

ILLINOIS INDEPENDENT TAX TRIBUNAL

MERCK SHARP & DOHME CORP.)	
(F/K/A SCHERING CORPORATION),)	
)	
Petitioner,)	
v.)	No. 16 TT 103
)	
ILLINOIS DEPARTMENT OF REVENUE)	Judge Brian F. Barov
)	
Respondent.)	

RESPONDENT’S ANSWER TO PETITION

NOW COMES the Department of Revenue of the State of Illinois (“Department”), through its attorney, Lisa Madigan, Attorney General of and for the State of Illinois, and for its Answer to Taxpayer’s Petition respectfully pleads as follows:

THE PARTIES

1. Petitioner is Merck Sharp & Dohme Corp. (f/k/a Schering Corporation) (“Schering”).

ANSWER: The Department admits the allegations in Paragraph 1.

2. Schering’s address is 2000 Galloping Hill Road, Kenilworth, New Jersey, 07033-1310.

ANSWER: The Department admits the allegations in Paragraph 2.

3. Schering’s telephone number is (908)740-1210.

ANSWER: The Department admits the allegations in Paragraph 3.

4. Schering’s taxpayer identification number is 22-1261880.

ANSWER: The Department admits the allegations in Paragraph 4.

5. Respondent is the Illinois Department of Revenue (the “Department”).

ANSWER: The Department admits the allegations in Paragraph 5.

JURISDICTION

6. This Tribunal has original jurisdiction over this action pursuant to 35 ILCS 1010/1-45.

ANSWER: The statement contained in Paragraph 6 contains a legal conclusion, not a material allegation of fact, and therefore does not require an answer pursuant to Rule

310(b)(2). Department admits the existence, force and effect at all relevant times of the statute set forth or referred to in Paragraph 6 and states that such statute speaks for itself.

BACKGROUND

7. The Department conducted an income tax audit of Schering with respect to the tax year ended December 31, 1999 (the "Tax Year").

ANSWER: The Department admits the allegations in Paragraph 7.

8. As a result of the audit, the Department issued a Notice of Deficiency (the "Notice") to Schering through which the Department assessed \$457,105.00 of income tax, \$238,295.00 of personal property tax replacement income tax (income tax and personal property tax replacement income taxes, are together, ("Tax")), interest of \$1,135,408.80, and penalty of \$500.00. A copy of the Notice is attached hereto as Exhibit A.

ANSWER: A copy of the Notice is required by Rule 310(a)(1)(D) and is not a material allegation of fact, and therefore does not require an answer pursuant to Rule 310(b)(2). Department admits Department issued a Notice of Deficiency dated March 22, 2016, to Merck Sharp & Dohme, Corp. for the period ending December 1999 in the amount of \$1,831,308.80, of which \$695,400.00 was the total net income and replacement tax due, a late-filing penalty of \$500.00, and interest of \$1,135,408.80. The Department states the Notice speaks for itself. The Department further states that an Amended Notice of Deficiency ("Amended Notice") was issued on July 26, 2016, which amended the original Notice to include late estimated payment or underpayment penalty as allowed under 35 ILCS 735/3-3(b-5)(1), as well as updated interest through the date of the Amended Notice. A copy of the Amended Notice is attached hereto as Exhibit A.

9. Through the Notice, the Department asserted that it is not prohibited by federal law from taxing Schering income.

ANSWER: The statements in Paragraph 9 contain legal conclusions, not material allegations of fact, and therefore do not require an answer pursuant to Rule 310(b)(2).

10. Through the Notice, the Department asserted that Schering and certain of Schering's subsidiary entities engaged in a unitary business in Illinois during the tax year.

ANSWER: The statements in Paragraph 10 contain legal conclusions, not material allegations of fact, and therefore do not require an answer pursuant to Rule 310(b)(2).

11. Through the Notice, the Department asserted penalty and interest under 35 ILCS 735/3-2(f) and 35 ILCS 735/3-3(i).

ANSWER: The Department admits interest on tax was computed as allowed by 35 ILCS 735/3-2; a nonfiling penalty as allowed by 35 ILCS 735/3-3(a-5); and since the liability qualified for amnesty all applicable penalty and interest amounts were doubled as

allowed by 35 ILCS 735/3-2(f) and 3-3(i). The Department further states the Notice speaks for itself.

12. Schering did not have officers, employee, agents or any other physical presence in Illinois during the Tax Year.

ANSWER: The Department denies the allegations in Paragraph 12.

ERRORS OF THE DEPARTMENT OF REVENUE

Error 1

13. Through the Notice, the Department erred by concluding that it may impose Tax with respect to Schering for the Tax Year. That conclusion is in error because the Department is prohibited by federal law from taxing Schering's income. 15 U.S.C. §§ 381-384 (P.L. 86-272"); U.S. CONST. amend. XIV; U.S. CONST. art. I, § 8, cl.3.

ANSWER: The Department denies the allegations contained in Paragraph 13 and states further that statements contain legal conclusions, not material allegations of fact, and therefore do not require an answer pursuant to Rule 310(b)(2).

Error 2

14. Through the Notice, the Department violated both the Commerce and Due Process Clauses of the United States Constitution because Schering did not engage in a unitary business in Illinois during the Tax Year. See Allied-Signal, Inc. v. Director, Div. of Taxation, 504 U.S. 768 (1992).

ANSWER: The Department denies the allegations contained in Paragraph 14 and states further that statements contain legal conclusions, not material allegations of fact, and therefore do not require an answer pursuant to Rule 310(b)(2).

15. The Department's conclusion that Schering engaged in a unitary business in Illinois during the Tax Year is invalid because the Department did not develop a factual foundation to support its assertion that Schering engaged in a unitary business in Illinois during the Tax Year. See, e.g., United States v. Janis, 428 U.S. 433, 442 (1976).

ANSWER: The Department denies the allegations contained in Paragraph 15 and states further that statements contain legal conclusions, not material allegations of fact, and therefore do not require an answer pursuant to Rule 310(b)(2).

Error 3

16. Through the Notice, the Department improperly determined Schering's Illinois taxable income. See 35 ILCS 5/101 et seq.

ANSWER: The Department denies the allegations contained in Paragraph 16.

Error 4

17. Through the Notice, the Department erroneously asserted a double interest penalty under 35 ILCS 735/3-2(f) ad 3-3(i) because Schering did not have “taxes due” under 35 ILCS 745/10. See Metropolitan Life Insurance Co. v. Hamer, 966 N.E.2d 1052 (Ill. App. Ct. 2012) rev’d 990 N.E.2d 1144 (Ill.2013).

ANSWER: The Department denies the allegations contained in Paragraph 17 and states further that statements contain legal conclusions, not material allegations of fact, and therefore do not require an answer pursuant to Rule 310(b)(2).

18. The Department’s improper application of a double interest penalty under 35 ILCS 735/3-2(f) and 3-3(i) violated the Due Process Clause of the United States Constitution by arbitrarily and unreasonably applying an interest penalty to a liability that was not known to Schering until after the amnesty period described in 35 ILCS 745/10 had expired.

ANSWER: The Department denies the allegations contained in Paragraph 18 and states further that statements contain legal conclusions, not material allegations of fact, and therefore do not require an answer pursuant to Rule 310(b)(2).

RELIEF REQUESTED

WHEREFORE, Schering respectfully requests that this Tribunal issue a judgment against the Respondent:

19. Declaring and adjudging that all Tax assessed through the Notice, and any related interest and penalty are invalid; and

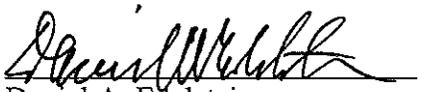
ANSWER: The Department denies the allegations contained in Paragraph 19, and asks that this Tribunal uphold the Notice and the Amended Notice.

20. Granted such other and further relief, legal or equitable, as the Tribunal deems just and appropriate.

ANSWER: The Department denies the allegations contained in Paragraph 20 in so far as it seeks relief for the Petitioner, and asks that this Tribunal uphold the Notice and the Amended Notice in favor of the Department.

Respectfully submitted,
Illinois Department of Revenue

By: **LISA MADIGAN, Attorney General,
State of Illinois**

By: 
Daniel A. Edelstein
Special Assistant Attorney General

Date: September 12, 2016

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Illinois Department of Revenue
100 West Randolph St., 7-900
Chicago, IL 60601
Phone : (312) 814-3318/3078/3120
Fax: (312) 814-4344

Notice of Deficiency

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



July 26, 2016



Letter ID: CNXXXX7682599844

#BWNKMGV
#GNXX XX76 8259 9844#
MERCK SHARP & DOHME CORP
STOP
K5 3008G
2000 GALLOPING HILL RD
KENILWORTH NJ 07033-1310

Taxpayer ID: 22-1261880
Audit ID: A2109196800
Reporting period: December 1999
Total Deficiency: \$2,510,962.36
Balance due: \$2,510,962.36

We have audited your account for the reporting period listed above. The members of the combined group are jointly and severally liable for the total balance due. The attached statement explains the computation of your deficiency and the balance due. This notice is an amendment to the notice we previously issued to you on March 22, 2016. Illinois law requires that we notify you of this deficiency and your rights.

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

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

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

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

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

Sincerely,

Constance Beard
Director

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

(217) 785-6711

EXHIBIT A

Duplicate

Bankruptcy Information

If you are currently under the protection of the Federal Bankruptcy Court, contact us and provide the bankruptcy number and the bankruptcy court. The bankruptcy automatic stay does not change the fact you are required to file tax returns.

Taxpayer Bill of Rights

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

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

Statement

Date: July 26, 2016
Name: MERCK SHARP & DOHME CORP
Taxpayer ID: 22-1261880
Letter ID: CNXXXX7682599844

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

Computation of deficiency

Reporting period: 31-Dec-1999

Income or loss	
Federal taxable income	\$557,162,594.00
Net operating loss deduction	\$0.00
Income or loss	\$557,162,594.00
Base income or loss	
Other subtractions	\$298,769,691.00
Total subtractions	\$298,769,691.00
Base income or net loss	\$258,392,903.00
Income allocable to Illinois	
Non-business income or loss	\$0.00
Non-unitary partnership bus. income or loss	\$0.00
Business income or loss	\$258,392,903.00
Apportionment formula	
Property Factor	
Total everywhere	\$2,747,699,703.00
Within Illinois	\$5,562,801.00
Factor	0.002025
Weighted factor	0.083333
Weighted total	0.000169
Payroll Factor	
Total everywhere	\$1,161,595,137.00
Within Illinois	\$17,449,362.00
Factor	0.015022
Weighted factor	0.083333
Weighted total	0.001252
Sales Factor	
Total everywhere	\$4,934,128,260.00
Within Illinois	\$210,000,000.00
Factor	0.042561
Weighted factor	0.833334
Weighted total	0.035468
Apportionment factor	0.036889
Business income/loss apportionable to IL	\$9,531,856.00

Statement

Date: July 26, 2016
Name: MERCK SHARP & DOHME CORP
Taxpayer ID: 22-1261880
Letter ID: CNXXXX7682599844

	Reporting period: 31-Dec-1999
Computation of deficiency	
Nonbusiness income/loss allocable to IL	\$0.00
Non-unitary part. business income app. to IL	\$0.00
Base income or net loss allocable to IL	\$9,531,856.00
Net income	
Base income or net loss	\$9,531,856.00
Approved Net Loss Carry Forward	\$0.00
Approved Net Loss Carry Back	\$0.00
IL net loss deduction (NLD) Verified	\$0.00
Standard exemption	\$37.00
Net income	\$9,531,819.00
Net replacement tax	
Replacement tax addback after apportionment	\$0.00
Replacement tax	\$238,295.00
Recapture of investment credits	\$0.00
Replacement tax before credits	\$238,295.00
Replacement tax investment credits	\$0.00
Net replacement tax	\$238,295.00
Net income tax	
Income tax	\$457,527.00
Recapture of investment credits	\$0.00
Income tax before credits	\$457,527.00
Income tax investment credits	\$0.00
Credit for replacement tax paid	\$422.00
Carryforward of credit for repl. tax paid	\$0.00
Net income tax	\$457,105.00
Total tax due	
Net replacement tax	\$238,295.00
Net income tax	\$457,105.00
Total net income and replacement tax due	\$695,400.00
Total tax deficiency	\$695,400.00
Plus late-filing penalty	\$500.00
Plus late ES payment or underpayment penalty	\$250,344.00
Plus interest on tax through July 26, 2016	\$1,564,718.36
Total deficiency	* \$2,510,962.36

Statement

Date: July 26, 2016
Name: MERCK SHARP & DOHME CORP
Taxpayer ID: 22-1261880
Letter ID: CNXXX7682599844

Computation of deficiency

Reporting period: 31-Dec-1999

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

Computation of balance due

Reporting period: 31-Dec-1999

Balance due

* \$2,510,962.36

