

ILLINOIS INDEPENDENT TAX TRIBUNAL

MORGAN STANLEY)	
AND CONSOLIDATED SUBS,)	
)	
Petitioner,)	
)	Case No. 16-TT-44
v.)	
)	Brian F. Barov
ILLINOIS DEPARTMENT OF REVENUE,)	Administrative Law Judge
)	
Respondent.)	

NOTICE OF FILING BY E-MAIL

TO: Mr. David A. Hughes
Horwood Marcus & Berk Chartered
500 W. Madison, Suite 3700
Chicago, Illinois 60601
(312) 606-3200
dhughes@hmblaw.com

PLEASE TAKE NOTICE that on April 27, 2016, Respondent filed by e-mail with the Illinois Independent Tax Tribunal, located at 160 N. LaSalle Street Room N506, Chicago, Illinois 60601, its **ANSWER** in the above captioned matter.

/s/ Jonathan M. Pope
Jonathan M. Pope
Special Assistant Attorney General

Jonathan M. Pope
Illinois Department of Revenue
100 West Randolph Street, 7-900
Chicago, IL 60601
(312) 814-3185
jonathan.pope@illinois.gov

Dated: April 27, 2016

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Petitioner,)	
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CERTIFICATE OF SERVICE

Jonathan M. Pope certifies that he is a Special Assistant Attorney General of the State of Illinois duly appointed by Lisa Madigan, Attorney General of the State of Illinois; that he is authorized to make this certificate; that on April 27, 2016 before the hour of 5:00 p.m. (C.S.T.) he served a true and exact copy of the foregoing instrument entitled **ANSWER** on Petitioner by sending the same as an attachment to an e-mail message addressed to Petitioner at its designated e-mail address:

Mr. David A. Hughes: dhughes@hmbllaw.com

 /s/ Jonathan M. Pope
Jonathan M. Pope
Special Assistant Attorney General

Jonathan M. Pope
Illinois Department of Revenue
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ANSWER

NOW COMES the Illinois Department of Revenue (“Department”), through its attorney, Lisa Madigan, Illinois Attorney General, by Jonathan Pope, Special Assistant Attorney General, and for its Answer to the Petition of Edmund J. Sweeney (“Petitioner”) respectfully pleads as follows:

THE PARTIES

1. Petitioner’s headquarters and principal place of business are located at 1585 Broadway, New York, NY 10036.

ANSWER: The Department admits the statement in Paragraph 1.

2. Petitioner is represented by David A. Hughes of Horwood Marcus & Berk Chartered, located at 500 West Madison St., Suite 3700, Chicago, Illinois 60661, who can be reached at 312-606-3212 or dhughes@hmblaw.com

ANSWER: The Department admits the statements in Paragraph 2.

3. Petitioner’s FEIN is 36-3145972.

ANSWER: The Department admits the statement in Paragraph 3.

4. Respondent, the Illinois Department of Revenue (“Department”), is an agency of the Executive Department of the State Government. 20 ILCS 5/5-15.

ANSWER: The Department admits the statement in Paragraph 4.

JURISDICTION

5. Petitioner is protesting the Notice of Deficiency, dated January 4, 2016, asserting a deficiency of Illinois corporate and replacement tax in the amount of \$192,134 for the tax year ended December 31, 2014 (the “Tax Year”). A true and accurate copy of the Notice of Deficiency is attached as Exhibit A.

ANSWER: The Department admits the statements in Paragraph 5.

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”).

ANSWER: The Department admits the statement in Paragraph 6.

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).

ANSWER: Petitioner’s assertion that the Tribunal has jurisdiction over this matter is a legal conclusion, not a material allegation of fact, and therefore does not require an answer pursuant to Illinois Independent Tax Tribunal Regulation (“Rule”) 310(b)(2) (86 Ill. Admin. Code § 5000.310).

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”).

ANSWER: The Department denies the allegations in Paragraph 8.

9. During each of the Loss Years, Petitioner held residual interests in Real Estate Mortgage Investment Conduits (“REMICs”).

ANSWER: The Department lacks sufficient knowledge to either admit or deny the allegations in Paragraph 9 and demands strict proof thereof.

10. As a residual interest holder in REMICs, Petitioner is subject to Internal Revenue Code (“IRC”) Section 860E.

ANSWER: Paragraph 10 contains a legal conclusion, not a material allegation of fact, and therefore does not require an answer pursuant to Rule 310(b)(2).

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).

ANSWER: The Department admits that Petitioner has accurately reproduced IRC Section 860E(a)(1). The Department denies all other allegations in Paragraph 11 related thereto.

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 IRS Section 172(b)(2). IRC § 860E(e)(3)(A).

ANSWER: The Department admits that Petitioner has paraphrased IRC Section 860E(a)(3). The Department denies all other allegations in Paragraph 12 related thereto.

13. Pursuant to IRS Section 860E, Petitioner's federal taxable income for the Loss Years could not be less than its excess inclusion income ("EII") for those years.

ANSWER: Paragraph 13 contains a legal conclusion, not a material allegation of fact, and therefore does not require an answer pursuant to Rule 310(b)(2). To the extent an answer is required, the Department denies all allegations in Paragraph 13.

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.

ANSWER: Paragraph 14 contains a legal conclusion, not a material allegation of fact, and therefore does not require an answer pursuant to Rule 310(b)(2). To the extent an answer is required, the Department denies all allegations in Paragraph 14.

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.

ANSWER: The Department lacks sufficient knowledge to either admit or deny the allegations in Paragraph 15 and demands strict proof thereof.

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.

ANSWER: The Department lacks sufficient knowledge to either admit or deny the allegations in Paragraph 16 and demands strict proof thereof.

17. On October 9, 2015, Petitioner timely filed its Tax return for the Tax Year.

ANSWER: Based on knowledge, information, and belief after a reasonable inquiry, the Department admits the allegation in Paragraph 17.

18. On its Tax return for the Tax Year, Petitioner claimed a net loss deduction (“NLD”) for net losses incurred during the Loss Years.

ANSWER: The Department admits that Petitioner attempted to claim \$2,022,402 in NLDs on its 2014 Form IL-1120, Line 38. The Department denies all other allegations in Paragraph 18 related thereto.

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**.

ANSWER: The Department admits the allegations in Paragraph 19.

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.

ANSWER: The Department admits the allegations in Paragraph 20.

21. Pursuant to the Notice, the Department applied an estimated Tax payment to the total deficiency of \$205,897.73, to reduce the amount to \$89,797.73

ANSWER: The Department admits the allegations in Paragraph 21.

COUNT I

22. Petitioner realleges and incorporates by this reference the allegations made in paragraphs 1 through 21, inclusive, hereinabove.

ANSWER: The Department incorporates and repeats its Answers to Paragraphs 1 through 21, as if fully set forth herein.

23. The Tax is “[a] tax measured by net income.” 35 ILCS 5/201.

ANSWER: The Department admits that Petitioner has accurately reproduced a portion of IITA Section 201(a). The Department denies all other allegations in Paragraph 23 related thereto.

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.

ANSWER: The Department admits that Petitioner has accurately paraphrased IITA Section 202. The Department denies all other allegations in Paragraph 24 related thereto.

25. “Base income” is defined as the taxpayer’s taxable income with enumerated modifications. 35 ILCS § 5/203(b)(1).

ANSWER: The Department admits that Petitioner has accurately paraphrased IITA Section 203(b)(1). The Department denies all other allegations in Paragraph 25 related thereto.

26. Section 207(a) provides for the general computation of net losses. 35 ILCS § 5/207(a).

ANSWER: Paragraph 26 contains a legal conclusion, not a material allegation of fact, and therefore does not require an answer pursuant to Rule 310(b)(2).

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).

ANSWER: Paragraph 27 contains a legal conclusion, not a material allegation of fact, and therefore does not require an answer pursuant to Rule 310(b)(2).

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).

ANSWER: Paragraph 28 contains a legal conclusion, not a material allegation of fact, and therefore does not require an answer pursuant to Rule 310(b)(2).

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 the 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).

ANSWER: The Department admits that Petitioner has accurately paraphrased IITA Section 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).

ANSWER: Paragraph 30 contains a legal conclusion, not a material allegation of fact, and therefore does not require an answer pursuant to Rule 310(b)(2). To the extent an answer is required, the Department denies all allegations in Paragraph 30 related thereto.

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).

ANSWER: The Department denies the allegations in Paragraph 31.

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.

ANSWER: Paragraph 32 contains a legal conclusion, not a material allegation of fact, and therefore does not require an answer pursuant to Rule 310(b)(2). To the extent an answer is required, the Department denies all allegations in Paragraph 32 related thereto.

WHEREFORE, the Department prays that the Tribunal enter an order that:

- a. finds Petitioner is not entitled to the NLD for the Tax Year;
- b. finds the Notice of Deficiency is correct as issued;
- c. finds the estimated Tax Payment was correctly applied as asserted in the Notice of Deficiency; and
- d. grants such further relief as this Tribunal deems appropriate under the circumstances.

COUNT II

33. Petitioner realleges and incorporates by reference the allegations made in paragraphs 1 through 32, inclusive, hereinabove.

ANSWER: The Department incorporates and repeats its Answers to Paragraphs 1 through 32, as if fully set forth herein.

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.”

ANSWER: The Department admits that Petitioner has accurately reproduced Article I, Section 2 of the Illinois Constitution. The Department denies all other allegations in Paragraph 34 related thereto.

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.”

ANSWER: The Department admits that Petitioner has accurately reproduced a portion of Section 1 of the Equal Protection Clause of the Fourteenth Amendment of the United States Constitution. The Department denies all other allegations in Paragraph 35 related thereto.

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 the law.

ANSWER: Paragraph 36 contains a legal conclusion, not a material allegation of fact, and therefore does not require an answer pursuant to Rule 310(b)(2). To the extent an answer is required, the Department denies all allegations in Paragraph 36 related thereto.

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).

ANSWER: Paragraph 37 contains a legal conclusion, not a material allegation of fact, and therefore does not require an answer pursuant to Rule 310(b)(2). To the extent an answer is required, the Department denies all allegations in Paragraph 37 related thereto.

WHEREFORE, the Department prays that the Tribunal enter an order that:

- a. finds the Notice violates neither the Illinois nor United States Constitutions;
- b. finds Petitioner is not entitled to an NLD for the Tax Year;
- c. finds the Notice of Deficiency is correct as issued; and
- d. grants such further relief as this Tribunal deems appropriate under the circumstances.

COUNT III

38. Petitioner realleges and incorporates by reference the allegations made in paragraphs 1 through 37, inclusive, hereinabove.

ANSWER: The Department incorporates and repeats its Answers to Paragraphs 1 through 37, as if fully set forth herein.

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”).

ANSWER: The Department admits that Petitioner has accurately reproduced portions of 35 ILCS §§ 735/3-3(b-20)(1), (2). The Department denies all other allegations in Paragraph 39 related thereto.

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.

ANSWER: The Department admits that Petitioner has accurately reproduced a portion of 35 ILCS § 735/3-8. The Department denies all other allegations in Paragraph 40 related thereto.

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).

ANSWER: The Department admits that Petitioner has accurately reproduced 86 Ill. Admin. Code Sec. 700.400(b). The Department denies all other allegations in Paragraph 41 related thereto.

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).

ANSWER: The Department admits that Petitioner has accurately reproduced a portion of 86 Ill. Admin. Code Sec. 700.400(c). The Department denies all other allegations in Paragraph 42 related thereto.

43. The Department will also consider a taxpayer's filing history in determining whether the taxpayer acted in good faith in determining any paying his tax liability. 86 Ill. Admin. Code Sec. 700.400(d).

ANSWER: The Department admits that Petitioner has accurately reproduced a portion of 86 Ill. Admin. Code Sec. 700.400(d). The Department denies all other allegations in Paragraph 43 related thereto.

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.

ANSWER: Paragraph 44 contains a legal conclusion, not a material allegation of fact, and therefore does not require an answer pursuant to Rule 310(b)(2). To the extent an answer is required, the Department lacks sufficient knowledge to either admit or deny the allegations in Paragraph 44 and demands strict proof thereof.

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.

ANSWER: Paragraph 45 contains a legal conclusion, not a material allegation of fact, and therefore does not require an answer pursuant to Rule 310(b)(2). To the extent an answer is required, the Department lacks sufficient knowledge to either admit or deny the allegations in Paragraph 45 and demands strict proof thereof.

WHEREFORE, the Department prays that the Tribunal enter an order that:

- a. finds Petitioner is not entitled to the NLD for the Tax Year;
- b. finds the Notice of Deficiency is correct as issued; and

- c. grants such further relief as this Tribunal deems appropriate under the circumstances.

Respectfully Submitted,

LISA MADIGAN
State of Illinois Attorney General

By: /s/ Jonathan M. Pope
Jonathan M. Pope
Attorney for the Department

Jonathan M. Pope
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Illinois Department of Revenue
Office of Legal Services
100 W. Randolph St., 7-900
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Dated: April 28, 2016

ILLINOIS INDEPENDENT TAX TRIBUNAL

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)	Brian F. Barov
ILLINOIS DEPARTMENT OF REVENUE,)	Administrative Law Judge
)	
Respondent.)	

AFFIDAVIT OF KEVIN ANGUISH
PURSUANT TO TRIBUNAL RULE 5000.310(b)(3)

STATE OF ILLINOIS

COUNTY OF SANGAMON

Under penalties as provided by Section 1-109 of the Code of Civil Procedure, 735 ILCS §5/1-109, I, Kevin Anguish, being first duly sworn on oath, depose, and state as follows:

1. I am currently employed by the Illinois Department of Revenue.
2. My current title is Public Service Administrator.
3. I reviewed Petitioner's IL-1120, Corporation Income and Replacement Tax Return, for the tax year ending December 31, 2014.
4. I lack the requisite knowledge to either admit or deny the allegations alleged in Taxpayer's Petition Paragraphs 9, 15, 16, 44, and 45.
5. I am an adult resident of the State of Illinois and can truthfully and competently testify to the matters contained herein based upon my own personal knowledge.

Under penalties as provided by law pursuant to Section 1-109 of the Code of Civil Procedure, the undersigned certifies that the statements set forth in this instrument are true and correct, except as to matters therein stated to be on information and belief and as to such matters the undersigned certifies as aforesaid that he verily believes the same to be true.



 Kevin Anguish
 Public Service Administrator
 Illinois Department of Revenue

Date: 4/27/16