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JUL 29 1997

July 21, 1997

Mr. Brian Toman
Franchise Tax Board
Legal Branch
P. O. Box 1720
Rancho Cordova, CA 95741-1720

Re: **Multistate Tax Commission Regulation Project**

Dear Brian:

Here are my reactions to the July 17 teleconference of Task Force C.

Definition of Business and Nonbusiness Income

Regarding "Issue 1" in my memo of July 7, I did not hear anything in the discussion that added any weight to my suggestion that the pro rata principle of the property factor regulation should prevail over the majority principle of the business income regulation. For that reason, and also because the five-story building and the 20-story building examples have been in the business income regulation for some years, I think we should drop this issue and forego precise correlation with the property factor regulation on this point.

With regard to my "Issue 2," there seemed to be a consensus in the discussion that the phrase at lines 96-98 should be stricken from the draft so that we do not have a declaration that exiting from the line of business in which a property was used will never have an influence on whether gain or subsequent sale of that property is business income.

The discussion of Issue 2 led us into the general problem of recapture of expenses previously deducted from business income. It was noted that "treatment of expenses" was another issue assigned to Task Force C; therefore, a final decision on what to do about lines 96-98 should be deferred to see if anything helpful comes out of our deliberations on expenses.

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Definition/Test(s) of a Unitary Business

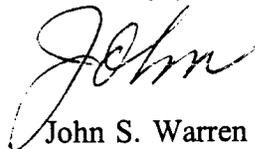
At the end of the discussion on this subject, I urged the Task Force to move forward from abstract discussion to specific language. I invited each participant to submit the wording which he or she would like to see in the regulation in addition to or in place of the wording in the April 1995 draft or in my July 7, 1997 redraft. (This applies to the changes and additions suggested in the memo prepared by your staff dated June 3, 1997. It would be helpful if you would splice some or all of them into the regulation itself).

It was recognized that this sort of thing couldn't be done before the teleconference set for July 24, so that date was cancelled. Rather, people who are motivated to submit alternative drafts should try to turn them in before the Whitefish meeting.

During the teleconference, while you were absent, Paul Mines made a statement which disturbed me a little. He expressed great affection for the single business entity presumption in IV.A.3. Although I have high regard for Paul's views, I don't see how that presumption can co-exist with III.B. One or the other will have to go, and I think you and I agree that III.B. states the sounder rule. A single entity presumption would be an invitation to taxpayers to control the outcome of the unitary business issue by the corporate structure they adopt.

Regarding the other two subjects assigned to Task Force C, treatment of expenses and defining nonbusiness income, nothing had been submitted in writing and there was no discussion. I think we should still pursue the former, but I doubt if anything will come of the latter.

Sincerely yours,



John S. Warren

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cc: Michael Mazerov