IN THE ILLINOIS INDEPENDENT TAX TRIBUNAL

PEPSICO, INC. AND AFFILIATES,	)	
	)	Case Nos. 16 TT 82 and 17 TT 16
Petitioner,	)	
	)	
v.	)	
	)	Chief Judge James M. Conway
ILLINOIS DEPARTMENT OF REVENUE,	)	
	)	
Respondent.	)	

PETITIONER PEPSICO, INC. AND AFFILIATES' REPLY MEMORANDUM IN SUPPORT OF ITS MOTION FOR SUMMARY JUDGMENT

THEODORE R. BOTS
DAVID A. HEMMINGS
BAKER & MCKENZIE LLP
300 E. Randolph Street, Ste. 5000
Chicago, IL 60601
Telephone: (312) 861-8845
Fax: (312) 698-2004
theodore.bots@bakermckenzie.com
drew.hemmings@bakermckenzie.com

GEORGE M. CLARKE
BAKER & MCKENZIE LLP
815 Connecticut Avenue, NW
Washington, DC 20006
Telephone: (202) 835-6184
Fax: (202) 416-7184
george.clarke@bakermckenzie.com

Attorneys for Petitioner,
PepsiCo, Inc. and Affiliates

TABLE OF CONTENTS

I. The Department Now Postures That Summary Judgment Is Inappropriate 2

A. The Parties Engaged In Extensive Factual Discovery and Executed Comprehensive Joint Stipulations of Fact to Resolve the Dispute On Cross-Motions for Summary Judgment 3

B. Realizing It Could Not Prevail on a Fully Stipulated Record, the Department Reversed Course on Summary Judgment 3

1. The Department Distorts Jointly Stipulated Facts 5

2. The Department Engrafts Unwritten And Yet to Be Defined Qualifications and Standards Onto the Illinois 80/20 Rule.............7

C. Summary Judgment Is Proper: There Are No Facts In Dispute 7

II. The Statutory Text of the Illinois 80/20 Rule Fully Reflects Legislative Intent.............9

A. The Department's Extra-Statutory Interpretation of the 80/20 Rule Is Unsupported, Undefined, and Unprecedented.............10

B. The Illinois 80/20 Rule Has Remained Unchanged for Nearly 40 Years.............12

III. PGM LLC Is the Employer of Its Expatriate Employees Under Universally Accepted Common Law Agency Principles............. 13

A. The Department's Common Law Employer Analysis is Based on Overruled Precedent 13

1. The "Economic Realities" of Social Legislation Standard in *Silk* Was Overruled By the U.S. Supreme Court.............14

2. The *Bartels* Case Mirrors the Flawed and Overruled *Silk* "Economic Realities" Analysis 17

3. Contractual Rights Are Critical to Common Law Employer-Employee Determinations In Three Party Arrangements.............19

B. The Department Misapplies Common Law Agency Factors Applicable to Independent Contractors to Employer-Employee Leasing Arrangements 20

C. PGM LLC Is The Employer of Its Expatriate Employees Under Applicable Common Law Employer-Employee Agency Principles.............25

1. The Expatriates Are PGM LLC's Employees Under Common Law Agency Principles Applicable to Global Employment Companies 25

a. *PGM LLC Has the Right to Control and Direct Expatriate Employees* 25

b. *PGM LLC Has the Right to Discharge Its Expatriates' Overall Employment*...30

c. *Expatriates Are Temporarily Assigned to FHCs By PGM LLC* 31

d. *All Parties (PGM LLC, the FHCs, and the Expatriates) Executed Contracts with the Intent for PGM LLC to be the Common Law Employer*..31

2. The Department Misapplies Common Law Agency Factors That Are Not Applicable to Three Party GEC / PEO Arrangements 32

a. *PGM LLC Does Not Require A Profit to Be A Common Law Employer of Its Expatriate Employees* 32

b. *Foreign Host Company Input on Expatriate Employee Performance Reviews Does Not Shift the Employer-Employee Relationship* 33

c. *The Foreign Host Company Furnishing Tools or Facilities Does Not Inform the Employer-Employee Analysis in GEC / PEO Arrangements* 36

3. PGM LLC Is the Common Law Employer Even Under the Department's Overruled "Economic Realities" Standard..................36

4. The Professional Employer Organization Cases Cited By the Department Are Distinguishable..39

a. *Professional & Executive Leasing – Overruled Law and Inapposite Facts*..39

b. *Burnetta – The Client Company Retained the Right to Control and Direct* 40

c. *Utah State Tax Commission – The Client Company Retained the Right to Control and Direct* 42

IV. PepsiCo Has Met Its Burden of Proof...44

A. FLNA and PGM LLC Operate As A Single, Unitary Business 44

B. The Law and Facts Are Clear: PGM LLC Compensation Is Includible As FLNA Foreign Compensation...47

1. Foreign Compensation Consolidated Into PGM LLC in Accordance

with Best Business Practice 48

2. Extraction of PGM LLC Foreign Payroll Is Improper 48

V. PGM LLC's Substance As A Global Employment Company Cannot Be Recast By the Department's Misguided Arguments 49

A. The Department Misconstrues Illinois and Federal Substance-Over-Form Case Law 50

1. *JI Aviation* Provides No Support for the Department's Claim that PGM LLC Lacks Economic Substance or Business Purpose 50

2. The Department's Interpretation of *Hartney Fuel Oil* Supports Exclusion of FLNA From PepsiCo's Illinois Combined Return as an 80/20 Company 51

3. The Department Cannot Dismiss *Summa Holdings* Based On Irrelevant Factual Differences 52

B. The PepsiCo Corporate Group's 2010 Global Restructuring Is Not A Sham Transaction 53

C. The Department is Prohibited From Disregarding an Entity (1) Possessing Economic Substance; or (2) Formed for A Substantial Non-Tax Business Reason 54

D. PGM LLC (1) Is A Substantive Business Enterprise; and (2) Was Created for Non-Tax Business Reasons to Serve the PepsiCo Corporate Group 57

1. PGM LLC Has Practical Economic Substance Beyond Tax Savings .58

2. PGM LLC Was Formed For Non-Tax Business Reasons 62

3. Even If PGM LLC Were Disregarded, Its Payroll Is Part of FLNA ..64

E. The Department's Sham Transaction and Economic Substance Arguments Would Require the Tax Tribunal to Override Jointly Stipulated Facts and Ignore Reality 65

CONCLUSION 67

IN THE ILLINOIS INDEPENDENT TAX TRIBUNAL

PEPSICO, INC. AND AFFILIATES,	)	
	)	Case Nos. 16 TT 82 and 17 TT 16
Petitioner,	)	
	)	
v.	)	
	)	Chief Judge James M. Conway
ILLINOIS DEPARTMENT OF REVENUE,	)	
	)	
Respondent.	)	

PETITIONER PEPSICO, INC. AND AFFILIATES' REPLY MEMORANDUM IN SUPPORT OF ITS MOTION FOR SUMMARY JUDGMENT

This dispute has been pending before the Tax Tribunal since April 2016. The facts are clear and undisputed. The parties executed Joint Stipulations of Fact ("Joint Stipulation" or "Joint Stip."), consisting of 158 stipulations, 47 exhibits, and thousands of pages of authenticated business records and evidential documents. The law is equally clear. Application of the controlling statutory and regulatory framework to the Joint Stipulation requires Frito-Lay North America, Inc. ("FLNA") to be an "80/20 Company" under the Illinois Income Tax Act, 35 ILCS 5/101, *et seq*. (the "IITA").

The Department attempts to obfuscate this result by distorting the Joint Stipulation and proposing that unwritten and undefined criteria somehow inform the result of this matter. Neither tactic succeeds. Nor should either serve as a basis to prolong this dispute any longer. Simply put, PepsiCo Global Mobility, LLC ("PGM LLC") is a global *employment* company. The *stipulated* record demonstrates that PGM LLC was formed and is the employer of the expatriate employees for valid and commonly understood business reasons separate and apart from any Illinois tax savings. *See* Joint Stip. ¶¶ 7, 54-59, 65, 67, and 73. PGM LLC substantively impacts the economic welfare of all parties involved by "causing" "high-performing expatriate executives, directors,

managers, and analysts from [the] PepsiCo Corporate Group" "to provide specific technical services to the applicable foreign host company [("FHC")]", while at the same time securing PGM LLC expatriates' "eligibl[ity] to participate in the PepsiCo Corporate Group's U.S. benefits plans". Joint Stip. ¶¶ 62, 82, 84. As the common law employer of expatriates, PGM LLC rapidly deploys talented professionals within the PepsiCo Corporate Group to emerging international markets with the goal of developing those expatriates' long-term capabilities, while at the same time increasing profitability at the ground level where those expatriates are seconded. *See* Joint Stip. ¶¶ 62 158, Exhibit 22.

Neither the substance of PGM LLC nor the impact of the Illinois 80/20 Rule can seriously be disputed. The Department cannot rewrite binding PGM LLC secondment and employment agreements solely to increase its Illinois tax collections. And it cannot disregard controlling common law agency employer-employer principles on the basis of a bankrupt analytical framework set forth in seventy-year old cases that have been expressly disavowed by the U.S. Supreme Court. For the reasons discussed in PepsiCo's opening brief, and as further elaborated herein, FLNA is an 80/20 Company under Illinois law and PepsiCo is entitled to summary judgment on Count I of Case No. 16 TT 82 (the "First Petition") and Count I of Case No. 17 TT 16 (the "Second Petition").

I. <u>The Department Now Postures That Summary Judgment Is Inappropriate</u>

From the outset, the parties agreed that "joint stipulations will be the most efficient and effective way of presenting most of the relevant facts to Judge Conway." Discovery Letter From Department Opposing Counsel to PepsiCo Counsel (July 19, 2018). Attached hereto as **Exhibit C**. Well before discovery was even completed, the Department explained that "both parties are interested in ultimately resolving Count I [the FLNA 80/20 Company issue] based on either cross-motions for summary judgment or through a stipulated record with some live witnesses." *Id.*

A. The Parties Engaged In Extensive Factual Discovery and Executed Comprehensive Joint Stipulations of Fact to Resolve the Dispute On Cross-Motions for Summary Judgment

For two-and-a-half years, the parties engaged in collaborative discovery efforts on the FLNA 80/20 Company issue, including: extensive documentation review, numerous in-person and telephonic conferences, and depositions of six fact witnesses over three days in Purchase, New York.[1] Summarizing the significant progress made by the parties in discovery over the years, counsel for the Department informed the Tax Tribunal:

> The Parties have collaborated and worked very diligently over the last several months to complete the joint stipulation. In this regard we have exchanged countless emails and documents, and held numerous conferences (in person and by phone) to negotiate the stipulations. Counsel for both parties have fully negotiated and finalized all 28 pages worth of stipulations, along with 46 corresponding exhibits. Counsel for PepsiCo has informed us that their client has fully signed off on all of the stipulations/exhibits. We are currently awaiting approval by Department senior litigation management of the final stipulations / exhibits, provided to them earlier today. Senior management review and signoff is required as matter of Department policy given the substantial tax dollars at issue.

Department email to Judge Conway (Dec. 19, 2019), attached hereto as **Exhibit D**. In connection with requesting an extension of time before the next status conference, counsel for the Department further elaborated "the inconvenience of the three-week delay we propose in the next status conference and *setting dates for cross motions for summary judgment* will be offset by the time economies of avoiding what would have otherwise undoubtedly been a lengthy trial were we not to reach agreement on the factual stipulations." *Id*. (emphasis added).

B. Realizing It Could Not Prevail on a Fully Stipulated Record, the Department Reversed Course on Summary Judgment

The Department's senior management signed off on the Joint Stipulation and the document

[1] The Department issued its discovery requests on August 17, 2017. The Joint Stipulation was executed on January 17, 2020.

was executed by counsel for both parties and filed with the Tax Tribunal on January 17, 2020. The parties continued to repeatedly represent to the Tax Tribunal their agreement to resolve Count I on cross-motions for summary judgment, as reflected in the numerous court orders. *See, e.g.*, Order (Nov. 13, 2019) ("A schedule for summary judgment motions and oral argument will be set …"), attached hereto as **Exhibit E**; and Order (Feb. 28, 2020) (after an in-person informal conference before Judge Conway, an order was entered stating the "Department will file its response / summary judgment motion by June 11, 2020."), attached hereto as **Exhibit F**.

And yet, despite years of diligent factual investigation, the Department reneged on cross-motions for summary judgment at the very last minute without notification to PepsiCo or the Tax Tribunal. This is more than a minor procedural skirmish. The reason *why* the Department so fundamentally changed its position has implications for the Tax Tribunal. Despite all of this extensive and time-consuming joint pre-trial work, the Department now asserts PepsiCo has not met its burden to prove FLNA is an 80/20 Company. In order to support that premise, the Department has to i) distort the jointly stipulated facts; and ii) engraft amorphous and yet to be defined standards onto Illinois law, including 35 ILCS 5/1501(a)(27)(A) (the "80/20 Rule"). Obviously, the Department knew taking such a position in a cross motion would be viewed with a jaundiced eye by the Tax Tribunal -- truly a "head's I win, tails you lose" strategy. Its revised tactic should fare no better. The stipulated facts prove FLNA is the common-law employer of the expatriate employees and the 80/20 Company black-letter rule defines the scope of the unitary group with needed and legislatively-purposeful specificity. Even in merely opposing PepsiCo's Motion for Summary Judgment, the Department cannot distort agreed facts simply because it does not like the result of those facts when applied to a clear, mechanical legal test.

1. The Department Distorts Jointly Stipulated Facts

The jointly stipulated facts -- as written without modification -- bind the parties. *See People v. Pablo*, 2018 IL App (3d) 150892 ("A stipulation signed by attorneys for both parties is binding."). Once stipulated to, facts are no longer assertions or allegations. Rather, the stipulated facts are binding on the parties. The Department's distortion of the jointly stipulated facts is deep and far-reaching. Such misstatements include (but are not limited to):

Department Attempted Distortion	Actual Stipulation
"[T]here is nothing that substantively ties recruitment and retention of talent to PGM LLC" and "[T]here is nothing that substantively ties to PGM LLC th[e] talent development function." Dept. Br. at 56.	"As a global business, a critical element of the PepsiCo Corporate Group's ability to recruit and retain high quality candidates is the ability to offer such candidates global postings through an expatriate program (the "Expatriate Program")." Joint Stip. ¶ 7. "After PGM LLC's formation, the PepsiCo Corporate Group utilized PGM LLC as the single Expatriate Program entity for foreign-based (non-U.S.) secondments." Joint Stip. ¶ 58.
"PGM LLC's *alleged* principal business purpose is that it '. . . facilitates the secondment of high-performing expatriate executives, directors, managers, and analysts . . .' PepsiCo Brief at p. 11 quoting Joint Stip. ¶ ¶ 62 and 92." Dept. Br. at 25 (emphasis added).	"PGM LLC facilitates the secondment of high-performing expatriate executives, directors, managers, and analysts from PepsiCo Corporate Group affiliates/operating companies who fulfill temporary key roles with the objective of developing and retaining talent and expanding foreign business operations in established and emerging international (non-U.S.) markets." Joint Stip. ¶ 62.
"PepsiCo *asserts* that PGM LLC provides other benefits to the PepsiCo Corporate Group, such as … centralizing Permanent Establishment foreign tax exposure related to expatriates ..." Dept. Br. at 26 (emphasis added).	"Having a single entity, like PGM LLC, be the counterparty to all of the Secondment Agreements for all outbound expatriate employees: centralizes Permanent Establishment foreign tax exposure related to expatriates working abroad to a single legal entity; ..." Joint Stip. ¶ 67.
"PepsiCo *asserts* that PGM LLC provides other benefits to the PepsiCo Corporate Group, such as preserving employee participation in U.S. benefits plans …" Dept. Br. at 26 (emphasis added). "PepsiCo *asserts* that PGM LLC permits expatriates to continue to participate in U.S. retirement plans which requires that they be PGM LLC common-law employees." Dept. Br. at 55 (emphasis added).	"Due to their Secondment Agreement with PGM LLC, a U.S. entity, seconded expatriates participate in the PepsiCo Corporate Group's U.S. benefits plan (wages, salaries, bonuses, stock options, etc.)." Joint Stip. ¶ 81. "Due to their Secondment Agreement with PGM LLC, a U.S. entity, seconded expatriates are eligible to participate in the PepsiCo Corporate Group's U.S. benefits plans, including: the PepsiCo Savings Plan; the PepsiCo Salaried Employees Retirement Plan; the PepsiCo Pension Equalization Plan for the Pre-Section 409A Program; the PepsiCo Pension Equalization Plan for the Section 409A Program; the PepsiCo Automatic Retirement Contribution Equalization Plan; and the PepsiCo Employee Health Care Program. Representative copies of the PepsiCo U.S. Benefits Plans are attached hereto as Exhibit 29." Joint Stip. ¶ 82.

	"An Employee is eligible to participate in the Plan if he or she is classified by an Employer as being a *common law employee* of an Employer …" Joint Stip. ¶ 82, Exhibit 29 (PepsiCo (U.S.) Savings Plan) (PEP00003658) (emphasis added).
"FLNA and PGM LLC are not in the same line of business." Dept. Br. at 45.	"The majority of expatriates seconded through the Expatriate Program either work for the snack-foods business all of the time or work partially for the snack-foods business." Joint Stip. ¶ 68.
"[T]he PepsiCo Corporate Group Executive Team makes compensation determinations for expatriates." Dept. Br. at 26.	"The PepsiCo Corporate Group's Executive Compensation Team evaluates the overall performance of *all employees on the U.S. benefits plan* (including all PepsiCo Corporate Group domestic U.S. employees and all expatriates seconded outside the U.S.) and makes all final compensation determinations" (emphasis added). Joint Stip. ¶ 88.
"PGM LLC's contractual right to terminate as a matter of economic reality is illusory." Dept. Br. at 28.	"The Secondment Agreements state that PGM LLC may end an assignment for any reason, including by termination of overall employment, upon written notice to the foreign host company." Joint Stip. ¶ 98. "This letter agreement … describes the terms and conditions of your active employment with PepsiCo Global Mobility, LLC … *and confirms the arrangements relating to your separation from the Company*." Joint Stip. ¶ 158, Exhibit 26 (Marc [redacted] Termination Letter) (PEP00000052-71) (emphasis added).
"[T]he Foreign Host Companies as a practical matter have the right to terminate expatriates' employment by PGM LLC … Termination of an assignment by Foreign Host Company management effectively ends their employment by PGM LLC." Dept. Br. at 28.	"[T]he Secondment Agreement does not provide the foreign host company the right to terminate a seconded expatriate's overall employment." Joint Stip. ¶ 97 "The duration of your assignment is an estimate and, at any time after the effective date of this Letter, you may be reassigned to another location in which the Company [PGM LLC] or any of its affiliates does business. The terms and conditions of any such reassignments will be subject to the future needs of the Company [PGM LLC] …" Joint Stip. ¶ 158, Exhibit 25 (Rockchel [redacted] Letter of Understanding) (PEP00000125).

The Department cannot work with taxpayers for years conducting discovery and negotiating a fully stipulated record and then, in court, suggest that there remain unknown and yet to be defined facts which are required to overturn the Department's assessment. PepsiCo made its people and information fully available to the Department from the outset when the Department first initiated its audit of PepsiCo over six years ago.[2] This cooperation continued throughout formal discovery, extensive investigation, in-person depositions, and culminating in negotiation of a comprehensive joint stipulation. The Department had full access and ample opportunity to

[2] The Department's audit of PepsiCo was initiated on April 2, 2014 for the 2010 and 2011 tax years and December 22, 2015 for the 2012 and 2013 tax years, attached hereto as **Exhibit G**.

explore all the areas of factual inquiry required in this case. The parties did not spend years hammering out a concrete factual record -- with sophisticated counsel on both sides -- for that record to turn to dust the moment it is placed in the Tax Tribunal's hands. Having been called out, the manufactured uncertainty the Department is attempting to inject into the comprehensive, agreed record must stop.

2. The Department Engrafts Unwritten And Yet to Be Defined Qualifications and Standards Onto the Illinois 80/20 Rule

Throughout its response, the Department concludes that FLNA cannot be an 80/20 Company under Illinois law without articulating any actual statutory or regulatory standard or criteria to guide that conclusion. This is not to say that the relevant PGM LLC and FLNA structures and relationships need not have substance consistent with their form. Like all of tax law, they must. However, the Department cannot convert the statutory, black-letter, objective test governing the 80/20 Company exclusion to Illinois's definition of a unitary group into a subjective one singularly defined by whether the Department agrees with the end result.

C. Summary Judgment Is Proper: There Are No Facts In Dispute

For all the reasons discussed in PepsiCo's opening brief, there are no issues of material fact on Count I of the First Petition or Count I of the Second Petition. The only remaining question is the legal effect of those facts. During the Tax Years at Issue, FLNA's average foreign property and foreign payroll factors pursuant to 35 ILCS 5/1501(a)(27) equaled: 81.72% (2011); 86.54% (2012); and 87.18% (2013). *See* Joint Stip. ¶¶ 137-139. By stipulation, "the Department agrees as to the completeness and accuracy of these dollar amounts reported for PGM LLC; however, the Department does not agree these amounts constitute PGM LLC's 'compensation' or 'wages' for purposes of the 80/20 Company computations under 35 ILCS 5/1501(a)(27)." Joint Stip. ¶ 147. As a result, it is the *classification* of PGM LLC's payroll that is disputed. Thus, the only issue to

be resolved is whether PGM LLC's foreign expatriate employees' agreed compensation amounts are properly included in FLNA's 80/20 Company calculation as "payroll" under Illinois law.

Buried in a footnote, the Department explains its view of the dispute's procedural posture:

> PepsiCo's Motion for Summary Judgment mistakenly asserts that the parties have agreed that the issue of whether FLNA is excluded from PepsiCo's Illinois unitary combined group as an 80/20 Company "is purely a question of law." The Department does not agree to this characterization of the issue. This issue is clearly a mixed question of law and fact.

Dept. Br. at Page 9-10, Footnote 1. The facts stated in the Joint Stipulation, paired with clear law, require that summary judgment be granted in favor of PepsiCo. This is the case regardless of whether the question is a mixed one. *See Blue Lake Rancheria v. United States*, 653 F.3d 1112 (9th Cir. 2011) ("Where a case turns on a mixed question of law and fact and, as here, the only disputes relate to the legal significance of undisputed facts, 'the controversy collapses into a question of law suitable to disposition on summary judgment.'"). Later in the footnote, the Department summarizes what else is missing in its flawed view of this dispute: "[A]pplicable law *as well as simple logic*, dictates that PGM LLC … cannot transform FLNA … into a corporation conducting 80% or more of its business outside the United States." *Id.* (emphasis added). But who's logic and under what standard? The Department leaves these questions open in an effort to undermine what it once wanted: summary judgment. But the Department's "logic" does not prevent a summary judgment determination on Illinois *law*, particularly where a taxpayer is baited into spending *six years* proving up a complete stipulated record only for the Department to switch tactics after a summary judgment motion has been filed calling for more investigation into yet-to-be defined criteria and standards. The time has come to decide this dispute.

Accordingly, there are two clear paths toward resolution. First, and most appropriately, the Tax Tribunal should grant PepsiCo's Motion for Summary Judgment based on application of

a complete stipulated record to clear-cut law. Alternatively, the Tax Tribunal can redirect this mater to trial. In such case, the Tax Tribunal must require the Department to articulate its new legal standards, criteria, and factors, as well as the specific additional factual areas PepsiCo must now present at such a trial. Of course, the latter option does not accord with the law and a fully stipulated record. *See Beelman Truck Company v. Cosentino*, 253 Ill. App. 3d (5th Dist. 1993) (upholding the taxpayer's summary judgment motion for tax exemption "when the party opposing the summary judgment motion [*i.e.*, the Department] '*fail[ed] to controvert the proofs offered in support of the motion and the movant's showing of uncontradicted facts ... entitle[d] him to judgment as a matter of law ...*'") (emphasis added); and *Horwitz v. Holabird & Root*, 287 Ill. Dec. 510 (2004) ("[T]he nonmovant must present a factual basis arguably entitling that party to a judgment.").

II. **The Statutory Text of the Illinois 80/20 Rule Fully Reflects Legislative Intent**

The "Illinois tax system is based largely on … the development of understandable tax laws … It is the further intent of the General Assembly to promote improved taxpayer self-assessment by improving the clarity of tax laws and efforts to inform the public of the proper application of those laws." 20 ILCS 2520/2 (Taxpayers' Bill of Rights Act). At the time Illinois enacted its domestic combined reporting regime nearly forty years ago, in most combined reporting states, "combined reporting [wa]s applied by audit, by regulations or by an administrative ruling process." Letter From Governor James R. Thompson to the Illinois House of Representatives regarding House Bill 2588 (1982). As a result, in other states, domestic combined reporting was administered by administrative (or judicial) fiat resulting in widespread confusion and uncertainty among corporate taxpayers. In adopting Illinois's current combined reporting rule, Governor Thompson was "*convinced*" "Illinois can serve as a model for the rest of states" through "spelling

out in *clear statutory language* how combined reporting is to be applied to unitary businesses." *Id.* (emphasis added). Such "clear statutory language" included the definition of "unitary business group" as it stands today to exclude from the definition of that group "those members whose business activity without the United States is 80 percent or more of any such member's total business activity," *measured by the "property and payroll factor computations*." *Id.* (emphasis added). With this clear statutory language, "Illinois will provide the certainty and stability so important to businesses" and absent from other combined reporting jurisdictions where enforcement was not anchored in law. *Id.*

The legislature thus had two goals i) implement domestic combined reporting; and ii) do so in a way with clear law to be applied by the Department and businesses in a reliable way. The component of Governor Thompson's "legislative intent" letter actually codified into law is the 80/20 Rule; not some amorphous, ill-defined multifactor test to be subjectively enforced. When implementing domestic combined reporting, the law as written proves the legislature chose a mechanical 80/20 Rule with certainty over a regime chaotically seeking to perfectly define the unitary group no matter the administrative cost. *See also Hartney Fuel Oil Co. v. Hamer*, 376 Ill. Dec. 294, 302 (2013) ("When interpreting a statute, the primary objective is to give effect to the legislature's intent, which is best indicated by the plain and ordinary language of the statute itself."). In this case, there is no dispute FLNA is excluded from the PepsiCo combined group as an 80/20 Company by operation of the plain and ordinary language of IITA Sections 5/304(a) and 5/1501(a)(27)(A).

A. The Department's Extra-Statutory Interpretation of the 80/20 Rule Is Unsupported, Undefined, and Unprecedented

The Department's response cobbles together unwritten "fair reflection of income" arguments with no clear standards or definitions. *See* Dept. Br. at 15-17. Such unsupported,

undefined, and unprecedented theories undermine the rule of law in favor of results-based policy determinations expressly rejected by Governor Thompson and the Illinois legislature.

The IITA requires corporate taxpayers "that are members of the same unitary business group [to] be treated as one taxpayer for purposes of any original return …" 35 ILCS 5/502(e). At its very core, the 80/20 Rule is a bright-line definition intentionally chosen by the legislature (over inconsistent and subjective alternatives) to *exclude* from the "unitary combined group" "those members whose *business activity* outside the United States is 80% or more of any such member's total *business activity* ..." as exclusively measured by a taxpayer's foreign property and payroll factors. *See* 35 ILCS 5/1501(a)(27)(A) and Ill. Admin. Code tit. 86, § 100.9700(c).

Consistent with any bright-line test, the 80/20 Rule cuts both ways -- that is, its application may over- or under- represent the amount of income the Department or a given taxpayer subjectively believes is "fairly" reflective of business operations. For example, application of the mechanical 80/20 Rule may exclude a foreign loss entity from the Illinois combined group, despite contributions of foreign employees to the entity's U.S. operations. Should the Department prevail in its quest to unilaterally re-write the law, it would call into question every dollar of property and payroll ever reported by any taxpayer to "fairly" re-determine the proper location and inclusion, and in the process, obliterate what was once, *by legislative design*, a simple, readily-understood, and mechanical rule. This is exactly what the legislature sought to avoid when it enacted the 80/20 Rule. The statutory language and surrounding history is consistent and clear. Illinois's 80/20 Rule requires objective certainty over subjective administrative anarchy. *See Granite Trust Co. v. United States*, 238 F.2d 670, 675 (1st Cir. 1956) ("the Commissioner's own regulations … emphasize the rigid requirements of the section and make no allowance for the type of [end-result theory] advanced in this case.").

B. <u>The Illinois 80/20 Rule Has Remained Unchanged for Nearly 40 Years</u>

During the last four decades, the Department *could have* proposed a regulation to readjust property or payroll under certain defined circumstances on a prospective basis pursuant to its rulemaking authority in the Illinois Administrative Procedure Act, 5 ILCS 100/1-1, *et seq*. To date, the Department has failed to exercise such authority. Perhaps because such a regulation would be in conflict with application of the current statute; however, at least it would be *something* to support the Department's position.

More appropriately, the Illinois legislature can amend the 80/20 Rule as *it* sees fit without need for improper executive or judicial rulemaking. The Department's own brief recognizes this very possibility in citing to *Caterpillar Tractor Co. v. Lenckos*, 84 Ill.2d 102 (1981). In that case, Caterpillar Tractor Company and its affiliates argued the IITA authorized use of unitary worldwide combined apportionment in addition to separate reporting. The Illinois Supreme Court examined the language of the IITA, including statutorily defined terms under Section 1501(a)(1), and concluded "it is clear that the use of the combined or unitary apportionment method is authorized under the Act …" *Id.* at 121. Much like the present matter, in construing the plain language of the law, the Illinois Supreme Court in *Caterpillar* considered the legislative history and determined it expressly supported the clear language of the law. *See id.*

As stated in the Department's response brief, "[i]n 1982, the year immediately following the *Caterpillar* decision, the General Assembly attempted to overrule this decision by enacting legislation rejecting world-wide combined apportionment in favor of separate apportionment." Dept. Br. at 13. The same path is appropriate here. The legislature is the proper branch of government to change its own law; not the Tax Tribunal and not the Department. In fact, the Illinois Senate and the Illinois House of Representatives attempted to do just that on February 5,

2019 when they introduced tandem bills -- Senate Bill 1115 (2019) and House Bill 2085 (2019). The bills propose to return Illinois to worldwide combined reporting as the default method for corporate income tax filers and remove the 80/20 Rule entirely from Illinois law. While neither bill has advanced to date, the legislature is aware and capable of amending the law as *it* sees fit without need for unilateral and *ultra-vires* decision making from other branches of government.

III. PGM LLC Is the Employer of Its Expatriate Employees Under Universally Accepted Common Law Agency Principles

PGM LLC is the common law employer of its expatriate employees pursuant to Ill. Admin. Code tit. 86, § 100.3100(b) (citing 26 U.S.C. § 3401(c) and Treas. Reg. § 31.3401(c)-1). As the stipulated record clearly shows, PGM LLC: i) has the right to control the employees; ii) has the right to discharge its employees; iii) each seconded expatriate is employed by PGM LLC and temporarily assigned / seconded to the applicable foreign host company; and iv) all documentation clearly proves PGM LLC, its expatriate employees, and the FHC intended PGM LLC to remain the common law employer throughout the duration of the assignment / secondment. *See Striker*, T.C.M. 2015-248 (setting forth the criteria for determining the common law employer in context of temporary international assignments). Notwithstanding this clear result, the Department invents its own common law employer-employee standard for this dispute by i) attempting to resurrect seventy-year old precedent expressly disavowed by the U.S. Supreme Court; and ii) conflating the common law employer-employee analysis applicable to independent contractors with the analysis required for three-party arrangements, *i.e.*, PGM LLC, the FHCs, and the expatriates.

A. The Department's Common Law Employer Analysis is Based on Overruled Precedent

Throughout its response, the Department relies on tenuous arguments to override statutory tests. Nowhere is this more apparent than the Department's attempt to inject supposed "economic

realities" into the common law employer-employee analysis through citation to case law expressly overruled by the U.S. Supreme Court.

1. The "Economic Realities" of Social Legislation Standard in *Silk* Was Overruled By the U.S. Supreme Court

The Department's disingenuous narrative begins with the assertion "[t]he United States Supreme Court's decisions in *United States v. Silk*, 331 U.S. 704 (1947) and *Bartels v. Birmingham*, 332 U.S. 126 (1947) are seminal cases in defining the common-law employer-employee relationship for federal payroll tax purposes." Dept. Dr. at 19.[3] The Department cites *Silk* and its progeny arguing "the term 'employee' [is] not a term of art defined by this legislation by 'some simple, uniform and easily applicable test,' but instead [is] a general common-law test that must be construed to remedy the social ills that were the focus of this legislation." Dept. Br. at 19 (citing *Silk*, 331 U.S. at 713). Applying such reasoning, the Department states the term "employee" must include "workers who were such as a matter of *economic reality*" in furtherance of the underlying purpose of the legislation using the term "employee." *Id*. (citing *Silk*) (emphasis in the Department's brief).

The Department's reliance on *Silk* is in error. The U.S. Supreme Court expressly abandoned the antiquated "economic realities" common law employer-employee analysis / factors in its decisions: *Community for Creative Non-Violence v. Reid*, 490 U.S. 730 (1989) ("*CCNV*"); and *Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318 (1992) ("*Darden*"). In *Darden*, the Court evaluated whether a former insurance agent of Nationwide Mutual Insurance Co. ("Nationwide"), Robert Darden ("Darden"), forfeited eligibility for retirement benefits after his relationship with Nationwide was terminated. Shortly after being terminated, Darden began selling insurance

[3] *See* **Exhibit H** for the *Silk* Shepard's Report and **Exhibit I** for the *Bartels* Shepard's report.

policies for Nationwide's competitors. Due to these new business activities, Nationwide disqualified Darden from receiving retirement plan benefits which he was otherwise eligible to receive. Darden filed suit for the benefits as an eligible "participant" in the retirement plan, "which he claimed were non-forfeitable because [the benefits] already vested under terms of [Employee Retirement Income Security Act of 1974 ("ERISA")]." *Id.* at 320. ERISA, in turn, defined "participant" as "'any employee or former employee of an employer' … Thus, Darden's ERISA claim can succeed only if he was Nationwide's 'employee' … " *Id.* at 321.

The U.S. District Court had granted summary judgment to Nationwide, finding "'the total factual context' of Darden's relationship with Nationwide shows that he was an independent contractor and not an employee.'" *Id.* The U.S. Court of Appeals for the Fourth Circuit reversed. In doing so, the Fourth Circuit noted "'Darden most probably would not qualify as an employee' under traditional principles of agency law … " *Id.* However, the Fourth Circuit held "the traditional definition [of employee] [is] inconsistent with 'declared policy and purposes' of ERISA, … quoting *Silk* …, and specifically with the congressional statement of purpose found in § 2 of the Act …" *Id*. Therefore, even though Darden was likely an independent contractor under common law agency principles, the Fourth Circuit ruled as a matter of equitable "policy and purpose" of the ERISA statute, Darden qualified as an employee, and thus, was entitled to pension benefits. *See id.*

The U.S. Supreme Court reversed the Fourth Circuit's ruling, focusing its analysis on whether Darden was an "employee" of Nationwide based on "the general common law of agency," as articulated in *CCNV* (setting forth non-exhaustive criteria for identifying a master-servant agency relationship in an employee versus independent contractor analysis). *Id.* at 323-324. The Supreme Court further elaborated on, and disavowed the "economic realities" test set forth in *Silk*:

> *Silk*, which interpreted "employee" for purposes of the … Social Security Act … [is] feeble precedent[] for unmooring the term from the common law … In [*Silk*], the Court read "employee," which neither statute helpfully defined, to imply something broader than the common-law definition; after [the *Silk*] opinion, Congress amended the statute so construed to demonstrate that the usual common-law principles were key to meaning.
>
> … [*CCNV*'s] presumption that Congress means an agency law definition for "employee" unless it clearly indicates otherwise *signaled our abandonment of Silk's emphasis on "construing that term 'in light of the mischief to be corrected and the end to be attained*.'"

Id. at 324-325 (emphasis added). Further rejecting *Silk*'s application of "economic realities," the *Darden* Court concluded:

> Any such approach would *severely compromise* the capacity of companies like Nationwide to figure out who their "employees" are and what, by extension, their pension-fund obligations will be. To be sure, the traditional agency law criteria offer no paradigm of determinacy. But their application generally turns on factual variables within an employer's knowledge, thus permitting categorical judgments about the "employee" status of claimants with similar job descriptions. Agency law principles comport, moreover, with our recent precedents and with the common understanding, reflected in those precedents, of the difference between an employee and an independent contractor.

Id. at 327 (emphasis added). The Supreme Court in *Darden* thus held the focus of employer-employee determinations must be governed by common law *agency* principles; and expressly rejected use of the amorphous and tenuous "economic realities" test advanced by *Silk*.

Applied to the present matter, the classification of an employer-employee relationship is controlled by *common law agency* principles. Specifically, for Illinois payroll factor purposes, the term "employee" "includes every individual performing services if the relationship between him and the person for whom he performs such services is the legal relationship of employer and employee. *The term has the same meaning under the Illinois Income Tax Act as under 26 U.S.C. Section 3401(c) and 26 CFR 31.3401(c)-1*." Ill. Admin. Code tit. 86, § 100.3100(b) (emphasis added). Accordingly, the common law employer-employee relationship is governed by common-

law agency or "master-servant" principles as articulated in *CCNV* and *Darden* and outlined in PepsiCo's opening brief. PGM LLC is and *must be* the common law employer for reasons completely separate from the Illinois 80/20 Rule, *i.e.*, PepsiCo's U.S. savings plan, pension plan, healthcare plan, etc. Joint Stip. ¶ 82.[4] The Department's attempt to resurrect the tenuous and abandoned "economic realities" test as a means to redefine the term "employee" in the context of the Illinois 80/20 Rule is exactly what the U.S. Supreme Court struck down in *Darden*.

2. The *Bartels* Case Mirrors the Flawed and Overruled *Silk* "Economic Realities" Analysis

The other supposedly "seminal" case cited by the Department to inject "economic realities" into common law employer-employee determinations is *Bartels v. Birmingham*, 332 U.S. 126 (1947). The U.S. Supreme Court's ruling in *Bartels* mirrors -- and was issued just one week after -- its later abandoned *Silk* ruling. *See id*. The "Form B" employment contracts at issue in *Bartels* stated certain musicians would be employees of various ballroom operators for just one night despite an ongoing relationship with the musicians' band leader. *Id*. at 127-128. The contracts at issue were used exclusively to shift the incidence of social security taxes from one party (the band leader) to another (the operators). *Id*. at 129.

Like *Silk*, the analysis set forth in *Bartels*, and relied upon by the Department here, has been expressly abandoned and rejected by the U.S. Supreme Court in *CCNV* and *Darden*. More specifically, applying the now overruled "economic realities" standard, the Supreme Court in *Bartels* held: "Obviously control is characteristically associated with the employer-employee

[4] "Due to their Secondment Agreement with PGM LLC, a U.S. entity, seconded expatriates are eligible to participate in the PepsiCo Corporate Group's U.S. benefits plans, including: the PepsiCo Savings Plan; the PepsiCo Salaried Employees Retirement Plan; the PepsiCo Pension Equalization Plan for the Pre-Section 409A Program; the PepsiCo Pension Equalization Plan for the Section 409A Program; the PepsiCo Automatic Retirement Contribution Equalization Plan; and the PepsiCo Employee Health Care Program." Joint Stip. ¶ 82.

relationship *but in the application of social legislation employees are those who as a matter of economic reality are dependent upon the business to which they render service*." *Id*. at 130 (citing *Silk*) (emphasis added). Simply put, the Department's reliance on *Bartels* in an effort to downplay the legal significance of operative employment agreements and related documentation set forth in the extensive factual record here, is fatal to its case. Common law agency principles control this analysis. As articulated by the U.S. Supreme Court in *Darden* and *CCNV*, amorphous and subjective "social equities" and "economic realities" cannot be used to rewrite binding legal contracts in an effort to redefine parties' employment relationships.

In response to the flawed analysis set forth in *Silk* and *Bartels*, federal and state laws utilizing the common law term "employee" were amended to circumvent the "economic realities" standard that had corrupted the common law employer analysis. For example, in 1971, the California legislature enacted Cal. Unempl. Ins. Code § 680 to require "certain persons contracting for the services of musicians [to be] 'employers' for unemployment insurance purposes. The undisputed underlying legislative intent of section 680 was to reverse the effect of judicial rulings [*i.e.*, *Silk* and *Bartels*] that musicians who contracted to provide services under the form B union contract were nevertheless independent contractors and not common law employees of the entertainment entity that hired them." *Far West Services, Inc. v. Gene Livingston*, 156 Cal. App. 3d 931, 940 (1984).[5] In *Far West Services*, the California Court of Appeal evaluated the same Form B contract at issue in *Bartels* and determined under California's revised law that the contract "contains the same basic terms and conditions of employment peculiar to the music entertainment industry and binds the employer as well as the employee to provisions not dissimilar from an

[5] Examples of federal laws amended in response to *Silk*'s "economic realities" standard include the National Labor Relations Act and the Social Security Act of 1948. *See Darden*, 503 U.S. at 325.

ordinary collective bargaining agreement … To conclude otherwise would render the form B contract a nullity regarding the binding of the employer and employee to the union regulations. Moreover, it would cast aside the apparent intention and understanding of the parties …" *Id.* at 940.

After decades of extensive legislative efforts to circumvent the flawed *Silk* and *Bartels* rulings, the U.S. Supreme Court abandoned the "economic realities" standard in favor of common law agency factors, as held in *CCNV* and *Darden*. Now without interference from hidden and subversive "economic realities", parties can contract based on i) the peculiar nature of each industry [*e.g.*, the music industry, global employment companies, etc.]; and ii) the intention of all parties executing the agreements -- without fear of unpredictable government intervention. These contracts memorializing employment relationships, like PGM LLC's, are exclusively evaluated under / governed by common law agency principles.

3. Contractual Rights Are Critical to Common Law Employer-Employee Determinations In Three-Party Arrangements

The Department improperly disregards binding PGM LLC secondment agreements and contracts of employment as if the State were best positioned to subjectively enforce / dictate the parties' right to contract. This is not the law. As explained above, the law requires that the contractual rights in such agreements are preserved and enforced as the parties intended. Even the IRS has recognized this. By revenue ruling, the IRS determined a medical professional service corporation assigning professional employees (nurses, dental hygienists, etc.) to client companies / "subscribers" was the common law employer of those assigned workers. *See* Rev. Rul. 75-41 (1975). In reaching this determination, the IRS analyzed Treas. Reg. § 31.3401(c)-1(b) (as cited by Illinois's payroll factor regulation, Ill. Admin. Code tit. 86, § 100.3100) and concluded "the regulation[] require[s] the finding of a legal relationship of a contractual nature that may be

examined to determine whether it comprises a common law employer-employee relationship. … In the instant case, the individuals have entered into contracts with the corporation under which the latter has the right to control and direct the performance of their services … Accordingly, it is held that the corporation is the employer of the individuals for purposes of the Federal Insurance Contributions Act, the Federal Unemployment Tax Act, and the Collection of Income Tax at Source on Wages." *Id.* (emphasis added). In sum, the underlying legal contract is the most reliable mechanism for "companies like [PepsiCo] to figure out who their 'employees' are and what, by extension, their pension-fund obligations will be", along with many other employment benefits with real life consequences, *e.g.*, healthcare plans, savings plans, etc. *See Darden*, 503 U.S. at 327 and Joint Stip. ¶ 82.

B. The Department Misapplies Common Law Agency Factors Applicable to Independent Contractors to Employer-Employee Leasing Arrangements

The second critical flaw in the Department's common law employer-employee analysis is utilizing factors applicable to an independent contractor analysis to assess three party arrangements involving: i) an employee; ii) a global employment company ("GEC") (or professional employer organization ("PEO"));[6] and iii) a client company directly receiving the services. In the former scenario, the question is solely *if* an individual is an employee or an independent contractor of an organization receiving his or her services. In the latter scenario, the question is not *if* the individual is an employee, but rather, *who* is the employer of the leased employee -- the GEC / PEO or the client company? Of course, both scenarios require a common law employer-employee agency analysis described in *CCNV*, *Darden*, etc., but the relevant factors within such an analysis vary

[6] PepsiCo utilizes the terms / acronyms GEC and PEO throughout this brief as a matter of convenience, regardless of whether any given entity is (or is not) a common law employer based on applicable facts.

dramatically depending on whether the inquiry is focused on an independent contract arrangement or a GEC / PEO arrangement.

For purposes of evaluating whether the expatriates at issue in this dispute are employees of PGM LLC or one of the FHCs, the Department states: "the following factors [are] critical in determining the economic realities of a true employer-employee relationship between a business and a worker: i) business control of the worker; ii) business investment in facilities used by the worker; iii) business opportunities for profit or loss from services provided by the worker; and iv) the worker's skill level and permanency of the worker's relationship with the business." Dept. Br. at 19-20 (citing *Silk* in context of determining whether individual truckers were independent contractors or common law employees of a Chicago-based trucking business).

The factors from *Silk*'s independent contractor analysis relied on by the Department are different than the factors relevant in determining whether an individual expatriate is a common law employee of PGM LLC *or* one of the FHCs. Specifically, in a three party arrangement, the amount of "profit and loss" an individual worker receives is meaningless because, unlike an independent contractor arrangement, there is no dispute the individual is a paid employee of *one* of the businesses, rather than operating his or her own independent business for his or her own profit as does an independent contractor. The "tools or workplace" factor is also meaningless because the entire point of an employee leasing arrangement is for a GEC / PEO to assign an employee to a client location on a temporary basis, whereas investment in "tools" or "facilities" is informative in context of an independent contractor analysis to determine which of the two parties bears the business expense for these items. Therefore, the only factors cited by the Department which are relevant to the present matter are the right to control the worker, the skill level of the employee, and the permanency of the relationship. Each of these factors are consistent with

Samuel Striker v. Commissioner, T.C.M. (RIA) 2015-248 (2015).

In *Striker*, the U.S. Tax Court applied a common law employer-employee analysis to determine whether an individual taxpayer was an employee of the North Atlantic Treaty Organization ("NATO") or the U.S. Army while the individual was deployed on NATO missions. 2015-248. The Department criticizes PepsiCo's reliance on such authority as applying to "dramatically different circumstances," and yet, fails to explain how *Silk*'s independent contractor analysis for individual truck drivers provides a better factual, let alone legal, analogy. Dept. Dr. at 30. In contrast to *Silk*, the Tax Court in *Striker* directly addresses the common law employer-employee analysis *in context of three party arrangements* (the employee, the U.S. Army, and NATO) by citation to Treas. Reg. § 31.3401(c)-1(b) -- the exact authority cited in Illinois's payroll factor regulation, Ill. Admin. Code tit. 86, § 100.3100, for defining the common law employer-employee relationship. *See Striker*, T.C.M. 2015-248.

Notably, the U.S. Tax Court specifically distinguished between the common law factors informative to an independent contractor analysis and those factors chiefly relevant to three-party arrangements, such as the ones at issue in this dispute:

> Our precedents have identified numerous factors that may be relevant in determining whether an employment relationship exists. … Petitioner urges that several of these factors point to his status as an employee: he did not offer services to the general public; he provided no capital and had no opportunity for profit and loss; and he did not provide his own tools or workspace.

Striker, T.C.M. 2015-248. The factors identified by the taxpayer in *Striker* parallel the factors cited by the Department in reliance on *Silk*. However, the Tax Court further stated:

> But those factors are chiefly relevant in determining *whether a person is an independent contractor as opposed to an employee*; they shed little light on whether petitioner, concededly an employee, *was an employee of the Army or NATO*. The common law factors most relevant to the latter determination are the right to control, the right to discharge, the permanency of the relationship, and the nature of the relationship the parties believed they were creating.

Id. (emphasis added). In this language, the Tax Court clearly articulates the differences in analyzing whether an individual is an employee or an independent contractor versus which of two entities owns the employment relationship with that individual. It is the latter question that faces the Tax Tribunal and the latter analysis which must be conducted here.

The Tax Court's ruling in *Striker* -- as applied to three-party arrangements -- is not some outlier to be easily cast aside. To the contrary, the U.S. Court of Appeals for the Ninth Circuit in *Blue Lake Rancheria v. United States* addressed whether a wholly owned employee leasing company was the common law employer of the workers it assigned to various client companies.[7] 653 F.3d 1112 (9th Cir. 2011). Specifically, in *Blue Lake*, a federally recognized Indian tribe established Mainstay Business Solutions ("Mainstay") to provide employee leasing and temporary staffing for small- and medium- sized businesses. *Id.* at 1113. "Mainstay contracted with each of its clients to hire the client's employee's as its own and then 'lease' those employees back to the client. The client supervised the leased employees on a day-to-day basis, but Mainstay paid their wages, provided benefits, and performed other human resources functions. According to Mainstay, this arrangement allowed the client to free itself from H.R. responsibilities and focus on its business, and resulted in better benefits for employees." *Id.*

The taxpayer in *Blue Lake* argued the employees Mainstay leased to its clients were common law employees of Mainstay. If so, the taxpayer would be eligible for a refund of Federal Unemployment Tax Act ("FUTA") taxes paid by Mainstay because federal law exempts from the tax "'services performed in the employ of' an Indian tribe from the definition of 'employment' for

[7] The U.S. Court of Appeals for the Ninth Circuit is the same circuit the Department relies on for its outdated case, *Professional & Executive Leasing, Inc. v. Commissioner*, 862 F.2d 751 (9th Cir. 1988) (discussed below).

purposes of FUTA." *Id.* at 1115. Applying applicable common law agency factors outlined by the U.S. Supreme Court in *CCNV* (cited above and upheld by *Darden*) and Treas. Reg. § 31.3306(i)-1(b), the Ninth Circuit clarified those authorities "are directed at determining whether an individual is an employee or an independent contractor." *Id.* at 1120. In this regard, "[m]ost of the cases applying this test involve a simple two-party relationship: worker and hiring party. As we have observed, 'the assessment of the triangular relationship between worker, temporary employment agency and client *is not wholly congruent with the two-party relationship involving independent contractors*.' The employee-independent contractor dichotomy is not at play in such a situation." *Id.* (emphasis added) (citing *Vizcaino v. U.S. Dist. Court*, 173 F.3d 713, 723 (9th Cir. 1999)). Therefore, the Ninth Circuit in *Blue Lake* provides the same distinction for three party employee leasing arrangements as articulated by the U.S. Tax Court in *Striker*.

After clarifying the proper common law employer-employee agency factors to be applied in context of an employee leasing arrangement, the Ninth Circuit concluded "Mainstay was a common-law employer of its leased employees." *Id.* In so ruling, the Ninth Circuit explained:

> Although the client, not Mainstay, supervised the leased employees on a day-to-day basis, the employees were required to comply with Mainstay's employment policies regarding such issues as smoking, telephone use, timekeeping, and breaks. … Moreover, Mainstay set the level of compensation and had ultimate responsibility for paying employees … Mainstay treated the leased employees as its own for tax purposes, issuing W-2 forms, withholding and remitting income taxes, and paying the employer portion of FICA taxes. Mainstay provided employment benefits, including health insurance, life insurance, and a 401(k) retirement plan. Under its contracts with clients, Mainstay retained the rights to recruit, screen, and hire employees for assignment at clients' businesses; to terminate employees; to administer all unemployment claims; and to reassign employees to other clients if necessary.
>
> …
>
> All of these factors lead us to conclude that Mainstay was a common-law employer of its leased employees. The fact that Mainstay did not furnish tools or that the employees did not render their services on Mainstay property is not sufficient to tip

the balance away from this conclusion.

Id. at 1120-1121. The principals and factors articulated by the Ninth Circuit in Mainstay are equally applicable here and lead to the same result -- PGM LLC is the common law employer of the expatriates.

C. PGM LLC Is The Employer of Its Expatriate Employees Under Applicable Common Law Employer-Employee Agency Principles

U.S. Supreme Court precedent is clear: the employee-employer analysis is governed by common law agency principals. *See Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. at 324-325. The reason for this is simple: subjective "economic reality" inquiries cannot be consistently applied, and thus, "severely compromise" the capacity of employers to figure out who their employees are in a reliable and consistent manner. *Id.* at 327. To this end, common law agency factors verify the expatriates are PGM LLC employees.

1. The Expatriates Are PGM LLC's Employees Under Common Law Agency Principles Applicable to Global Employment Companies

As demonstrated by the authorities cited above, the common law factors "most relevant" to a GEC three-party arrangement are: (i) the right to control; (ii) the right to discharge; (iii) the permanency of the relationship; and (iv) the nature of the relationship the parties believed they were creating. *See, e.g., Striker*, T.C.M. 2015-248; and PepsiCo Opening Br. at 26-27. Each of these factors supports the conclusion that PGM LLC is the common law employer of the expatriate employees.

a. *PGM LLC Has the Right to Control and Direct Expatriate Employees*

PGM LLC has "the right to control and direct the individual who performs the services" pursuant to Ill. Admin. Code tit. 86, § 100.3100(b) (citing 26 U.S.C. § 3401(c) and Treas. Reg. § 31.3401(c)-1). The Department misrepresents that the right to control and direct the seconded

expatriates lies solely with the FHCs because the expatriates are subject to their day-to-day direction and control. *See*, *e.g*., Dept. Br. at 32-34. The Department's position is in direct conflict with the controlling authorities (Ill. Admin. Code tit. 86, § 100.3100, citing Treas. Reg. § 31.3401(c)-1) and supporting case law (*Striker*, *Blue Lake*, etc.). Rather, the requirement is for the common law employer to retain "the *right* to control and direct the individual who performs the services." Treas. Reg. § 31.3401(c)-1(b) (emphasis added). "In this connection, it is not necessary that the employer actually direct or control the manner in which services are performed; it is sufficient if he has the *right* to do so." *Id.* (emphasis added).

Here, PGM LLC has the right to control and direct its expatriate employees. *See* Joint Stip. ¶ 83 ("The Secondment Agreements and the Contracts of Employment / Letters of Understanding … were created with the intent to govern the expatriates' conduct and rights on assignment."). Critically, the intent of *all* parties executing the Secondment Agreements and Contracts of Employment (PGM LLC, the FHCs, and each expatriate) is for PGM LLC to "cause [the] expatriate to provide specific technical services to the applicable foreign host companies." Joint Stip. ¶ 84. In providing such services, the expatriates are required "to do all things established by PGM LLC to complete the assignment and to adhere to all PGM LLC policies …" *Id.* Just like the U.S. Army in *Striker*, the U.S. Air Force in *Gillis v. Commissioner*, T.C.M. (RIA) 1986-576 (1986), Mainstay in *Blue Lake*, and the medical professional service corporation in the IRS Rev. Rul. 75-41, PGM LLC's legal *right* to control and direct its expatriates as required under Ill. Admin. Code tit. 86, § 100.3100 and Treas. Reg. § 31.3401(c)-1 cannot be refuted.

Faced with binding substantive legal contracts among all parties involved, the Department attempts to recast PGM LLC as "bare legal shell" with "no economic substance." Dept. Br. at 2. However, this argument too fails when contrasted against the jointly stipulated facts:

- "The Expatriate Program is overseen in its entirety by a group of individuals within the PepsiCo Corporate Group's human resources function (the 'PepsiCo Corporate Group HR Function')." Joint Stip. ¶ 99.

- "More specifically, within the PepsiCo Corporate Group HR Function, there are approximately twenty individuals located throughout the world who execute employee transfers, relocations, and secondments throughout the PepsiCo Corporate Group in locations across the world ("Global Mobility HR Function"). See Exhibit 8 (Global Mobility HR Function Employee List (PEP00002531))." Joint Stip. ¶ 100.

- "The total cost of the individuals dedicated to the Global Mobility HR Function is attached hereto as Exhibit 9 (Global Mobility HR Function Cost Summary (PEP00004921)); these individuals provide human resource services to a variety of businesses within the PepsiCo Corporate Group in addition to their Global Mobility HR Function services." Joint Stip. ¶ 102.

- "Roughly 26% of the Global Mobility HR Function's time and resources are devoted to management and support functions for PGM LLC and its expatriates. Exhibit 9 (Global Mobility HR Function Cost Summary (PEP00004921); and Exhibit 8 (Global Mobility HR Function Employee List) (PEP00002531)." Joint Stip. ¶ 103.

- "In providing management and support functions to PGM LLC and the expatriates, the Global Mobility HR Function addresses HR issues unique to expatriate assignments such as education, immigration, and work permit issues." Joint Stip. ¶ 104.

- "The Global Mobility HR Function was divided into three main teams to oversee each expatriate seconded by PGM LLC: 1) the "Center of Excellence Team"; 2) the "Services Team"; and 3) the "Relationship Team". According to Exhibit 18 (Global Mobility Progress Toward Transformation (Mar. 2011) (PEP00001337-1362))." Joint Stip. ¶ 105.

In sum, PGM LLC's management and support functions are performed by HR professionals within the PepsiCo Corporate Group. *See* Dept. Br. at 26. In fact, these HR professionals "provide human resource services to a variety of businesses within the PepsiCo Corporate Group." Joint Stip. ¶ 102.[8] There is no legal requirement for these individuals to be employed directly by PGM LLC when the vast majority of their time / resources (74%) are spent performing activities for various other PepsiCo Corporate Group businesses / entities. *See* Joint

[8] "No intercompany payment is made by or on behalf of PGM LLC, *or any other PepsiCo Corporate Group entity*, to reimburse PepsiCo, Inc. for human resource services provided to the entities within the PepsiCo Corporate Group." Joint Stip. ¶ 91 (emphasis added).

Stip. ¶ 103. Simply put, in the real world, the dog wags the tail; not the other way around.

The Department ironically seizes on the lack of intercompany agreement for the services provided by the Global Mobility HR Function to PGM LLC, yet at the same time seeks to completely disregard the PGM LLC Secondment Agreements and Contracts of Employment. *See* Dept. Br. at 25-26. The fact that PGM LLC provides substantive business services as a functional GEC to its expatriates cannot be seriously disputed. Yet the Department compares PGM LLC to the entities (Zebra Domestic Intangibles, Inc. ("ZDI") and Zebra International Intangibles, Inc. ("ZII")) at issue in *Zebra Technologies Corp. v. Topinka* to argue PGM LLC lacks substance. *See* Dept. Br. at 40 (citing *Zebra Tech.*, 344 Ill. App. at 482-483). This comparison is improper for two reasons. As an initial matter, the Illinois Circuit Court in *Zebra* found there was "genuine economic substance" to forming ZDI and ZII. *Zebra Tech v. Topinka*, Dkt. No. 1998-L-50479 (Jul. 23, 2001). However, the Illinois Appellate Court affirmed the Circuit Court's conclusion that the "taxpayer failed to sustain its burden on the threshold issue of qualifying to exclude ZDI and ZII from its unitary business group under section 1501(a)(27) of the Act." *Zebra Tech.*, 344 Ill. App. at 484.

The fact that Global Mobility HR Function personnel perform PGM LLC's management and support functions, does not serve as a basis to negate PGM LLC's substance. *See* Joint Stip. ¶¶ 99-110. Unlike the taxpayer in *Zebra*, PepsiCo has met its burden through extensive discovery and a fully stipulated record. Unlike *Zebra*, in this case, the "total cost of the individuals dedicated to the Global Mobility HR Function" has been investigated, proven up, quantified and stipulated to by the parties. *See Zebra Tech.*, 334 Ill. App. at 482-483 and Joint Stip. ¶ 102 and Joint Stip. Exhibit 9. Further, even though the Department has recognized in *Zebra* "there was no statute that allowed the Department to impute payroll figures for these services …", as agreed and stipulated

by the Department here, even if payroll for the Global Mobility HR Function were attributed to PGM LLC pursuant to a "substance over form" analysis, FLNA's status as an 80/20 Company would not change.[9]

In asserting PGM LLC does not have the right to control its expatriates, the Department further argues PGM LLC does not control compensation paid to expatriates because such payment is "limited to recording charges for expatriate compensation as expenses and crediting reimbursement of these charges by Foreign Host Companies as miscellaneous revenue." Dept. Br. at 45. The Department's characterization ignores the stipulated fact that Hewitt Payroll Services ("Hewitt") is contracted "to issue payroll checks to all PepsiCo Corporate Group affiliate employees on the U.S. benefits plan, including to all expatriates seconded outside the United States, and files all necessary payroll tax returns reporting their compensation." Joint Stip. ¶ 123. Therefore, *all* PepsiCo Corporate Group U.S. compensation runs through Hewitt Payroll Services, a third-party payroll processor. *See* Joint Stip. ¶ 111 ("Like all entities within the PepsiCo Corporate Group, a third party service provider acting in the name of PGM LLC withholds and remits all U.S. payroll and employment taxes required by statute, law, rule, or regulations to be withheld and paid under U.S. law.")

Applying the Department's logic, payroll must solely belong to Hewitt because it is the entity actually drawing the checks and sending them to PepsiCo Corporate Group employees. Under this line of reasoning, because PepsiCo uses Hewitt for all of its U.S. payroll, Hewitt would

[9] "The total cost of the individuals dedicated to the Global Mobility HR Function" equals between $1.5 million and $2.3 million in payroll and $630 thousand and $3.1 million in property for the Tax Years at Issue (2011-2013). *See* Joint Stip. ¶ 102, Exhibit 9 (PEP00004921). Attributing 100% of the these amounts, let alone the actual amount (26%) (some of which is foreign payroll), does not change FLNA's 80/20 Company status under Illinois law. *See* Joint Stip. ¶ 103, Exhibit 8 (PEP00002531) and Exhibit 9 (PEP00004921).

be the employer of all of the individual's on PepsiCo's U.S. compensation plan, including those individuals employed by PepsiCo, Inc., The Gatorade Company, Frito-Lay, Inc., FLNA, etc. To the contrary, for all of the reasons stated in PepsiCo's opening brief, PGM LLC controls its employees' compensation. *See* PepsiCo Opening Br. at 33-34: "Actual cash payments made to seconded expatriates originate in PGM LLC's books and records as a payroll expense." (Joint Stip. ¶ 112); "Income taxes are withheld and U.S. payroll and employment taxes are remitted in PGM LLC's name on payments to expatriates who are seconded outside the U.S." (Joint Stip. ¶ 114); "For each of the Tax Years at Issue, Forms W-2, Wage and Tax statements were submitted in PGM LLC's name when required under U.S. law to the expatriates seconded to foreign host companies. PGM LLC's Forms W-2/W-2c Files are attached hereto as Exhibit 27 (PEP00000186-209 (2011); PEP00000222-245 (2012); and PEP00000257-296 (2013))." (Joint Stip. ¶ 115); "For each of the Tax Years at Issue, Federal Insurance Contributions Act ('FICA') tax was withheld from payments to expatriates. That tax was remitted in PGM LLC's name to the IRS on Form 941, Employer's Quarterly Federal Tax Return. PGM LLC's Form 941, Employer's Quarterly Federal Tax Returns for the Tax Years at Issue are attached hereto as Exhibit 28 (PEP00001872-1883 (2011); PEP00001860-1871 (2012); and PEP00001652-1663 (2013))." (Joint Stip. ¶ 116); etc.

b. *PGM LLC Has the Right to Discharge Its Expatriates' Overall Employment*

Just as the Department ignores PGM LLC's right to control and direct its expatriate employees, the Department also concludes "PGM LLC's contractual right to terminate as a matter of economic reality is illusory." Dept. Br. at 28. Once again, the Department ignores the stipulation it signed. As stated there, "PGM LLC may end an assignment for any reason, including by termination of overall employment, upon written notice to the foreign host company." Joint

Stip. ¶ 98. Such authority is not merely "illusory"; rather, the authority to terminate is expressly vested in PGM LLC *and PGM LLC has exercised this authority*. *See* Joint Stip. ¶¶ 98-110 and 158, Exhibit 25 (Secondment Agreement, Section 7.1 (stating the expatriate's secondment to the FHC may end "immediately on termination of the Employee's [expatriate's] employment with Employer [PGM LLC];") (PEP00001645)) and Exhibit 26 (Marc [redacted] Termination Letter) (PEP00000052-71). An expatriate's overall employment with PGM LLC does not "effectively end" upon an FHC electing to end an assignment. To the contrary, "the Secondment Agreement *does not* provide the foreign host company the right to terminate a seconded expatriate's overall employment." Joint Stip. ¶ 97 (emphasis added). The factual record is clear, the right to terminate the expatriates' employment resides solely with PGM LLC.

c. *Expatriates Are Temporarily Assigned to FHCs By PGM LLC*

The third *Striker* factor is permanency of the relationship. Under this factor, there is a distinction between assignments where an individual is temporarily "detailed,", "loaned," or "assigned" (*e.g.*, the taxpayers in *Striker* and *Gillis*) compared with those assignments where the individual is permanently "transferred" (*e.g.*, the taxpayer in *Adair v. Commissioner*, T.C.M. (RIA) 1995-493 (1995)). *See* PepsiCo Opening Br. at 35-36. The Department does not address this point and instead conflates this factor with the second factor (right to terminate) described above. *See* Dept. Br. at 28. As stated in PepsiCo's opening brief, all PGM LLC expatriate employees are temporarily *assigned* for three to five years to an FHC -- not permanently / indefinitely transferred to these entities. *See* Joint Stip. ¶ 78.

d. *All Parties (PGM LLC, the FHCs, and the Expatriates) Executed Contracts with the Intent for PGM LLC to be the Common Law Employer*

The fourth *Striker* factor, the nature of the relationship the parties believed they were

creating, is indisputable as *all* parties (PGM LLC, the FHCs, and the expatriates) intended PGM LLC to be the common law employer. *See* Joint Stip. ¶ 85 ("In the Secondment Agreements and accompanying Letters of Understanding, the Parties state their intent that the expatriates remain employed by PGM LLC during the term of the assignment."). Indeed, this is the entire purpose / premise of a GEC. The expatriates must remain common law employees of PGM LLC to: i) limit U.S. entity legal liability in foreign jurisdictions; ii) preserve U.S. Benefits plan eligibility; iii) limit permanent establishment foreign tax exposure; iv) facilitate business and government compliance efficiency; v) recruit and retain talent; vi) develop talent; and vii) deploy technical expertise. *See* Joint Stip. ¶¶ 7, 54-59, 65, 67, and 73; and PepsiCo Opening Br. at 43-48.

2. The Department Misapplies Common Law Agency Factors That Are Not Applicable to Three-Party GEC / PEO Arrangements

The Department's common law employer-employee analysis is limited to factors / criteria such as profit and loss, input on employee evaluations, and investment in tools / facilities that are not informative to GEC / PEO three-party arrangements.

a. *PGM LLC Does Not Require A Profit to Be a Common Law Employer of Its Expatriate Employees*

The Department argues PGM LLC cannot be the common law employer because it "derives absolutely no profit from the business activities of its alleged expatriate employees. Instead, PGM LLC is simply credited with a dollar-for-dollar reimbursement from foreign subsidiaries for the compensation charged to PGM LLC for services expatriates perform benefitting exclusively Foreign Host Companies." Dept. Br. at 28 (citing examples of for-profit PEO arrangements with unrelated third parties). The Department's reliance on PGM LLC's individual profit making ability as informative to an intercompany GEC / PEO common law employer-employee determination is misplaced. As stated by the U.S. Tax Court, the "opportunity for profit and loss"

is "chiefly relevant in determining *whether a person is an independent contractor as opposed to an employee*." *See Striker*, T.C.M. 2015-248. PGM LLC's profitability is not instructive here because i) there is no dispute the expatriates receive W-2 wages as *employees*, and thus, are not independent contractors generating profit / loss for themselves; and ii) both PGM LLC and the FHCs are wholly related entities without the same profit motives as the unrelated party examples cited in the Department's response. *See* Dept. Br. at 28. Furthermore, dollar-for-dollar reimbursement is "irrelevant" to PGM LLC's classification as the common law employer. *See Gillis*, T.C.M. 1986-576 ("The fact that a third party was the ultimate source of the funds [the employees' salaries] was *irrelevant* when that third party had no separate contract with the employees, and no authority to hire, fire or supervise them." (emphasis added)).

b. *Foreign Host Company Input on Expatriate Performance Reviews Does Not Shift the Employer-Employee Relationship*

The Department's belief that the FHCs' input on expatriate employee evaluations somehow informs common law employer-employee determinations is misplaced. In connection with a PGM LLC secondment, "[a] foreign host company manager generally assesses the seconded expatriate's day-to-day performance and determines an annual performance rating reflective of these day-to-day services and submits this rating to the PepsiCo Corporate Group's Executive Compensation Team." Joint Stip. ¶ 87. This makes sense. The FHC is close to the day-to-day activities of the expatriate employee. But that evaluation authority does not amount to evidence that PGM LLC's overall right to control and direct its expatriate employees is lost. Indeed, multiple things can be true at once: i) the individuals employed by the FHCs who work with the seconded expatriates on a daily basis are best positioned to evaluate the expatriates' day-to-day performance on a micro level; ii) PGM LLC (through Global Mobility HR Function personnel) provides management and

support functions to each expatriate throughout the duration of the assignment on a macro level;[10] and iii) PGM LLC retains the legal right to control and direct its expatriate employees throughout the duration of their secondment. *See* Joint Stip. ¶¶ 83-110.

This is how secondment / leased employee arrangements are supposed to work. For instance, in IRS Rev. Rul. 87-41 (1987) a PEO ("Firm") was "engaged in the business of providing temporary technical services to its clients." Much like the present matter, the Firm's contract with its client stated: "the Firm is to provide the Client with workers to perform computer programming services meeting specified qualifications for a particular project. … The individual has not been an employee of or performed services for the Client." *Id.* With regard to evaluation, "[t]he work of the Individual and other programmers is regularly reviewed by the Firm. The review is based primarily on reports by the Client about the performance of these workers." *Id.* Despite day-to-day control and the ability for the client company to evaluate the leased employee, the IRS determined "the legal relationship is between the Firm and the individual, and the Firm retains the right of control to insure that the services are performed in a satisfactory fashion." *Id*. *See also Striker,* T.C.M. 2015-248 ("During both deployments petitioner received formal and informal evaluations of his work from his [NATO] [Human Terrain Team] HTT team leader. The formal evaluations, conducted pursuant to the Defense Civilian Intelligence Personnel System (DCIPS), were required by DoD for all intelligence personnel.").

Similar to the arrangements in Rev. Rul. 87-41 and *Striker*, each PGM LLC expatriate's "overall performance" is evaluated by the "PepsiCo Corporate Group's Executive Compensation Team"; not the FHCs. *See* Joint Stip. ¶ 88. However, unlike the facts in Rev. Rul. 87-41 and

[10] Such management and support functions include being "the primary contact for the seconded employee," "providing training and education tools and teaching support," "managing expectations," etc. *See* Joint Stip. ¶¶ 109-110.

Striker, in this matter we are dealing with wholly related business entities. In the related party context, it is generally more efficient for centralized management of a unitary business group to run through a single entity or function and thus facilitate economies of scale. Ill. Admin. Code 100.3010(b)(3) ("[T]he activities of the person will be considered a single business if there is evidence to indicate that the segments under consideration are integrated with, dependent upon, or contribute to each other and the operations of the person as a whole.").

Here, "the overall performance of *all employees* on the U.S. benefits plan (including all PepsiCo Corporate Group domestic U.S. employees and all expatriates seconded outside the U.S.)" run through the same Executive Compensation Team evaluation and compensation determination process. Joint Stip. ¶ 88 (emphasis added). Consistent with the most fundamental precepts of a unitary business, performance evaluations for *all* PepsiCo Corporate Group U.S. employees are made by the same Executive Compensation Team, regardless of the employees' legal entity employers (PepsiCo, Inc., Frito-Lay, Inc., FLNA, PGM LLC, etc.). With regard to PGM LLC, Global Mobility HR Function personnel bridge the gap between the Executive Compensation Team and PGM LLC's expatriates. *See* Joint Stip. ¶¶ 99-110 and Joint Stip., Exhibit 18 (PEP00001347) (the Global Mobility HR Function serves as the "[b]usiness strategic partner to … Compensation and Benefits" and "Build[s] and maintain[s] links to regional Talent and Reward Teams.").

The same principle applies with regard to the Department's statement that "PGM LLC has no management employees who hired the expatriates or oversaw their work." Dept. Br. at 31 (*cf.*, Joint Stip. ¶ 76 ("PepsiCo Corporate Group management identifies and approves individuals for assignment to foreign host companies pursuant to its determination of the skill set and interest of each individual, and the business needs of the foreign host companies.")). The reality is that an

individual does not become a PGM LLC employee until after he / she is selected by PepsiCo Corporate Group management and the selected individual then agrees and executes an employment contract with PGM LLC. *See* Joint Stip. ¶ 64 ("For each individual included on the PGM LLC Payroll Reports for the 2011 - 2013 tax years, PGM LLC and the individual executed an agreement (*i.e.*, a 'Letter of Understanding') outlining applicable terms which apply during the assignment.").

c. The Foreign Host Company Furnishing Tools or Facilities Does Not Inform the Employer-Employee Analysis in GEC / PEO Arrangements

Relying on *Silk*, as applied to independent contractor arrangements, the Department asserts PGM LLC is not a common law employer because it does not invest in facilities used by its expatriates while seconded to the FHCs. *See* Dept. Br at 20, 28. When an employee is assigned to a client company (in this case the FHCs) it is common (if not universal) for the client company to host the employee in its facilities and to furnish tools. As a result, instructive case law addressing common law GEC / PEO arrangements accord no weight to this factor. *See Striker*, T.C.M. (RIA) 2015-248 (2015) (quoted above), *Blue Lake Rancheria*, 653 F.3d 1112 (9th Cir. 2011) (quoted above), and *Transport Labor Contract/Leasing, Inc. & Subs. v. Commissioner*, 123 TC 154 (2004) (in context of a three-party arrangement, the U.S. Tax Court found "each trucking company client's owning or leasing the truck driven by each driver-employee whom it leased from TLC is a neutral factor in determining whether TLC was the employer of each driver-employee."), *reversed* 461 F.3d 1030 (8th Cir. 2006) (on other grounds). Furnishing tools or facilities to expatriate or leased employees is simply not informative to the common law employer-employee analysis in a GEC / PEO arrangement.

3. PGM LLC Is the Common Law Employer Even Under the Department's Overruled "Economic Realities" Standard

Tenuous and discredited "economic realities" and subjective result based policy

considerations have no place in the common law employer-employee analysis. The Department's contention that PGM LLC's relationship with its expatriates must be viewed in light of "the application of social legislation" and "economic reality" is erroneous -- such authority from *Silk* (and re-iterated in *Bartels*) has been expressly abandoned and rejected by the U.S. Supreme Court in now controlling case law, *CCNV*, 490 U.S. 730 and *Darden*, 503 U.S. 318. *See* Dept. Br. at 24. Instead, common law employer-employee agency principles *are* the substance of the relationship and ultimately control whether PGM LLC is the employer of its seconded expatriates.

However, even if viewed under broader "economic realities," the entire purpose of a global *employment* company is to hire workers as their common law employees and then assign those employees to provide services directly at client companies. This is exactly the case here. On February 26, 2010, the PepsiCo Corporate Group acquired The Pepsi Bottling Group ("PBG") and PepsiAmericas, Inc. ("PAS"). *See* Joint Stip. ¶¶ 40-41. As the Department has agreed, PBG and PAS -- former independent and publicly traded companies -— utilized their own GEC for their expatriate employees prior to acquisition by and integration into the PepsiCo Corporate Group. *See* Joint Stip. ¶ 47 ("At the time of the acquisitions, the PepsiCo Corporate Group, PBG, and PAS each utilized respectively the following separate entities for their foreign expatriate programs: Beverages Foods & Services Inc. [("BFSI")] (PepsiCo Corporate Group), C&I Leasing, Inc. [("C&I Leasing")] (PBG), and Pepsi-Cola General Bottlers, Inc. [("PCGB")] (PAS)."). As a result of the acquisitions, "approximately 200 U.S./foreign national expatriates within the PepsiCo Corporate Group -- consisting of high performing executives, managers, and analysts -- were scattered across various PepsiCo affiliates (including former PBG and PAS affiliates) and seconded outside the U.S. to serve the various businesses of the PepsiCo Corporate Group as part of the then-existing Expatriate Programs." Joint Stip. ¶ 54. "After PGM LLC's formation, the

PepsiCo Corporate Group utilized PGM LLC as the single Expatriate Program entity for foreign-based (non-U.S.) secondments." Joint Stip. ¶ 58. Accordingly, three publicly traded companies independently utilized GECs to serve as common law employers for reasons completely separate from state taxation.

Put in the proper context, PGM LLC *has to be* the common law employer of its expatriate employees for a variety of business reasons existing well before PBG and PAS were acquired and well before state taxation was ever a consideration: i) PGM LLC limits U.S. entity legal liability in foreign jurisdictions (Joint Stip. ¶ 65); ii) PGM LLC preserves expatriates eligibility to participate on U.S. benefits plans (Joint Stip. ¶ 82); iii) PGM LLC limits permanent establishment foreign tax exposure (Joint Stip. ¶ 67); iv) PGM LLC provides business and government compliance efficiency (Joint Stip. ¶ 63, 67, and 104); v) PGM LLC assists with recruiting and retaining talent (Joint Stip. ¶ 7); vi) PGM LLC assists with development of talent (Joint Stip. ¶ 73); and vii) PGM LLC deploys technical expertise to foreign markets where such expertise is not otherwise available (Joint Stip. ¶ 73). *See* PepsiCo Opening Br. at 43-48.

In sum, the "economic reality" of any functional GEC, like PGM LLC or any of its predecessors, is that of a common law employer of globally mobile expatriates. Even the Department's bankrupt *Silk* / *Bartels* analytical framework does not change the result when looking at the overall facts and circumstances of PGM LLC. Here, as evidenced by the factual record, PGM LLC is the common law employer of the expatriate employees for a whole host of valid non-tax legal and business reasons separate and apart from the Illinois 80/20 Rule. The federal common law definition of "employee" codified into the 80/20 Rule through Ill. Admin. Code tit. 86, § 100.3100(b) (incorporating IRC § 3401(c) and Treas. Reg. § 31.3401(c)-1)) does not stand alone, but rather, is directly / inextricably tied to the federal employee-employer classification for all

these other important business reasons. Thus, looking at the "economic realities" of the situation as a whole, PGM LLC's classification as the common law employer of the expatriate employees cannot seriously be debated; the Department's premise that PGM LLC cannot be the common law employer for all these purposes -- including the 80/20 Rule -- has to be wrong.

4. The Professional Employer Organization Cases Cited By the Department Are Distinguishable

Scattered throughout the Department's response are various cases applying the common law employer-employee analysis to three-party arrangements involving a PEO, a client company, and leased employees. While some of these cases comport with the proper agency analysis (as set forth in Ill. Admin. Code tit. 86, § 100.3100, IRC § 3401(c), Treas. Reg. § 31.3401(c)-1(b), *CCNV*, *Darden*, *Striker, Gillis, Adair, Blue Lake,* etc.), the facts at issue in those cases are distinguishable from the present matter. Three principle PEO cases cited by the Department are: *Professional & Executive Leasing, Inc. v. Commissioner*, 89 TC 225 (1987), *affirmed* 862 F.2d 751 (9th Cir. 1988) ("*PEL*"); *Burnetta v. Commissioner*, 68 TC 387 (1977); and *Taxpayer v. Utah State Tax Commission*, Appeal Nos. 05-0594 and 05-1764 (Nov. 2011). Not surprisingly, the Department ignores or distorts the Joint Stipulation in a feeble attempt to align PGM LLC with the entities / PEOs held not to be common law employers in these cases.

a. Professional & Executive Leasing – Overruled Law and Inapposite Facts

As an initial matter, in *PEL*, the U.S. Court of Appeals for the Ninth Circuit upheld the U.S. Tax Court's determination that a PEO was not the common law employer of employees based on *Silk's* discredited "economic realities" test. *See PEL*, 89 TC 255 (citing to *Silk* and *Bartels* to determine the "economic reality" of the PEO). Twenty-five years later, the Ninth Circuit revisited the same issue in *Blue Lake* (2011) and applying the proper common law agency factors articulated

by the U.S. Supreme Court in *CCNV* (1989) and *Darden* (1992) determined the PEO (Mainstay) was the common law employer of its hired workers. *See Blue Lake Rancheria*, 653 F.3d at 1116 ("A 'common-law employer' is the employer under the general common law of agency.") (citing *CCNV*, 490 U.S. at 740 and omitting any citation / reference to bad law in *Silk* and *Bartels*). Accordingly, controlling law renders the *PEL* case useless.

The facts in *PEL* also do not align with the facts in this dispute. In *PEL*, professionals and executives (medical doctors, lawyers, dentists, veterinarians, and business operators) who already worked for a professional services business were "hired" by a PEO solely for fringe benefits who immediately re-leased those individuals back to their original employers indefinitely. *See PEL*, 89 TC 225. By contrast, "PGM LLC facilitates the secondment of high-performing expatriate executives, directors, managers, and analysts from PepsiCo Corporate Group affiliates/operating companies who fulfill temporary key roles with the objective of developing and retaining talent and expanding foreign business operations in established and emerging international (non-U.S.) markets." Joint Stip. ¶ 62. "The term/duration of the temporary assignment is set in advance of the secondment and typically lasts no longer than three to five years." Joint Stip. ¶ 78. Therefore, in stark contrast to the PEO in *PEL*, PGM LLC deploys talented professionals within the PepsiCo Corporate Group to emerging international markets on a temporary basis with the goal of developing those expatriates' long-term capabilities, while increasing profitability at the ground level where those expatriates are seconded.

b. Burnetta – The Client Company Retained the Right to Control and Direct

The Department's reliance on *Burnetta* is confusing as this case completely supports PGM LLC as the common law employer. The PEO in *Burnetta* is another simple payroll entity ("Staff") formed exclusively for "payroll and recordkeeping services for its clients." 68 TC at 391. Staff's

activities were thus limited to "calculating, payroll, writing checks, keeping records, making federal, state and city reports." *Id.* Staff's clients, in turn, had (and exercised) significant rights of control over the "leased" employees. Specifically, the clients: determined initial pay and raises; completed initial interviewing and hiring; and had the right to and did fire employees. *Id.*

The U.S. Tax Court contrasted these facts against Rev. Rul. 75-41 (cited above), where the IRS determined the PEO at issue was the common law employer of assigned workers based on binding legal contracts between the parties. *Id.* *See supra*, Section III.A.3. As applied to the facts in *Burnetta*, the Tax Court concluded Rev. Rul. 75-41 is "clearly distinguishable" as "the revenue ruling indicated that the right to control was vested in the service corporation [PEO] and not the subscriber [client company], while the facts before us reveal exactly the opposite." *Burnetta*, 68 TC at 400-401. To this end, the Tax Court in *Burnetta* placed significant weight on the lack of employment agreements between the PEO and the workers. *Id.* ("Another element in that ruling missing from the facts of the instant case is the existence of employment contracts between the service corporation and the workers, the terms of which the subscribers had no right to alter.").

Applying *Burnetta*'s analysis to the present matter demonstrates why PGM LLC is the common law employer of the expatriates. PGM LLC has substantive employment contracts with each expatriate and maintains the rights of any employer under the common law, including the right to terminate. *See* Joint Stip. ¶ 97 ("PGM LLC may end an assignment for any reason, including by termination of overall employment, upon written notice to the foreign host company."); and Joint Stip. ¶ 158, Exhibit 26 (Marc [redacted] Termination Letter) (PEP00000052-71). In sum, just because the Tax Court in *Burnetta* concluded the client company was the common law employer does not in and of itself support the Department's case here. To the contrary, *Burnetta* clearly distinguishes why PGM LLC is a common law employer for all the

reasons stipulated in the record, while other simple payroll entities without employment contracts / the right to control and direct under Treas. Reg. § 31.3401(c)-1(b) are not.

c. *Utah State Tax Commission – The Client Company Retained the Right to Control and Direct*

The third PEO case cited by the Department is *Taxpayer v. Utah State Tax Commission*, Appeal Nos. 05-0594 and 05-1764 (Nov. 2011). *See* Dept. Br. at 35. This case directly supports PGM LLC's classification as the common law employer of its expatriates. The taxpayer ("Taxpayer") in *Utah State Tax Commission* is a marketing company that develops, distributes, and sells proprietary products. Appeal Nos. 05-0594 and 05-1764 at Page 2. The Taxpayer contracted with a PEO ("Business-1") whereby Business-1 "leased" employees who worked at Taxpayer's Utah facilities to Taxpayer. *Id.* at Page 15. The Utah State Tax Commission ("Tax Commission") evaluated this arrangement and ultimately determined that the leased employees were common law employees of the Taxpayer / client company and thus were includable in Taxpayer's Utah payroll factor numerator and denominator. *Id.* at Page 83.

As applied to this dispute, the following facts distinguish the Business-1 / PEO from PGM LLC:

	Business-1 (Utah PEO)	**PGM LLC (GEC)**
Right to Control and Direct	Taxpayer (client company) issued an employee handbook to each employee leased from Business-1 (PEO). Appeal Nos. 05-0594 and 05-1764 at Page 85. The handbook stated Taxpayer (Client Co.) "hires each of its employees by and through Business-1 [and that] Taxpayer [Client Co.] *retains the right to supervise its employees and all other rights of an employer*." *Id*. (internal citations omitted). "The employees leased to Taxpayer by Business-1 performed services for Taxpayer … pursuant to policies and procedures instituted by Taxpayer."	"The seconded expatriates are required to do all things established by PGM LLC to complete the assignment and to adhere to all PGM LLC policies …" Joint Stip. ¶ 84. As the employer, PGM LLC "*shall cause* the Employees to perform the Role [or "Services"] in accordance with the terms of this [Secondment] Agreement." Joint Stip. ¶ 63, Exhibit 25 (Secondment Agreement, Section 1 (emphasis added)) (PEP00001643). *See also* PepsiCo Opening Br. at 30-33. The FHCs, by comparison, do not retain the ultimate right to control and

		direct PGM LLC employees outside day-to-day functions.
Right to Terminate	"In the handbook, it is explained that employment is 'at will' and can be terminated either by the employee or Taxpayer [Client Co.]. However, it does not indicate whether Business-1 [PEO] can terminate an employee." *Id.* at Page 85. Furthermore, a representative for Taxpayer (Client Co.) testified that "hiring and firing decisions would have been made by personnel and management at Taxpayer [Client Co.], not at Business-1 [PEO]." *Id.*	PGM LLC "may end an assignment for any reason, including *by termination of overall employment*" and it *has exercised that authority*. Joint Stip. ¶¶ 98 and 158, Exhibit 26 (Marc [redacted] Termination Letter) (PEP00000052-71) (emphasis added). Conversely, "the foreign host company" "does not" have "the right to terminate a seconded expatriate's overall employment." Joint Stip. ¶ 97.
Retirement Benefits	Taxpayer (Client Co.) provided "retirement benefits for its employees." *Id.* at Page 89.	PGM LLC's expatriates *must be* common law employees of PGM LLC (and remain so throughout the duration of their secondment) for reasons completely separate and apart from state tax savings. *See, e.g.* Joint Stip. ¶¶ 67, 81, and 82 (to preserve expatriates' eligibility to participate in the PepsiCo Corporate Group's U.S. savings plan, pension plan, healthcare plan, etc.). Critically, the foreign host companies are *not* eligible employers for the PepsiCo (U.S.) Savings Plan because they do not compensate their employees from U.S. payroll.
HR Functions	The handbook issued by Taxpayer (Client Co.) "provided new hire orientation and on-the-job training." *Id.* at 85. No such training was indicated to have been provided by Business-1 (PEO).	PGM LLC expatriates benefit from important HR services including but not limited to: "on-boarding; providing training and education tools and teaching support … managing expectations and consulting on relocations." Joint Stip. ¶ 110.

In addressing each of these factors, the Tax Commission cited *the* seminal case *Nationwide Mut. Ins. Co. v. Darden* and concluded "the employees are common law employees of Taxpayer [Client Co.] whose wages should be included in Taxpayers' payroll factor. Business-1 [PEO] had no actual *or constructive control* over the work performed by Taxpayers' employees. Taxpayers' employee handbook provided that Taxpayer retained the right to supervise is employees and all other rights of an employer." *Id.* at Page 86 (emphasis added) (citing *Darden*, 503 U.S. 318). As is abundantly clear, PGM LLC has constructive control over its expatriate employees through

controlling legal agreements and exercises actual control over these individuals through Global Mobility HR Function personnel. *See* Joint Stip. ¶¶ 54-110.

IV. PepsiCo Has Met Its Burden of Proof

A taxpayer bears the burden to show a notice of deficiency from the Department is incorrect. *See Ford Motor Company v. Dept. of Revenue*, 2019 IL App (1st) 172663 ("Section 904(a) of the Income Tax Act provides that the findings of the Department evidenced by a notice of deficiency are *prima facie* correct and constitute *prima facie* evidence of the correctness of the amount of tax and penalties due. 35 ILCS 5/904 (a)."). With regard to this matter, the Illinois Appellate Court has held the 80/20 Company classification is an exemption from tax. *See Zebra Tech. Corp. v. Topinka,* 334 Ill. App. 3d. 474 (1st Dist. 2003) ("Such exemptions are to be strictly construed, and doubts concerning the applicability of the exemptions will be resolved in favor of taxation.").

Knowing this, the Department acts as if PepsiCo's alleged burden was impenetrable, *i.e.*, that no amount of factual investigation can ever be good enough if the Department does not like the result. This is not the law. Instead, "[w]hen the taxpayer introduces credible evidence to the contrary, the burden is again placed on the Department to prove its contentions by a preponderance of the evidence." *Balla v. Dept. of Revenue*, 96 Ill. App. 3d 293 (1st Dist. 1981) (citing *Goldfarb v. Dept. of Revenue*, 411 Ill. 573 (1952)). Here, through over six years of cooperation with the Department on audit, investigation, discovery, and negotiating a fully stipulated record, PepsiCo has more than met its burden.

A. FLNA and PGM LLC Operate As A Single, Unitary Business

The Department's first "burden of proof" argument is PepsiCo has not proven "FLNA conducts a single trade or business with PGM LLC." Dept. Br. at 43. The reasoning is that

"FLNA's domestic snack foods business is separate and independent from any business activities attributed to PGM LLC." *Id.* In support, the Department cites an Illinois regulation for the position that "activities of the person will be considered a single business if there is evidence to indicate that the segments under consideration are integrated with, dependent upon, or contribute to each other and the operations of the person as a whole." Ill. Admin. Code tit. 86, § 100.3010(b)(3). In this regard, "[t]he following factors are considered to be good indicia of a single trade or business, and *the presence of any one of these factors creates a strong indication that the activities of the person constitute a single trade or business*[:] "A) Same Type of Business"; "B) Steps in a vertical process"; and "C) Strong Centralized Management. *Id.* (emphasis added). Accordingly, if FLNA and PGM LLC satisfy just one of these factors, they qualify as a "single trade or business" under the Department's regulation. In this case, all three criteria are easily satisfied.

The PepsiCo Corporate Group operates a food and beverage consumer products businesses across the globe through a cohesive unitary structure. *See* Joint Stip. ¶ 4. At the very heart of this structure is PepsiCo's senior management which "evaluates the overall performance of all employees on the U.S. benefits plan (including all PepsiCo Corporate Group domestic U.S. employees and all expatriates seconded outside the U.S.) and makes all final compensation determinations." Joint Stip. ¶ 88. Furthermore, all employees within the PepsiCo Corporate Group benefit from a centralized human resources function located in PepsiCo, Inc. *See* Joint Stip. ¶ 89. While the PepsiCo Corporate Group's operations ultimately branch "into three principal business lines -- the beverage business …, the snack foods business …, and the grain-based business" all remain inextricably linked to a single, centralized nucleus. *See* Joint Stip. ¶ 5.

"[O]utside the U.S., the PepsiCo Corporate Group's three principal business lines are combined, and foreign (non-U.S.) employees and foreign (non-U.S.) employer entities serve all,

or some combination of, the beverage business, the snack-foods business, and/or the grain-based business." Joint Stip. ¶ 6. PGM LLC ties the PepsiCo Corporate Group's domestic and international businesses together by facilitating "global postings through an expatriate program … Such postings allow the PepsiCo Corporate Group to, among other things, share information across the globe, identify and capitalize on best practices, familiarize executives with the different market dynamics in which the PepsiCo Corporate Group operates, and grow their executives to be the next generation of high-performing leaders which will run the business. These benefits accrue to the PepsiCo Corporate Group generally, including each business in the PepsiCo Corporate Group that sends executives on an assignment through the Expatriate Program and each business within the PepsiCo Corporate Group which receives executives who have been on such an assignment." Joint Stip. ¶ 7. Furthermore, "PepsiCo Corporate Group management identifies and approves individuals for assignment to foreign host companies pursuant to its determination of the skill set and interest of each individual, and the business needs of the foreign host companies." Joint Stip. ¶ 76.

PGM LLC and FLNA operate in "the same general line" of business. In fact, "[t]he majority of expatriates seconded through the Expatriate Program either work for the snack-foods business all of the time or work partially for the snack-foods business. See Exhibit 7 (Breakout of Beverage, Food, and Combination PGM LLC Employees (Sample) (PEP00004906-PEP00004908))." Joint Stip. ¶ 68. In this regard, PGM LLC expatriates develop the foreign snack foods business while on secondment abroad to FHCs. *See* Joint Stip. ¶ 73 ("Seconded expatriates are assigned to foreign host companies for a variety of reasons, including … to provide highly skilled industry knowledge and technical expertise not otherwise available to the foreign host company through the local talent pool.").

There is also no question FLNA and PGM LLC complement one another as vertically integrated businesses. For example, the "domestic snack food business" -- *managed by FLNA* -- "sends executives on assignment through the Expatriate Program and also receives executives who have been on such an assignment." *See* Joint Stip. ¶ 11 ("The management team for the domestic snack food business is employed by and operates out of FLNA, in its Texas offices."); and Joint Stip. ¶ 13 ("The domestic snack foods business sends executives on assignment through the Expatriate Program and also receives executives who have been on such an assignment."). Furthermore, "[a]t least nine of the expatriates listed on the PGM LLC Payroll Reports were working at FLNA Hong Kong during each of the 2011-2013 tax years." Joint Stip. ¶ 31.[11] The skills developed by the PGM LLC expatriates while on secondment are thus reinvested into the PepsiCo Corporate Group's domestic entities when the individuals repatriate back to the U.S., some of whom return directly to FLNA. *See* Joint Stip. ¶¶ 11, 13. FLNA is also connected to the international market through its foreign business operations, *i.e.*, FLNA Hong Kong, CEME, QFL, and Bev Svcs. *See* Joint Stip. ¶¶ 10-39, 61. Accordingly, PGM LLC operates as a single business with FLNA and the broader PepsiCo Corporate Group.

B. The Law and Facts Are Clear: PGM LLC Compensation Is Includible As FLNA Foreign Compensation

The Department's second "burden of proof" argument is that PGM LLC's expatriate compensation is not proven to fairly reflect substantive foreign business activity of FLNA. *See* Dept. Br. at 47-50. In support, the Department argues (i) expatriate compensation "parked" in PGM LLC as foreign payroll does not fairly represent foreign business activity conducted by PGM

[11] "**PepsiCo Hong Kong, LLC ("FLNA Hong Kong")** is a U.S. single member LLC and is treated as a division of FLNA for both federal and Illinois corporate income tax purposes." Joint Stip. ¶ 24.

LLC; and thus (ii) extraction of PGM LLC foreign compensation is appropriate under Illinois law. Each of these arguments is unsupported by the record and the law.

1. Foreign Compensation Consolidated Into PGM LLC in Accordance with Best Business Practice

The Department's characterization of foreign compensation as "parked" in PGM LLC disregards critical portions of the factual record. As described in detail in PepsiCo's opening brief, PGM LLC was formed for legitimate non-tax business reasons to consolidate and unify various pre-existing independently formed and functioning expatriate entities, programs, and policies. PepsiCo Opening Br. at 39-41 (citing Joint Stip. ¶¶ 27, 54-55, 57-58, and Joint Stip. Exhibit 6). It is also the case that PGM LLC's "business activity" is measured by its payroll under 35 ILCS 5/1501(a)(27)(A). The Department claims PepsiCo's position is "untenable" because PepsiCo "followed the rules, as set out in IITA Section 1501(a)(27) and Department regulations … contrary to economic reality." Dept. Br. at 37. In reality, it is the Department's unsupported, undefined, and unprecedented arguments that are "untenable" as a matter of law.

2. Extraction of PGM LLC Foreign Payroll Is Improper

The Department claims "PepsiCo has not met its burden of proving that expatriate compensation charged to PGM LLC fairly represents substantive foreign business activity includible in FLNA's payroll." Dept. Br. at 47. As a result, such "payroll must be removed from FLNA's 80/20 computation in order of that computation to reflect economic reality." *Id* at 48-49. By reference to *Zebra Tech* and *IBM*, the Department asserts it "is not bound by formalistic evidence propounded by a taxpayer in support of its 80/20 Test payroll and property factors. Instead, [the courts in *Zebra* and *IBM*] ruled that to qualify for an 80/20 Test exclusion a taxpayer must present clear and convincing substantive evidence that a corporation conducts 80% of its business activities outside the United States." *Id.* at 49.

The facts in *Zebra* and *IBM* were presented on undeveloped records dramatically different than what is presented here. *See* PepsiCo Opening Br. at 50-53 (citing *Zebra Tech*., 344 Ill. App. 3d at 484 ("taxpayer failed to sustain its burden on the threshold issue of qualifying to exclude ZDI and ZII from its unitary business group under section 1501(a)(27) of the Act."); and *International Business Machines Corp. v. Dept. of Revenue*, 14 TT 229 (Jun. 2015) (the taxpayer provided "little support for IBM … as it has not been tested by deposition or trial testimony or agreed to by stipulation by the Department."). The Department misrepresents PepsiCo's position by claiming "PepsiCo dismisses *Zebra* and *IBM* as irrelevant." Dept. Br. at 48. To the contrary, these cases are instructive in showing a taxpayer must develop a factual record to support its 80/20 Company position -- *exactly* what PepsiCo and the Department did here. After four years of extensive effort, and even longer than that during audit, a robust stipulation was jointly executed facilitating both parties' agreement to move on cross-motions for summary judgment. *See id.* and **Exhibit D**.

While the Department's notice of deficiency may be considered *prima facie* correct, the taxpayer's corresponding ability to produce evidence to overcome its burden is not (nor should it be) insurmountable under the law. *See Balla v. Dept. of Revenue*, 96 Ill. App. 3d 293 (1st Dist. 1981) ("When the taxpayer introduces credible evidence to the contrary, the burden is again placed on the Department to prove its contentions by a preponderance of the evidence."). Upon reviewing the law as applied to the facts, it is clear PepsiCo *has* met its burden. The burden is now on the Department to put forth evidence and/or legal authorities sufficient to support its assessment.

V. PGM LLC's Substance As A Global Employment Company Cannot Be Recast By the Department's Misguided Arguments

PGM LLC is fundamental to the PepsiCo Corporate Group's global business operations. PGM LLC's standing as a viable business enterprise formed for non-tax business reasons is

established by the factual record here and cannot be seriously debated.

A. The Department Misconstrues Illinois and Federal Substance-Over-Form Case Law

The Department misconstrues federal and Illinois case law, including: *JI Aviation, Inc. v. Dept. of Revenue*, 335 Ill. App. 3d 905 (1st Dist. 2002); *Hartney Fuel Oil Co. v. Hamer*, 376 Ill. Dec. 294, 302 (2013); and *Summa Holdings, Inc. v. Commissioner*, 848 F.3d 779, 781–82 (6th Cir. 2017).

1. *JI Aviation* Provides No Support for the Department's Claim that PGM LLC Lacks Economic Substance or Business Purpose

The Department's attempt to equate PGM LLC to a transaction structured for the sole purpose of securing federal income tax benefits under IRC § 1031 in connection with the transfer of a Gulfstream G-II aircraft is misleading at best. *See* Dept. Br. at 71. In *JI Aviation*, JI Aviation, Inc. ("JI Aviation") entered into an aircraft acquisition agreement with Richland Development Corp. ("Richland") for the purchase of a Gulfstream G-II aircraft. 335 Ill. App. 3d at 907. Richland was a non-retail subsidiary of the Pennzoil Company ("Pennzoil") charged with managing real estate and providing staffing support to Pennzoil and its affiliates. A special provision of the agreement allowed the seller to receive the purchase price through a third party, Nationsbanc Leasing Corporation of North Carolina ("Nationsbanc"). *Id.* The special provision was an accommodation to Richland because Nationsbanc is a retailer of aircraft. Critically, "[t]he *entire purpose* *of that provision was to effectuate a like-kind exchange pursuant to section 1031 of the Internal Revenue Code* … by exchanging the Gulfstream G-II for a Gulfstream G-IV aircraft, which Nationbanc had acquired on behalf of Richland." *Id.* (emphasis added). Therefore, by allowing the transaction to run through a conduit entity (Nationsbanc), Richland / Pennzoil secured federal income tax savings under IRC § 1031.

Unlike Nationsbanc in *JI Aviation*, PGM LLC has economic substance and business

purpose separate from any state-tax savings. As *the* global employment company for the PepsiCo Corporate Group, "PGM LLC facilitates the secondment of high-performing expatriate executives, directors, managers, and analysts from PepsiCo Corporate Group affiliates/operating companies who fulfill temporary key roles with the objective of developing and retaining talent and expanding foreign business operations in established and emerging international (non-U.S.) markets." Joint Stip. ¶ 62. Furthermore, PGM LLC was formed for numerous non-tax business reasons without consideration for Illinois state tax savings, including but not limited to securing expatriates' eligibility to participate in PepsiCo's U.S. savings plan, pension plan, healthcare plan, etc. Joint Stip. ¶ 82; and Joint Stip. ¶¶ 7, 54-59, 65, 67, and 73 (addressing other non-tax business reasons PGM LLC exists). The Department's attempt to analogize PGM LLC with the conduit entity in *JI Aviation* defies the stipulated record and must be rejected.

2. The Department's Interpretation of *Hartney Fuel Oil* Supports Exclusion of FLNA From PepsiCo's Illinois Combined Return as an 80/20 Company

The Department's interpretation of the Illinois Supreme Court's *Hartney Fuel Oil* ruling is entirely consistent with PepsiCo's position that FLNA must be excluded from the Illinois combined return as an 80/20 Company. *See* Dept. Br. at 59-64. In this regard, the Department argues:

> The court found that while Hartney's actions were not consistent with the state statute, they were consistent with the Department's regulations … The court ruled as a matter of equity that Hartney was entitled to abatement of the taxes at issue under the Illinois Taxpayer Bill of Rights. … the court dismissed the Local Government's substance over form argument because Hartney in structuring its business operations had relied on the invalid Department regulations that unduly narrowed the scope of the statute.

Dept. Br. at 62-63. The present matter is even worse than the Department's argument in *Hartney*. The disputed regulation in *Hartney* improperly narrowed the scope of the statute. Here, the

Department is attempting to improperly expand the scope of the 80/20 Rule / statute without a regulation. Indeed, if businesses structured in reliance on invalid regulations are to be respected, there is absolutely no basis for the Department to argue, or this Tax Tribunal to find, that substance over form arguments can serve to unwind valid business operations structured in reliance on valid and long standing Illinois statutes. *See Hartney Fuel Oil*, 376 Ill. Dec. at 313 ("It is not incumbent upon this court to decide the best tax policy; *the court is to decide the tax policy the legislature has chosen and communicated through the statute*" (emphasis added); and at 302 ("Administrative regulations have the force and effect of law and are interpreted with the same cannons as statutes.").

3. The Department Cannot Dismiss *Summa Holdings* Based on Irrelevant Factual Differences

The Department also dismisses *Summa Holdings* as "irrelevant" due to factual and legal distinctions between effectuating tax-savings transactions through a domestic international sales corporation ("DISC") in accordance with clear federal law (IRC §§ 995(g) and 408A) and qualifying as an 80/20 Company under clear Illinois law (35 ILCS 5/1501(a)(27)(A)). *See* Dept. Br. at 64-68. As the Tax Tribunal is well aware, however, under our system a case need not have the same facts in order to be applicable and apposite. In *Summa*, the U.S. Court of Appeals for the Sixth Circuit ruled that "[b]ecause Summa Holdings used the DICS and Roth IRAs for their congressionally sanctioned purpose -- tax avoidance -- the Commissioner had no basis for recharacterizing the transactions and no basis for recharacterizing the law's application to them." *Summa Holdings*, 848 F.3d at 782. So too here. The Illinois legislature carefully defined the term "unitary business group" to exclude entities from the Illinois combined group using a mechanical 80/20 Rule. *See* 35 ILCS 5/304(a) and 5/1501(a)(27)(A). Both disputes are thus centered around enforcing clear laws for their congressionally sanctioned purposes. Viewed under the proper lens,

the clear and undeniable import of *Summa* is the Department may not "recharacterize the meaning of statutes--to ignore their form, their words, in favor of *his* perception of their substance." *Summa Holdings*, 848 F.3d at 785 (emphasis added). That holding has power here too.

B. The PepsiCo Corporate Group's 2010 Global Restructuring Is Not A Sham Transaction

One focus of the PepsiCo's Corporate Group 2010 global restructuring was to reorganize FLNA's domestic and foreign business operations to create a more effective business structure. *See* Joint Stip. ¶¶ 48-53. In this regard, three Expatriate Program entities were consolidated into one Expatriate Program entity, PGM LLC. *See* Joint Stip. ¶¶ 57-58. In Illinois, "absent a fact pattern of sham or lack of business purpose, a court should accept transactions between related though separate corporations as proper and not disregard them because of the relationship between the parties." *Wendy's International, Inc. v. Hamer*, 375 Ill. Dec. 194 (2013). To this end, Illinois courts have upheld taxpayers' eligibility for exemption based on structuring their affairs in accordance with the law:

> So long as the bank was legally exempt from ROTA and it engaged in meaningful transactions with its subsidiary pursuant to the laws which extended an exemption from use tax to First Chicago, there is nothing in the law which says the Department may disregard the lawful nature of the transaction by casting aspersions of unlawful tax evasion upon First Chicago.

First Chicago Building Corporation v. Department of Revenue, 49 Ill. App. 3d 237 (1st Dist. 1977). Applying this reasoning, the Illinois Appellate Court rejected the Department's sham transaction argument and concluded "the taxpayer and the bank logically and intelligently arranged their affairs in accordance with the letter and spirit of the law." *Id*.

Furthermore, in *PepsiCo Puerto Rico, Inc. v. Commissioner*, the IRS evaluated the PepsiCo Corporate Group's structure and held:

> [D]isregarding petitioners' international corporate structure based solely on the entities' interrelatedness is, without more, unjustified. …. If we were to find

> otherwise, we would risk minimizing or perhaps eviscerating, the legal distinctions between corporate branches and subsidiaries.
>
> "[I]t is one thing to say that transactions between affiliates should be carefully scrutinized and sham transactions disregarded, and quite a different thing to say that a genuine transaction affecting legal relations should be disregarded for tax purposes merely because it is a transaction between affiliated corporations. We think that to strike down a genuine transaction because of the parent-subsidiary relation would violate the scheme of the statute and depart from the rules of law heretofore governing intercompany transactions. [A]ll legitimate and genuine corporation stock holder arrangements have legal -- and hence economic -- significance, and must be respected in so far as the rights of third parties, including the tax collector, are concerned. *Kraft Foods Co. v. Commissioner*, 232 F.2d [118] at 124 [(2nd Cir. 1956)] …"

T.C.M. (RIA) 2012-269 (2012). Here, the PepsiCo Corporate Group's 2010 global restructuring, including formation and placement of PGM LLC, required a "series of transactions that constitute a corporate … reorganization under [IRC] subchapter C" and thus cannot be characterized as a sham under any circumstance even if Illinois tax savings resulted from these internal transactions. *See* JCT Tech. Explanation (2010).

C. The Department Is Prohibited From Disregarding an Entity (1) Possessing Economic Substance; or (2) Formed for A Substantial Non-Tax Business Reason

The Department's attempt to cast aside PGM LLC as an individual entity "totally lacking any real economic substance" without recognition of broader non-tax functions served by the entity is entirely without merit. Dept. Br. at 50. In both federal and state taxation, courts have universally recognized "economic substance and business purpose must be assessed not in the narrow confines of the specific transactions between the parent and the subsidiaries, but in the broader context of the operation of the resultant businesses." *The Sherwin-Williams Company v. Commissioner of Revenue*, 438 Mass. 71, 86 (2002). Therefore, in the most simple terms, whether an entity or transaction will "be respected for taxing purposes, depends on whether it has had practical economic effects beyond the creation of … tax benefits." *Id*. Naturally, then, a transaction or entity "ceases to merit tax respect when it has no economic effects other than the creation of tax

benefits." *United Parcel Serv. of America, Inc. v. Commissioner*, 254 F.3d 1014 (11th Cir. 2001) (internal citations omitted).

In *Sherwin-Williams*, The Sherwin-Williams Company ("Sherwin-Williams") formed two subsidiaries under Delaware law, Sherwin-Williams Investment Management Company, Inc. ("SWIMC") and Dupli-Color Investment Management Company, Inc. ("DIMC"), for purposes of holding and managing Sherwin-Williams trademarks and to invest and manage royalty income earned from ownership of the trademarks. *Sherwin-Williams*, 438 Mass. at 72-74. Pursuant to licensing agreements, Sherwin-Williams paid royalties to SWIMC and DIMC at arm's length rates and deducted those royalty payments from its Massachusetts taxable income. *Id.* The Massachusetts Commissioner of Revenue assessed Sherwin-Williams additional state income tax liability on the basis that "the transfer and license back of the marks was a sham and could be disregarded under the 'sham transaction doctrine.'" *Id.*

The Massachusetts Supreme Judicial Court reversed the assessment allowing Sherwin-Williams to claim the royalty expense deductions on its state income tax return. *Id*. at 94. In so ruling, the Massachusetts high court stated:

> In context of a business reorganization resulting in new corporate entities owning or carrying on a portion of the business previously held or conducted by the taxpayer, this requires inquiry into whether the new entities are "viable," that is, "formed for a substantial business purpose or actually engag[ing] in substantive business activity." … In making this inquiry, consideration of the often interrelated factors of economic substance [("Prong #1")] and business purpose [("Prong #2")] is appropriate.

Id. at 85 (citing *Northern Ind. Pub. Serv. Co. v. Commissioner*, 115 F.3d 506, 512 (7th Cir. 1997)). *See also Rice's Toyota World, Inc. v. Commissioner*, 752 F.2d 89 (4th Cir. 1985) ("To treat a transaction as a sham, the court must find" "that the transaction has no economic substance … [Prong #1]" *and* "that the taxpayer was motivated by no business purposes other than obtaining

tax benefits in entering the transaction [Prong #2],"). Thus, if a transaction satisfies *either* prong set forth above, it must be respected for tax purposes. *See Sherwin-Williams*, 438 Mass. at 85 (where the court also noted "[o]ther courts have rejected a rigid two step analysis, opting instead to treat economic substance and business purpose as 'more precise factors to consider in the application of [the] traditional sham analysis; that is, whether the transaction had any practical economic effects other than the creation of income tax losses.'") (citing *Sochin v. Comm'r*, 843 F.2d 351, 354 (9th Cir. 1988)).

With regard to Prong #1, economic substance, the *Sherwin-Williams* court found "evidence of economic substance, or substantive business activity, beyond the creation of tax benefits" from forming SWIMC and DIMC, notwithstanding Sherwin-Williams expensing / deducting the royalty payments from Massachusetts taxable income. *Id.* at 86. To this end, the court stated both "subsidiaries became viable, ongoing business enterprises within the family of Sherwin-Williams companies, and not businesses in form only, to be 'put to death' after exercising the limited function of creating a tax benefit." *Id.* Therefore, the court concluded "[t]he separate corporate identities of Sherwin Williams and the subsidiaries must be respected …" *Id.* at 87. With regard to Prong #2, business purpose, the court concluded "Sherwin Williams failed to prove that it undertook the reorganization for any of the reasons adopted by its board of directors … other than reducing its State tax burden." *Id*. at 88-89. In other words, the entire motivation for the reorganization (and formation of SWIMC and DIMC) was to reduce state taxable income. *See id*.

Regardless of its conclusion on Prong #2, *i.e.*, there was no business purpose found, the Massachusetts court still reversed the assessment of tax under Prong #1, economic substance, because: "tax motivation is irrelevant where a business reorganization results in the creation of a viable business entity engaged in substantive business activity rather than in a 'bald and

mischievous fiction.'" *Id*. at 89 (citing *Northern Ind. Pub. Serv. Co.*, 115 F.3d at 512)).

The Massachusetts Supreme Judicial Court's ruling in *Sherwin-Williams* is often contrasted with another one of its cases, *Syms Corp. v. Commissioner of Revenue*, 436 Mass. 505 (2002). In *Syms*, Syms Corp. ("Syms") was a New Jersey corporation operating two stores in Massachusetts while engaged in off-price retailing. *Id.* at 506-507. Syms created the subsidiary SYL, Inc. ("SYL"), as a wholly owned trademark holding company to hold all Syms related trademarks. *Id*. at 507. Syms then made annual royalty payments to SYL, which SYL only held for a few weeks before returning the payment amounts to Syms in the form of a tax-free dividend. *Id*. at 507-508.

The Massachusetts Commissioner of Revenue disallowed Syms's deduction of royalty expense payments made to SYL from its corporate excise tax. *Id*. at 506. On appeal, the Massachusetts Supreme Judicial Court, upheld the Appellate Tax Board, finding "that the transfer and license back transaction had no practical economic effect on Syms other than the creation of tax benefits, and that tax avoidance was the clear motivating factor and its only business purpose." *Id*. at 511-512. In so ruling, the Court noted "[a] tax avoidance motive is, of course, not necessarily fatal. A corporation created, or a transaction engaged in for the purpose of reducing taxes may not be disregarded so long as it has some economic substance [Prong #1] *or* valid business purpose [Prong #2]." *Id.* at Footnote 8 (emphasis added).

D. PGM LLC (1) Is A Substantive Business Enterprise; and (2) Was Created for Non-Tax Business Reasons to Serve the PepsiCo Corporate Group

To win, the Department must show that PGM LLC lacks any sort of economic substance or business purpose. To get there, the Department disregards critical portions of the Joint Stipulation and otherwise defies the practical reality for forming a global *employment* company. Tax-savings aside, (1) PGM LLC functions as a substantive business enterprise creating real

economic effect for the entire PepsiCo Corporate Group; and (2) PGM LLC was formed for legitimate business reasons.[12]

1. PGM LLC Has Practical Economic Substance Beyond Tax Savings

After the acquisition of PBG and PAS, the PepsiCo Corporate Group had three separate GECs facilitating foreign expatriate employment arrangements -- BFSI (PepsiCo Corporate Group), C&I Leasing (PBG), and PCBG (PAS). *See* Joint Stip. ¶ 47. At this time, "PriceWaterhouseCoopers ("PwC") assessed the PepsiCo Corporate Group's overall global mobility practices" and determined there was "[s]ignificant duplication of effort across the function & opportunities to streamline …" Joint Stip. ¶¶ 55-56. Significant duplication of effort across PepsiCo's expatriate program thus resulted in increased costs on PepsiCo's business / global operations. In response, the PepsiCo Corporate Group implemented PwC's recommendations by "utiliz[ing] PGM LLC as the single Expatriate Program entity for foreign-based (non-U.S.) secondments." Joint Stip. ¶ 58. Formed as *the* global employment company for the PepsiCo Corporate Group, PGM LLC facilitates global business operations -- that is, PGM LLC seconds the right people to the right places, at the right time, with proper support in a lawful manner, to develop foreign non-U.S. entity business operations at the ground level with high-performing expatriate managers, directors, and executives. *See* Joint Stip. ¶¶ 62, 73, 75, 77, 92; Joint Stip. ¶ Exhibits 17-24. *See also* PepsiCo Opening Br. at 37-48 (for detailed descriptions of PGM LLC's business operations as a functional GEC).

Attempting to reject PGM LLC's economic substance, the Department suggests the entity does not operate in accordance with best practices for a variety of hyper-technical reasons. None

[12] Both are interrelated and either one alone is sufficient for PGM LLC to be respected for state tax reasons. *See Rice's Toyota*, 752 F.2d 89, *Northern Ind. Pub. Serv. Co.*, 115 F.3d 506, *Sherwin-Williams*, 438 Mass. 71, *Syms Corp.*, 436 Mass. 505, *et al*.

of these arguments serve as a basis to negate PGM LLC's function as a GEC to the PepsiCo Corporate Group for economic reasons completely outside the limited scope of this dispute:

GEC Best Practice	Hyper-Technical Argument	PGM LLC Substantive Reality
"Having the GEC be responsible for core employment functions." Andrew Liazos, "Global Employment Company: Is It the Right Fit for Your Organisation?", *The National Law Review* (2014).	"There is no simplification of global mobility administration." Dept. Br. at 54.	"The Expatriate Program is overseen in its entirety by a group of individuals within the PepsiCo Corporate Group's human resources function (the 'PepsiCo Corporate Group HR Function')." Joint Stip. ¶ 99. "[W]ithin the PepsiCo Corporate Group HR Function, there are approximately twenty individuals located throughout the world who execute employee transfers, relocations, and secondments throughout the PepsiCo Corporate Group in locations across the world ('Global Mobility HR Function')." Joint Stip. ¶ 100. "Roughly 26% of the Global Mobility HR Function's time and resources are devoted to management and support functions for PGM LLC and its expatriates." Joint Stip. ¶ 103. "In providing management and support functions to PGM LLC and the expatriates, the Global Mobility HR Function addresses HR issues unique to expatriate assignments such as education, immigration, and work permit issues." Joint Stip. ¶ 104. "The Global Mobility HR Function was divided into three main teams to oversee each expatriate seconded by PGM LLC: 1) the '**Center of Excellence Team**'; 2) the '**Services Team**'; and 3) the '**Relationship Team**'." Joint Stip. ¶ 105.
"Having <u>an</u> individual(s) employed to the operate the GEC" *Id.* (emphasis added).	"PGM LLC employs not even a single individual to oversee the administration of PepsiCo's expatriate program." *Id.*	See above, Joint Stip. ¶¶ 99-105.
"Establishing a reasonable service fee for the IME's services" *Id.*	"There is no 'reasonable service fee' charged by PGM LLC to Foreign Host Companies for the expatriate services. There is simply	"In consideration of Employer [PGM LLC] making available the Employees and the provision of the Services by the Employees for Host

	a pass-through of their compensation cost." *Id.* "PGM LLC does not generate a 'mobility P&L to facilitate proactive cost management' of the global mobility function." *Id.*	Company, Host Company will pay to Employer a secondment fee based on the cost to Employer of each Employee's compensation, benefits and reimbursed business expenses …" Joint Stip. Exhibit 25, Secondment Agreement, Section 3.1 ("Obligations of Host Company" (PEP00001643).
"Drafting appropriate legal documentation of the employment and assignment of the IME." *Id.*	None.	"For each individual included on the PGM LLC Payroll Reports for the Tax Years at Issue, PGM LLC and the applicable foreign host company executed a Secondment Agreement." Joint Stip. ¶ 63. "For each individual included on the PGM LLC Payroll Reports for the 2011 - 2013 tax years, PGM LLC and the individual executed an agreement (*i.e.*, a "Letter of Understanding") outlining applicable terms which apply during the assignment." Joint Stip. ¶ 64.
"Operating the GEC in a manner consistent with the GEC's legal documentation." *Id.*	"PGM LLC is not operated consistently with letters of understanding and secondment agreements that post expatriates to overseas assignments with Foreign Host Companies because the individuals who sign these contracts on behalf PGM LLC are not even employed by PGM LLC." *Id.*	See above, Joint Stip. ¶¶ 99-105.

When viewed solely from the perspective of seconding U.S. expatriates to related foreign host companies for limited durations completely aside from state tax savings, PGM LLC operates as a functional GEC -- that is, in sum, PGM LLC was established for the purpose of "[h]aving a single human resources group [to] support[] [internationally mobile employees ("IME")] allow[ing] for continuous employment with one entity, while providing uniform global compensation and benefits for IMEs moving through numerous locations." *See* Liazos, "Global Employment Company: Is It the Right Fit for Your Organisation?". Indeed, the parties *stipulated*

"PGM LLC facilitates the secondment of high-performing expatriate executives, directors, managers, and analysts from PepsiCo Corporate Group affiliates/operating companies who fulfill temporary key roles with the objective of developing and retaining talent and expanding foreign business operations in established and emerging international (non-U.S.) markets." Joint Stip. ¶ 62. For a growing international business, there is no greater economic effect than expanding business operations into emerging foreign markets. *See* Joint Stip. Exhibit 22 ("As we grow in newer markets, we need rapid deployment of experienced people who have proven skills, enabling us to beat the competition while developing local capabilities.").

Simply put, PGM LLC would not be "put to death" upon any adverse state tax judicial or administrative ruling. *See Sherwin-Williams*, 438 Mass. at 85. Ignoring the substantive business operations of PGM LLC, the Department seizes on PGM LLC's lack of profit making as if, to be valid in a purely intercompany context, a GEC must book a profit directly from its services in order to be respected. *See* Dept. Br. at 7, 28, 31, 36, 47, 57, and 71-72. A global employment company servicing wholly related affiliates has a broader economic effect and a larger profit motive for the overall PepsiCo Corporate Group. PGM LLC is critical to PepsiCo's Expatriate Program. *See* Joint Stip. ¶¶ 7, 58. Through the Expatriate Program, PepsiCo employees receive invaluable training / experience that inures to the benefit and increased profitability to the overall PepsiCo Corporate Group. *See* Joint Stip. ¶¶ 62 158, Exhibit 22. Furthermore, the common law relationship between PGM LLC and its expatriates has real life implications for all parties involved. Employment by PGM LLC is critical to the expatriates' continued eligibility to participate in the PepsiCo's U.S. savings plan, pension plan, healthcare plan, etc. *See, e.g.,* Joint Stip. ¶¶ 67, 81, and 82. If PGM LLC were improperly determined not to be the common law employer of its expatriates, these individuals would lose eligibility to participate in those plans for

the three to five year duration of their secondment. *See id.* and Joint Stip. ¶ 78. In many instances, this loss of eligibility would severely alter the economics of the foreign assignment for the expatriate employee. Expatriate employees are thus entirely dependent on PGM LLC's existence as a viable business enterprise within the PepsiCo Corporate Group and their agreed status as a PGM LLC employee for their own welfare.

In sum, PGM LLC is a substantive business enterprise that creates profound economic benefits to the entire PepsiCo Corporate Group. Its compensation cannot be extracted from FLNA's payroll under Prong #1 of federal and state case law. *See, e.g., Sherwin-Williams*, 438 Mass. at 89-90, *et al*. This factor alone is sufficient to defeat the Department's substance-over-form argument. *See id.*

2. PGM LLC Was Formed For Non-Tax Business Reasons

The non-tax business reasons for forming PGM LLC were expressly agreed to by the Department in the jointly stipulated facts. *See* PepsiCo Opening Br. at 39-49. These reasons include:

- Consolidate Expatriate Entities From Three to One Pursuant to PepsiCo's Global Restructuring: "At the time of the PepsiCo Corporate Group's 2010 global restructuring, approximately 200 U.S./foreign national expatriates within the PepsiCo Corporate Group -- consisting of high performing executives, managers, and analysts -- were scattered across various PepsiCo affiliates (including former PBG and PAS affiliates) and seconded outside the U.S. to serve the various businesses of the PepsiCo Corporate Group as part of the then-existing Expatriate Programs." Joint Stip. ¶ 54.

  "Prior to PGM LLC's formation, the PepsiCo Corporate Group utilized three separate Expatriate Program entities for foreign-based (non-U.S.) secondments -- Beverages Foods & Services, Inc. (PepsiCo Corporate Group), C&I Leasing, Inc. (PBG), and Pepsi-Cola General Bottlers, Inc. (PAS)." Joint Stip. ¶ 57. "After PGM LLC's formation, the PepsiCo Corporate Group utilized PGM LLC as the single Expatriate Program entity for foreign-based (non-U.S.) secondments." Joint Stip. ¶ 58.

- Improve the PepsiCo Corporate Group's Global Mobility Practices: "At the time of and in connection with the PepsiCo Corporate Group's 2010 global restructuring, PriceWaterhouseCoopers ('PwC') assessed the PepsiCo Corporate Group's overall

global mobility practices. *See, e.g.*, Exhibit 17 (PepsiCo Global Mobility Transformation Plan (Jan. 2011) (PEP00004813-4831)). Joint Stip. ¶ 55. "PwC identified the following areas of improvement for the PepsiCo Corporate Group's global mobility practices: 1) 'G[lobal] M[obility] function and processes do not align with the business strategy'; 2) 'Service delivery model is not in line with 'best practice's'; 3) 'Significant duplication of effort across the function & opportunities to streamline, automate & remove non-value added work"; 4) "Inconsistency in services across countries and regions'; and 5) 'Lack of career progression/opportunities within the team.' *See* Exhibit 17, Slide 4 (PepsiCo Global Mobility Transformation Plan (Jan. 2011) (PEP00004816))." Joint Stip. ¶ 56.

"As part of the restructuring, the PepsiCo Corporate Group identified approximately $14 million dollars per year in total tax savings in 13 states by creating PGM LLC as a division of FLNA. *See* Exhibit 6 (PepsiCo Global Mobility, LLC - Background to the Change in Entity (Sept. 2010) (PEP000002880-2888))." Joint Stip. ¶ 59. These state tax savings were discovered *after* the need for PGM LLC was identified. *See* Joint Stip. Exhibit 6 (formation of PGM LLC was necessitated "to resolve the compliance issued related to the employment structure" from eliminating expatriate payroll of Beverages Foods & Services, Inc. After the need for PGM LLC was identified, the "[p]roject revealed an opportunity for tax savings through a new employing entity.").[13]

- Protect U.S. Entities within the PepsiCo Corporate Group: "One of the purposes of forming PGM LLC was to attempt to protect other U.S. entities within the PepsiCo Corporate Group, such as PepsiCo, Inc., FLI, or FLNA, from having direct legal liability for actions of or disputes regarding the seconded expatriates actions in all of the countries in which each of those executives are assigned." Joint Stip. ¶ 65.

- Preserve Seconded Expatriates' U.S. Benefits, Centralize Permanent Establishment Foreign Tax Exposure, Centralize Business and Government Reporting Compliance: "Having a single entity, like PGM LLC, be the counterparty to all of the Secondment Agreements for all outbound expatriate employees: (i) preserves seconded employees' continued participation in U.S. benefits plans (*e.g.*, pre-tax retirement contribution plans authorized under 26 U.S.C. § 401(k)); (ii) centralizes Permanent Establishment foreign tax exposure related to expatriates working abroad to a single legal entity; (iii) centralizes tax, business, and other government compliance requirements (including but not limited to: certificates of coverage, foreign country work permits, and simplifies the process of foreign assignments)." Joint Stip. ¶ 67.

- Recruit and Retain Talent: "As a global business, a critical element of the PepsiCo Corporate Group's ability to recruit and retain high quality candidates is the ability to offer such candidates global postings through an expatriate program." Joint Stip. ¶ 7.

[13] The Department falsely states "PepsiCo's tax consultants" estimated these tax savings would result. *See* Dept. Br. at 72. To the contrary, PwC was hired by PepsiCo solely to advise on global mobility best practices. *See* Joint Stip. ¶¶ 55-56. The opportunity for tax savings was identified internally by PepsiCo's corporate and tax teams. *See* Joint Stip. Exhibit 6.

- Develop Talent: "Seconded expatriates are assigned to foreign host companies for a variety of reasons, including: 1) to advance their career development within the PepsiCo Corporate Group …" Joint Stip. ¶ 73.

- Deploy Technical Expertise: "Seconded expatriates are assigned to foreign host companies for a variety of reasons, including: … 2) to provide highly skilled industry knowledge and technical expertise not otherwise available to the foreign host company through the local talent pool." Joint Stip. ¶ 73.

Accordingly, the PepsiCo Corporate Group formed PGM LLC for a variety of critical and commonly understood business needs separate and apart from any Illinois state tax savings. PGM LLC must be respected as a substantive business enterprise with real economic effect under *Sherwin-Williams* Prong #1. The non-tax business reasons for forming PGM LLC under Prong #2 are also unassailable. 438 Mass. 71.

3. Even If PGM LLC Were Disregarded, Its Payroll Is Part of FLNA

Disregarding PGM LLC does not change the result that its expatriate compensation / payroll is incorporated into FLNA's payroll by operation of federal and Illinois law. PGM LLC is "a single member LLC disregarded [from FLNA] for federal and state income tax purposes." Joint Stip. ¶ 27. FLNA is thus required to treat PGM LLC as a branch for both federal and Illinois corporate income tax purposes. *See* 35 ILCS 5/403(a); 35 ILCS 5/1501(a)(4); and *Dover Corp. v. Comm'r*, 122 TC 324, n.19 (1997) ("Nor do the check-the-box regulations require that the taxpayer have a business purpose for such an election or, indeed, for any election under those regulations. Such elections are specifically authorized 'for federal tax purposes'. Sec. 301.7701-3(a), Proced. & Admin. Regs."). FLNA, in turn, is a substantive business entity employing the management team "run[ning] the strategic arm of [the domestic snack foods] business …." *See* Joint Stip. ¶ 11. Therefore, the seconded expatriates' compensation cannot be separated from FLNA regardless of whether PGM LLC is respected.

E. The Department's Sham Transaction and Economic Substance Arguments Would Require the Tax Tribunal to Override Jointly Stipulated Facts and Ignore Reality

As explained above, PGM LLC is critical to the PepsiCo Corporate Group's global business operations. The Tax Tribunal would have to improperly ignore and outright disregard the undisputed facts from the Joint Stipulation for the Department to prevail on its sham transaction and/or economic substance arguments. Such facts include:

1. PGM LLC is integral to the PepsiCo Corporate Group's business.

    - "After PGM LLC's formation, the PepsiCo Corporate Group utilized PGM LLC as the single Expatriate Program entity for foreign-based (non-U.S.) secondments." Joint Stip. ¶ 58

    - "As a global business, a critical element of the PepsiCo Corporate Group's ability to recruit and retain high quality candidates is the ability to offer such candidates global postings through an expatriate program (the "Expatriate Program"). Such postings allow the PepsiCo Corporate Group to, among other things, share information across the globe, identify and capitalize on best practices, familiarize executives with the different market dynamics in which the PepsiCo Corporate Group operates, and grow their executives to be the next generation of high-performing leaders which will run the business. These benefits accrue to the PepsiCo Corporate Group generally, including each business in the PepsiCo Corporate Group that sends executives on an assignment through the Expatriate Program and each business within the PepsiCo Corporate Group which receives executives who have been on such an assignment." Joint Stip. ¶ 7.

2. PGM LLC is integral to FLNA's business.

    - "The management team for the domestic snack food business is employed by and operates out of FLNA, in its Texas offices. That management team runs the strategic arm of that business which includes setting objectives for sales growth, investments, and new product development." Joint Stip. ¶ 11.

    - "The domestic snack food business sends executives on assignment through the Expatriate Program and also receives executives who have been on such an assignment." Joint Stip. ¶ 13.

3. PGM LLC expats actually work in FLNA's business

    - "The majority of expatriates seconded through the Expatriate Program either work for the snack-foods business all of the time or work partially for the snack-foods business." Joint Stip. ¶ 68.

- "At least nine of the expatriates listed on the PGM LLC Payroll Reports were working at FLNA Hong Kong during each of the 2011-2013 tax years." Joint Stip. ¶ 31.

4. PGM LLC has authority over and actually has terminated employees.

   - "The Secondment Agreements and the Contracts of Employment / Letters of Understanding were intended to be the legal basis by which the seconded expatriates perform services/roles for the foreign host companies. Those agreements were created with the intent to govern the expatriates' conduct and rights on assignment. Those are the written agreements which set out the terms between PGM LLC, the expatriates, and the foreign host companies." Joint Stip. ¶ 83.

   - "The seconded expatriates are required to do all things established by PGM LLC to complete the assignment and to adhere to all PGM LLC policies and to the laws and regulations of any country in which the seconded expatriate is assigned." Joint Stip. ¶ 84.

   - "In providing management and support functions to PGM LLC and the expatriates, the Global Mobility HR Function addresses HR issues unique to expatriate assignments such as education, immigration, and work permit issues." Joint Stip. ¶ 104.

   - "PGM LLC may end an assignment for any reason, including by termination of overall employment, upon written notice to the foreign host company" *and it has exercised that authority*. Joint Stip. ¶¶ 98, 158 Exhibit 26 (Marc [redacted] Termination Letter) (PEP00000052-71).

5. PGM LLC operates as a substantive business enterprise and was formed for non-tax business reasons.

   - "PGM LLC facilitates the secondment of high-performing expatriate executives, directors, managers, and analysts from PepsiCo Corporate Group affiliates/operating companies who fulfill temporary key roles with the objective of developing and retaining talent and expanding foreign business operations in established and emerging international (non-U.S.) markets." Joint Stip. ¶ 62.

   - The PepsiCo Corporate Group consolidated three global employment companies into one by "utiliz[ing] PGM LLC as the single Expatriate Program entity for foreign-based (non-U.S.) secondments." Joint Stip. ¶ 57.

   - "One of the purposes of forming PGM LLC was to attempt to protect other U.S. entities within the PepsiCo Corporate Group, such as PepsiCo, Inc., FLI, or FLNA, from having direct legal liability for actions of or disputes regarding the seconded expatriates actions in all of the countries in which each of those executives are assigned." Joint Stip. ¶ 65.

   - "Having a single entity, like PGM LLC, be the counterparty to all of the Secondment Agreements for all outbound expatriate employees: (i) preserves seconded employees'

> continued participation in U.S. benefits plans (*e.g.*, pre-tax retirement contribution plans authorized under 26 U.S.C. § 401(k)); (ii) centralizes Permanent Establishment foreign tax exposure related to expatriates working abroad to a single legal entity; (iii) centralizes tax, business, and other government compliance requirements (including but not limited to: certificates of coverage, foreign country work permits, and simplifies the process of foreign assignments)." Joint Stip. ¶ 67.

CONCLUSION

The Department's decision to back out of its agreed cross-motion for summary judgment tells the Tax Tribunal everything it needs to know. Unable to prevail on a record it agreed to, the Department is now scrambling to muddy the waters with unsupported, undefined, and unprecedented standards in conflict with clear law. But the facts have been agreed. Based on those facts, PGM LLC's foreign expatriate employees' agreed compensation amounts are properly included in FLNA's 80/20 Company calculation as "payroll" under Illinois law. And thus, FLNA is an 80/20 Company properly excluded from PepsiCo's Illinois combined group. Summary judgment in favor of PepsiCo must be granted.

Respectfully submitted,

PepsiCo, Inc. and Affiliates

By: *_/s/ Theodore R. Bots_*
Attorney for Petitioner

Theodore R. Bots (ARDC No. 6224515)
David A. Hemmings (ARDC No. 6307850)
BAKER & MCKENZIE LLP
300 E. Randolph Street, Ste. 5000
Chicago, IL 60601
Telephone: (312) 861-8845
Fax: (312) 698-2004
theodore.bots@bakermckenzie.com
drew.hemmings@bakermckenzie.com

George M. Clarke (ARDC No. 6331046)

BAKER & MCKENZIE LLP
815 Connecticut Avenue, NW
Washington, DC 20006
Telephone: (202) 835-6184
Fax: (202) 416-7184
george.clarke@bakermckenzie.com

Attorneys for Petitioner,
PepsiCo, Inc. and Affiliates

EXHIBIT C

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF LEGAL SERVICES DIVISION
CHICAGO, ILLINOIS

July 19, 2018

Mr. Ted Bots
Mr. Drew Hemmings
Baker & McKenzie LLP

Re: Illinois Department of Revenue v. Pepsico Inc. & Affilliates
Docket Nos.: 16 TT 82 and 17 TT 16

Dear Ted:

Thank you for speaking with us yesterday about the proposed stipulations for Pepsi. While we expressed areas of concern regarding certain parts of the stipulations, I believe both parties are interested in ultimately resolving Count I based on either cross-motions for summary judgement or through a stipulated record with some live witnesses. In either case, agreeing on joint stipulations will be the most efficient and effective way of presenting most of the relevant facts to Judge Conway. We may have to conduct representative depositions to fill-in some of the gaps or ultimately have witnesses testify. Towards this end, the following are some of the areas of concern we expressed yesterday regarding the stipulations:

1) Stipulations 12-18 covers the restructuring of Pepsi entities in 2010. In order to give this context, we believe it would be necessary to provide information as to the business activities of the various FLNA entities (Stipulation 19-24). Additionally, it is our understanding from speaking with Matt that FLNA acted as an intermediary between two Pepsi entities: a manufacturer and a sales organization. We would like Judge Conway to understand how Global Mobility's business activities relate to FLNA's business activities.

2) We think it will help Judge Conway to understand Global Mobility's structure if we provided a breakdown between the number of employees and the amount of payroll relating to the relocation activities of Global Mobility and the number of employees and the amount of payroll related to the seconded employees. Also, please individually identify the Global Mobility employees, the amount of their compensation and location, who manage the relocation support activities specified in fact stipulations 37-39 (managing corporate risk, providing human resource

functions and assigning individuals to foreign host companies), 44-45 (setting duration of foreign assignment and compensation of assigned employees), and 51-52 (terminating or otherwise ending an employee assignment). Please explain why there is no property for Global Mobility on the 80/20 Test calculation worksheets. We assume Global Mobility had employees engaged in the relocation activities provided by Global Mobility and they had to be housed somewhere. Finally, please provide a pro forma U.S. Corporation Income Tax Return or income statement for Global Mobility for 2011-2013 such as those referenced in fact stipulation 53 and attached as exhibits for other legal entities owned by FLNA.

3) In our last meeting a month ago, I asked questions regarding the fact that the seconded employees of Global Mobility are on its U.S. payroll. Your employment expert indicated the reason the seconded employees were included on its U.S. payroll was to allow the employees to retain their pension benefits and in order to protect the seconded employees from foreign jurisdiction liability. Also, that there was a benefit to the host companies with respect to nexus. We think it is important for Judge Conway to understand why the seconded employees were on the U.S. payroll instead of on the foreign payrolls of the host companies.

4) I believe at our meeting a month ago I indicated that I have problems with Stipulations 39-42, in particular 39 and 40. The subject matter covered under these stipulations are basically interpreting the secondment contracts. I think we need to discuss if this is an area that would be best covered by witness testimony or re-wording the stipulations after representative depositions were taken.

5) Lastly, once we get closer to a final preliminary version of the stipulations, we can discuss the documents you wish to stipulate to and why they are necessary. Additionally, once we have a preliminary final draft agreed upon, we will need to run it by Audit to make sure they agree with the facts set-out in the stipulations. Please call us after you have had a chance to review our concerns so we can discuss this further. Thank you.

Sincerely,

Ronald Forman
Special Asst. Attorney General
100 West Randolph Street Level 7-900
Chicago, Illinois 60601
Tel: (312) 814-9500
Fax: (312) 814-4344
E-mail address: ronald.forman@illinois.gov

EXHIBIT D

Hemmings, Drew

From: Lindquist, Alan <Alan.Lindquist@illinois.gov>
Sent: Thursday, December 19, 2019 3:03 PM
To: Conway, James
Cc: Bots, Theodore R; Clarke, George M; Hemmings, Drew; Kasiak, Joseph; Odigie, Jessica
Subject: [EXTERNAL] PepsiCo, Inc. v. IL DOR (Case Nos. 16 TT 82 and 17 TT 16) - Status Update

Dear Judge Conway,

The following is an update on the Parties' progress in advance of the December 20th deadline to submit the final joint stipulation of facts. The Parties have collaborated and worked very diligently over the last several months to complete the joint stipulation. In this regard we have exchanged countless emails and documents, and held numerous conferences (in person and by phone) to negotiate the stipulations. Counsel for both parties have fully negotiated and finalized all 28 pages worth of stipulations, along with 46 corresponding exhibits. Counsel for PepsiCo has informed us that their client has fully signed off on all of the stipulations/exhibits. We are currently awaiting approval by Department senior litigation management of the final stipulations/exhibits, provided to them earlier today. Senior management review and signoff is required as matter of Department policy given the substantial tax dollars at issue.

While we expected to send you the executed stipulations this Friday, we have determined we will be unable to secure final Department approval by the deadline, as a result of the extended negotiations that were necessary with opposing counsel to produce the draft stipulations now with senior Department management. Given the upcoming holidays, other year-end commitments, and the deliberate nature of their review that will be required given the central issue in this case, Department senior management will not begin finalizing their review of the stipulations/exhibits until Monday, January 6th. To this end, the Parties request: i) a new deadline to submit the executed joint stipulation of January 17, 2020; and ii) the next status conference to be reset from January 3rd to January 24th at which time the Parties will propose a briefing schedule for summary judgment cross-motions for the Court's consideration.

Both sides fully intended that they would, and truly regret that they will not be able to, meet this Friday's deadline for filing the executed stipulations. However, we trust that the inconvenience of the three-week delay we propose in the next status conference and setting dates for cross motions for summary judgment will be offset by the time economies of avoiding what would have otherwise undoubtedly been a lengthy trial were we not to reach agreement on the factual stipulations.

We hope that this proposal meets with your approval, however, both sides are available for discussion of this matter with you at your earliest convenience in the event this proposal is not acceptable. Thank you.

Sincerely,

Alan

Alan V. Lindquist
Illinois Department of Revenue
Special Assistant Attorney General
James R. Thompson Center
100 W. Randolph Street, 7th Floor
Chicago, Illinois 60601

State of Illinois - CONFIDENTIALITY NOTICE: The information contained in this communication is confidential, may be

attorney-client privileged or attorney work product, may constitute inside information or internal deliberative staff communication, and is intended only for the use of the addressee. Unauthorized use, disclosure or copying of this communication or any part thereof is strictly prohibited and may be unlawful. If you have received this communication in error, please notify the sender immediately by return e-mail and destroy this communication and all copies thereof, including all attachments. Receipt by an unintended recipient does not waive attorney-client privilege, attorney work product privilege, or any other exemption from disclosure.

EXHIBIT E

ILLINOIS INDEPENDENT

TAX TRIBUNAL

PEPSICO INC. AND AFFILIATES, Petitioner,	)	
	)	
v.	)	16 TT 82
	)	Chief Judge James M. Conway
ILLINOIS DEPARTMENT OF REVENUE, Respondent.	)	

ORDER

1. This order applies to 17 TT 16—Pepsico Inc. and Affiliates v. IDOR, as well;

2. The parties are to submit finalized stipulations by December 20, 2019; and

3. A status conference will be held on January 3, 2020 at 9:30 a.m. by telephone. A schedule for summary judgment motions and oral argument will be set at that time.

/s/ *James Conway*
JAMES M. CONWAY
Chief Administrative
Law Judge

Date: November 13, 2019

EXHIBIT F

ILLINOIS INDEPENDENT

TAX TRIBUNAL

PEPSICO INC. AND AFFILIATES, Petitioner,	)	
v.	)	16 TT 82
	)	Chief Judge James M. Conway
ILLINOIS DEPARTMENT OF REVENUE, Respondent.	)	

ORDER

The parties having appeared before the Tribunal today for a status conference, it is hereby ORDERED:

1. This order applies to 17 TT 16—Pepsico Inc. and Affiliates v. IDOR, as well;
2. Petitioner will file its summary judgment motion by April 17, 2020;
3. Department will file its response/summary judgment motion by June 11, 2020;
4. Petitioner will file its reply/response by July 23, 2020; and
5. The next status conference will be held on July 30, 2020 at 9:30 (CST) a.m. by telephone. A date for arguments on the motions will be set at that time.

_/s/ *James Conway*________
JAMES M. CONWAY
Chief Administrative
Law Judge

Date: February 28, 2020

EXHIBIT G

Notice of Audit Initiation

Income Tax

April 2, 2014

Letter ID: CNXXXX14X775XX87

#BWNKMGV
#CNXX XX14 X775 XX87#
PEPSICO INC
PEPSICO INC & AFFILIATES
ATTN: TAX DEPT 3N
700 ANDERSON HILL RD
PURCHASE NY 10577-1401

Taxpayer ID:	13-1584302
Account ID:	11653-34528
Audit ID:	A101371904
Return type:	IL-1120
Audit periods:	01/2010 - 12/2011

This letter confirms that on April 2, 2014, you were notified through our telephone conversation that an audit has been initiated on your IL Business Income Tax for your account ID and periods shown above. As part of the audit process, we will perform compliance reviews for all other Illinois taxes administered by the Illinois Department of Revenue. The opening conference has been scheduled for April 21, 2014, at 8:30 am.

If you are a partnership, S corporation, or trust, this also constitutes the initiation of an audit on your partners, shareholders, or beneficiaries regarding the amount of underpayment or overpayment that results from changes to your return that flow through to their returns.

The following books and records are needed to start the examination:

- federal income tax returns, including RARs, amended returns, etc., for each tax year
- Illinois income tax returns (with required supporting schedules), including amended returns, error and billing notices, etc.
- corporate organization chart including a list of all officers and directors for each affiliate, if applicable
- annual report to shareholders for each tax year
- SEC 10-Ks for each tax year
- reports to shareholders
- list of all officers and directors including affiliates, if any
- documents and work papers to support any modification, apportionment factor (both numerator and denominator), non-business income, credits and/or partnership income claimed on the return.
- Schedule(s) K-1-P or K-1-T, whichever is applicable

Additional records and documentation may be requested as the examination proceeds.

Liabilities for periods whose returns are due on or after January 1, 2005, that were not paid prior to the audit initiation date, as shown above, will have a late payment penalty imposed of 15 percent. After the conclusion of this audit, if any liability is not paid within 30 days of the date of the issuance of Form IL-870, Waiver of Restrictions, this penalty will increase to 20 percent. Liabilities due as a result of a timely filed report of a federal change are not subject to this penalty.

For unpaid liabilities due prior to July 1, 2009, and which were eligible for amnesty under the Tax Delinquency Amnesty Act, penalty and interest imposed on the liability will generally be doubled.

We are enclosing, PIO-60, Illinois Audit Information, which explains general audit procedures and methods.

If you have any questions, please contact us using the information listed below.

Sincerely,

Garie Love
Revenue Auditor

ILLINOIS DEPARTMENT OF REVENUE
CENTURY PLAZA, 45 EISENHOWER DR, SUITE 2, NJ-A
PARAMUS, NJ 07652-1416

217 720-5246
201 845-5266 fax

Joann Lariviere
Audit Supervisor
Phone: 217 725-5109

Notice of Audit Initiation

Income Tax

December 22, 2015

Letter ID: CNXXX17335682721

#BWNKMGV
#CNXX X173 3568 2721#
PEPSICO INC
PEPSICO INC & AFFILIATES
ATTN: TAX DEPT 3N
700 ANDERSON HILL RD
PURCHASE NY 10577-1401

Taxpayer ID:	13-1584302
Account ID:	11653-34528
Audit ID:	A1776594944
Return type:	IL-1120
Audit periods:	01/2012 - 12/2013

This letter confirms that on December 22, 2015, you were notified through our telephone conversation that an audit has been initiated on the BIT return(s) for the account ID or license no. and period(s) shown above. As part of the audit process, we will perform compliance reviews for all other Illinois taxes administered by the Illinois Department of Revenue. The opening conference has been scheduled for December 22, 2015, at 08:30AM.

If you are a partnership, S corporation, or trust, this also constitutes the initiation of an audit on your partners, shareholders, or beneficiaries regarding the amount of underpayment or overpayment that results from changes to your return that flow through to their returns.

The following books and records are needed to start the examination:

- federal income tax returns, including RARs, amended returns, etc., for each tax year
- Illinois income tax returns (with required supporting schedules), including amended returns, error and billing notices, etc.
- corporate organization chart including a list of all officers and directors for each affiliate, if applicable
- annual report to shareholders for each tax year
- SEC 10-Ks for each tax year
- reports to shareholders
- list of all officers and directors including affiliates, if any
- documents and work papers to support any modification, apportionment factor (both numerator and denominator), non-business income, credits and/or partnership income claimed on the return
- Schedule(s) K-1-P or K-1-T, whichever is applicable
- minutes of directors and committee meetings
- internal audit reports
- operating and accounting manuals
- detailed financial statements
- payroll records
- UI 3/40
- IL-941 returns
- IL-501 returns
- Form(s) IL-W-3 (prior to 2008)
- Form(s) IL-W-4
- state by state apportionment work-papers by property, payroll and sales

Additional records and documentation may be requested as the examination proceeds.

Liabilities for periods whose returns are due on or after January 1, 2005, that were not paid prior to the audit initiation date, as shown above, will have a late payment penalty imposed of 15 percent. After the conclusion of this audit, if any liability is not paid within 30 days of the date of the issuance of Form IL-870, Waiver of Restrictions, this penalty will increase to 20 percent. Liabilities due as a result of a timely filed report of a federal change are not subject to this penalty.

For unpaid liabilities due prior to July 1, 2009, and which were eligible for amnesty under the Tax Delinquency Amnesty Act, penalty and interest imposed on the liability will generally be doubled.

We are enclosing, PIO-60, Illinois Audit Information, which explains general audit procedures and methods.

If you have any questions, please contact us using the information listed below.

Sincerely,

Julie Lee
Revenue Auditor

ILLINOIS DEPARTMENT OF REVENUE
CENTURY PLAZA, 45 EISENHOWER DR., 3RD FLOOR
PARAMUS NJ 07652-1416

217 720-1834
217 725-5680 cell
201 845-5266 fax

julie.lee@illinois.gov

Joann Lariviere
Audit Supervisor
Phone: 217 725-5109

EXHIBIT H

Shepard's®: Report Content

Appellate History: Not Requested

Citing Decisions: Narrowed By:Analysis:Warning

Other Citing Sources: Not Requested

Table Of Authorities: Not Requested

***Shepard's*®:** United States v. Silk 331 U.S. 704,67 S. Ct. 1463,91 L. Ed. 1757,1947 U.S. LEXIS 2847,1947-2 C.B. 167,35 A.F.T.R. (P-H) 1174: (U.S. June 16, 1947)

No subsequent appellate history. **Prior history** available.

Citing Decisions (3)

Narrow by: Analysis: Warning

Analysis: Superseded by statute as stated in (3)

Headnotes:HN1 (1), HN2 (1)

U.S. Supreme Court

1. **Nationwide Mut. Ins. Co. v. Darden**, 503 U.S. 318, 112 S. Ct. 1344, 117 L. Ed. 2d 581, 1992 U.S. LEXIS 1949, 60 U.S.L.W. 4242, 6 Fla. L. Weekly Fed. S 86, 92 Cal. Daily Op. Service 2467, 92 D.A.R. 4075, 14 Employee Benefits Cas. (BNA) 2625

   R **Superseded by statute as stated in:**
   It was on this point that the District Court granted summary judgment to Nationwide. After applying common-law agency principles and, to an extent unspecified, our decision in United States v. Silk, 331 U.S. 704, 91 L. Ed. 1757, 67 S. Ct. 1463 (1947), the court found that "'the total factual context' of Mr. Darden's relationship with Nationwide shows that he was an independent contractor and not an employee." App. to Pet. for Cert. 47a, 50a, quoting NLRB v. United Ins. Co. of America, 390 U.S. 254, 19 L. Ed. 2d 1083, 88 S. Ct. 988 (1968).

   Discussion: | **Court:** U.S. | **Date:** March 24, 1992 | **Headnotes:**: HN2

4th Circuit - Court of Appeals

2. **Cilecek v. Inova Health Sys. Servs.**, 115 F.3d 256, 1997 U.S. App. LEXIS 12645, 70 Empl. Prac. Dec. (CCH) P44736, 73 Fair Empl. Prac. Cas. (BNA) 1764, 174 A.L.R. Fed. 789

   R **Superseded by statute as stated in:**
   Following Reid, the Court in Nationwide adopted the "common-law test for determining who qualifies as an 'employee' under ERISA." 503 U.S. 318 at 323, 112 S. Ct. 1344, 117 L. Ed. 2d 581. And again recently, the Court agreed that "employee" under Title VII is defined by "traditional principles of agency law." Walters v. Metropolitan Educ. Enter. Inc., 136 L. Ed. 2d 644, 117 S. Ct. 660, 666 (1997).
   ... Because Congress had overruled the Supreme Court's earlier interpretations of "employee" under both the National Labor Relations Act and the Social Security Act, in each of which the Court had defined employee "in light of the mischief to be corrected and the end to be obtained," see United States v. Silk, 331 U.S. 704, 713, 91 L. Ed. 1757, 67 S. Ct. 1463 (1947), the Court in Reid and Nationwide abandoned that approach, adopting the presumption that "Congress means an agency law definition for 'employee' unless it clearly indicates otherwise." Nationwide, 503 U.S. at 325. **(HN1)**

Discussion: | **Court:** 4th Cir. Va. | **Date:** June 2, 1997 | **Headnotes:**: HN1

National Labor Relations Board

3. SuperShuttle DFW, Inc., 2019 NLRB LEXIS 15, 2019 L.R.R.M. (BNA) 24595, 367 N.L.R.B. No. 75

R **Superseded by statute as stated in:**
... 88 L. Ed. 1170 (1944) , the Supreme Court articulated a policy-based economic realities test for determining independent-contractor status in cases involving New Deal social legislation. As the Court explained in **U.S. v. Silk, 331 U.S. 704, 67 S. Ct. 1463, 91 L. Ed. 1757, 1947-2 C.B. 167(1947)** , [t]he problem of differentiating between employee and an independent contractor or between an agent and an independent contractor has given difficulty through the years before social legislation ...

Court: National Labor Relations Board | **Date:** January 25, 2019

Legend

- Warning - Negative Treatment is Indicated
- Q Questioned - Validity questioned by citing references
- Caution - Possible negative treatment
- Positive - Positive treatment is indicated
- A Analysis - Citing Refs. With Analysis Available
- I Cited - Citation information available
- ! Warning - Negative case treatment is indicated for statute
- R Red - Warning Level Phrase
- O Orange - Questioned Level Phrase
- Y Yellow - Caution Level Phrase
- G Green - Positive Level Phrase
- B Blue - Neutral Level Phrase
- LB Light Blue - No Analysis Phrase

End of Document

EXHIBIT I

Shepard's®: Report Content

Appellate History: Not Requested

Citing Decisions: Narrowed By:Analysis:Warning

Other Citing Sources: Not Requested

Table Of Authorities: Not Requested

***Shepard's*®:** Bartels v. Birmingham 332 U.S. 126,67 S. Ct. 1547,91 L. Ed. 1947,1947 U.S. LEXIS 2987,1947-2 C.B. 174,35 A.F.T.R. (P-H) 1340,172 A.L.R. 317: (U.S. June 23, 1947)

No subsequent appellate history. **Prior history** available.

Citing Decisions (1)

Narrow by: Analysis: Warning

Analysis: Superseded by statute as stated in (1)

California Courts of Appeal

1. Far West Services, Inc. v. Livingston, 156 Cal. App. 3d 931, 203 Cal. Rptr. 486, 1984 Cal. App. LEXIS 2147

   R **Superseded by statute as stated in:**
   In 1971, the Legislature enacted section 680 (Stats. 1971, ch. 1281, § 1), stating certain persons contracting for the services of musicians are "employers" for unemployment insurance purposes. (1a) The undisputed underlying legislative intent of section 680 was to reverse the effect of judicial rulings that musicians who contracted to provide services under the form B union contract were nevertheless independent contractors and not common law employees of the entertainment entity which hired them. (See, e.g., Mark Hopkins, Inc. v. Cal. Emp. etc. Com. (1948) 86 Cal.App.2d 15, 16-18 [193 P.2d 792]; Bartels v. Birmingham (1947) 332 U.S. 126 [91 L.Ed. 1947, 67 S.Ct. 1547, 172 A.L.R. 317].)

   Discussion: | **Court:** Cal. App. 4th Dist. | **Date:** June 4, 1984

Legend

	Warning - Negative Treatment is Indicated	R	Red - Warning Level Phrase
Q	Questioned - Validity questioned by citing references	O	Orange - Questioned Level Phrase
	Caution - Possible negative treatment	Y	Yellow - Caution Level Phrase
	Positive - Positive treatment is indicated	G	Green - Positive Level Phrase
A	Analysis - Citing Refs. With Analysis Available	B	Blue - Neutral Level Phrase
I	Cited - Citation information available	LB	Light Blue - No Analysis Phrase
!	Warning - Negative case treatment is indicated for statute		

End of Document

CERTIFICATE OF SERVICE

The undersigned counsel of record certifies that on October 19, 2020 **PETITIONER PEPSICO, INC. AND AFFILIATES' REPLY MEMORANDUM IN SUPPORT OF ITS MOTION FOR SUMMARY JUDGMENT** was filed with the Illinois Independent Tax Tribunal and served on the following persons:

Judge James M. Conway Chief Administrative Law Judge Illinois Independent Tax Tribunal 160 N. LaSalle Street, Room N506 Chicago, IL 60601 James.Conway@illinois.gov	**Alan V. Lindquist** Illinois Department of Revenue Special Assistant Attorney General 100 W. Randolph Street, 7th Floor Chicago, IL 60601 Alan.Lindquist@illinois.gov
Joseph T. Kasiak Illinois Department of Revenue 100 W. Randolph Street, Ste. 7-900 Chicago, IL 60601 Joeseph.Kasiak@illinois.gov	**Jessica Odigie** Illinois Department of Revenue 100 W. Randolph Street, Ste. 7-900 Chicago, IL 60601 Jessica.Odigie@illinois.gov

/s/ Theodore R. Bots
Attorney for Petitioner,
PepsiCo, Inc. and Affiliates