes. Nevertheless, the item of income had to be tracked like every other item of income. Accordingly, Appellant should have interest dated the CODI attributing it to each member according to their share of California source income.

Now, let's take a look at slide 1, which we have on the screen there.

So this is a visual simplified representation of combined reporting correctly treating the CODI, in the taxable year ending in 2010, with rounded numbers. The first boxes on the top row represent the income from the members of the combined reporting group, debtor member MGM Studios and all the other over 100 members combined, all on a separate annual basis income from all sources.

As mentioned, Appellant had about $3.2 billion in excluded debt. The resulting CODI is the hash box within debtor members income.

Below that is the entire combined reporting group with all members combined still from all sources. It is one box because it's all the members combined. The $3.2 billion of CODI is within that. It was part of the debtor members income that was combined. Next, we're apportioning. That is the arrow leading from the group income, all sources, to group income, California source. That year Appellant reported a California apportionment percentage cap of 34 percent. Appellant determined the cap in accordance with the combined reporting regulations, which require application of California's Uniform Division of Income for Tax Purposes Act, UDITPA.

Below the arrow is the California source combined reporting group income, which is a smaller amount than income from all sources because it's only 34 percent of the total. The box representing CODI is also smaller, $1.1 billion in California source CODI, but the box is still within the combined reporting group. The bottom row is interest dating. Appellant calculated interest data apportionment percentage, IAP, for each member under the combined reporting regulations. The IAP is each member's share of the California source income. The percents are

zero percent, 90.5 percent, and 9.5 percent.

The correct interest dating is just IAP times the California source amount. Which for the CODI would be zero for the debtor member, about a billion for studios, and 100 million for the other members combined. Now, from here, it's straightforward how to assign the attribute reduction under IRC section 108. MGM Studios has its own attributes. These attributes are reduced by $1 billion in total in the order described in IRC section 108(b). The debtor member doesn't have any attribute reduction, only the members with IAP have attribute reduction.

Respondent now points out that Appellant does not accurately describe Respondent's position. Appellant appears to describe the position from the audit issue presentation sheet, which is our Exhibit D, and which is not Respondent's position. Respondent's current position, which requires applying California's combined reporting method to the CODI, including interest dating, was stated in the protest. The assessment was calculated accordingly, and Respondent's briefing also expressed this position.

Let's look at slide two. And this information was taken from a spreadsheet used to compute the assessment at the close of the protest. As Appellant's combined reporting group had over 100 members, there could

be a lot of information. So this is simplified, and the numbers are rounded, and Respondent used the same process for each member. The amount of CODI interest dated to each member is the interest dated CODI. And that was zero for the debtor member, about a billion for studios, and $100 million to all the other members combined. And we saw this on the preceding slide.

Respondent reduced the CSNOLs on a member-by-member basis based on the amount of CODI assigned to that member. That could reduce the CSNOL to zero. Any amount left would be the remaining attribute reduction, again, on a member-by-member basis. The remaining CSNOL for 2011 for each member would be the CSNOL available at the end of 1210 [sic], minus the reduction. So you can see that the debtor member still had about $66 million of CSNOLs available. Studios had none, and all the other members in the aggregate had about $139 million.

Appellant claims that Respondent reduced a group CRG NOL amount. First, Respondent does not reduce a group CSNOL because no such thing exists. The tax attributes belong to each individual member, not the group. Second, a key aspect of Respondent's position is that Respondent requires interest dating. Respondent believes that this is the core issue. The CODI is assigned to each member

according to their IAP. That is the share of California source income for that year. Most members, including the debtor member had zero. They will not have any attribute reduction. Studios has the lion share.

In any case, Respondent does not eliminate each member's CSNOL. The debtor member, for example, retains its full CSNOLs based on its zero percent IAP. Additionally, Respondent has not calculated any basis reduction. The calculations are time intensive and would require additional substantiation from Appellant. There is no immediate material tax effect. In any case, the additional tax assessed at issue does not reflect any amount from a reduced basis. In a later year, if there is a material tax effect, Appellant may be required to substantiate the basis of the effected asset, and it may be necessary to properly reflect the basis reduction at that time. But Respondent did not require or perform such a calculation presently because there was no need.

At any rate, Appellant's description of Respondent's presumed basis adjustment is incorrect. Respondent would reduce each member's basis according to the remaining attribute reduction for each member and would reduce the basis of each member's assets, not the debtor member's assets. Now, that's how Appellant should have assigned the CODI.

Let's take a look at slide three. And this is a visual representation of what Appellant did on its return, maintained through audit and protest and its briefing. And so, what is different?

Let's take a look at slide one just for one second so we can get a comparison there. There we go. That was the correct way. Now let's go back to slide three. Okay. And so that's what Appellant did.

So what is different? The big difference is that the debtor member wasn't combined with the rest. You have MGM Studios and the other members combine the CRG total from all sources, then apportioned to California source amounts, then interest dated. The debtor member skips this whole process. The debtor member was not combined with the group and was just treated separately. The CODI never goes to the combined reporting group. The red box does not become a part of the combined income from all sources for all members. It is not apportioned with the rest of the income, and it is not interest dated. The assessed amount is based on this difference.

Now, Appellant apparently has a new argument as of this oral hearing that the debtor member is treated entirely on a separate entity basis with its own zero percent California apportionment percentage. Previously, Appellant applied a 34 percent apportionment percentage

exclusively to the CODI. Furthermore, IRC section 108(b)(2) states that the attribute reduction shall be made in a specific order, and NOL is before basis reduction. Yet, Appellant skips the NOL reduction and goes straight to asset basis reduction. Appellant treats the apportionment percentage as 100 percent. Yet, it subtracts the federal amount from the basis. That is the background of this case, and we are now moving on to Respondent's argument.

The first issue is, does IRC section 108 require a separate accounting? Appellant claims that because IRC section 108 uses taxpayer in the singular, all of the attribute reduction must be to that single taxpayer, and that taxpayer is a debtor member. Appellant claims to use the plain meaning of the statute. This plain meaning is not correct. Briefly, the plain meaning rule is that the literal reading of the text using each word gives you the correct interpretation of the statute, unless there is an ambiguity. We start exclusively from the text, that is intrinsic evidence.

However, if there's an ambiguity, then the ambiguity must be resolved. Sometimes this means including intrinsic evidence, such as the intent of the legislatures memorialized outside of the statute. And what does the text of the federal statute say about

reduction of California only tax attributes? Nothing. The text is silent. That is an ambiguity. We have situation that the text of IRC section 108 does not address. Appellant makes no provision as to how California conforms to federal tax law. IRC section 108 does not stand on its own but is incorporated into an existing system.

Let's take the meaning of the term "taxpayer" for California purposes. The Court of Appeal in the 2001 Citi Corp -- that is C-I-T-I-C-O-R-P -- North America decision stated it was not unreasonable to interpret the term taxpayer as applying to the unitary group, referring to State Board of Equalization SBE Finnigan -- that would be F-I-N-N-I-G-A-N -- decision. In fact, the Court of Appeal pointed out that R&TC section 23030 states that the definitions apply, except where context requires. Moreover, Appellant's argument that the taxpayer must refer to the single debtor member in the group context was explicitly rejected in the Marvel Tax Court case, which was affirmed by the Second Circuit.

There, the taxpayer argued the word taxpayer, quote, "Refers only to the debtor member of a consolidated group," end quote. That is Appellant's argument. Appellant claims taxpayer can only refer to debtor member. The Tax Court rejected this argument. OTA should as well.

The Tax Court stated, quote, "Nowhere does the statute specifically define the taxpayer as either a member entity of a consolidated group or the consolidated group as whole," end quote. This is an ambiguity. The meaning is not clear from the text alone.

Does IRC section 108 specify which member of the California combined reporting group reduces the tax attribute? The answer to this question must be no. There's not a clear and unambiguous direction from within the statute. IRC section 108 was not written with California combined reporting in mind. Congress did not intend to override California combined reporting. Congress simply did not speak to California combined reporting. So the Tax Court rejected the idea that a plain reading required allocating the debt to a single member. To resolve the ambiguity, the Tax Court looked to another source of intent. And, again, OTA should do the same.

One source of intent was the Senate report on the enactment of IRC section 108. That report stated that IRC section 108 would, quote, "Carry out the Congressional intent of deferring, but eventually collecting, within a reasonable period, tax on ordinary income realized from debt discharge," end quote. IRC section 108 is nominally an exclusion for CODI when the extinguishment occurs in a

bankruptcy. The recently bankrupt debtor doesn't pay tax on additional income immediately. That's unfair. They just declared bankruptcy. IRC section 108 is a deferral. Instead of paying the tax on the income immediately, they pay the tax once they're back on their feet. So, tax attributes are reduced, starting with NOLs.

If it was just an exclusion and not a deferral, there would be no change in tax attributes. The Tax court would have the attribute reduction match the income. That defers the CODI. They're going to pay the tax on that income once they are back on their feet. Put simply, there are three steps. The first step, there is CODI. The debt is distinguished, which creates income. The second step is deferral. There is a current elimination of CODI coupled with tax attribute reduction. And the third step, the taxpayer would use the tax attribute, but it has been reduced and is unavailable. Accordingly, the CODI has been deferred.

Key to the deferral is that the tax attribute reduction matches how the CODI would have been recognized. Using combined reporting, if it was just debt forgiveness without bankruptcy, MGM Studios would have had about $1 million in income, and the other members who have had about $100 millions in income. This is the amount of CODI after apportioning and interest dating to each member.

IRC section 108 defers this CODI. Congress intended to differ but eventually collect tax on this income.

So the attribute staring with CSNOL are reduced by $1 billion for studios and $100 million for the other members. Thus, pursuant to Marvel, Appellants claim that only the debtor member can have an attribute reduction is not the plain meaning. You cannot come to this conclusion from the text alone. And Appellant's limitation of attribute reduction to the debtor member is contrary to the intent of IRC section 108 from extrinsic sources. MGM Studios would have had $1 billion in CODI, and the other members who have had $100 million. Appellant would permanently eliminate this amount. Respondent would differ it.

Furthermore, Appellant's claim plain meaning has absurd results and self contradictory in how Appellant handles California conformity. In some sense, Appellant want to have its tax attribute cake and eat it. For Appellant, taxpayer must mean the specific taxpayer identified for federal purposes. So Appellant emphasizes specific over general. Yet, IRC section 108 also refers to the federal net operating loss. That's specific.

IRC section 108 does not identify the attribute as California source net operating loss or CSNOL. To stretch net operating loss into CSNOL would be a

generalization. Appellant wants IRC section 108 to be extremely specific as to the identification of taxpayer with no adjustment for state differences. But inconsistently, net operating loss should be general, accounting for state differences. The same goes for amount. IRC section 108 reduces the attribute by the amount of extinguished debt. Thus, IRC section 108 instructs to reduce the attributes by $3.2 billion, which is the amount extinguished. Yet, in its position through briefing, Appellant used the $1.1 billion amount. The bankruptcy did not only reduce the amount from California sources.

Moreover, to have a consistent plain meaning, Appellant should resist the -- should reduce the tax attributes in order as stated in the statute. In today's hearing, Appellant skips over the net operating loss reduction in IRC section 108(b), which ignores the text of the statute. Thus, Appellant's plain meaning, without making any necessary adjustments for California, has absurd results and is self-contradictory.

Let's take a look at slide four. At the end of the day, the tax imposed here is the California corporate income tax, and it's described in R&TC Section 23501. That statute imposes a tax on, quote, "Net income derived from sources within this state," end quote. Sources

within this state, it is imposed on California source income, not -- it is not imposed on federal income. How do you determine California source income? Apparently, Appellant claims that you must use IRC section 108 as exactly as it is written. But California is not like, for example, Maryland, where you start with a federal amount and make adjustments.

R&TC section 25101 controls the sourcing. That section states that when the income of a taxpayer comes from within and without the state, you have to apportion that income. The Barclays United States Supreme Court case stated, quote, "California scheme required the taxpayer to aggregate the income of all corporate entities composing the unitary business," end quote. This is in contrast to the separate accounting method which, quote, "Treats each corporate entity discreetly for the purposes of determining income tax liability," end quote. Even if the term is -- taxpayer is applied on a separate entity basis in order to apportion, Appellant must combine all the unitary business income and apportion it as a single unit. Appellant must apply the combined reporting regulations.

And the combined reporting regulations provide the details on how to arrive at the California source income for each taxpayer member of a combined reporting

group. Then subdivision (d)(5) states the final resulting value is the taxpayer member's California source income. The amount of attribute reduction under IRC section 108 is this final resulting value. The amount will be calculated for each taxpayer member, which, again, is the $1 billion for studios and $100 million for the other members in the aggregate. Additionally, as mentioned, California does not use the federal net operating loss.

Rather, the attribute is the California source net operating loss, which, again, is computed using the combined reporting Regulation subdivision (e). And subdivision (e) states if the final resulting value of subsection (d)(5) of this Regulation is a loss for a taxpayer member, that taxpayer member has a California source net operating loss. Appellant, which would modify the CSNOLs, which for years included amounts apportioned and interest dated to the specific taxpayer member through the combined reporting regulations with an amount not apportioned and interest dated to the taxpayer member. Subdivision (e) states that taxpayer member. It does not say the combined reporting group has the CSNOL.

To summarize, Issue 1 is whether IRC section 108 requires a separate accounting because it refers to a singular taxpayer. Appellant claims that because IRC section 108 refers just to just taxpayer, the plain

meaning explicitly limits California sourcing to this one taxpayer. But the Tax Court found this ambiguous and look to extrinsic intent. That legislative intent was to defer, not permanently eliminate $100 billion in incomer for studios and about $100 million for the other members. The attribute reduction should match how the CODI would have been generated, but for the exclusion. Moreover, the federal statute does not help identify a California source amount. For the corporation income tax, a taxpayer must calculate the true amount for each member of the unitary business, which entails applying the combined reporting regulations.

And that leads us to Issue 2. Did Appellant properly interest date according to the combined reporting regulations? The CODI is business income. That business income is treated as generated by the unitary business in order to determine the correct California source amount. Under the combined reporting regulations, it must be interest dated; that is assigned to each member of the combined reporting group in proportion to that member's share of the California source income. Appellant failed to do so. You cannot have a separate accounting for business income. This is a fundamental principle of state tax law discussed in Barclays, as well as many other decisions.

To apportion, you must look at the entire unitary business, not just a part. Respondent refers to OTA's precedential 2019 Robert Half Legal decision, which on the first page of the discussion states that there is no dispute the income at issue was business income of the unitary business. Quote, "A unitary enterprise as business income is apportioned among the tax jurisdictions according to a formula," end quote.

Consequently, in Robert Half Legal, the disputed item, payment of that like a sales tax by a retailer, could not be treated as non-business income and separated from the business income. The CODI was business income of the unitary enterprise. As such, even if somehow the CODI were required to belong to the debtor member and not the unitary business under IRC section 108 for state tax computation, it would have to be part of the unitary business enterprise, and, from there, interest dated to each member. So Issue 2 is paramount to Issue 1. The result in Issue 1 does not matter if Issue 2 applies.

John Deere Plow, the California Supreme Court case, is an illustrative example of a separate accounting of a portion of business income that was rejected. In John Deere, the taxpayer claimed that looking at all its operations, the operations in California had the highest costs and lowest return. So they believed that those

operations should not count in the apportionment of out of state operations. This is a separate accounting. The taxpayer tried to divide a portion of the business income and treated differently. The court disagreed with the taxpayer. The unitary income is derived from the functioning of the business as a whole. No portion is separate and distinct.

In the present case, the debtor member was, according to Appellant, the primary obligor and so, had to be treated differently. This is not a justification for separate accounting. Appellant is attempting to treat the debtor member as separate and distinct. The CODI is an item of business income and is integrated with the unitary business and can't be segregated. One way of looking at it is for California apportionment purposes, the debt is a unitary business. In the present case, it is particularly inconsistent for Appellant to treat the CODI as different from business income. The loan documents for the debt at issue provided that the proceeds of the loan will spent on the business.

And let's take a look at slide five. Moreover, for the entire period, the debt was outstanding. Appellant treated the interest expense from the debt as a business expense, and it generated CSNOLs. And for years the interest expense deduction was apportioned and

interest dated like any other business income item. It substantially increased the CSNOLs of members other than the debtor member. We can see here it resulted in approximately $394 million in CSNOLs for studios. But now that when the debt is extinguished, Appellant stopped apportioning and interest dating the income resulting from the debt.

In effect, under Appellant's approach, Appellant denies that the CODI was the business income. And so unlike, for example, Robert Half Legal, it does not need to be treated as unitary business income. In part, Appellant reaches this conclusion on the basis that, according to Appellant, there was no income. Yet in Gitlitz, G-i-t-l-i-t-z, the United States Supreme Court addressed Appellant's argument, which was raised by the IRS. Quote, "Quite simply, if discharge of indebtedness of an insolvent entity were not income, it would necessarily not be included in gross income," end quote. There would be no need for IRC section 108 if it were not income.

An excluded item of CODI is still an item of income. It does not simply disappear. If there were no CODI, how would IRC section 108 apply in the first place? You cannot exclude CODI if it does not exist. Appellant refers to a Treasury Regulation, which I believe it is

1.61-12(b)(1), which says that CODI from a bankruptcy discharge is not realized. First, that's not the issue. It doesn't matter if it's realized or not. Second, Gitlitz explicitly cited and dismissed this regulation as to whether the CODI was an item of income. Furthermore, IRC section 108 does not exclude CODI so much as defer it. If it were absolutely excluded, there would be no change in tax attributes. In fact, this case is specifically about those tax attributes.

In effect, Appellant has said that CODI needs to be separated from the business income. The combined reporting regulations require the business income to be apportioned and interest dated. And I refer you to Regulation section 25106.5(c)(7)(A)(2), which describes the rules for interest dating. So in sum on Issue 1, Appellant claims that the plain meaning of the federal statute requires a specific outcome for California sourcing. This plain meaning interpretation is incorrect.

Marvel rejected Appellant's interpretation of the term taxpayer in IRC section 108 in the group context. Marvel found it ambiguous and looked to extrinsic intent. And OTA should find that evidence, as well as Marvel's reasoning persuasive. The senate wanted to defer CODI, not eliminate it permanently. Appellant's approach would permanently eliminate $1.1 billion of California source

CODI, and Respondent's approach would defer it.

Further, Appellant's claim as to the plain meaning has absurd results in the California context. Appellant requires an extremely specific reading of IRC section 108. Taxpayer must be the exact same person under federal tax law. Yet, IRC section 108 does not discuss California sourcing, and Appellant's reading requires a general, instead of specific reading of net operating loss and amount.

On Issue 2, because the CODI is business income, it must be apportioned and interest dated using the combined reporting regulations, which Appellant has not done. Appellant, in effect, attempts to treat the CODI similarly to nonbusiness income by separating it from the business income. Furthermore, Respondent believes Issue 2 controls, even if Appellant prevails on Issue 1.

And that's the end of our presentation, and I would be glad to handle any questions.

JUDGE LAMBERT: Okay. Thank you, Mr. Beck.

Yes, we will -- I'll have the panel ask questions, and we'll take a break after that for rebuttals.

Judge Gast, did you have any questions?

JUDGE GAST: Yes, I have a few questions. I'll start with the taxpayer.

Could you address why in your first page you don't reduce NOLs when 108(b) explicitly says you're supposed to?

MR. CAMPBELL: Yes. Thank you for the question. Happy to address that.

In applying 108, the first attribute you reduce is NOL carryforwards. The one thing that's very clear in attribute reduction is that you have to use a post-apportioned amount of the excluded CODI to reduce the attribute in California because the NOL carryforward itself is post-apportioned amount. So if your federal cancellation of debt that's excluded is $3.2 billion, your federal NOL might be substantial. You could reduce it, but your state NOL in California and other states is going to be some percentage of that.

JUDGE LAMBERT: Mr. Campbell, also --

MR. CAMPBELL: Can you hear?

JUDGE LAMBERT: Just make sure you talk slower, please.

MR. CAMPBELL: Okay. So the federal amount is very large. And so the NOL carryover attribute in California is a percentage amount. So you have to use a -- apply a percentage to the full amount of the excluded CODI to reduce NOLs. For the other tax attributes like basis, you don't.

And I'll get to your question in a second.

Tax credits also are slightly different because California has, you know, a different tax credit. It's not dollar-for-dollar, and the statute provides for -- the California statute makes a modification for that. So, again, there's no dispute that you apply a percentage -- the apportionment percentage to the excluded amount in order to reduce the California NOL, and that's in TAM, you know, 2015-2 is -- it says, that, and we all agree that to.

In our view, as we said, in applying the statute in California, all of this -- everything about 108 excluded CODI is not income, and that's going to be one of the fundamental issues that I can hear here. It is not income. It's fundamentally not income. It's an excluded amount. Why is that? Because the whole point of this is not cripple the debtor, as we all agree. And so you don't tax them on this exclusion after the bankruptcy. Instead, you introduce attributes. And, in this case, when you get to California, MGM has an NOL carryover of $66 million, and its apportionment percentage in the year of the discharge is zero. And it's remained zero since then, by the way, but it's zero.

So if you were to apply the $3.2 billion and use the post-apportioned amount of that in California, its

zero. And, by the way, that makes sense in the effect that you don't reduce the $66 million. It stays there. And that leaves the entire amount to reduce basis. And why does this make sense in this case or in any case? It's because that 6 -- we don't have income going forward. So that's $66 million that's sitting is trapped. It will never -- it would have never been used by MGM Inc., right.

So whether -- and, by the way, whether it was reduced or not, at the end of the day, it doesn't have too much of an impact. But in our -- what we did on the return, is we did reduce the $66. But as I said in our presentation, after doing this for 12 years and looking at the statute and considering the fact that this is all outside of UDITPA to begin with and clearly, it the debtors -- debtor members' excluded amount. So, you would use the debtor members' apportionment percentage to reduce the debtor members' NOL.

In this case, that leads to a zero reduction in NOL, and everything goes to basis. And guess what? MGM Inc. has income that it wouldn't have otherwise had as result of the reduction in basis. So there's no -- just to counter a couple of things. We're not getting around anything. We're not skipping over NOLs. We're not, you know, permanently excluding anything. There's an absolute consequence because we follow the rules, and it's just our

attribute reduction basis.

Okay. But -- so, to answer your question, the way we're -- the way the statute correctly applies in California would be to use the members' apportionment percentage in computing the first -- just for NOLs -- in computing the first apportionment amount.

Does that answer your question?

JUDGE GAST: Yeah. I guess why even use an apportion percentage for NOLs then, in this situation and, you know, pre-apportion that amount, I guess. Because what's the authority? Because you keep saying what's the authority for FTB's position? What's the authority to even apply an apportionment in this situation --

MR. CAMPBELL: Well, it's two different --

JUDGE GAST: -- other than the TAM, I guess.

MR. CAMPBELL: Well, it's two different issues. One is -- sorry -- two issues -- treating this as includable COD. And if it were, then it would be income or business income and apportioned, et cetera. That's all red herring. Because if it were income, we'd be applying the combined reporting rules. It's not income. And, you know, it's excluded. It's not realized. It has -- it's just not income. So you can't even -- there's nothing for UDITPA to apply to because there's not -- no income to apportion.

So why? Because let's put it this way. Let's say for federal purposes your entity, your corporation has $100 million NOL carryover. Okay. And let's say it does business in 10, 220, 40 states, whatever, right. Its carryover in those states is not going to be the federal $100 million. It's going to be whatever the apportioned amount was over the last several years. So maybe it's got $10 million in one state, and $10 in another, and $20 in another, whatever. If you were to take the $100 million excluded CODI and reduce to -- and use that to reduce the California $10 million annual carryforward to zero, I mean, that's too much. Like, that's comparing apples to oranges.

So that's why, you know, the TAM and -- and nobody has ever thought otherwise that you have to treat -- you have to use an apportion percentage of the excluded amount to reduce the NOL carryforward. It's -- otherwise, there's just a huge disconnect and mismatch between MGM Inc.'s attribute in California and, you know, the reduction amount. When you get to the other attributes, you know, you do have to use a pre-apportioned amount. So if you look at our tables, you'll see that -- like when we're looking at the FTB's method just to carry it through, we took the remaining amount after an NOL reduction and grossed it back up to what that would be,

and then use that to reduce basis, right.

Does that answer your question?

JUDGE GAST: Yeah. It does. I was just curious because, you know, you're taking an attribute and then applying combined reporting concepts to potentially reduce an NOL. Because if MGM Inc. had an apportionment percentage, you would have reduced its NOL; correct?

MR. CAMPBELL: Exactly. That's -- yeah. So we're -- I would say -- I mean, that's -- I'd say it slightly differently. If MGM Inc. had a percentage of 1, 2, 10, 20, whatever, we would use that percentage, multiply it by the $3.2 billion, and reduce it -- reduce that $66 million. And whether it was reduced to zero or not, would be whatever. Let's say it was reduced to zero. Fine. And then the balance be the pre-apportioned amount, and then you can reduce basis.

It just so happens that MGM's percentage is zero. And that is important here because -- just think about it and what everybody is -- the other side is saying is, we're somehow escaping something. No. That $66 million when it stays there -- which, I guess, is what the FTB's chart shows on the other page. Their position is it just remains. It remains, and it's trapped, and it's never used. And that's fine. That's our view of the correct application too. It's just we -- yeah.

JUDGE GAST: Okay. And if other members of the group, such as in this case, have an apportionment percentage, you don't apply that at all to the CODI so that they reduce their own NOLs. Only if MGM Inc. had its own apportionment percentage would then you reduce NOLs of just that member -- with respect to that member's interstate apportionment percentage. Because then you're kind of excluding the other member's interest dated apportionment percentage from computing an NOL reduction for themselves. Is that right? Is that your position?

MR. CAMPBELL: No. I think we have to take a step back. There's only one corporation here that has excluded CODI. So any discussion of interest dating, et cetera, is already assuming you treat that as income, for some reason, and then get to apportionment. That is the fundamental flaw here and why this is all -- as I'll say in rebuttal -- kind of a smoke show and a distraction, because the issue here is -- is very simple.

We have a corporation that has excluded CODI. It's not income. And, you know, similar to other situations that the OTA has recognized, you know, UDITPA applies to apportion group's income. We don't have income here. So all this is, is a very mechanical intersection of, hey, in bankruptcies you have a discharge. It's excluded under 108. We adopt 108. You've got to reduce

the attributes.

And just to jump ahead for a second, all -- as I said in our opening, everything that we're hearing and even just the fact that these questions are -- exist, demonstrate that to get to this result, you would need rules. It's very simple. I can say everything I just heard is referring to and citing to combined reporting regulations. I -- my simple question is do the combined reporting regulation ever anywhere speak to the assignment of -- or the use of reduced -- a taxpayer's -- debtor member's reduced tax attributes under 108? No, they don't.

Now maybe -- maybe citing the rule making authority, if they have the authority to make this type of rule, they could start that process; and we can all have an open discussion about what that looks like and end up with something like the consolidated return regulations, but we don't have that. So it's a complete distraction to get into a discussion of intrastating this amount. The point is MGM Inc. has an excluded amount. It reduced its attributes. And a reduction of its attributes, both federal and in California, has an absolute impact going forward on MGM Inc.'s and the group's income.

Because as income is recognized, its included in the group and dealt with by UDITPA. But we have a simple

fact that right now we're pulling 108, which is an exclusion. There's no income. And all we're going to do is, as of the date of the discharge, reduce MGM's attributes. It's not that difficult. And, you know, I'm going to leave it at that because everything else is just theory and academic discussion, but it's not the law that's being applied -- that needs to be applied.

JUDGE GAST: Okay. Thank you. I just have one more follow up on that point. So if MGM Inc. had, let's say, 1 percent here, and you multiply it by the $3.1 billion, it would have a reduction in NOL. But how do you derive that 1 percent? Aren't you applying a combined number in the numerator of that apportionment percentage in mixing combined reporting mechanics to get to that reduction?

MR. CAMPBELL: Well, if what you're -- I mean, that -- that 1 percent is that entity's sales over total sales, right. So --

Right?

MR. HAN: Yup.

MR. CAMPBELL: Yeah. So --

JUDGE GAST: The combined group sales?

MR. CAMPBELL: Yes. Exactly.

JUDGE GAST: Okay.

MR. CAMPBELL: I mean, there's no other -- if you

were to not do that -- and again, this kind of goes back the TAM. If you were to not do that, you would be reducing the $66 to zero, which would be unfair. In fact, violate everything that the FTB is trying to say, which is, like, hey, that's not the right percentage that you gen -- you generated those NOLs. It's not 100 percent. It's some apportion amount. So what apportionment percentage do you use? You'd use that entity's apportionment percentage.

Sorry, if I'm talking fast.

The group's -- it's the -- it's the concept that the group's percentage; that's not relevant. The debtor member's percentage is relevant, but the group's percentage isn't relevant to that number. That's what we're saying that the right analysis is. But you're right. I mean, you do have to a use a percentage. But if you don't -- I mean, again, just go back to the TAM. That seems to be a fundamental -- makes sense because you're matching. It's apples to apples as oppose to a disconnect, which would be a federal number and a state number, which don't match. Everything else though, is pre-apportioned.

JUDGE GAST: Okay. Thank you. I have a few more questions. Could you address FTB's -- and I apologize if you're doing it on rebuttal. But FTB's argument about

Marvel, Citi Corp, I think they threw in Finnigan, R&TC section 3036, it's all contextual what taxpayer means in IRC 108. Also California has the conformity statute that says where there's obvious differences, you go with California law. Can you address that point?

MR. CAMPBELL: If it's okay, we can -- that's in our rebuttal. And I think just to organize our thoughts after all that, we'd want to do it and -- and just keep our rebuttal, if that's okay.

JUDGE GAST: Okay. I'll turn it over then to some questions for FTB. And sorry if I'm long-winded here. This is pretty complicated.

So FTB's method, wouldn't that result in the debtor -- the actual debtor here, MGM Inc., never reducing its own California attributes if it has a zero percent intra-state apportionment. So even though its going through bankruptcy, it has a $3 billion CODI. It gets no attribute reduction. Is that correct? And then if so, how does that-- how -- how do you square that -- how do you square that with the Bankruptcy Code 346(j)(2) about similar reduction at the federal level that has to happen at the state level?

MR. BECK: So again, ultimately, the tax is on California source income, and you have to determine the California source amount. And the California source

amount requires looking at it from the unitary -- the business income is generated by the unitary business and the -- so I'm sorry. Could you repeat your question? I lost my train of thought. I apologize.

JUDGE GAST: Yeah. No problem. I'll ask for one step here. Does it make sense that the actual debtor would never have attribute reduction if it has a zero percent apportionment -- intrastate percentage under your method, when it's the one that went through title of a bankruptcy?

MR. BECK: So the unitary -- for this purpose, California looks at that debtor as part of a unitary business where each member contributes to the whole. And then when you come back and look at which part is California source, you can sort of rearrange that from what was the strict federal amount. And so, in some sense, its not MGM Inc. that alone -- or it's not -- the debt was not necessarily MGM Inc.'s, it was the unitary businesses. That's how California approaches it.

And, additionally, just in terms of kind of looking at it from the big picture, every member -- or we can go -- I don't have the details on me, but most of the members also guaranteed the debt. And during its lifetime of the debt, the interest expense was used to reduce income of other members through the combined reporting.

So -- and also, the amount reduced for California source doesn't affect -- I mean, may be some portion of that that was not California source would go to the MGM Inc. but -- yeah.

JUDGE GAST: Okay. Thank you. So your fundamental theory on your position is that if CODI had been included in gross income, it would have been interest dated, and that's what you should use to apply attribute reduction under 108?

MR. BECK: Exactly. Yes.

JUDGE GAST: Okay. Is there any guidance, other than the TAM, that talks about what you do with amounts excluded from gross income in any context for purposes of combined reporting?

MR. BECK: It -- the combined report requires listing of items of income. And the -- when the regulations were first promulgated, they referred to -- they said that they were based on FTB's practice and they -- I believe it's publication 1061, which is a guide for combined reporting. And if you look at the sample combined report which -- and this is in close -- in our briefing. The combined report correct dividends under R&TC 25106, right; which is those dividends are removed -- are excluded from income under -- based on the earnings of the combined group.

And the examples, combined report, tracked those amounts. So its -- it's necessary to track even excluded amounts. And it's not -- it's like -- an excluded amount does not simply disappear. You know, it's necessary to track it. Especially, given that in this particular case, the exclusion results in attribute reduction.

JUDGE GAST: Okay. Thank you. And I think I heard you say -- just to be clear -- that the refund claim here, which I guess is based on the NOAs that were paid, they don't involve any asset basis reduction issue? It's just an NOL reduction that happened in that? Okay.

MR. BECK: My understanding is that at audit they did not compute any -- any basis reduction, and no basis reduction was computed thereafter. And the reason was, is that it didn't appear to be material.

JUDGE GAST: Okay. And thanks for bearing with me. One more question. Is there guidance in any other state in the combined reporting context that deals with what you do with CODI in attribute reduction? Was that looked at all in making this position?

MR. BECK: I don't believe there's any guidance in -- in any other state.

JUDGE GAST: Okay. No further questions. Thank you.

JUDGE LAMBERT: Thanks.

Judge Kletter, did you have any questions?

JUDGE KLETTER: Yeah. I have a couple of questions for taxpayer. I just want to make sure that I'm understanding the position that was set forth here today. So I'm going to ask a series of just quick yes, no questions to make sure that I am understanding what was said. So, is there any dispute that MGM was a unitary member of the group during the year that the CODI was forgiven?

MR. CAMPBELL: Right. MGM Inc. and the other members in the combined group are a unitary business.

JUDGE KLETTER: Okay. Great. And the income that was forgiven arose in the, you know, the -- sorry. The income that was forgiven came from activities that were conducted in the ordinary course of the unitary group's activities?

MR. CAMPBELL: No. No. There's no income that's forgiven. There is debt that is borrowed by MGM Inc. They borrowed money. The money is, as FTB says we all understand, was used in the business but the debt is MGM Inc.'s debt. And the debt in the bankruptcy case is forgiven. In the bankruptcy case, the way that works is the lenders foreclose. And so you filed for bankruptcy because you can't pay your bills. And the lenders come in, and they took over the company. They got 99 percent

of the stock of the company, and that extinguished $3.2 billion of MGM Inc.'s debt. And the law is very clear that's not income. In the year of the discharge, that's just excluded. It would otherwise be income, but it's not. So it's excluded, and what --

JUDGE KLETTER: Right. I'm sorry.

MR. CAMPBELL: -- you have to do is reduce the attributes of that entity.

JUDGE KLETTER: I apologize for using the work income, but I'm saying the debt was incurred in the conduct to --

MR. CAMPBELL: Oh, yeah. The debt -- the debt is -- was incurred in the past, and the proceeds were used however they were used and, you know -- but that's all, you know, in the past, but yes.

JUDGE KLETTER: Okay. So, you agree that the debt was incurred in the conduct of the unitary group's activities?

MR. CAMPBELL: I agree with that. It's --

JUDGE KLETTER: Okay.

MR. CAMPBELL: It's just not --

JUDGE KLETTER: I understand.

MR. CAMPBELL: -- relevant to the point here.

JUDGE KLETTER: Now, you refer to the members apportionment percentage. And in referring to that, you

say that that member's apportionment percentage is taken as the numerator being the entity sales and the combined reporting group being denominator. I'm talking about when determining the net operating loss that is considered under (b)(1) of -- sorry -- (b)(2)(A) of 108. Do I have that correct that that's member apportionment percentage is entity sales over the group sales?

MR. CAMPBELL: Yeah. I think that's what the individual member's apportionment percentage is when you use the combined reporting rules. Yeah. That's correct.

JUDGE KLETTER: Sorry. I thought you said you don't use the combined reporting rules for the zero percent that was applied to the NOL?

MR. CAMPBELL: You don't, but it -- to the point being that, if you repeat your question -- if you're asking how -- why we use zero percent, its because MGM Inc. has no sales factor -- no factor whatsoever in California. So it's when you take the federal full amount that's excluded from income, you multiply that by MGM Inc.'s sales factor or factor in California --

JUDGE KLETTER: Zero times the number --

MR. CAMPBELL: -- factor formula, but it would be zero. Yeah, it would be zero, right. So -- yeah.

JUDGE KLETTER: But if it were not zero, if it were 1 percent?

MR. CAMPBELL: Right. So if it were 1, yes. If it were 1 percent, you would apply an amount of the 1 amount of that amount to reduce MGM's California NOL. Again --

JUDGE KLETTER: And that 1 percent -- I'm so sorry. The 1 percent is derived by reference to the group?

MR. CAMPBELL: The 1 percent is MGM's sales factor, which is --

MR. HAN: It would be MGM Inc.'s California sales or recoup sales everywhere.

MR. CAMPBELL: Well, four factor at the time, but yeah. Right. So you -- look, the point -- there is no dispute in this case that you need to -- again, the TAM would say this but -- conceptionally. But you need to take an apportionment amount of the excluded CODI in order to apply that to reduce your attributes. The only debtor -- the only taxpayer here -- excuse me -- that has attribute production that has excluded -- an excluded amount to begin with and has attribute reduction is MGM Inc.

So the question is simply -- you know, you could use, as was done -- and I think it showed on some of the FTB's presentation or noted -- the combined group percentage. But our view, again as we said, like, after

12 years of thinking this through and then understanding that excluded amounts don't come into play, aren't even taken into account in UDITPA, which the OTA has said a couple of times now, that the right answer is like, look, you take -- for this purpose, you take MGM Inc.'s percentage, because the group's percentage isn't a relevant number for purposes of this excluded amount.

If you want to -- if -- if it ends up that we don't change that, that's fine. But we're not doing -- that doesn't lead to the conclusion that somehow you can use and take a leap, which is what the FTB is saying, to go from the fact that you need to use an apportioned amount. Look, I think everybody out there would be perfectly happy if you didn't use an apportioned amount, because then you could reduce all of your California NOL, which might have been a 10 percent, by 100 percent of the federal would go to zero. That wouldn't be right, but if that's what they're suggesting, then fine.

But the point is, we all agree. So you have to apply a percentage. They're using that to then say, "Oh, let's pretend this is income." And if it were income, it would be applied this way and be apportioned. But it's not income, and that's the whole point. You're actually defeating the entire purpose of the bankruptcy law to begin.

And then -- and beside the point is the attribute reduction, I think -- what was the words? -- seeing we have to track it, it's an item of income or something. It is being tracked. It's in the basis reduction that applied to MGM Inc. And we do have basis reduction. The auditor reversed that and, in fact, included income -- that MGM Inc.'s separate income in 2011 and 2015 because we had income from the fact that we had reduced basis.

So they reverse that in audit and said you don't have that income because you actually have more basis, right. So the notion here that we're somehow doing something that's not -- that there's something untoward here or you need to -- the bottom line is they're jumping to NOLs for the whole group, and there's no way to get there from 108. And the fact that you have a post-apportioned amount to reduce NOLs, which you have to, is in the link that says oh, you just treat this as income and now, all of a sudden, apply it.

I mean, there's just no statute. I mean, I just come back to saying, is there anything in the combined regs that we keep talking about that talk about reducing attributes? No. It's all about income, you know. And then you'd have to have sales and property and payroll. None of that relates to an excluded amount, you know, from the discharge of debt.

I don't know if I answered your question, Judge Kletter, but it's --

JUDGE KLETTER: Yeah. I would -- I'm just -- as a -- like, I'm just asking this literally. I'm not implying anything about I will rule. I haven't made any conclusions or any connotations. So my question is just trying to understand this fraction, which to me seems more like an inclusion or exclusion factor. Because I'm just trying to saying in a situation where there is one entity, the one entity has CODI income. They have $100,000 of sales --

MR. CAMPBELL: Yeah.

JUDGE KLETTER: -- okay, in California. How do you compute this factor? I understand that we used a post-apportioned CODI. I'm just saying --

MR. CAMPBELL: Right.

JUDGE KLETTER: -- how do we calculate this factor if there actually were California sales?

MR. CAMPBELL: Okay. So that's -- right. So in the -- if it were a single entity -- this probably illustrates the point, so this is good. If you had a single corporation, you'd have the federal amount, and you would have to multiply that by that single taxpayer's factor in order to get a post-apportion amount, so you could figure -- you know, match apples to apples, so to

speak, and reduce the California NOL carryforward.

So the question is, now what do you do in a group setting on that one point? And that is a question -- totally separate question from everything else that where I think that leads. So on that one question, our view, as shown on our little table, is that the right answer is that because it's the debtor's -- it's just the single -- it's a single entity, Judge Kletter. So that entity's excluded amount, and so you got to use that entity's factor.

If you -- the -- if, ultimately, it's decided that it's the group factor, so be it. But the point is, we think the right answer is it's that entity's factor, and that entity's factor is its sale. You could, to your point, maybe you're right. Maybe it's --it's sales of zero -- or property and payroll sales of zero over -- only as property and payroll sales. Maybe that's a possible answer. Maybe its the group. We used the group. But now I hear what you're saying.

At the end of the day, for us, for MGM Inc., it's zero no matter what. So whatever you do, if we're going with it's factor, which is the right way to go, you'd have zero NOL reduction. And what does that do? It means that all of the deferral and tracked, you know, excluded income is in the basis reduction, right. That's -- that's all.

JUDGE KLETTER: Yeah. I appreciate that. I think to summarize what you've said, that helps me understand why you say that MGM has no factor, and that has no relation to the group factor. So I appreciate that explanation. I have no further questions.

JUDGE LAMBERT: Okay. Thank you.

We could take a break now for 10 minutes, and we'll go off the record for that.

(There is a pause in the proceedings.)

JUDGE LAMBERT: So we are back on the record.

And, Mr. Campbell, you can now make your rebuttal.

MR. CAMPBELL: Okay. Thank you, Judge Lambert.

CLOSING STATEMENT

MR. CAMPBELL: First point, regarding the FTB's visual aid, there's a slide in there that we hadn't seen before. I don't think it was included in your submission after the prehearing conference. So that's why we were trying to figure it out while we were -- it was being present. But it's the one that talks about the Respondent's analysis of attribute reduction, and how it differed from audit. And honestly, haven't been able to, you know, follow everything that had been done. Anyway, but I want to say for the record that's new. I don't have

any comment on it at this point because it just follows the -- it seems it just applies their same theory.

MS. TAMAGNI: If I may?

MR. CAMPBELL: Yeah.

MS. TAMAGNI: We provided it on Monday. And I apologize if maybe you didn't receive it. But we did --

MR. CAMPBELL: With the other slides or separately?

MS. TAMAGNI: Separately.

MR. CAMPBELL: Oh, okay.

MS. TAMAGNI: I'm sorry about that.

MR. CAMPBELL: Well, maybe I missed it. Okay. Neither here nor there really.

Okay. So the first point, there's a lot of points. The first point, which I think really should dispose of 50 percent of what we're hearing and what the FTB is writing and what they're presenting here, and what they responded -- or referred to as the dispositive fact that this is business income of the group. The entire argument of the FTB, from what you can see on their visual aid and everything they say, starts from the false premise that there is CODI income. Like you said, well, you can't exclude something if it didn't exist in the first place.

True. We had debt relief. If it were -- if we weren't in bankruptcy, then you'd have income in the year

like you would any other year, and you'd apportion it, and you'd go on your merry way. This is bankruptcy. We don't have income. That is a -- just the most important thing to start with. It shouldn't even be a question. But we don't have income. So there is nothing to apportion. That's the whole point here.

Instead, what all this about is reducing tax attributes so that going forward the rules will apply to the group's income going forward. And the tax attributes will be reduced, and that will definitely impact, you know, the unitary business income going forward.

In this case, MGM's attributes are reduced, just like they are under federal law, just like they are under California law. We're applying section 108. And then based on the facts that exist for this entity, the attribute reduction ends being in the basis of its assets, which includes, for example, a note receivable, that as a result now we're paying tax on -- for including an income when we have received principle payments and paying tax on it, which we did. It's in the record. So that's how this works in this case.

All the FTB is doing is saying, hey, under this theory, we think it would be -- it's appropriate, for a million different reasons that they put out there, to try to attach this to a group's NOL and reduce that. It's

just not a thing. You can't do that. There's no way to get there. So, again, the big picture, the first point is there is no income here to even get into the combined reporting regs, right.

Okay. Number two, I keep hearing, throughout the presentation, that MGM taxpayer didn't claiming -- like, we didn't assign as if we did things incorrectly. We didn't assign things using the interest dated apportionment percentages following the rules; that were making arguments that were made in Marvel that aren't correct. Whatever. I asked the FTB a simple question. Please point to a single word in the combined reporting regulations that you refer to constantly that say that attributes -- that even discuss attribute reduction. Attribute reduction is not income. There is literally nothing in the rules that addresses attribute reduction.

That is -- ends the question here. That's why this is so -- sorry if I'm -- you know, there are no rules here. We applied the rule that exist, and whatever all the -- everything that the FTB is saying is based on rules that don't exist. That's very clear.

It brings me to the next point, which is -- and, Judge Gast, you hit the nail on the head. One of the questions you asked was, are there other states that, you know, that have rules that address this? Yes. Some

states expressly adopt the consolidated return rules. Illinois has its own rule that does something totally different. It takes the federal excluded amount from the federal Form 982. And it just then takes that and it multiplies that by the Illinois apportionment percentage and reduces that. That's a specific rule that everybody knows exists and applies in Illinois.

The consolidated return rules themselves, federal law, and any state that adopts them, again, very detailed set of rules that take you from 108 and the debtor member, so to speak, right, MGM Inc., and would say, okay, once you -- if -- if you reduce your NOL and then you reduce what other -- you know, basis is last, and you get to basis. And it says if you're reducing the basis and the stock of your subsidiaries, you're going to transfer that amount and reduce the basis -- excuse me -- reduce the tax attributes of the subsidiaries themselves. That's a very specific rule that gets to the point that you could reduce attributes within an entity in the group.

We don't have those rules. We expressly don't have those rules. Everything that I'm -- if you read the briefs again and listen to this, it's all theoretical discussion about, well, based on some theories that maybe the debt was used to generate, you know, group losses as a whole, that we should somehow now apply the combined rule

some way. That's fine. That's a great theory, but it's a theory. And again, as I said before, the FTB is charged with applying the law that's written, not, like, creating a theory here and trying to, you know, get a new rule on appeal. There is no way to get there from here.

I -- MGM in 2010 or any point thereafter, could not have filed a return. Just think of it this way. We could not have filed a return and gotten this result. We don't have income, so there's nothing to apportion. Ergo, how could we even do what they're saying, right? I mean, it's that straightforward.

Point 4, we are told that we are skipping over the first attribute reduction of NOLs, and we're not, obviously. So there's no skipping over NOLs. We've been talking about the NOL reduction the entire time. The first attribute is NOLs. And as you pointed out, for federal purposes, we reduce our federal NOL. For California, the debtor member here has a zero factor, so we would not reduce its NOL carryforward. We would move on and reduce basis. We're not skipping over everything -- anything.

And, again, to reiterate, deferral, so to speak, that 108 is implementing; so we have income -- more income going forward occurs in this case because MGM has reduced its basis and its asset.

Okay. The rest of this is sort of responding to FTB's argument.

And also, Judge, Gast your specific questions about Marvel and Gitlitz and separate accounting. I think you mentioned sort of the same things that FTB raised.

Gitlitz has no relevance here. Gitlitz involved the question of whether excluded CODI was quote, unquote, "Item of income in Section 1366 of the code, which is the section that passes, you know, items of income loss and everything else to shareholders of S corporations for purpose of determining their basis." The Supreme Court in that case specifically said 108 simply does not say that discharge of indebtedness income ceases to be an item of income when the S corp isn't solvent. Under 1366, it just provides that the discharge of indebtedness ceases to be included in gross income.

So that in this case, in that statute, an item of income could still be passed through, and it had some impact. Well, guess what. That was widely criticized anyway, and that was reversed shortly after the decision by Congress. But in any event, we not dealing with an item of income. We are dealing with, in the context of S corp basis. We are dealing with combined reporting, and the FTB's argument, which is all that we're defending here. We're not -- you know, this is an argument that was

foisted upon us that somehow the combined reporting rules act to assign excluded income. They don't. Gitlitz doesn't say anything about that.

Separate accounting, this is an interesting one. We keep being told -- so Barclays is just thrown around and John Deere. Separate accounting is simply a label used to describe what is not a -- you know, the unitary theory, unitary business, UDITPA. You know, there was separate accounting, and then there's apportionment of business income being conducted by multistate businesses. That isn't at issue here. We're not asking for a separate accounting. We -- you know, if you listen to the record of the transcript back, I mean, I'm going to keep hearing we're totally, you know, separate accounting and disregarding all these -- no, we're not.

In -- even in combined reporting, each entity, as the FTB's brief painstakingly details step-by-step, each taxpayer member computes their separate net income. They have their own income. They have their own deductions. There's a separate net income. And then things are combined. And then each entity's factor, you know, numerators are used to create some percentage.

And then by the way, if there's a loss and you get to generate an NOL that goes out to everybody, that stays separate. There is no such thing in California as a

combined NOL. NOLs are separate. So the notion that we're doing something that not within UDITPA or separate accounting, that's just not true. I mean, we're doing nothing other than keeping track of MGM Inc.'s income and loss. And, in this case, this is just outside of UDITPA because we have an excluded amount. It's not -- it's not income. And maybe --

And I'm turning it to David just because the notion that an excluded item -- excluded income is somehow income has been discussed many times, and ruled to be -- you know, that's just not the case.

MR. HAN: Right. As colleague Chris said, the FTB's entire argument starts from the false premise that there is COD income, but the statutes clearly say that the income is excluded. And the OTA has made crystal clear in its opinions, like Minnesota Beat and the Microsoft case, items are exempted, excluded, or not recognized, or not realized for that matter, do not enter gross income to begin with and are not included in California gross income.

As the OTA wrote in Minnesota Beat, exempted, excluded, or not recognized, they are terms of art. They have specific meaning in the context and structure of the Revenue & Taxation Code. They also have unique meaning for purposes of UDITPA. And to echo what the OTA wrote in

Appeal of Microsoft, the FTB does not provide any legal authority or evidence establishing that the plain language of the statute should not be followed.

Here, the FTB is citing to authorities to tell you how to apportion income in a combined reporting group, but it has not provide any legal authority establishing that excluded CODI, like the one at issue here, should be treated as if it is includable in the combined group.

MR. CAMPBELL: All right. So again, we're dealing with an excluded item that's not even subject to UDITPA, so to speak. That is what is -- it just follows from the fact that this is not income. It's not business income in the -- like, that's not what this is. We're just trying to solve -- just trying to apply 108 to this excluded amount.

Marvel -- by the way, all these Marvel, Gitlitz, all are these are addressed in our briefs. But just here, I think the comment, was we're -- are making the same argument in Marvel that was rejected. No, we're not. Marvel doesn't even apply here. But Marvel would actually, you know, as we wrote in our response, supports us, if you want to look at it that way. The FTB, first of all, in footnote 5, I think, of their determination letter says to be clear, Marvel did not rule on the status of the California combined reporting.

So, again, I think we all understand Marvel is not applicable here. But just, for the record, the case involved the application of 108(b) to a consolidated group. And the question was whether the consolidated group's NOL, subject to reduction for its, you know, particular taxable year was the CNOL, the consolidated group, the, you know, group consolidated NOL, or the apportion allocable to each member. Well, the court said, at the time, since -- said, the code in regulations governing affiliated groups of corporations filing consolidated returns -- again, we don't have those rules -- provide only one definition of NOL -- consolidated NOL. And so, therefore, the court said, you know, you don't -- you can't -- you think about this as a separate NOL. You have a consolidated NOL because that's what the rule says.

Okay. Well, that was again, a point there that was expressed in the rule at the time. By the way, that rule was then changed, which also discussed in Marvel, Inc. But the point is we don't have those rules. And just the mere discussion of these cases that are addressing specific rules for where things are moved from you know, one taxpayer -- which, clearly, 108 applies to the taxpayer that had the discharge -- into subsidiaries or, you know, in a consolidated group, you need rules to

do that, right. And you need clear rules to do that.

I'm trying -- I think the last point to respond to, I'm trying to get them all. There seems to be a general claim that -- again, this is from the discussion of how the debt proceeds were used or the interest deductions, or the fact we're a unitary group, et cetera. Some general claim that we're all debtors or that the whole -- which actually, they don't actually take that position. The auditor did, but that's just a total impossible. That's just not the way the law works, a that's in the responses. And again, FTB understands we have a debtor member, and there's one debtor and one taxpayer that had the excluded income.

So -- but the notion that this is somehow one big group and that we're not applying the unitary theory in this context, and that the buildup of losses is attributable to, you know, maybe the debt used in the past. That's all being presented to support a conclusion that you can apply attribute reduction in 108 to other members in the group. But again, you can't. The statute doesn't say that. The statute applies to one entity, and the combined reporting rules don't change that. They don't address this.

Again, the whole point is if the FTB would like to create -- start a rule-making process, fine. But right

now they don't address that, and we couldn't file a return the way they say. So this is all a red herring, and we've explained this in our briefs. But MGM Inc. is the only taxpayer who had excluded CODI, the only taxpayer who reduces its tax attributes, and we did. I think our conclusion is simply that the FTB's position in this case -- and we've been playing defense the entire time, so to speak. We've applied the language. We reduced our attributes correctly, and the determination letter in this case -- I think it was -- is that the F -- there is strong reason to do it this other way. Well, again, strong reason is not the basis for determination. In fact, I don't know how, you know, strong reason for doing the return. Do we have to anticipate the FTB had strong reason for doing something else? You just can't, right. So strong reason is not a valid basis. It expressly says that in the determination letter.

And then by citing the rule making authority, again, it just goes to show there are no law today that -- that reach this result. And, again, if they want -- if we want to have rules, then the legislature or the FTB can start that process, but we don't have rules. And so all we're asking today is that, as the Appellant in this case, is reject the FTB's position. Our tax attributes were reduced. We have -- you know, our basis was reduced, and

there's no basis -- or excuse me -- no authority. I'll repeat this. No authority, there's no statute, no regulation, no case law, no nothing that allows the FTB to reduce NOL of studios or any other members of our group. You just can't do it.

So, I think that's it for us.

JUDGE LAMBERT: Thank you, Mr. Campbell and Mr. Han.

FTB, Mr. Beck, you can now make your rebuttal and proceed when ready.

MR. BECK: Thank you.

CLOSING STATEMENT

MR. BECK: So first, we can see during the life of the debt, the combined reporting group took interest expense deductions and -- from this debt. And this debt in IRC section 163, which controls the interest expense deductions, refers to singular taxpayer. So even though that just referred to a single taxpayer, they're able to apply the item on a group basis. And just the fact is its not a correct plain meaning interpretation of Internal Revenue Code to look at a singular taxpayer and say that that directs just to -- that -- that directs the taxpayer to do it on a separate accounting basis for California purposes. The Internal Revenue Code is incorporated into

existing system, and that requires treating items of income on a combined basis.

Second point, in response to one of Judge Gast's question, I believe I said I wasn't aware of how other states treated this. And my understanding is that Massachusetts, New York, New Jersey, Wisconsin, and New Mexico at least treat combine reporting of IRC section 108 the same way that I've described.

And so I'll just move onto my concluding remarks. And the dispositive fact is that the CODI was business income. As such, it needed to be apportioned and interest dated, and Appellant failed to interest date the CODI. On Issue 1, IRC section 108 does not have a plain meaning that requires a specific outcome in California combined reporting. Rather, taking into account the full picture of congressional intent, IRC section 108 seeks to defer CODI extinguished in a bankruptcy. That CODI was about $1 billion for MGM Studios and $100 million for the other members. IRC section 108 would defer that income by reducing the tax attributes from those taxpayers.

On Issue 2, which Respondent believes is the -- decides the issue, notwithstanding the outcome in Issue 1, the correct application of the combined reporting regulations requires interest dating the business income, which leads to the result advocated by Respondent. And,

again, business income cannot be divided. You can see that from John Deere, Barclays, and Robert Half -- Robert Half. Excuse me. Accordingly, OTA should for Respondent.

That's all I have for you. Thank you.

JUDGE LAMBERT: Thank you, Mr. Beck.

Now, Mr. Campbell, you can make closing remarks.

MR. CAMPBELL: Well, I think I made closing remarks, but I just want to make a couple of comments to that.

ADDITIONAL CLOSING STATEMENT

MR. CAMPBELL: When you look -- when you determine that other states did something that the way you do it -- which I have no idea that's the case in terms of the substance -- is that because those states have specific rules that apply, like Illinois and the states that incorporate the consolidated return regs? I imagine it is. It's a rhetorical question. You can look it up. You're going to find a rule, or you're not going to find a rule. So states that have rules have rules. It's helpful to have rules. We don't have rules.

Again, coming back to the concept of the broader, I think, I policy argument that's being made, there's two things wrong with it. One is A, you just don't have income. So that's just not the right conceptual framework

to solve this problem. Okay. You don't have income. That's the whole point. In discharge of indebtedness you're excluded for a very important policy reason and then you reduce your attributes going forward. So that isn't addressed by the consolidated return regs. There's no dispute as to that point.

But the notion that the group benefited from the use of the debt in the past, and that somehow the only way to rectify that is to reduce the group's NOLs; that's not true. The group benefited from these deductions in the past. The group that is, you know, detriment, so to speak, going forward by the fact that we have MGM Inc., as a member of that group, has reduced basis in its assets. So it will recognize income and does as a result of that.

You know, that's the failure of this whole thing is that there's a mindset here which is like, you know what, we want to reduce -- we're just focusing on the losses. This is all focusing on the losses, and you can't -- there's nothing in the law that allows you to reach the NOL carryovers of the entities in the group. And that's -- at the end of the day, that's it.

That ends the discussion. There's no law that does it. Other states -- the federal government has specific rules. Other states have rules. We follow the statute, and its -- there's an invitation to, you know,

create rules, I guess, but we don't have them. We're following -- we did what we had to do under the law as it was written, and that's where we are.

So I don't -- I think that concludes our case.

JUDGE LAMBERT: Thank you.

So if there's nothing further, I'm going to conclude the hearing.

We will issue a written opinion within 100 days, and the record is now closed.

So thanks to both parties for appearing today. Have a nice day -- rest of your day.

(Proceedings concluded at 3:38 p.m.)

HEARING REPORTER'S CERTIFICATE

I, Ernalyn M. Alonzo, Hearing Reporter in and for the State of California, do hereby certify:

That the foregoing transcript of proceedings was taken before me at the time and place set forth, that the testimony and proceedings were reported stenographically by me and later transcribed by computer-aided transcription under my direction and supervision, that the foregoing is a true record of the testimony and proceedings taken at that time.

I further certify that I am in no way interested in the outcome of said action.

I have hereunto subscribed my name this 1st day of April, 2026.

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ERNALYN M. ALONZO
HEARING REPORTER