

**ILLINOIS INDEPENDENT TAX TRIBUNAL**

MERCK SHARP & DOHME CORP.  
(F/K/A SCHERING CORPORATION),

Petitioner

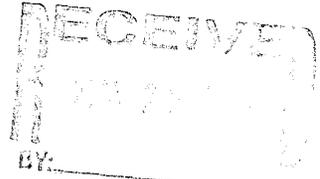
-v.-

ILLINOIS DEPARTMENT OF REVENUE,

Respondent.

Case No. 16T106

**PETITION**



Petitioner, Merck Sharp & Dohme Corp. (f/k/a Schering Corporation), by and through its undersigned counsel, Alston & Bird LLP, respectfully alleges as follows:

**THE PARTIES**

1. Petitioner is Merck Sharp & Dohme Corp. (f/k/a Schering Corporation) (“Schering”).
2. Schering’s address is 2000 Galloping Hill Road, Kenilworth, New Jersey, 07033-1310.
3. Schering’s telephone number is (908) 740-1210.
4. Schering’s taxpayer identification number is 22-1261880.
5. Respondent is the Illinois Department of Revenue (the “Department”).

**JURISDICTION**

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

## **BACKGROUND**

7. The Department conducted an income tax audit of Schering with respect to the tax year ended December 31, 2002 (the "Tax Year").

8. As a result of the audit, the Department issued a Notice of Deficiency (the "Notice") to Schering through which the Department assessed \$839,715.00 of income tax, \$437,794.00 of personal property tax replacement income tax (income tax and personal property tax replacement income taxes are, together, "Tax"), interest of \$1,508,238.24, and penalty of \$500.00. A copy of the 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's income.

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.

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

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

## **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.

### **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).

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).

### **Error 3**

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

### **Error 4**

17. Through the Notice, the Department erroneously asserted a double interest penalty under 35 ILCS 735/3-2(g) and 3-3(j) 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).

18. The Department's improper application of a double interest penalty under 35 ILCS 735/3-2(g) and 3-3(j) 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.

**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

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

Dated: May 17, 2016

Respectfully submitted,

ALSTON & BIRD LLP  
Counsel for Plaintiff,  
Merck Sharp & Dohme Corp.  
(f/k/a Schering Corporation)



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Syed Fahad Saghir (ARDC No. 6290645)  
950 F Street NW  
Washington, DC 20004  
202-239-3220  
fahad.saghir@alston.com

# Exhibit A

# Notice of Deficiency

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



#BWNKMGV  
#CNXX X1X8 1551 5X45#  
MERCK SHARP & DOHME CORP  
STOP  
K5 3008G  
2000 GALLOPING HILL RD  
KENILWORTH NJ 07033-1310

March 22, 2016



Letter ID: CNXXX1X815515X45

Taxpayer ID: 22-1261880  
Audit ID: A2109196800  
Reporting period: December 2002  
Total Deficiency: \$2,786,247.24  
Balance due: \$2,786,247.24

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. **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](http://tax.illinois.gov)). If we do not receive your protest within **60 days**, this deficiency will become final. A protest of this notice does not preserve your rights under any other notice.
- **In any case**, you may instead, under Sections 2a and 2a.1 of the State Officers and Employees Money Disposition Act (30 ILCS 230/2a, 230/2a.1), pay the total liability under protest using Form RR-374, Notice of Payment Under Protest (available on our website at [tax.illinois.gov](http://tax.illinois.gov)), and file a complaint with the circuit court for a review of our determination.

If you do not protest this notice or pay the 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

cc: MERCK SHARP & DOHME CORP  
ATTN: FRED O MARCUS  
500 WEST MADISON ST  
CHICAGO IL 60661

## **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: March 22, 2016  
Name: MERCK SHARP & DOHME CORP  
Taxpayer ID: 22-1261880  
Letter ID: CNXXX1X815515X45

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

## Computation of deficiency

Reporting period: 31-Dec-2002

|  |                    |
|--|--------------------|
| Income or loss                               |                    |
| Federal taxable income                       | \$722,796,293.00   |
| Net operating loss deduction                 | \$0.00             |
| Illinois bonus depreciation addition         | \$40,372,859.00    |
| Income or loss                               | \$763,169,152.00   |
| Base income or loss                          |                    |
| Other subtractions                           | \$330,468,835.00   |
| Total subtractions                           | \$330,468,835.00   |
| Base income or net loss                      | \$432,700,317.00   |
| Income allocable to Illinois                 |                    |
| Non-business income or loss                  | \$0.00             |
| Non-unitary partnership bus. income or loss  | \$0.00             |
| Business income or loss                      | \$432,700,317.00   |
| Apportionment formula                        |                    |
| Sales Factor                                 |                    |
| Total everywhere                             | \$5,584,586,679.00 |
| Within Illinois                              | \$226,013,971.00   |
| Apportionment factor                         | 0.040471           |
| Business income/loss apportionable to IL     | \$17,511,815.00    |
| Nonbusiness income/loss allocable to IL      | \$0.00             |
| Non-unitary part. business income app. to IL | \$0.00             |
| Base income or net loss allocable to IL      | \$17,511,815.00    |
| Net income                                   |                    |
| Base income or net loss                      | \$17,511,815.00    |
| Approved Net Loss Carry Forward              | \$0.00             |
| Approved Net Loss Carry Back                 | \$0.00             |
| IL net loss deduction (NLD) Varified         | \$0.00             |
| Standard exemption                           | \$40.00            |
| Net income                                   | \$17,511,775.00    |
| Net replacement tax                          |                    |
| Replacement tax addback after apportionment  | \$0.00             |
| Replacement tax                              | \$437,794.00       |
| Recapture of investment credits              | \$0.00             |
| Replacement tax before credits               | \$437,794.00       |

# Statement

Date: March 22, 2016  
Name: MERCK SHARP & DOHME CORP  
Taxpayer ID: 22-1261880  
Letter ID: CNXXX1X815515X45

## Computation of deficiency

Reporting period: 31-Dec-2002

|   |                  |
|---|------------------|
| Replacement tax investment credits          | \$0.00           |
| Net replacement tax                         | \$437,794.00     |
| Net income tax                              |                  |
| Income tax                                  | \$840,565.00     |
| Recapture of investment credits             | \$0.00           |
| Income tax before credits                   | \$840,565.00     |
| Income tax investment credits               | \$0.00           |
| Credit for replacement tax paid             | \$850.00         |
| Carryforward of credit for repl. tax paid   | \$0.00           |
| Net income tax                              | \$839,715.00     |
| Total tax due                               |                  |
| Net replacement tax                         | \$437,794.00     |
| Net income tax                              | \$839,715.00     |
| Total net income and replacement tax due    | \$1,277,509.00   |
| Total tax deficiency                        | \$1,277,509.00   |
| Plus late-filing penalty                    | \$500.00         |
| Plus interest on tax through March 22, 2016 | \$1,508,238.24   |
| Total deficiency                            | * \$2,786,247.24 |

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

## Computation of balance due

Reporting period: 31-Dec-2002

|             |                  |
|-------------|------------------|
| Balance due | * \$2,786,247.24 |
|-------------|------------------|

# Explanation of Audit Adjustments

## Income Tax



March 22, 2016

#BWNKMGV  
#CNXX XX35 8623 12X7#  
MERCK SHARP & DOHME CORP  
STOP  
K5 3008G  
2000 GALLOPING HILL RD  
KENILWORTH NJ 07033-1310



Letter ID: CNXXXX35862312X7

Taxpayer ID: 22-1261880

Account ID: 20432-61952

Audit ID: A2109196800

Reporting period: December 2002

### Explanation of adjustments for tax period ending 12/31/2002

|  | <u>Income change</u> | <u>Tax impact</u> |
|--|----------------------|-------------------|
| We have determined that you were required to file an income tax return. Since you did not file a return, we have computed your Illinois Income Tax liability based on the information that we have available.<br>[35 ILCS 5/502(a), 904(b)]  | \$0.00               | \$0.00            |
| We have determined that you do not have nexus protection under PL 86-272. Any applicable income earned will be subject to apportionment and Illinois Income Tax.<br>[35 ILCS 5/304 and 86 IL Adm. Code 100.9270]   |                      |                   |
| We determined that you and one or more of your related corporations were engaged in a unitary business during the tax years identified in this notice. Accordingly, you and the other members of the unitary business group must use combined apportionment to determine how much of your business income is taxable by Illinois. Corporations (other than S corporations) who are members of a unitary business group must file a single combined return for each year.<br>[35 ILCS 5/304(e), 502(e), 1501(a)(27)] See attached list of the members of your unitary business group. |                      |                   |
| We adjusted your Illinois net income or loss to correctly reflect income or loss.<br>[35 ILCS 5/203(b), (c), (d), (e)]   | \$510,275,997.00     | \$1,507,551.00    |
| We adjusted your Illinois net income or loss to reflect a change in your federal income or loss, which you failed to report.<br>[35 ILCS 5/506(a), 506(b), 403(b)]   | \$212,520,296.00     | \$627,866.00      |
| We adjusted your addition modifications to reflect the correct addback of the federal bonus depreciation, or the correct reversal of the Illinois depreciation for bonus depreciation assets in the last year you are allowed a federal depreciation deduction, as required to be shown on the Form IL-4562.<br>[35 ILCS 5/203(b)(2)(E-10), (b)(2)(E-11), (c)(2)(G-10), (c)(2)(G-11), (d)(2)(D-5), (d)(2)(D-6)]  | \$40,372,859.00      | \$119,277.00      |
| We adjusted your subtraction modifications for foreign dividends on Schedule J, Foreign Dividends, to reflect the correct amount as allowed by Illinois law.<br>[35 ILCS 5/203(b)(2)(G), (b)(2)(O), (h)]   | \$330,468,835.00     | -\$976,332.00     |
| We adjusted your sales factor to include all business receipts on federal 1120, Lines 1 through 10, to the extent not expressly excluded from the sales factor.<br>[86 IL Adm. Code 100.3370(a)(1)]  | \$5,584,586,679.00   | \$0.00            |
| We adjusted your Illinois sales numerator to account for the Illinois destination sales of those entities whose activities exceeded the protection afforded by PL 86-272.  | \$226,013,971.00     | \$0.00            |
| We adjusted your replacement tax paid credit as required by Illinois law.<br>[35 ILCS 5/201(i)]  | -\$853.00            | -\$853.00         |

Date: March 22, 2016

Letter ID: CNXXXX35862312X7  
Name: MERCK SHARP & DOHME CORP  
Taxpayer ID: 22-1261880  
Account ID: 20432-61952  
Audit ID: A2109196800  
Reporting period: December 2002

Explanation of adjustments for tax period ending 12/31/2002

Income change

Tax impact

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

We are imposing a late-filing or nonfiling penalty because you did not file a processable return by the due date (including any extensions). This penalty is figured at the rate of 2 percent of the amount of tax required to be shown due on your return, after subtracting any payments made or credits allowed by the due date of the return. This penalty cannot exceed \$250.

[35 ILCS 735/3-3(a-10)]

Because this liability qualified for amnesty, and you did not pay this liability during the amnesty period held October 1, 2010, through November 8, 2010, your applicable penalty and interest amounts were doubled.

[35 ILCS 735/3-2(g) and 3-3(j)]



