In The Illinois Independent Tax Tribunal
Cook County, Illinois

INNOPHOS HOLDINGS INC., *Petitioner,* v. **ILLINOIS DEPARTMENT OF REVENUE,** *Respondent.*	14 TT 214 Chief Judge JAMES M. CONWAY.

PETITIONER'S REPLY, IN SUPPORT OF ITS MOTION FOR PARTIAL SUMMARY JUDGMENT, AND, ITS RESPONSE TO DEFENDANT 'S CROSS-MOTION FOR SUMMARY JUDGMENT

Petitioner's reply in support of its motion for partial summary judgment (Count I, Count II, and Count IV) and its response to Defendants' sequential[1] cross-motion for partial summary judgment is organized in three categories: (1) Statutory Construction of Illinois Income Tax Act ("IITA")[2] § 304; (2) Standards for Alternative Apportionment; and (3) Miscellaneous. Within these umbrella categories, the arguments regarding specific counts to which the cross-motions relate are addressed.

I. STATUTORY CONSTRUCTION

A. Section 304(f): The Department asks the Tax Tribunal to read into § 304(f) terms that the Legislature did not use for tax years ending on or after December 31, 2008.

[1] Usually cross-motions are contemporaneously filed and briefed, but the Department has styled its response to Petitioner's motion as a motion in its own right.
[2] All references herein to "Section 304" or "§ 304" are to the IITA (35 ILCS 5/304).

Through P.A. 098-0478 the General Assembly amended § 304(f) to provide that it may be used when "the allocation and apportionment provisions of subsections (a) through (e) and of subsection (h) do not . . . for taxable years ending on or after December 31, 2008, fairly represent the market for the person's goods, services, or other sources of business income in this State."

The Department wants the Tax Tribunal to construe § 304(f) as amended to read that it may be used when "the allocation and apportionment provisions of subsections (a)(3)(C-5) through (e) and subsection (h) do not fairly represent the market for the person's intangible goods, services, or other sources of business income" in this State. The best indication of the intent of the General Assembly is in the words enacted, *Brunton v. Kruger*, 2015 IL 117663, ¶ 24 ("The best indication of [the legislature's] intent is the language of the statute itself . . . . We will not depart from the plain statutory language by reading into it exceptions, limitations, or conditions that conflict with the expressed intent of the legislature.") (internal citations omitted). And, in P.A. 098-0478 the General Assembly did not use the term "(3)(C-5)" and did not use the word "intangible." The Department's incessant use in its Response/Motion of the term "intangible" adjacent to the term "goods" to limit the meaning of the term "goods" suggests ambiguity in the meaning of the term "goods." However, despite the suggestion by the Department, no legislative history is offered to suggest that the General Assembly intended some limitation on the plain meaning of the term "goods." Barring that, the term "goods" is to be given its plain and ordinary meaning. *People v. Gaytan*, 2015 IL 116223, ¶ 23 ("The best indication of [the legislature's] intent is the statutory language, given its plain and ordinary meaning.")

The term "goods" has appeared, undefined, in several Illinois statutes. For instance, in the Illinois Probate Code it appeared (and still does) in the phrase "goods and chattel," and for that purpose it has been said that "[t]he words goods and chattels in the Probate Act refer to tangible personal property such as furniture, automobiles, jewelry and the like as distinguished from such items as stocks, bonds, mortgages, accounts receivable, notes and the like." *In re matter of the Estate of Sally Berman,* 39 Ill. App. 2d 175, 179 (2d. Dist. 1963) (internal citation omitted). Similarly, with reference to Section 42 of the former Civil Practice Law, a court explained that "here are two classes of personal property, tangible and intangible" and with regard to which property was subject to a judgment lien the court said that "[w]hatever personal property may be described as tangible, *i.e.*, property having real physical existence, comes within the definition of 'goods and chattels' as those terms are used in section 10" and that "[w]hatever personal property may be described as intangible, *i.e.*, property not having physical existence such as claims, interests and rights, is not a good or chattel." *In re Marriage of Sharon Rochford,* 91 Ill. App. 3d 769, 775 (1st Dist. 1980). Lastly, for purposes of Article 2 of the Uniform Commercial Code which applies to "transactions in goods" the Court noted that "[t]he UCC defines goods as 'all things, including specially manufactured goods, which are movable at the time of identification of the contract for sale'" and that "there is a 'transaction for goods' only if the contract is predominantly for goods and incidentally for services." *Brandt v. Boston Scientific*, 204 Ill. 2d 640, 645 (2003) (internal citation omitted). The foregoing survey shows that tangible personal property fits quite comfortably under the commonly understood definition of "goods."

The Department cannot limit the scope of the amendment made by P.A. 98-0478. As written, for any tax year ending on or after December 31, 2008, § 304(f) requires that every paragraph and subparagraph of § 304 be interpreted to accomplish the General Assembly's intent that the statutory apportionment formula "fairly represent the market" in Illinois for whatever the taxpayer's business "sales" are comprised of, whether that be sales of goods, of services, intangible assets, or other business income such as rents, royalties, and the like. In fact, in *GTE*, the old alternative apportionment provision was held to be applicable to sales of tangible personal property. *See GTE Automatic Elec., Inc. v. Allphin*, 68 Ill.2d 326 (1977). The only thing about § 304(f) that changed was the focus on the market as opposed to business activities. Under *GTE* and the plain words of the statute, tangible personal property is subject to alternative apportionment. The Department never offers a convincing rationale for banishing tangible goods from § 304(f).

B. Section 304(a)(3)(B)(ii): The Department asks the Tax Tribunal to uphold its audit adjustment to Petitioner's apportionment, made after January 1, 2014 to a tax year ending after December 31, 2008, on the basis that not doing so will not clearly reflect Illinois "business activity," even though the General Assembly replaced "market" for "business activity" for such tax years in P.A. 98-0478.

1. Statutory Terms.

The Department also seeks to support its adjustment under the throwback rule found in § 304(a)(3)(B)(ii) for a tax year ending <u>after</u> December 31, 2008 by continuing to use standards the Legislature restricted to tax years ending <u>before</u> December 31, 2008. The Department argues with respect to tax years ending after December 31, 2008, that to interpret §§ 304(a)(3)(B) and 304(f) "to exclude from the numerator of the sales factor sales derived from tangible personal property sold to purchasers in states where Petitioner was not taxable ignores the legislative intent because doing so would exclude from taxation income Petitioner derived from its **business activities** in Illinois." *Defendants' Response/Motion*, p. 10 (emphasis added).

P.A. 098-0478 limited IITA § 304(f) to be used "[i]f the allocation and apportionment provisions of subsections (a) through (e) and of subsection (h) do not, for taxable years ending **before** December 31, 2008, fairly represent the extent of a person's **business activity** in this State." P.A., 098-0478, eff. Jan. 1, 2014 (emphasis added). It is inconsistent with the legislative intent for a tax year ending **after** December 31, 2008 for the Department to continue to use "*business activities*" as a basis to include non-Illinois sales in the apportionment formula numerator, because for such later years the legislature clearly said that fair reflection of the "market" is the rule. Because of express retroactive direction in P.A. 98-0478, the only legislative intent operative on and after December 31, 2008, was for the apportionment factor to fairly reflect the Illinois **market.** An adjustment made by the Department to any tax year ending on or after December 31, 2008, that is supported on the basis of fairly reflecting "business activity" is contrary to the legislative intent expressed in P.A. 098-478. Therefore, when making an adjustment under § 304(a)(3)(B)(ii) after January 1, 2014, to a tax year ending after December 31, 2008, the Department's stated basis that not doing so "*would exclude from taxation income Petitioner derived from its business activities in Illinois*" is contrary to the governing legislative intent for such a tax year.

The Department argues that "interpreting P.A. 098-0478 in the manner advocated by Petitioner violates the principle that a statute cannot be repealed by implication." *Response/Motion*, p. 24. Section 4 of the Illinois Statute on Statutes, if it were applicable in this instance, would indeed preclude Petitioner from arguing that a silent repeal of § 304(a)(3)(B)(ii) occurred. *See*, 5 ILCS 70/4; *see also*, *Caveney v. Bower*, 207 Ill. 2d 82, 92 (2003). However, "[b]ecause it is a *default* standard, *section 4* of the Statute on Statutes is inapplicable to situations where the legislature has clearly indicated the temporal reach of a statutory amendment." *Allegis Realty Investors v. Novak*, 223 Ill. 2d 318, 332 (2006). Here, § 304(f) expressly limited use of "business activity" as an apportionment litmus test to tax years ending *before* December 31, 2008, and, the Illinois "market" was expressly made the new and retroactive litmus test for fair apportionment for tax years ending on or *after* December 31, 2008. The question here is how, after January 1, 2014, to harmoniously interpret a provision that requires that non-Illinois market sales be added to the Illinois sales numerator after a provision is adopted that requires the statutory apportionment formula to fairly reflect the market for the Petitioner's goods in this State for tax years ending on or after December 31, 2008.

As explained below, § 304(a)(3)(B)(ii) exists because of the authority given to the Director in Section 304(f), and it was intended to enforce a concept of "full" apportionment – *i.e.,* that no more and no less than 100% of a taxpayer's income is taxed, if all States are employing the same formula – rather than to serve any purpose of "fair" apportionment. Over four decades the Illinois apportionment formula changed from three-factors, to four-factors (double-weighted sales), to single factor, to market, without reference to what other States or the Multistate Tax Commission were doing at the time of such transitions. Hence, full apportionment can no longer be gleaned from the IITA to be the goal of Illinois tax policy. P.A. 098-474, by requiring the apportionment formula to reflect the market, removes any basis for applying the throwback rule found in § 304(a)(3)(B)(ii).

2. *Legislative Intent.*

Section 304(a)(3)(B) "contains the language of section 16 of the Uniform Division of Income for Tax Purposes Act." *GTE Automatic Electric, Inc. v. Allphin*, 68 Ill. 2d 326, 334. (1977). As such, § 304(a)(3)(B) was adopted because "unless these sales which are not taxable either in the State of origin or in the State of destination are considered 'sales within Illinois,' the intent of the General Assembly will be thwarted and plaintiff will enjoy a tax loophole." *Id.* at 337. The Court observed that "[a]ssuming that the General Assembly intended that all of plaintiff's multistate business income be taxed in a fair and equitable manner by those States having jurisdiction to tax it, and did not intend any overlap or gap in the taxing of such income, it nevertheless failed to take into account this type of sale, and there is a gap in section 304(a)(3)(B)" with respect to drop-shipment sales that did not originate in or terminate in Illinois.

In *GTE* the Court linked § 304(a)(3)(B)(ii) with § 304(e) – the precursor to § 304(f) – holding that "[w]e are of the opinion that as to that part of plaintiff's business activity which does not fall within subsection (a), defendant may utilize section 304(e) to effectuate the legislative intent of avoiding either an overlap or gap in allocating and apportioning all the business income from plaintiff's multistate operations." *Id.* at 339. Thus, contrary to the Department's position here, the interpretation of § 304(a)(3)(B)(ii) is inextricably linked to § 304(f), and it is exclusively intended to enforce the perceived original intent of the General Assembly that the IITA should assure full taxation of no more and no less than 100% of a taxpayers' income, a policy position often described as "full apportionment." It is a "full" apportionment provision rather than a "fair" apportionment provision.

Note that the "intent of the General Assembly" referred to by the Court in 1977 in *GTE* was the intent behind an equally-weighted formula consisting of property, payroll, and sales factors. It is that formula that was at issue in all the throwback cases discussed by the Department. The tax years at issue in *Hartmarx Corp. v Bower*, 309 Ill. App. 3d 959 (1st Dist. 1999), were 1986 through 1990. The decision in *Beatrice Cos., Inc. v. Whitley*, 292 Ill. App. 3d 532 (1st Dist. 1997), does not disclose the tax years at issue, but it is reasonable to assume they preceded the tax years at issue in *Hartmarx*. The tax years at issue in *Dover Corp. v. Department of Revenue*, 271 Ill. App. 3d 700 (1st Dist. 1995), were 1984 and 1985. None of the cases relied on by the Department to support throwback of sales is from the modern-era of single sales factor apportionment with market sourcing – all are cases where an equally-weighted three factor formula with origin-based (i.e., business activity) sourcing reflected the *intent* of the General Assembly.[3]

[3] There are cases in the post-three-factor apportionment era which repeat the supposed intent of the General Assembly discerned in *GTE, supra*, such as *Panhandle Eastern Pipeline Co. v. Hamer*, 2012 IL App. (1st) 113559, and *Northwest Airlines, Inc. v. Department of Revenue*, 295 Ill. App. 3d 889 (1998). The problem is that *Panhandle Eastern Pipeline Co.* involves a pipeline – a transportation company. Under § 304(d) transportation companies have always apportioned income under a single-factor formula because the Uniform Division for Income Tax Purposes Act ("UDITPA") was silent, and provided no method to avoid gaps or overlaps, with regard to taxation of specialized industries like transportation, financial organizations, and insurance companies (and utilities, in some states). Thus, the citation to *GTE* in the *Panhandle Eastern* decision is dicta, and it offers no reasoned basis to assume that the original legislative intent for a three-factor formula persisted when the General Assembly amended for a single sales factor and market apportionment. Likewise, in *Northwest Airlines, Inc.*, the transportation company apportionment formula was at issue, which is not based on

Indeed, although Illinois went to a double-weighted sales factor in 1987, it failed in the attempt to do so in 1985 when Governor Thompson vetoed the bill that would have ushered it in at that time. At the time, newspapers reported that "Senator Dawn Clark Netsch (D., Chicago, arguing against the bill), said the change would disrupt the uniformity among the states in corporate income taxation, further destabilize state tax policy, and cost the state treasury more than $20 million a year." Barnhart, *Corporate Tax Break Veto Stands* , CHICAGO TRIBUNE (Nov. 1, 1985). The news also reported that "Thomas Johnson, Illinois director of revenue, said that there may be nothing wrong with a double-weighted sales factor as long as it's adopted uniformly among the states with corporate income taxes and not for discriminatory or retaliatory purposes." *Id.* Clearly, by 1987 when double-weighting of the sales factor finally became law the General Assembly abandoned the goal of uniformity and thereby also abandoned the foundation for achieving full apportionment.

The Department would like to persuade the Tax Tribunal that the General Assembly retained the intent of assuring the taxation of no more and no less than 100% of the taxpayer's income, even after it deviated from UDITPA and became one of the first states with a single sales factor apportionment formula.[4] In each and every year, the intent of the General Assembly is drawn from the text of the laws it adopts, and amends.

UDITPA and cannot accomplish the UDITPA goal of full apportionment through uniform formulae throughout the states. More notably, though, as discussed further *infra*, *Northwest Airlines* recognized limitations to the full apportionment justification for certain adjustments and refused to allow such an adjustment in that case.

[4] "The intent of P.A. 90-0613 was to encourage the growth of manufacturing industries in the State. The single-factor reduces the income tax burden on firms that have a relatively large share of their property and payroll in Illinois, while making the most of their sales out of state." Illinois Economic and Fiscal Commission, *Illinois Corporate Income Tax,* July 2002, p. 6.

Gaytan, 2015 IL 116223, ¶ 23. Except where the intent is clear to clarify the existing law through an amendment, amendments change the law and may change the intent of the amended law from that of the General Assembly that originally enacted the law. *People ex rel. Bell v. New York Cent. R. Co.*, 10 Ill. 2d 612, 619–20 (1957) ("The provisions of a special act [*e.g.*, throwback rule] may be amended or repealed by a general act [*e.g.*, § 304(f)], either expressly or by implication from the inconsistency between the two acts where the legislative intention to repeal or modify the provisions of the special act clearly appears.").

The Department, however, believes that legislative intent is static as originally declared in *GTE* and then repeated by rote thereafter despite changes in the law. So believing, the Department contends that a temple called "full-apportionment" sitting on three-pillars of business activity – property, payroll and sales – still stands even though two of the pillars have been knocked down the third has been repurposed to reflect only the market, and not the business activity occurring elsewhere that is not subject to taxation. The Department argues that the amendment to § 304(f) is related solely to the prior amendments to add § 304(a)(3)(C-5)(iv) for tax years ending on or after December 31, 2008 to apportion service income on a "market basis." Response/Motion pp. 29–33. Prior to that 2008 amendment, service income was sourced by a method that looked at where the costs of performing a service were incurred – essentially reflecting business activity – to determine where to source the receipts. Starting in 2008, § 304(a)(3)(C-5) discarded those vestiges of business activity used to source receipts and instead adopted the place where a service is "received" as indicative of the market to which such service receipts should be sourced. Section 304(a)(3)(C-5) also adopted a "throw-out" rule with respect to apportionment of service income in 2008. Under a "throw-out" rule, sales of services that are received in a state in which the taxpayer is subject to tax, but in which the taxpayer does not file a tax return and pay tax, are thrown out of the denominator (as distinguished from the throwback rule which used to apply to sales of tangible personal property). When throw-out is applied, the Illinois "market" reflected by the statutory apportionment formula grows as a percentage of the total "market" because the total "market" has been reduced by throwing out sales to states in which no tax was paid.

In Illinois, "full" apportionment was based on the belief, or hope, that if all states adopted a uniform three-factor apportionment formula then no more and no less than 100% of a taxpayer's income would be subject to state taxation. We know that didn't happen, given the lack of uniformity among the States, and we know that Illinois was an early adopter of different formulas without regard to the formulas other states used. Wrongly limiting P.A. 98-0478 to "intangible" goods, in order to reconcile it with § 304(a)(3)(C-5), only highlights the lack of uniformity the Department still promotes at the same time that it recites the slogan of full apportionment. Which other state can Illinois point to that defines "goods" as intangible but excludes tangible personal property from that definition? Which other state has turned to single-factor apportionment with market sourcing, but retained alternative apportionment only for intangible goods? And, if no other state has done so, how can retaining IITA § 304(a)(3)(B)(ii) while changing everything that surrounds it in the statute have any hope of furthering the goal of "full" apportionment?

Unlike insurance companies (§ 304(b)), financial organizations (§ 304(c)), and transportation companies (§ 304(d)) – each of which is forbidden from combining with a taxpayer using a different apportionment subparagraph of § 304 (*see*, IITA § 1501(a)(28)) – taxpayers using subparagraph (a) of § 304 must place sales of tangible personal property and sales of service in <u>the same</u> statutory apportionment formula. That means, for a tax year ending on or after December 31, 2008, that the same formula <u>*would*</u> act like a Victorian girdle, with the throwback rule inflating the numerator with some non-Illinois sales of tangible personal property in order to avoid gaps in taxation related to "business activity," while the throw-out rule is squeezing and deflating the denominator by purging some non-Illinois sales of services in order to avoid gaps in taxation related to the "market." The statutory formula *would* act that way, <u>but for</u> P.A. 098-0478, which retroactively set "market" as the standard for both goods and services, and any other business income. Without P.A. 098-0478, neither IITA § 304(a)(3)(B)(ii) nor § 304(a)(3)(C-5)(iv), whether acting alone or in combination, would fairly reflect the "market" for the taxpayers goods and services in Illinois. This explains the express retroactive application of P.A. 098-0478 to cure such anomalies in market apportionment through the use of § 304(f), as amended.

The original intent of the General Assembly for § 304(a)(3)(B)(ii), which the Department asserts here as a continuing reason for validating its assessment, has not been shown by the Department to have been preserved by the double-weighted sales factor enactment in 1987, by the single-factor enactment in 2000, by the market-apportionment enactment in 2008, or by P.A. 98-0478 in 2014, which was made retroactive to tax years ending on or after December 31, 2008.

C. There is no statutory or regulatory bar to the Tax Tribunal's consideration or grant of relief under IITA § 304(f).

A harmonious reading of the provisions affected by P.A. 098-478 is a requirement of statutory construction. *Evanston Ins. Co. v. Riseborough*, 2014 IL 114271, ¶ 24 ("Statutes relating to the same subject are governed by one spirit and a single policy, and we must presume that the legislature intended these statutes to be consistent and harmonious."). Such a reading leads to the conclusion that the IITA § 304(a)(3)(B)(ii) throwback rule of adding non-Illinois sales to the Illinois sales factor numerator was limited to tax years ending before December 31, 2008. Such a harmonious reading is possible, as is demonstrated by going through all the potential return filing scenarios that may arise under the two provisions in light of the amendment.

i) *Original returns*. P.A. 98-0478 became effective on January 1, 2014. It is therefore axiomatic that no taxpayer filing a return due prior to January 1, 2014 could possibly have petitioned for IITA § 304(f) relief as amended by P.A. 098-0478, *i.e.*, claiming that the throwback of non-Illinois sales to the numerator distorted the Illinois "market," 120 days prior to filing that return as required by the Department IITA regulation § 100.3390(e)(1). Such a taxpayer could have filed a timely pre-return filing petition under IITA § 304(f) to avoid the throwback of sales to the numerator then required by § 304(a)(3)(B)(ii), but only claiming that the throwback of such sales to the numerator distorted "business activity" in Illinois, as that was the litmus test in effect under § 304(f) at that time. However, such a filing would have been futile, given *Hartmarx Corp. v. Bower*, 309 Ill. App. 3d 959 (1st Dist. 1999), and prior cases. It is preposterous for the Department to argue that "market" relief under § 304(f) as amended should be denied to Petitioner because it could have filed for unavailable "business activity" relief before IITA § 304(f) was amended. However unreliable the pertinent case law may have become as it failed to keep up with the IITA's changes to the apportionment formula, until P.A. 098-0478, "market" fairness was not the standard to which the statutory apportionment formulae were held.

ii) *Amended returns and audit protests.* Contrary to the Department's contention that Petitioner cannot ask for § 304(f) relief, after P.A. 098-0478 became effective on January 1, 2014, for such open tax years as fall within that retroactive scope Department Regulation § 100.3390 indeed allows relief for taxpayers under the amended § 304(f) provision.

Firstly, an argument that could not have been made before January 1, 2014, with the Illinois "market" as the reference for fair apportionment under IITA § 304(f), can now be the subject of a petition for an original return pursuant to Regulation § 100.3390, although only original returns for the 2014 year are able to take advantage of that provision. 86 Ill. Admin. Code § 100.3390(e). Secondly, it allows a petition making the newly-available § 304(f) "market" argument to be attached to an amended return for a taxpayer that filed an original return with the IITA § 304(a)(3)(B)(ii) throwback of non-Illinois sales to the Illinois numerator for a tax year ending on or after December 31, 2008 that is still open for amendment. 86 Ill. Admin. Code § 100.3390(e)(2). Thirdly, it allows a request for relief making the newly available § 304(f) "market" argument "as part of a protest to a notice of deficiency issued as a result of the audit" of a tax year ending on or after December 31, 2008, such as Petitioner has done here, as Petitioner had no need for the relief of § 304(f) until assessed by the Department. 86 Ill. Admin. Code § 100.3390(e)(3). While there are portions of Regulation § 100.3390 that the Department should amend to conform to the amended § 304(f) that it purports to implement, the procedural portions of the Regulation do allow Petitioner's § 304(f) "market" argument to be made here.

iii) *Tax Tribunal*. The notion that this Tax Tribunal cannot address IITA § 304(f) relief without a petition first being submitted to the Department is wrong. First, while § 304(f) states that a "person may petition for, or the Director may, without a petition, permit or require" alternative apportionment, it does not specify that the petition must be directed to the Director. 35 ILCS 5/304(f). The statutory language does not preclude a petition to any person or forum that has jurisdiction over a claim of unfair apportionment, and so the petition may, for instance, be addressed to a court or a Tax Tribunal. The Department reads into the statute a requirement that is not explicitly stated therein. Moreover, the Department's argument has been made and rejected.

At the time of *Miami Corporation v. Department of Revenue*, 212 Ill. App.3d 702 (1991), the Department's Regulation 100.3390 was not in existence. Regulation 100.3390 was adopted on November 1, 1993. Prior to that time there was no regulation in place governing how, when, or from whom § 304(f) relief could be obtained, so *Miami Corporation* is not a precedent for anything other than when a court can determine whether a statutory formula distorts and that, contrary to what the Department argues here, it need not remand to the Department for the Director to determine the appropriate alternative if the record before it contains the necessary facts. The *Miami Corporation* court, relying on the statutory language of § 304, and on the facts of record before it, concluded the lower court was empowered and able to make the alternative apportionment determination.

Moreover, in *Caterpillar Financial Services Corporation v. Whitley*, 288 Ill. App. 3d 389 (1997), the taxpayer paid a notice of deficiency under protest, bypassing the Department, and "in count III CFSC sought relief pursuant to section 304(f) of the IITA . . . in the form of an order that the Department include foreign property, payroll and sales in the apportionment formula to calculate CFSC's taxable income." *Id.* at 394 (emphasis added). Among the issues the appellate court ruled upon was that "a taxpayer can pay under protest into the fund and subsequently raise any legitimate claim to establish its right to a refund," (*id.* at 397, emphasis added) which would, of necessity, include a refund because of a successful argument under count III of Caterpillar's complaint pleading relief under § 304(f). It is preposterous to say that a taxpayer's choice of forum between the Protest Monies Act and the Tax Tribunal, the latter of which was created in part to reduce the growing number of Protest Monies Act cases, will affect whether a taxpayer can obtain complete relief because § 304(f) is obtainable in one forum and unobtainable in the other. The Department's regulation § 100.3390 was already adopted more than three years prior to the appellate court decision in *Caterpillar Financial* and it does not appear that the Department argued the appellate court should limit its ruling to give the Director "dibs" on the alternative apportionment determination. Therefore, the Tax Tribunal does have jurisdiction and authority to make a determination under § 304(f) with respect to a tax year ending on or after December 31, 2008, pursuant to: (i) a petition for such relief made in the Tax Tribunal petition itself; (ii) in defense of an audit adjustment; (iii) raising a basis for alternative relief that could not have been raised in the original return; and which (iv) would not have been raised in an amended return after January 1, 2014, as it is solely in response to a Department audit adjustment.

II. STANDARDS FOR ALTERNATIVE APPORTIONMENT

A. Illinois

The Department tries to create a safe-harbor for its adjustments by stating that "[a]pportionment formulae 'owe their very existence to the absence of exact alternatives for dividing the tax base of a unitary business, and cannot be expected to achieve precision." *Response/Motion,* p. 19 (citations omitted). Other cases describing the "rough approximation" of apportionment and that "the very nature of the problem is incapable of precise and arithmetical solution" are cited as well. *Id.* (citations omitted). The problem for the Department is that IITA § 304(a)(3)(B (ii) is only activated after the standard apportionment formula has determined the Illinois sales. Whatever difficulty was encountered in dividing the tax base of a unitary business was concluded before § 304(a)(3)(B)(ii) comes into play to determine if a tax return was filed and tax was paid in specific other states to which the unitary tax base was divided. That means that the adjustment of § 304(a)(3)(B)(ii) is both precise and intentional, and not at all the result of approximation and wrestling with a problem incapable of precise solution.

Having laid the foundation for how imprecise and difficult it is for a state to apportion income – when in fact the adjustment made here was simple, precise and intentional – the Department then builds on that theme by turning to cases that suggest deviation from a statutory formula is only compelled when there is "clear and cogent evidence that the formula taxes income 'out of all appropriate proportion' to the taxpayer's business conducted in the taxing state." *Response/Motion*, pp. 20–21. The Department attempts to reduce the Tax Tribunal's inquiry to a quantitative determination of how much distortion is constitutionally sufficient to compel relief; but that is not what the law requires for § 304(f) relief.

In *Miami Corporation*, the Department made the same arguments, but the appellate court ultimately concluded that "[w]hile we acknowledge that the increase of plaintiff's liability from approximately $719,000 to more than $2.4 million does not necessarily prove malapportionment (*see Citizens Utilities Co. v. Department of Revenue*, 111 Ill. 2d 32 (1986)), we find that the distortion created by the use of the formula amounts to **an unfair representation** of plaintiff's activities in this State." *Miami Corporation*, 212 Ill. App. 3d at 709. Section 304(f) is focused on fairness, and *Miami Corporation* instructs us that the method, not just the outcome it produces, can be determinative of whether the apportionment formula is fair. In *Miami Corporation*, at a time when the apportionment formula had a property factor based on the value of real and *tangible* property "the oil and gas reserves in Louisiana which generated in excess of 80% of plaintiff's income are not reflected in the formula because these elements are *intangibles.*" *Id.* (italics in original).

Similarly here, the sales factor in IITA § 304(a)(3) is designed to reflect sales destined to Illinois. For tax years ending on or after December 31, 2008, the role of the sales factor is to fairly reflect the market for the taxpayer's goods in Illinois. *See* IITA § 304(f) as amended by P.A. 098-0478. The Department is adding *non-Illinois market sales* to the numerator and unfairly distorting the apportionment factor's reflection of the Illinois market. For tax years ending before December 31, 2008, adding sales to the Illinois numerator may or, may not, on a quantitative basis, have distorted *business* *activity* in this State, but for tax years ending after December 31, 2008, adding such sales does, on a qualitative basis, distort the market for the taxpayer's goods in this State.

Also, the Department fails to acknowledge that its argument for full apportionment – *i.e.,* that there be no gaps or overlaps in taxation – has limits. In *Northwest Airlines, Inc. v. Department of Revenue*, 295 Ill. App. 3d 889 (1998), the appellate court agreed with the taxpayer that the miles an aircraft flies over Illinois airspace – "flyover miles" – did not belong in the Illinois apportionment numerator as Illinois miles. The appellate court explained:

> We are aware that the purpose of the Act is "to assure that 100%, and no more or no less, of the business income of a corporation doing multistate business is taxed by the States that have jurisdiction to tax it." *GTE*, 68 Ill.2d at 335. Thus, "overlaps" and "gaps" in taxation are to be avoided. *GTE*, 68 Ill. 2d at 339. We are also aware that the exclusion of flyover miles from the numerator of the apportionment fraction increases the number of "nowhere miles" (miles not apportioned to any taxing state), thus increasing the gap in taxation of airlines. However, full apportionment cannot be achieved outside the constitutional parameters established by our supreme court." *Northwest Airlines*, 295 Ill. App. 3d at 894.[5]

In *Northwest Airlines* the argument was that flyover miles have no nexus with Illinois and thus cannot be included as Illinois business activity. Here, statutorily, the General Assembly has provided that formulas, or audit adjustments pursuant to a formula, that do not fairly reflect the Illinois market for the taxpayer's goods – such as adding known non-Illinois sales to be counted as Illinois market sales – may be modified by adding or subtracting business activities that will result in a fair reflection of the Illinois market. Such a modification might be for the Department to accept an original return as filed for a

[5] In a footnote the court explained that "[a] gap exists because miles flown outside the United States are included in the 'everywhere miles' of the apportionment denominator, but are not included in the numerator of any taxing state." *Id.*

tax year ending after December 31, 2008, which it did not make the throwback called for in § 304(a)(3)(B)(ii), or for the Tax Tribunal to reverse the Department's adjustment to such a return that is made after January 1, 2014, and which added back known non-Illinois sales to the Illinois sales numerator.

B. Other UDITPA States

Illinois is not alone in granting alternative apportionment for qualitative reasons. Indeed, for reasons very similar to those advocated by the taxpayer and approved by the court here in *Miami Corporation*, in *Twentieth-Century Fox Film Corp. v. Department of Revenue*, 700 P.2d 1035 (Or. 1985), the State made an adjustment to the apportionment formula adding intangible property – the value of films physically located in Oregon – to the Oregon property factor. There, the State of Oregon argued with regard to its own UDITPA Section 18 provision, – which was the identical language that appeared in IITA § 304(f) prior to the amendment by P.A. 098-0478 – that "nothing in the language of O.R.S. 314.670 or the commentaries thereon supports the Tax Court's conclusion that unconstitutional results only may be remedied under that statute." *Id.* at 1039. The Court continued that "the Department points out that such interpretation would preclude a state tax administrator from remedying an under-apportionment of a taxpayer's income because the taxpayer's constitutional rights would not have been violated," and concluded "[w]e agree with the department." *Id.* The Court observed that "the phrase 'the department may require' alternatives to statutory apportionment and allocation in ORS 314.670 would have no meaning as a vehicle to remedy under-apportionment if unconstitutional results only could be remedied" and that "[t]his is so because 'the department' is not in a position to assert the constitutional claims invoked upon occasion to avoid arbitrary and unreasonable results under statutory apportionment." *Id.*[6]

Unlike other states, the Illinois Department of Revenue wants to forfeit the authority of the General Assembly provided for it to remedy under-apportionment, as it is only unconstitutional to take too much, not too little. Indeed, such a position is contrary to the intent of the drafters of UDITPA, as the commentary to Section 18 of UDITPA states that: "it is intended as *a broad authority*, within the principle of apportioning income fairly among the states which have contact with the income, to the tax administrator to vary the apportionment formula . . . where the provisions of the act do not fairly represent the extent of the taxpayer's business activity within the state." (emphasis supplied). National Conference of Commissioners on Uniform State Laws, *Uniform Division of Income for Tax Purposes Act*, p. 13 (1957) (Comments added in 1966); *see also* Pierce, *The Uniform Division of Income for State Tax Purposes*, 35 Taxes 747, 749 (1957). All the foregoing remains true for § 304(f) except that, as amended by P.A. 098-0478 for tax years ending on or after December, 31, 2008, the entire IITA Article III on apportionment rests upon "market" rather than "business activity" as that which the apportionment formula must fairly reflect. Adding known non-Illinois sales to the Illinois numerator of a single sales factor apportionment formula does not fairly reflect the Illinois market, and on January 1, 2014, when P.A. 098-0478 became effective, the direction to do so in § 304(a)(3)(B)(ii) for any tax year ending on or after

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[6] Other courts have allowed tax administrators to invoke alternative apportionment without establishing a constitutional violation. *See, e.g., Microsoft Corp. v. Franchise Tax Bd.*, 39 Cal. 4th 750 (2006); *Union Pacific Corp. v. Idaho State Tax Comm'n*, , 83 P.3d 116 (Idaho 2004).

December 31, 2008, can only be harmoniously reconciled with IITA § 304(f) if the addition of non-Illinois sales to the Illinois numerator is made pursuant to § 304(f).

C. Burden

By incorrectly asserting that a quantitative distortion of constitutional proportions is the *sine qua non* of alternative apportionment, the Department attempts to place a burden on Innophos that is not required by § 304(f) as enacted, by UDITPA as promulgated, nor by the case law interpreting the IITA and other UDITPA-based statutes. As the discussion above shows, the drafters of UDITPA intended, and Illinois and other courts have recognized, that there are qualitative basis for alternative apportionment that dispense with the need to prove a quantitatively gross distortion. Also, because having access to alternative apportionment only in the case of evidentiary proof of constitutionally meaningful quantitative distortion would foreclose Illinois and other UDITPA-based laws from addressing under-apportionment, and that restriction on the application of § 304(f) should work against the result-driven argument by the Department in this case.

The Department's own adjustment – adding known and identified non-Illinois sales to the Illinois numerator of the sales factor that is intended to fairly reflect the Illinois market – is itself evidence of a qualitative distortion of the type that decisions from Illinois and other states, and that the UDITPA drafters, approved as a proper basis alternative apportionment relief under IITA § 304(f) and other state laws adopting Section 18 of UDITPA.

III. MISCELLANEOUS

A. Uniformity

Innophos did not in its complaint or in its motion for partial summary judgment make any claim that the Department's adjustment in any way implicated the Uniformity Clause of Section 2, Article IX of the Illinois Constitution of 1970. Nevertheless, at page 23 of the Response/Motion the Department launches into a discussion of the Uniformity Clause under the pretext that "Petitioner appears to make a uniformity argument by asserting that the IITA did not contain a throwback provision for financial organizations, transportation companies, or insurance companies." *Response/Motion,* p. 23. There is no uniformity argument, but the Department's argument is revealing.

The Department writes, with respect to financial organizations, transportation companies and insurance companies that "the foregoing types of industries are different than companies such as petitioner that sell tangible personal property" because "[i]ncome derived from these industries is, for the most part, already sourced based on the 'market'" and, "[a]ccordingly, it is not necessary to include a 'throwback' provision in the apportionment formula for the industries identified above." *Id.* at 23–24. What the Department's argument ignores is that the three-factor formula was composed of two factors that reflected the Production States' contributions to the taxpayer's business [Capital (property), Labor (payroll)] and the Market States' contributions to the taxpayer's business [Market (sales)].[7] Section 304(a) has long established what is the

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[7] "The property, payroll and sales factors that comprise the three-factor apportionment formula are proxies for the extent of the capital, labor and markets that a business has within a state." Statement of James R. Eads, Jr., Executive Director, Federation of Tax Administrators, before the Subcommittee on Commercial and Administrative Law,

Illinois market by using a "destination" rule embodied in § 304(a)(3)(B)(i) which provides that sales of tangible personal property are sourced to Illinois if: "[t]he property is delivered or shipped to a purchaser . . . within this State regardless of the f.o.b. point or other conditions of the sale." 35 ILCS 5/304(A)(3)(B)(i). That is the Illinois market. IITA § 304(a)(3)(B)(ii) is not a market provision. Rather, § 304(A)(3)(B)(ii) is a full apportionment provision based on "business activity," which throws-back sales to the shipping state – the last business activity before delivery – sales that are destined to, and terminate in, another State's market. The basis for throwback was repudiated, in P.A. 098-0478 so that all apportionment formulae in Section 304, including the sales factor in subparagraph (a), are based on the market, just like the rest of the special industry formulas which the Department says here are "already sourced based on the 'market.'"

Petitioner is not making a Uniformity argument because all of § 304 is based on the "market" after January 1, 2014 (retroactive to 2008). There is not a lack of uniformity in the statute after P.A. 98-0478. However, the Department puzzlingly contends that some parts of § 304 are based on the "market" – like 304(b), (c) and (d), and parts of 304(a)(3) dealing with "intangible" goods and services, but tangible goods are <u>not</u> sourced based on the market because they are not "goods" for purposes of § 304(f) and therefore are still apportioned based on "business activity" under § 304(a)(3)(B)(ii) even after P.A. 98-0478. Such a result defies logic because it requires one to simultaneously read into the statute terms that are absent ("intangible") while

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Committee on the Judiciary, United States House of Representatives, *State Taxation: The Role of Congress in Developing Apportionment Standards,* p. 4 (May 6, 2010).

excluding tangible personal property from the definition of "goods," an exclusion for which there is no basis in law, legislative history, or common sense.

B. Burden

Having filed a cross-motion for summary judgment, the Department unsurprisingly states that "the parties agree that only questions of law exist with respect to Counts I, II, and IV of the Petition" and "[t]herefore, summary judgment is appropriate here." *Response/Motion*, p. 7. In the immediately following paragraph, however, the Department says: "There is no genuine issue of material fact in this matter. Petitioner has not produced any evidence that supports the positions in its motion." *Id.* Huh?! If the Department believes evidence should be produced by Petitioner on a material issue, then the issue is not ripe for summary judgment and the Department should not have filed a cross-motion for summary judgment.

Later in its Response/Motion the Department builds on that inconsistent theme by misstating the standard for alternative apportionment as one *solely* of quantitative distortion of constitutional significance. The Department restates that "Petitioner has not produced any evidence" of distortion, and that "Petitioner did not raise constitutional distortion in its Petition." *Response/Motion*, p. 21. Ignoring that alternative apportionment was also intended to be granted, and has been granted here and elsewhere, for qualitative considerations (see *supra* Part II), the Department has created a false basis to argue that evidence is material, despite filing a cross-motion for summary judgment, and to argue that there is a pleading omission. Such claims must fail.

Lastly, at page 5, it submits as the 12th of its "undisputed facts" that "Petitioner did not file a petition for alternative apportionment in accordance with IITA § 304(f) and

Regulation 100.3390 for tax year ending December 31, 2009 or tax year ending December 31, 2010." It is undisputed that Petitioner did not time travel back to 120 days prior to its 2009 and 2010 returns and file a § 304(f) petition for each original return based on the time-traveler's knowledge of the future event that would come to pass on January 1, 2014, that P.A. 098-478 would allow fair reflection of the "market" rather than of "business activity" to be the standard for the statutory apportionment formula, including § 304(a)(3)(B)(ii). Had Innophos been capable of such time travel there would be no due process claim before the Tax Tribunal, and the case before the Tax Tribunal would be about the Department's denial of Innophos's petition for alternative apportionment based on, at the time, non-existent language in IITA § 304(f). The Department would win that case. This is not that case.

IV. CONCLUSION

Counts I, II, and IV of the Petition read as follows:

> **Count I:** P.A. 98-0478 Rendered the "Throwback" Rule in IITA Section 304(a)(3)(B) Inapplicable to Returns for Tax years Ending on or After December 31, 2008.
>
> **Count II:** For Tax years Ending on or after December 31, 2008, a Throwback Adjustment must be Proposed Pursuant to Section 304(f) of the IITA, and the Proponent must Bear the Burdens of Proof and of going Forward with Evidence.
>
> **Count IV:** In the alternative, if Section 304(a)(3)(B) Required an Increase to the Numerators for 2009 and 2010, it was Impossible for Innophos to Petition then for Relief upon the now Available Basis that the Increase did not Fairly and Accurately Represent the Market for Innophos' Goods, and Innophos Would be Deprived of Due Process if such Relief is not now Granted.

Petitioner moves this Tribunal to enter Summary Judgment with respect to Counts I, II, and IV, for the reasons stated herein and in its original Motion for Summary Judgment.

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