

IN THE ILLINOIS INDEPENDENT TAX TRIBUNAL

CSX TRANSPORTATION, INC.)
)
 Petitioner,)
)
 v.)
)
 THE ILLINOIS DEPARTMENT OF REVENUE,)
)
 Defendant.)

No.

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PETITION

CSX Transportation, Inc. (“Petitioner”), by and through its attorneys, Eversheds Sutherland (US) LLP, complains of the Defendant, the Illinois Department of Revenue (“Department”), and alleges as follows:

PARTIES

1. Petitioner is a Virginia C corporation with its principal place of business in Jacksonville, Florida. It is located at 500 Water Street, C-115, Jacksonville, Florida 32202.
2. Petitioner is represented by Breen M. Schiller and Justin T. Brown of Eversheds Sutherland (US) LLP, located at 900 North Michigan Avenue, Suite 1000, Chicago, Illinois 60611-6521. Breen M. Schiller can be reached at 312-724-8521 or breenschiller@eversheds-sutherland.com and Justin T. Brown can be reached at 404-407-5001 or justinbrown@eversheds-sutherland.com.
3. Petitioner’s FEIN is 54-6000720.
4. Petitioner is the designated agent of a unitary group of corporations filing an Illinois combined corporate income tax return.
5. The Department is an agency of the Executive Department of the State Government and is tasked with the enforcement and administration of Illinois tax laws. 20 ILCS 5/5-15.

NOTICE

6. On September 24, 2020, the Department issued a Notice of Deficiency (“Notice”) to Petitioner in the amount of \$2,217,860.73 for the tax year ending December 2016 (“Year at Issue”). A true and accurate copy of the Notice is attached hereto as **Exhibit A**.

7. The adjustments made to the tax year ending December 2016 resulted in the Department’s assessment of \$1,648,546.00 in tax, \$242,438.28 in interest, and \$326,876.45 in penalties, for a total amount due of \$2,217,860.73.

8. In a separate letter issued on the same day as the Notice, the Department also assessed penalties for “late estimated payment” in the amount of \$14,163.73 for the taxable year ending December 31, 2016. It is unclear if this amount is included within the penalties calculated in the Department’s Notice. A true and accurate copy of this Letter is attached hereto as **Exhibit B**.

9. The Department’s adjustments to the Year at Issue fall into one of three categories: (1) an estimated adjustment to income “based on the best information available; (2) an adjustment to additional modifications to reflect an addback of intangible expense paid to an affiliated company; and (3) adjustment to the numerator of BOCT’s Illinois sales factor.

JURISDICTION

10. Petitioner brings this action pursuant to the Illinois Independent Tax Tribunal Act (“Tribunal Act”), 35 ILCS 1010/1-1 to 35 ILCS 1010/1-100 and the Illinois Income Tax Act (“Act”), 35 ILCS 5/201 et. seq.

11. The amount of additional Corporate Income and Replacement Taxes, interest and penalties for the tax year at issue exceeds \$15,000 thereby vesting jurisdiction in the Illinois Independent Tax Tribunal.

12. This Tribunal has jurisdiction over this matter pursuant to Sections 1-45 and 1-50 of the Tribunal Act because Petitioner timely filed this petition within 60 days of the Department's Notice.

BACKGROUND

13. The tax involved herein is the Illinois corporate income and replacement tax imposed under the Illinois Income Tax Act (the "Act"), 35 ILCS §5/201, et seq.

14. CSX Corporation ("CSX") is a publicly held company that, during the Year at Issue, through its subsidiaries, engaged in four business segments: Rail, Intermodal, Domestic Container Shipping and International terminals.

15. Petitioner is a transportation company and wholly owned subsidiary of CSX.

16. Petitioner is a Class I railroad which, through its subsidiaries, operates one of the largest rail networks in the United States.

17. Petitioner provides rail freight transportation over a network of more than 22,000 "first main" track miles in twenty-three states, the District of Columbia and two Canadian provinces.

18. The Baltimore and Ohio Chicago Terminal Railroad Company ("BOCT"), incorporated under the laws of the State of Illinois in 1910, is a wholly owned subsidiary of Petitioner.

19. BOCT is a carrier represented by the National Railway Labor Conference.

20. BOCT is a carrier that provides switching services for freight in interstate commerce.

21. BOCT performs intermediate and terminal switching services for Petitioner and third-party eastern and western carriers as well as third-party non-carrier customers.

22. BOCT has customers in both Illinois and Indiana.
23. BOCT performs switching services for the Canadian National Railroad (“CN”) at CN’s Kirk Yard located in Indiana.
24. BOCT has a direct freight customer located in Indiana.
25. During the Year at Issue, the majority of BOCT’s sales are intercompany sales with Petitioner.
26. Petitioner enters into contracts with third-party customers to ship freight by rail over and across interstate lines.
27. To the extent that switching services are required as part of the freight movement Petitioner will engage a switching entity, including BOCT, to perform those services.
28. Petitioner records a sale to its third-party interstate customer and to the extent that BOCT performs any switching services, Petitioner records intercompany expenses with BOCT based on BOCT’s tariff agreement.
29. The cost for BOCT’s provision of switching services to both Petitioner and third-parties are set by BOCT’s tariff agreement.
30. All pricing is set by this tariff agreement and is not determined on a transaction-by-transaction basis.
31. BOCT’s switching services performed on behalf of Petitioner become a part of Petitioner’s costs of doing business and is provided as a single cost to Petitioner’s customers.
32. Payments from Petitioner to BOCT are auto-generated by Petitioner’s internal computer system, based on the BOCT tariff agreement.
33. Industry standards dictate that railroads never invoice one another for interline moves of any type. Thus, the lack of invoicing for these transactions is true for both intercompany

transactions between BOCT and Petitioner as well as third-party transactions occurring between railroads.

34. BOCT records its intercompany sale with Petitioner and incurs the expense of the switching.

35. During the Year at Issue, BOCT incurred third-party switching expenses through third-party sales with common carriers, as well as third-party non-carrier customers.

36. During the Year at Issue, BOCT's revenue was earned from the switching of interstate freight car movements.

37. CSX Intermodal Terminals, Inc. ("CSXIT") is a standalone integrated intermodal company that links customers to railroads via trucks and terminals, providing coast-to-coast intermodal lift services.

38. During the Year at Issue, CSX filed a Federal Consolidated 1120 ("Federal Return") including all of its subsidiaries.

39. During the Year at Issue, for Illinois purposes CSX was required by statute to file two separate unitary combined Illinois corporate income and replacement tax returns. See 35 ILCS §5/1501(a)(27).

40. During the Year at Issue, Petitioner and its unitary transportation companies filed a combined Illinois corporate income and replacement tax return ("Transportation Group").

41. One of the entities included in Petitioner's combined Illinois corporate income and replacement tax return in each of the Year at Issue was BOCT.

42. During the Year at Issue, CSXIT filed a combined Illinois corporate income and replacement tax return including CSX's non-transportation companies ("Non-Transportation Group").

43. During the Year at Issue on its Federal Returns, CSX had intercompany eliminations under line 26 (other deductions) called intercompany service fees.

44. These eliminations were comprised of various intercompany transactions between members of its consolidated federal return and netted to zero at the federal level.

45. During the Year at Issue, for Illinois purposes intercompany transactions within the Transportation Group were properly eliminated by Petitioner.

46. During the Year at Issue, for Illinois purposes intercompany transactions that occurred between members of CSX's Transportation and Non-Transportation Groups were not eliminated because they did not occur between members of the same Illinois unitary combined group.

CONTROVERSY

47. Petitioner timely filed its 2016 Illinois unitary corporate income and replacement tax return on October 12, 2017 via efile.

48. In June 2019, Petitioner was contacted by the Department in order to commence a review of Petitioner's Illinois corporate income and replacement tax returns for the Year at Issue. The Department began its audit with a field visit to Petitioner's offices at the end of February, 2020.

49. Upon audit, the Department made an adjustment to Petitioner's income using an estimate "based on the best information available."

50. Upon audit, the Department adjusted Petitioner's addition modifications to reflect an addback of intangible expenses paid to an affiliated company.

51. Upon audit, the Department adjusted BOCT's Illinois sales factor.

52. Upon audit, the Department eliminated BOCT's total intercompany revenue with Petitioner from apportionable revenue and then added it back as one-hundred percent allocable revenue in the numerator and denominator of Petitioner's Illinois apportionment factor.

53. These adjustments resulted in the assessment of additional corporate income tax for the taxable year ending December 31, 2016 in the following amount: 1,648,546.00 in tax, \$242,438.28 in interest, and \$326,876.45 in penalties, for a total amount due of \$2,217,860.73. In a separate Letter, the Department also assessed penalties for "late estimated payment" in the amount of \$14,163.73 for the taxable year ending December 31, 2016. It is unclear if this amount is included within the penalties calculated in the Department's Notice.

COUNT I

The Department erred in its Estimated Adjustment to Petitioner's Income.

54. Petitioner realleges and reincorporates the allegations in paragraphs 1 through 53, inclusive, hereinabove.

55. Upon audit, the Department made an estimated adjustment to Petitioner's taxable income, citing to 35 ILCS §5/201. This statute provides for the imposition of tax, and does not contain any provisions regarding estimation of income.

56. Petitioner complied with the Department's audit and provided responses to all information requests made by the Department. Therefore, there is no reason for the Department to make an estimated adjustment to Petitioner's income.

WHEREFORE, Petitioner prays that the Court enter an Order that:

- a) finds and declares that the Department erred in its estimated adjustment to Petitioner's income for the Year at Issue;
- b) finds and declares the Notice of Deficiency invalid;

- c) enters judgment in favor of Petitioner and orders Defendant to withdraw the Notice of Deficiency;
- d) enjoins the Department from taking any action to assess, lien, levy, offset or in any other way prosecute and collect the amount of the proposed additional tax invalidated by the Order this Tribunal; and
- e) grants such further relief as the Court deems appropriate under the circumstances.

COUNT II

The Department erred in its Adjustment to Petitioner's Addition Modifications regarding Addback of Intangible Expenses Paid to an Affiliated Company.

57. Petitioner realleges and reincorporates the allegations in paragraphs 1 through 56, inclusive, hereinabove.

58. Upon audit, the Department made an adjustment to Petitioner's addition modifications to reflect the addback of intangible expenses paid to an affiliated company, citing 35 ILCS §5/203(b)(2)(E-13).

59. The statute cited by the Department for this adjustment provides for an addback of intangible expenses paid to: (1) a foreign person who would be a member of the same unitary group but for the fact that the person's business activity outside the US is 80% or more of that person's total business activity or (2) a person who would be a member of the same unitary business group but for the fact that the person is prohibited under 35 ILCS § 1501(a)(27) from being included in the unitary business group because he or she is ordinarily required to apportion business income under different subsections of Section 304. 35 ILCS § 5/203(b)(2)(E-13).

60. Petitioner disagrees with the Department's adjustment to its modifications because the Department has not provided any support for this modification.

61. This statute provides for three exceptions to the addback, including: (1) expenses paid from a transaction with a person subject to tax in a foreign country or state, other than a state which requires mandatory unitary reporting, to tax measured by net income with respect to such expenses; (2) expenses paid where the taxpayer can establish that the person paid the intangible expense to a person that is not a related member and the transaction giving rise to the expense did not have as a principal purpose the avoidance of Illinois income tax and is paid pursuant to a contract or agreement that reflects arm's-length terms; or (3) any item of expense from a transaction with a person if the taxpayer establishes that the adjustments are unreasonable or if the taxpayer and the Director agree in writing to the application or use of alternative apportionment. 35 ILCS §5/203(b)(2)(E-13)(i)-(iii).

62. To the extent that the Department is able to support its modification, Petitioner asserts an exception to the addback modification based on the exceptions set forth in 35 ILCS §5/203(b)(2)(E-13)(i)-(iii).

WHEREFORE, Petitioner prays that the Court enter an Order that:

- a) finds and declares that the Department erred in its adjustment to Petitioner's addition modifications for the Year at Issue;
- b) finds and declares the Notice of Deficiency invalid;
- c) enters judgment in favor of Petitioner and orders Defendant to withdraw the Notice of Deficiency;
- d) enjoins the Department from taking any action to assess, lien, levy, offset or in any other way prosecute and collect the amount of the proposed additional tax invalidated by the Order this Tribunal; and

e) grants such further relief as the Court deems appropriate under the circumstances.

COUNT III

The Department erred in its Adjustment of BOCT's Apportionment Methodology.

63. Petitioner realleges and reincorporates the allegations in paragraphs 1 through 46, inclusive, hereinabove.

64. Pursuant to the Act, corporations that are members of the same unitary business group are treated as one taxpayer. 35 ILCS §5/502(e).

65. The term “unitary business group” is defined, in relevant part, to mean, “a group of persons related through common ownership whose business activities are integrated with, dependent upon and contribute to each other...in no event, however, will any unitary business group include members which are ordinarily required to apportion business income under different subsections of Section 304...If a unitary business group would, but for the preceding sentence, include members that are ordinarily required to apportion business income under different subsections of Section 304, then for each subsection of Section 304 for which there are two or more members, there shall be a separate unitary business group composed of such members...” 35 ILCS §5/1501(a)(27).

66. Section 304(d) of the Act sets forth Illinois’ special apportionment method of formulary apportionment for entities that furnish “transportation services.” 35 ILCS §5/304(d).

67. During the Year at Issue, “business income derived from providing transportation services other than airline services shall be apportioned to this State by using a fraction, (a) the numerator of which shall be (i) all receipts from any movement or shipment of people, goods, mail, oil, gas, or any other substance (other than by airline) that both originates and terminates in

this State, plus (ii) that portion of the person's gross receipts from movements or shipments of people, goods, mail, oil, gas, or any other substance (other than by airline) that originates in one state or jurisdiction and terminates in another state or jurisdiction, that is determined by the ratio that the miles traveled in this State bears to total miles everywhere and (b) the denominator of which shall be all revenue derived from the movement or shipment of people, goods, mail, oil, gas, or any other substance (other than by airline).” 35 ILCS §5/304(d)(3).

68. Upon audit, the Department adjusted the numerator of BOCT’s sales factor re-characterizing intercompany revenues as intrastate rather than interstate, which resulted in allocating one-hundred percent of its income to Illinois.

69. BOCT performs intermediate and terminal switching services for customers in both Illinois and Indiana.

70. BOCT is a carrier represented by the National Railway Labor Conference.

71. BOCT is a carrier that provides switching services for freight in interstate commerce.

72. BOCT performs intermediate and terminal switching services for Petitioner and third-party common carriers, as well as third-party non-carrier customers.

73. BOCT had customers in both Illinois and Indiana.

74. BOCT performs switching services at CN’s Kirk Yard located in Indiana.

75. BOCT derives its income from providing transportation services, specifically switching services.

76. Pursuant to Illinois law, Petitioner’s Illinois Transportation Group is required to apportion its income according to the special apportionment methodology for transportation service providers codified at 35 ILCS §5/304(d)(3).

77. The Department had previously audited Petitioner's Illinois Transportation Group and determined that BOCT was properly included in the Transportation Group.

78. During the Year at Issue, BOCT was part of Petitioner's Illinois Transportation Group and required to source its income pursuant to the special apportionment methodology as provided in 35 ILCS §5/304(d)(3).

79. Accordingly, the proper section to apportion BOCT's income to Illinois is 35 ILCS §5/304(d)(3) and not 35 ILCS §5/304(a)(3)(c).

80. The Department's use of 35 ILCS §5/304(a)(3)(c) was erroneous.

81. The Department's apportionment of one-hundred percent of BOCT's income to Illinois when it has customers in more than one state and is part of Petitioner's Transportation Group was erroneous.

82. Accordingly, the Department erred in its adjustment of BOCT's Illinois sales factor numerator.

WHEREFORE, Petitioner prays that the Court enter an Order that:

- f) finds and declares that for the Year at Issue, BOCT properly sourced its income to Illinois using the special apportionment method for entities that furnish "transportation services" codified at 35 ILCS §5/304(d);
- g) finds and declares that BOCT is properly included as a member in Petitioner's Illinois Transportation Group;
- h) finds and declares that BOCT's revenues are interstate in nature;
- i) finds and declares that the Department erred in adjustment of the numerator of BOCT's Illinois sales factor to include receipts, other than receipts from the

sales of tangible personal property, for which the majority of the income-producing activities were performed in Illinois;

- j) finds and declares the Notice of Deficiency invalid;
- k) enters judgment in favor of Petitioner and orders Defendant to withdraw the Notice of Deficiency;
- l) enjoins the Department from taking any action to assess, lien, levy, offset or in any other way prosecute and collect the amount of the proposed additional tax invalidated by the Order this Tribunal; and
- m) grants such further relief as the Court deems appropriate under the circumstances.

COUNT IV

The Department's Inclusion of Receipts from Intercompany Transactions Unfairly Represents Petitioner's Illinois Activities.

83. Petitioner realleges and reincorporates the allegations in paragraphs 1 through 67, inclusive, hereinabove.

84. By Department regulation, income and deductions attributable to intercompany transactions between members of a unitary business group are eliminated from combined income when necessary to avoid distortion of either the numerator or denominator of the apportionment factor. 86 Ill. Admin. Code § 100.5270(b)(1).

85. Distortion occurs when an apportionment methodology unfairly reflects a taxpayer's activities in a state.

86. Forcing a taxpayer to use a distortive apportionment methodology violates the U.S. Supreme Court's requirements for apportionment methodologies. *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 (1983).

87. During the Year at Issue, BOCT and Petitioner were both part of the Illinois Transportation Group.

88. As members of the same unitary combined filing group, BOCT and Petitioner were required by Illinois law to eliminate intercompany transactions.

89. Upon audit, the Department incorrectly allocated one-hundred percent of BOCT's intercompany sales with Petitioner to the numerator and denominator of the Transportation Group's apportionment factor as intrastate (non-apportionable) Illinois receipts.

90. The Department's adjustments were erroneous as BOCT's intercompany receipts with Petitioner are required by law to be eliminated from the Transportation Group's Illinois combined return.

91. The Department's adjustment does not accurately reflect Petitioner's taxable activity within the State as it assigns one-hundred percent of BOCT's intercompany sales as one-hundred percent Illinois allocable revenue attributable to Petitioner; and therefore, results in distortion.

92. There is no Illinois authority that permits the Department to remove BOCT's intercompany receipts out of Petitioner's Illinois apportionable revenue, calculate the Group's interstate apportionment percentage and then add BOCT's intercompany revenue back as intrastate revenues into both the numerator and denominator of Petitioner's Illinois sales factor. BOCT's revenues are intercompany with Petitioner, and not directly tied to Petitioner's third-party revenues.

93. The Department cites to no Illinois authority for this adjustment.

94. Accordingly, the Department's adjustment was erroneous and not supported by law.

WHEREFORE, Petitioner prays that the Court enter an Order that:

- a) finds and declares that during Year at Issue, BOCT and Petitioner engaged in intercompany transactions;
- b) finds and declares that for the Year at Issue, the Department's failure to permit elimination of intercompany transactions within the Transportation Group is not supported by law and should be disallowed;
- c) finds and declares the Notice of Deficiency invalid;
- d) enters judgment in favor of Petitioner and orders Defendant to withdraw the Notice of Deficiency;
- e) enjoins the Department from taking any action to assess, lien, levy, offset or in any other way prosecute and collect the amount of the proposed additional tax invalidated by the Order this Tribunal; and
- f) grants such further relief as the Court deems appropriate under the circumstances.

COUNT V

The Department's Bifurcation of Petitioner's Third-Party Interstate Invoices is Unsupported by Law and Does not Accurately Represent Petitioner's Activity in the State.

95. Petitioner realleges and reincorporates the allegations in paragraphs 1 through 79, inclusive, hereinabove.

96. Petitioner is in the business of providing interstate railway services across the Eastern United States.

97. Petitioner enters into contracts with third-party customers to ship freight by rail over and across interstate lines.

98. To the extent that switching services are required as part of the freight movement, Petitioner engages a switching entity, including BOCT, to perform those services.

99. Pursuant to Illinois law, switching services are defined as ancillary transportation services. 86 Ill. Admin. Code §100.9715(c).

100. Pursuant to Illinois law and as agreed by the Department in previous audit cycles, BOCT's switching services are transportation services and part of Petitioner's interstate transaction.

101. United State Supreme Court jurisprudence provides that instrumentalities of interstate commerce remain interstate in nature from the beginning of the transaction until they come to rest. *Michelin Tire Corp. v. W.L. Wages*, 423 U.S. 276 (1976).

102. During the Year at Issue, Section 304(d) of the Act set forth Illinois' special apportionment method for entities that furnish "transportation services." 35 ILCS §5/304(d).

103. During the Year at Issue, "business income derived from providing transportation services other than airline services shall be apportioned to this State by using a fraction, (a) the numerator of which shall be (i) all receipts from any movement or shipment of people, goods, mail, oil, gas, or any other substance (other than by airline) that both originates and terminates in this State, plus (ii) that portion of the person's gross receipts from movements or shipments of people, goods, mail, oil, gas, or any other substance (other than by airline) that originates in one state or jurisdiction and terminates in another state or jurisdiction, that is determined by the ratio that the miles traveled in this State bears to total miles everywhere and (b) the denominator of which shall be all revenue derived from the movement or shipment of people, goods, mail, oil, gas, or any other substance (other than by airline)." 35 ILCS §5/304(d)(3).

104. Accordingly, during the Year at Issue Petitioner was required to apportion its interstate railway income pursuant to 35 ILCS §5/304(d)(3).

105. However, upon audit, instead of following 35 ILCS §5/304(d)(3) the Department attempted to bifurcate Petitioner's single interstate third-party transaction invoices into two separate transactions: (1) an intrastate transaction (BOCT's intercompany receipts with Petitioner; and (2) an interstate transaction (Petitioner's receipts with third-party customers).

106. The Department's attempted bifurcation results in an inaccurate measure of Petitioner's apportionable Illinois receipts because the Department wrongly assumes that there is a dollar for dollar correlation between Petitioner's third-party transaction and BOCT's intercompany transaction with Petitioner.

107. This assumption is incorrect and produces erroneous results.

108. As a result of this incorrect assumption, the Department allocated one-hundred percent of BOCT's intercompany switching receipts to Illinois as Petitioner's and apportioned the remaining balance as Petitioner's third-party receipts.

109. This adjustment resulted in BOCT's total intercompany sales being included as one-hundred percent Illinois allocable revenue in Petitioner's Illinois apportionment factor.

110. There is no Illinois authority, nor does the Department cite to any Illinois authority, that provides it the ability to bifurcate a single third-party interstate transaction into separate parts for apportionment purposes.

111. BOCT's switching services are interstate in nature and maintain their interstate character until the railway services activity ceases.

112. Accordingly, the Department erroneously allocated one-hundred percent of BOCT's intercompany sales with Petitioner to the numerator and denominator of Petitioner's

Illinois apportionment factor when: (1) BOCT's revenues are interstate in nature; (2) the majority of BOCT's revenues with Petitioner are intercompany and are required to be eliminated from Petitioner's Illinois combined return; and results in the Department incorrectly re-characterizing BOCT's intercompany interstate revenue as intrastate revenue attributable to Petitioner.

WHEREFORE, Petitioner prays that this Tribunal enter an Order that:

- a) finds and declares that BOCT's switching services are interstate in nature;
- b) finds and declares that BOCT's switching services are part of Petitioner's interstate transactions with third-party customers;
- c) finds and declares that instrumentalities of interstate commerce maintain their interstate character until the transaction ends;
- d) finds and declares that the Department's bifurcation of Petitioner's single third-party interstate transaction into two separate intrastate and interstate transactions was improper;
- e) finds and declares that the Department's audit adjustment improperly allocated one-hundred percent of BOCT's intercompany switching receipts to Illinois attributable to Petitioner;
- f) finds and declares the Notice of Deficiency invalid;
- g) enters judgment in favor of Petitioner and orders Defendant to withdraw the Notice of Deficiency;
- h) enjoins the Department from taking any action to assess, lien, levy, offset or in any other way prosecute and collect the amount of the proposed additional tax invalidated by the Order this Tribunal; and

i) grants such further relief as the Court deems appropriate under the circumstances.

COUNT VI

The Department's Notice is Without Effect Because the Department Did Not Supply a Basis for the Deficiency in Regard to its Adjustment to Petitioner's Sales Factor.

113. Petitioner realleges and reincorporates the allegations in paragraphs 1 through 97, inclusive, hereinabove.

114. In the "Explanation of Adjustments," the Department states that it, "adjusted your apportionment factor to reflect the proper method of apportionment required by Illinois law" and that it "calculated the factor to include receipts from transportation performed everywhere and in Illinois." As support, the Department cites to 36 ILCS §5/304(a), (d).

115. The Illinois Taxpayer Bill of Rights requires the Department to furnish taxpayers with an explanation of the tax liabilities and penalties associated with a tax notice. 20 ILCS 2520/4(b).

116. The Illinois Income Tax Act requires that the Department not only explain what adjustments are made on a Notice of Deficiency, it is required to provide the reasons therefor. 35 ILCS 5/904(c).

117. One of the primary issues in this case involve the adjustment to the numerator of Petitioner's Illinois sales factor.

118. The citations provided by the Department in its "Explanation of Audit Adjustments" for support for its adjustment are too broad to provide any clear explanation for the basis of the Department's adjustment.

119. 35 ILCS §5/304(a) sets forth the general sourcing rules for property, payroll, and sales factor purposes. The Department's citation to this subsection is insufficient to provide Petitioner with an explanation of the Department's adjustment.

120. 35 ILCS §5/304(d) sets forth the sourcing rules for income derived from furnishing transportation services, including services provided via pipelines, railways, and airways. The Department's citation to this subsection is insufficient to provide Petitioner with an explanation of the Department's adjustment.

121. The Department provides no authority, nor does any exist, that provides it the ability to allocate one-hundred percent of BOCT's intercompany switching receipts to Illinois attributed to Petitioner.

122. The Department failed to provide an accurate explanation of its adjustments that resulted in one-hundred percent allocation of BOCT's intercompany receipts to Illinois attributed to Petitioner.

123. The Department did not comply with the Taxpayer Bill of Rights

124. The Department did not comply with 35 ILCS 5/904(c).

125. Without providing an explanation as to its adjustments, the Department has deprived the Petitioner of a meaningful opportunity to protest the adjustments.

126. The Department has failed to establish its prima facie case.

127. Because the Notice does not comply with the Taxpayer Bill of Rights and 35 ILCS 5/904(c), depriving Petitioner of a meaningful opportunity to challenge the assessment, the Notice of Deficiency is invalid and should not be afforded a presumption of correctness.

WHEREFORE, Petitioner prays that this Tribunal enter an Order that:

- a) finds and declares that the Notice of Deficiency does not comply with the Taxpayer Bill of Rights;
- b) finds and declares that the Notice of Deficiency did not comply with 35 ILCS 5/904(c);
- c) finds and declare the Notice of Deficiency is invalid and not presumptively correct;
- d) finds and declares that the Department failed to establish a prima facie case; and
- e) grants such further relief as the Tribunal deems appropriate under the circumstances.

COUNT VII

The Department's Imposition of Penalties Should be Abated.

128. Petitioner realleges and reincorporates the allegations in paragraphs 1 through 112, inclusive, hereinabove.

129. On its Notice, the Department assessed penalties against the Petitioner in the amount of \$326,876.45 for the taxable year ending December 31, 2016. See Exhibit A.

130. In a separate letter issued on the same day as the Notice, the Department also assessed penalties for "late estimated payment" in the amount of \$14,163.73 for the taxable year ending December 31, 2016. See Exhibit B. It is unclear if this amount is included within the penalties calculated in the Department's Notice.

131. Illinois law provides that penalties shall not apply if a taxpayer shows that its failure to pay tax at the required time was due to reasonable cause. 35 ILCS §734-8.

132. The most important factor to be considered in a penalty abatement determination will be the extent to which a taxpayer made a good faith effort to determine its proper tax liability and to pay its proper tax liability in a timely fashion. 86 Ill. Admin. Code §700.400(b).

133. A taxpayer will be considered to have made a good faith effort to determine and pay its proper tax liability if it exercised ordinary business care and prudence in doing so. 86 Ill. Admin. Code §700.400(b).

134. Petitioner filed all of its corporate income and replacement tax returns for the Year at Issue in a timely fashion.

135. Petitioner, relying on Illinois law and prior audit determinations, exercised ordinary business care and prudence in determining its liability for the Year at Issue.

136. Petitioner, relying on Illinois law and prior audit determinations, exercised ordinary business care and prudence when it sourced its Transportation Group's income to Illinois according to 35 ILCS §5/304(d), the special apportionment methodology for transportation service companies.

137. Accordingly, the Department's assessed penalties should be waived for reasonable cause.

WHEREFORE, Petitioner prays that the Court enter an Order that:

- a) finds and declares the Department's assessment of penalties invalid;
- b) enters judgment in favor of Petitioner and against the Departments and orders the Department to abate the penalty imposed in its entirety;

- c) enjoins the Department from taking any action to assess, lien, levy, offset or in any other way prosecute and collect the amount of penalty invalidated by this Tribunal; and
- d) grants such further relief as the Court deems appropriate under the circumstances.

COUNT VIII

Consolidation with Related Case

138. Petitioner realleges and reincorporates the allegations in paragraphs 1 through 121, inclusive, hereinabove.

139. Petitioner currently has another matter pending before the Illinois Tax Tribunal on an identical issue (No. 19-TT-130). Petitioner requests that this petition be consolidated with that pending matter.

WHEREFORE, Petitioner prays that the Court enter an Order that:

- a) consolidates this petition with Case Number 19-TT-130; and
- b) grants such further relief as the Court deems appropriate under the circumstances.

Respectfully submitted,

CSX Transportation, Inc.
Petitioner

Breen M. Schiller

By: _____
One of Petitioner's Attorneys


Breen M. Schiller (breenschiller@eversheds-sutherland.com)
Eversheds Sutherland (US) LLP
900 North Michigan Ave., Suite 1000
Chicago, IL 60611-6521
(312) 724-8521

Justin T. Brown (justinbrown@eversheds-sutherland.com)
(pro hac vice admission pending)
Eversheds Sutherland (US) LLP
999 Peachtree St., NE, Suite 2300
Atlanta, GA 30309
(404) 407-5001

CERTIFICATE OF SERVICE

The undersigned hereby certifies that she caused a copy of the foregoing **Petition** to be served by electronic mail and by enclosing the same in an envelope, properly addressed, first-class postage prepaid and deposited in the US Mail at 700 Sixth Street, NW, Suite 700, Washington, DC 20001, before the hour of 5:00 p.m. on the 20th day of November, 2020.

James R. Reynolds
Illinois Department of Revenue
Office of Legal Services
100 W. Randolph St., 7-900
Chicago, IL 60601
James.R.Reynolds@Illinos.gov



Jaime L. Lane
Paralegal

EXHIBIT A

Notice of Deficiency

for Form IL-1120, Corporation Income and Replacement Tax Return



#BWNKMGV
#CNXX XXX1 3996 1447#
CSX TRANSPORTATION INC
ATTN: TAX DEPT
500 WATER ST # C-115
JACKSONVILLE FL 32202-4423

September 24, 2020



Letter ID: CNXXXXX139961447

Taxpayer ID: 54-6000720

Audit ID: A1230364672

Reporting period: December 2016

Total Deficiency: \$2,217,860.73

Balance due: \$2,217,860.73

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500 WATER ST # C-115

JACKSONVILLE FL 32202-4423

We have audited your account for the reporting period listed above. The attached statement explains the computation of your deficiency and the balance due. **Illinois law requires that we notify you of this deficiency and your rights.**

If you agree to this deficiency, pay the total balance due as soon as possible to minimize penalty and interest assessed. Make your check payable to the "Illinois Department of Revenue", write your taxpayer ID on your check, and mail a copy of this notice along with your payment.

If you do not agree, you may contest this notice by following the instructions listed below.

- **If the amount of this tax deficiency, exclusive of penalty and interest is more than \$15,000, or if no tax deficiency is assessed, but the total penalties and interest is more than \$15,000**, file a petition with the Illinois Independent Tax Tribunal within **60 days** of this notice. Your petition must be in accordance with the rules of practice and procedure provided by the Tribunal (35 ILCS 1010/1-1, et seq.) .
- **In all other cases**, file a protest with us, the Illinois Department of Revenue, within **60 days** of the date of this notice. If you file a protest on time, we must reconsider the proposed deficiency, and if requested, grant you or your authorized representative and administrative hearing. An administrative hearing is a formal legal proceeding conducted pursuant to the rules adopted by the Department and is presided over by an administrative law judge. Submit your protest on Form EAR-14, Format for Filing a Protest for Income Tax, (available on our website at tax.illinois.gov). If we do not receive your protest within **60 days**, this deficiency will become final. A protest of this notice does not preserve your rights under any other notice.
- **In any case**, you may instead, under Sections 2a and 2a.1 of the State Officers and Employees Money Disposition Act (30 ILCS 230/2a, 230/2a.1), pay the total liability under protest using Form RR-374, Notice of Payment Under Protest (available on our website at tax.illinois.gov), and file a complaint with the circuit court for a review of our determination.

If you do not protest this notice or pay the assessment total in full, we may take collection action against you for the balance due which, may include levy of your wages and bank accounts, filing of a tax lien, or other action.

Note: If you are under bankruptcy protection, see the "Bankruptcy Information" section on the following page of this notice for additional information and instructions. If you have questions, call us at the telephone number shown below.

Sincerely,

David Harris
Director

ILLINOIS DEPARTMENT OF REVENUE
AUDIT BUREAU
PO BOX 19012
SPRINGFIELD IL 62794-9012
217 524-2230

Bankruptcy Information

If you are currently under the protection of the Federal Bankruptcy Court, contact us and provide the bankruptcy case number and the bankruptcy court. The bankruptcy automatic stay does not change the fact you are required to file tax returns. For those under the bankruptcy protection, this notice is not an attempt to collect tax debt. Illinois law requires issuance of this notice to advise you of an amount due or a missing return that must be filed.

Taxpayer Bill of Rights

- You have the right to call the Department of Revenue for help in resolving tax problems.
- You have the right to privacy and confidentiality under most tax laws.
- You have the right to respond, within specified time periods, to Department notices by asking questions, paying the amount due, or providing proof to refute the Department's findings.
- You have the right to appeal Department decisions, in many instances, within specified time periods, by asking for Department review, by filing a petition with the Illinois Independent Tax Tribunal, or by filing a complaint in circuit court.
- If you have overpaid your taxes, you have the right, within specified time periods, to file for a credit (or, in some cases, a refund) of that overpayment.

The full text of the Taxpayers' Bill of Rights is contained in the Illinois Compiled Statutes, 20 ILCS 2520/1 et seq.

Statement

Date: September 24, 2020
Name: CSX TRANSPORTATION INC
Taxpayer ID: 54-6000720
Letter ID: CNXXXXX139961447

The attached EDA-27, Explanation of Adjustments, details your audit adjustments.

Computation of deficiency

Reporting period: 31-Dec-2016

Income or loss	
Federal taxable income	\$1,348,047,865.00
Net operating loss deduction	\$0.00
State Municipal and other interest excluded	\$5,956.00
Income tax and replacement tax deduction	\$7,226,572.00
Illinois bonus depreciation addition	\$799,713,519.00
Related party expenses additions	\$50,948,284.00
Other additions	\$0.00
Base income or loss	
Illinois bonus depreciation subtraction	\$672,881,316.00
Other subtractions	\$1,590,752.00
Total subtractions	\$674,472,068.00
Base income or net loss	\$1,531,470,128.00
Income allocable to Illinois	
Non-business income or loss	\$0.00
Non-unitary partnership bus. income or loss	\$0.00
Business income or loss	\$1,531,470,128.00
Apportionment formula	
Total sales everywhere	\$11,024,759,602.00
Total Illinois sales	\$551,588,828.00
Apportionment factor	0.050032
Business income/loss apportionable to IL	\$76,622,513.00
Nonbusiness income/loss allocable to IL	\$0.00
Non-unitary part. business income app. to IL	\$0.00
Base income or net loss allocable to IL	\$76,622,513.00
Net income	
Base income or net loss	\$76,622,513.00
IL net loss deduction (NLD)	\$0.00
Net income	\$76,622,513.00
Net replacement tax	
Replacement tax	\$1,915,563.00
Recapture of investment credits	\$0.00
Replacement tax before credits	\$1,915,563.00
Replacement tax investment credits	\$0.00
Net replacement tax	\$1,915,563.00
Net income tax	

Statement

Date: September 24, 2020
Name: CSX TRANSPORTATION INC
Taxpayer ID: 54-6000720
Letter ID: CNXXXXX139961447

Computation of deficiency	Reporting period: 31-Dec-2016
Income tax	\$4,022,682.00
Recapture of investment credits	\$0.00
Income tax before credits	\$4,022,682.00
Income tax investment credits	\$30,988.00
Net income tax	\$3,991,694.00
Refund or balance due	
Net replacement tax	\$1,915,563.00
Net income tax	\$3,991,694.00
Medical Cannabis Act Surcharge	\$0.00
Total net income and replacement tax due	\$5,907,257.00
Minus tax previously assessed	-\$4,258,711.00
Total tax deficiency	\$1,648,546.00
UPIA-5 late-payment penalty (Audit)	\$326,876.45
Plus interest on tax through September 24, 2020	\$242,438.28
Total deficiency	* \$2,217,860.73

If you intend to pay under protest, you must pay this total deficiency amount.

Computation of balance due	Reporting period: 31-Dec-2016
Balance due	* \$2,217,860.73

Explanation of Audit Adjustments

Income Tax



September 24, 2020



Letter ID: CNXXXX9799424X82

Taxpayer ID: 54-6000720
Account ID: 19369-25952
Audit ID: A1230364672
Reporting period: December 2016

#BWNKMGV

#CNXX XX97 9942 4X82#
CSX TRANSPORTATION INC
ATTN: TAX DEPT
500 WATER ST # C-115
JACKSONVILLE FL 32202-4423

Explanation of adjustments for tax period ending 12/31/2016

We estimated your income based on the best information available.
[35 ILCS 5/201]

Return Impact

\$984,995.00

Tax impact

\$2,856.00

We adjusted your addition modifications to reflect the addback of intangible expense paid to an affiliated company and required to be added back on Schedule 80/20.
[Ref: 35 ILCS 5/203(b)(2)(E-13)]

\$50,948,284.00

\$147,717.00

We adjusted your apportionment factor to reflect the proper method of apportionment required by Illinois law. We have calculated the factor to include receipts from transportation performed everywhere and in Illinois.
[35 ILCS 5/304(a), 5/304(d)]

\$0.00

\$1,497,973.00

Interest on tax and penalty, if applicable, has been computed as allowed by Illinois law. [35 ILCS 735/3-2]

We are imposing a penalty because you did not pay the amount required to be shown due on your return by the due date for payment. Once an audit has been initiated, the late payment penalty is assessed at 15 percent of the late payment. Failure to pay the amount due or invoke protest rights within 30 days from the "Date of Issuance" on the auditor's report issued with the EDA-143-I-APT, Notice of Audit Results, will result in this penalty increasing to 20 percent. [35 ILCS 735/3-3(b-20)(2)]

Taxpayer Statement



September 24, 2020 TDD 1 800 544-5304



Letter ID: CNXXX136211X1288

Account ID: 19369-25952

FEIN: 54-6000720

Total amount due: \$2,217,860.73

#BWNKMGV
#CNXX X136 211X 1288#
CSX TRANSPORTATION INC
ATTN: TAX DEPT
500 WATER ST # C-115
JACKSONVILLE FL 32202-4423

This statement lists our most recent information about your unpaid balance, available credits, or returns you have not filed. A payment voucher is included so you may pay the balance due.

Period	Tax	Penalty	Interest	Other	Payments/Credits	Balance
31-Dec-2016	5,907,257.00	341,040.18	217,610.15	-	(4,248,046.60)	2,217,860.73
31-Dec-2019	-	-	-	-	(5,663,700.19)	(5,663,700.19)

IL Business Income Tax

You have available credits of \$5,663,700.19

Account ID: 19369-25952

SOA

Retain this portion for your records.
Fold and detach on perforation. Return bottom portion with your payment.

P-000309

Taxpayer Statement (R-12/08) (136)

Letter ID: CNXXX136211X1288
CSX TRANSPORTATION INC

Mail this voucher and your payment to:
ILLINOIS DEPARTMENT OF REVENUE
PO BOX 19006
SPRINGFIELD IL 62794-9006



Total amount due: \$2,217,860.73

Write the amount you are paying below.

\$ _____

Write your Account ID on your check.

EXHIBIT B

Notice of Tax Due



#BWNKMGV
#CNXX X212 5358 4166#
CSX TRANSPORTATION INC
ATTN: TAX DEPT
500 WATER ST # C-115
JACKSONVILLE FL 32202-4423

September 24, 2020



Letter ID: CNXXX21253584166

Account ID: 19369-25952
Reporting period: December 2016

Here is information about your December 2016 Form IL-1120, Corporation Income and Replacement Tax Return.

- You did not make full estimated payment by the required due dates.

As a result we have assessed the amounts shown below.

To avoid cost of collection fees, additional penalties and interest for this assessment, you must pay on or before October 26, 2020. Please use the voucher on the enclosed Taxpayer Statement to make your payment.

	<u>Liability</u>	<u>Payments/Credit</u>	<u>Unpaid Balance</u>
Tax	4,258,711.00	(4,258,711.00)	0.00
Late Estimated Payment Penalty	14,163.73	0.00	14,163.73
Assessment Total	\$4,272,874.73	(\$4,258,711.00)	\$14,163.73

This reporting period on the attached taxpayer statement reflects the above plus any other activity.

If you believe you do not owe an amount identified above or have any questions, please call one of the numbers listed below.

1 800 732-8866
217 782-3336
TDD 1 800 544-5304

Note: If you are under bankruptcy protection, see the "Bankruptcy Information" section on the following pages of this notice for additional information and instructions.