

IN THE ILLINOIS INDEPENDENT TAX TRIBUNAL

MORGAN STANLEY AND  
CONSOLIDATED SUBS.

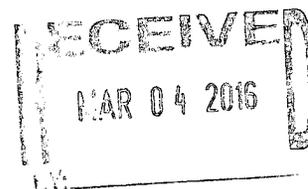
Petitioner,

v.

ILLINOIS DEPARTMENT OF REVENUE

Respondent.

No.



16 TT 44

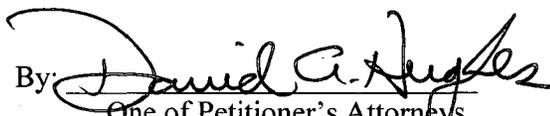
NOTICE OF FILING

To: Illinois Department of Revenue  
Office of Legal Services  
100 W Randolph St., Ste. 7-900  
Chicago, IL 60601

PLEASE TAKE NOTICE that on the 4th day of March, 2016, we filed with the Illinois Independent Tax Tribunal, 160 N. LaSalle Street, Room N506, Chicago, IL 60601 **Morgan Stanley and Consolidated Subsidiaries' Petition**, a copy of which accompanies this notice and is served on you herewith.

Respectfully submitted,

**MORGAN STANLEY AND  
CONSOLIDATED SUBS**  
Petitioner

By:   
One of Petitioner's Attorneys

David A. Hughes (dhughes@hmblaw.com)  
Horwood Marcus & Berk Chartered  
500 W. Madison Street, Suite 3700  
Chicago, IL 60661  
(312) 606-3200



6. The tax involved herein is the Illinois corporate income and replacement tax imposed under the Illinois Income Tax Act, 35 ILCS 5/201 *et seq.* (the “Tax”).
7. Pursuant to the Illinois Independent Tax Tribunal Act of 2012, this Tribunal has original jurisdiction over all determinations of the Department reflected on a Notice of Deficiency issued under the Illinois Income Tax Act where the amount at issue in the notice exceeds \$15,000, exclusive of penalties and interest. 35 ILCS 1010/1-45(a).

### **BACKGROUND**

8. Petitioner incurred losses for federal income tax and Illinois corporate income and replacement tax purposes for the tax years ended November 30, 2007, November 30, 2008 and December 31, 2008 (the “Loss Years”).
9. During each of the Loss Years, Petitioner held residual interests in Real Estate Mortgage Investment Conduits (“REMICs”).
10. As a residual interest holder in REMICs, Petitioner is subject to Internal Revenue Code (“IRC”) Section 860E.
11. Pursuant to IRC Section 860E(a), “[t]he taxable income of any holder of a residual interest in a REMIC for any taxable year shall in no event be less than the excess inclusion for such taxable year.” IRC § 860E(a)(1).
12. IRC Section 860E(a) further provides that any excess inclusion for any taxable year shall not be taken into account in determining the loss for a loss year pursuant to IRC Section 172(b)(2). IRC § 860E(a)(3)(A).
13. Pursuant to IRC Section 860E, Petitioner’s federal taxable income for the Loss Years could not be less than its excess inclusion income (“EII”) for those years.
14. For federal income tax purposes, Petitioner’s taxable income for the Loss Years reflected Petitioner’s EII, and the net operating losses (“NOLs”) generated in those years were carried over to future years.
15. On its originally filed Tax returns for each of the Loss Years, Petitioner paid Tax based on its EII and carried forward its net losses from those years.

16. On March 26, 2010, Petitioner filed amended Tax returns for each of the Loss Years, on which Petitioner amended its base income computation and carried forward its net losses from those years.
17. On October 9, 2015, Petitioner timely filed its Tax return for the Tax Year.
18. On its Tax return for the Tax Year, Petitioner claimed a net loss deduction (“NLD”) for net losses incurred during the Loss Years.
19. On November 17, 2015, the Department issued a Return Correction Notice for the Tax Year, indicating that the Department was disallowing Petitioner’s NLD because the Department’s records did not support Petitioner’s computation of the NLD. A true and accurate copy of the Return Correction Notice is attached as **Exhibit B**.
20. On January 4, 2016, the Department issued the Notice of Deficiency (the “Notice”), disallowing Petitioner’s NLD for the Tax Year, and imposing late payment penalties and statutory interest.
21. Pursuant to the Notice, the Department applied an estimated Tax payment to the total deficiency of \$205,897.73, to reduce the amount due to \$89,797.73.

## COUNT I

### **Petitioner is Entitled to the Net Loss Deduction**

22. Petitioner realleges and incorporates by this reference the allegations made in paragraphs 1 through 21, inclusive, hereinabove.
23. The Tax is “[a] tax measured by net income.” 35 ILCS § 5/201.
24. “Net income” is defined as the portion of the taxpayer’s base income for the taxable year that is allocable to the State, “less the standard exemption allowed by Section 204 and the deduction allowed by Section 207.” 35 ILCS § 5/202; *see also* Ill. Admin. Code 100.2050.
25. “Base income” is defined as the taxpayer’s taxable income with enumerated modifications. 35 ILCS § 5/203(b)(1).

26. Section 207(a) provides for the general computation of net losses. 35 ILCS § 5/207(a).
27. Section 207(a) also provides that net losses “shall be allowed as a net operating loss carryover to each of the 12 taxable years following the taxable year of such loss.” 35 ILCS § 5/207(a).
28. Section 207(e) provides for the computation of net losses for residual interest holders in REMICs that are subject to IRC Section 860E. 35 ILCS § 5/207(e).
29. Pursuant to Section 207(e), the net loss for a residual interest holder in a REMIC is equal to: (i) the amount computed under Section 207(a), without regard to Section 207(e), or if that amount is positive, zero; (ii) minus an amount equal to the amount computed under Section 207(a), without regard to Section 207(e), minus the amount that would be computed under Section 207(a) if the taxpayer’s federal taxable income were computed without regard to IRC Section 860E and without regard to Section 207(e). 35 ILCS § 5/207(e).
30. As Petitioner is a residual interest holder in a REMIC that is subject to IRC Section 860E, Petitioner is required to compute its net loss pursuant to Section 207(e) and is entitled to carryover any such loss for 12 subsequent taxable years. *See* 35 ILCS § 5/207(a), (e).
31. Petitioner is entitled to carryover the net losses generated in the Loss Years and deduct such losses as an NLD on its Tax return for the Tax Year. *See* 35 ILCS §§ 5/202; 5/207(a).
32. As Petitioner properly computed and deducted the NLD for the Tax Year, the Department’s disallowance of the NLD for the Tax Year was improper.

**WHEREFORE**, Petitioner prays that the Tribunal find and enter an order that:

- (a) Petitioner is entitled to the NLD for the Tax Year;
- (b) there is no Tax deficiency for the Tax Year;
- (c) the Notice be stricken;
- (d) the estimated Tax payment applied to the asserted deficiency be restored as a credit for future years; and

- (e) grants such further relief as the Tribunal deems appropriate under the circumstances.

## COUNT II

### The Notice Violates the Illinois and United States Constitutions

33. Petitioner realleges and incorporates by reference the allegations made in paragraphs 1 through 32, inclusive, hereinabove.
34. Article I, Section 2 of the Illinois Constitution provides that “[n]o person shall be deprived of life, liberty or property without due process of law nor be denied the equal protection of the laws.”
35. The Equal Protection Clause of the Fourteenth Amendment of the United States Constitution provides that no state may “deny to any person within its jurisdiction the equal protection of the laws.”
36. The Department’s disallowance of the NLD violates the Equal Protection and Due Process Clauses of the Illinois and United States Constitutions because it results in Petitioner being treated differently than other similarly-situated Illinois taxpayers and thus deprives Petitioner of property without due process and equal protection of law.
37. The Notice violates both the Due Process and Commerce Clauses of the United States Constitution because the Tax asserted is out of all appropriate proportion to, and does not fairly represent, the business conducted by Petitioner in Illinois. *Allied-Signal, Inc. v. Director, Division of Taxation*, 504 U.S. 768 (1992); *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159 (1983); *ASARCO Inc. v. Idaho State Tax Comm’n*, 458 U.S. 307, 330 (1982); *F.W. Woolworth Co. v. Taxation and Rev. Dep’t*, 458 U.S. 354, 364 (1982); *Hans Rees’ Sons, Inc. v. North Carolina*, 283 U.S. 123 (1931).

**WHEREFORE**, Petitioner prays that the Tribunal find and enter an order that:

- (a) The Notice violates the Illinois and United States Constitutions;
- (b) Petitioner is entitled to the NLD for the Tax Year;
- (c) there is no Tax deficiency for the Tax Year;
- (d) the Notice be stricken;
- (e) the estimated Tax payment applied to the asserted deficiency be restored as a credit for future years; and
- (f) grants such further relief as the Tribunal deems appropriate under the circumstances.

### **COUNT III**

#### **Penalties Should Be Abated**

- 38. Petitioner realleges and incorporates by this reference the allegations made in paragraphs 1 through 37, inclusive, hereinabove.
- 39. The Uniform Penalty and Interest Act imposes late payment penalties for failure to timely pay Tax and estimated Tax. *See* 35 ILCS §§ 735/3-3(b-20)(1) (imposing a late payment penalty “for failure to pay, prior to the due date for payment, any amount of tax the payment of which is required to be made prior to the filing of a return or without a return”) (the “Estimated Tax Penalty”); (b-20)(2) (imposing a late payment penalty “for failure to pay the tax shown due or required to be shown due on a return on or before the due date prescribed for payment of that tax”) (the “Tax Penalty”).
- 40. The Tax Penalty and the Estimated Tax Penalty “shall not apply if the taxpayer shows that his failure to file a return or pay tax at the required time was due to reasonable cause.” 35 ILCS § 735/3-8.
- 41. The determination of whether a taxpayer acted with reasonable cause “shall be made on a case by case basis taking into account all pertinent facts and circumstances” and “[t]he most important factor to be considered in making a determination to abate a penalty will be the extent to which the taxpayer made a good faith effort to determine his proper tax

liability and to file and pay his proper liability in a timely fashion.” 86 Ill. Admin. Code Sec. 700.400(b).

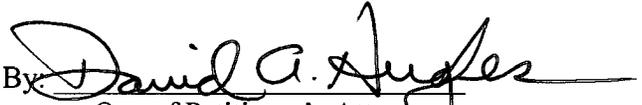
42. A taxpayer will be considered to have made a good faith effort to determine and file and pay his proper tax liability “if he exercised ordinary business care and prudence,” which “is dependent upon the clarity of the law or its interpretation and the taxpayer’s experience, knowledge, and education.” 86 Ill. Admin. Code Sec. 700.400(c).
43. The Department will also consider a taxpayer’s filing history in determining whether the taxpayer acted in good faith in determining and paying his tax liability. 86 Ill. Admin. Code Sec. 700.400(d).
44. The Tax Penalty and the Estimated Tax Penalty asserted in the Notice should be abated because, as discussed above, Petitioner acted in good faith in computing its net losses for the Loss Years and the NLD for the Tax Year.
45. Petitioner’s filing history further establishes that Petitioner consistently acts in good faith in determining and timely filing its Tax returns and paying Tax.

**WHEREFORE**, Petitioner prays that the Tribunal find and enter an order that:

- (a) the Tax Penalty and the Estimated Tax Penalty asserted in the Notice be abated;  
and
- (b) grants such further relief as the Tribunal deems appropriate under the circumstances.

Respectfully submitted,

**MORGAN STANLEY AND  
CONSOLIDATED SUBS**  
Petitioner

By:   
One of Petitioner's Attorneys

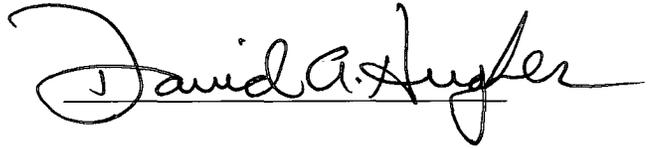
David A. Hughes  
Horwood Marcus & Berk Chartered  
500 West Madison Street, Suite 3700  
Chicago, IL 60661  
(312) 606-3200  
dhughes@hmblaw.com

1224349

**CERTIFICATE OF SERVICE**

Undersigned counsel of record hereby certifies that he caused a copy of the foregoing **Petition** to be served upon other counsel of record herein by causing the same to be delivered by messenger before the hour of 5:00 p.m. on the 4th day of March, 2016.

Illinois Department of Revenue  
Office of Legal Services  
100 W. Randolph St., 7-900  
Chicago, IL 60601

A handwritten signature in black ink that reads "David A. Hughes". The signature is written in a cursive style with a large initial "D" and a horizontal line underlining the name.

# Notice of Deficiency

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



January 4, 2016



Letter ID: CNXXXX6162336164

#BWNKMGV  
#CNXX XX61 6233 6164#  
MORGAN STANLEY DEAN WITTER & CO &  
MORGAN STANLEY AND CONSOLIDATED SUBS  
ATTN: PRIYA TAMOSAITIS JAMES.PERRAGLIA  
1633 BROADWAY FL 25TH  
NEW YORK NY 10019-6708

Taxpayer ID: 36-3145972  
Reporting period: December 2014  
Total deficiency: \$205,897.73  
Balance due: \$89,797.73



We have determined that you owe amounts 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, you must pay the total balance due as soon as possible to minimize penalty and interest assessed. Make your check payable to "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 this notice. If you file a protest on time, we must reconsider the proposed deficiency, and if requested, grant you or your authorized representative an administrative hearing. An administrative hearing is a formal legal proceeding conducted pursuant to 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](http://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 deficiency under protest using Form RR-374, Notice of Payment Under Protest (available on our website at [tax.illinois.gov](http://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 balance due 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.

If you have questions, contact us at the telephone number shown below.

Sincerely,

Constance Beard  
Director of Revenue

BUSINESS PROCESSING DIVISION  
ILLINOIS DEPARTMENT OF REVENUE  
PO BOX 19014  
SPRINGFIELD IL 62794-9014  
217 557-9676

# Return Correction Notice

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



November 17, 2015 TDD 1 800 544-5304



Letter ID: CNXXXX8473123521

Account ID: 20178-33472

FEIN: 36-3145972

Reporting Period: December 2014

#BWNKMGV  
#CNXX XX84 7312 3521#  
MORGAN STANLEY DEAN WITTER & CO &  
MORGAN STANLEY AND CONSOLIDATED SUBS  
ATTN: PRIYA TAMOSAITIS JAMES.PERRAGLIA  
1633 BROADWAY FL 25TH  
NEW YORK NY 10019-6708



## We have found problems with your return.

- We changed the amount of total payments and credits you claimed on your return. Our records indicate that you have the following amounts available:

- Credit for previous year overpayment	\$0.00
- Estimated payments	\$116,100.00
- IL-505-B payments	\$0.00
- Pass-Through Withholding and/or Gambling Withholding Credit	\$0.00

The payments we have on file are listed below. If you disagree, please send us a copy of the front and back of each missing cancelled check or money order you issued or any electronic confirmation you received to make your payments.

NUMBER ON CHECK	DATE	AMOUNT
1416335101023	06/04/14	\$112,000.00
1423935101000	08/19/14	\$4,100.00

- We disallowed your unitary Illinois Net Loss Deduction (NLD) because you claimed more loss than our records indicate you have available. Please take the following actions, as applicable, to correct your return:
  - Verify that you are using your unitary Illinois NLD and not the Federal Net Operating Loss Deduction from your federal tax returns.
  - Send us a breakdown showing how you figured the amount of unitary Illinois NLD that you claimed.
  - If you have Illinois net loss due to adding a new member with an NLD to your unitary business group or due to a merger of one member with an NLD into another member, or you previously filed under a different FEIN, please provide us with the FEIN, the tax year the loss was earned, and the date of the acquisition or merger.
  - Provide any other documentation that would support your unitary Illinois NLD. This includes filing any returns claiming an Illinois loss that we may not have on file. If you earn a loss in a tax year, you must file that return in order to claim the loss in any subsequent tax year.