

**ILLINOIS INDEPENDENT TAX TRIBUNAL  
CHICAGO, ILLINOIS**

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**THE DEPARTMENT OF REVENUE  
OF THE STATE OF ILLINOIS**

v.

**Innophos Holdings, Inc.  
Petitioner**

**Docket No. 14-TT-214**

**James M. Conway,  
Administrative Law Judge**

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**NOTICE OF FILING**

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PLEASE TAKE NOTICE that on August 10, 2015, on or before 5:00 p.m., the undersigned filed the Department's Motion for Summary Judgment and Response to Petitioner's Motion for Summary Judgment with the Illinois Independent Tax Tribunal, located at 160 North LaSalle Street, Room N506, Chicago, IL 60601, in the above-captioned matter.

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**STATE OF ILLINOIS  
DEPARTMENT OF REVENUE  
OFFICE OF ADMINISTRATIVE HEARINGS  
CHICAGO, ILLINOIS**

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<b>INNOPHOS HOLDINGS INC.,</b>	)	
	)	
<b>Petitioner,</b>	)	
	)	
<b>v.</b>	)	<b>Case No. 14-TT-214</b>
	)	
<b>ILLINOIS DEPARTMENT OF REVENUE,</b>	)	<b>James M. Conway</b>
	)	<b>Chief Administrative Law Judge</b>
	)	
<b>Respondent.</b>	)	

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**DEPARTMENT’S MOTION FOR SUMMARY JUDGMENT  
AND RESPONSE TO PETITIONER’S MOTION FOR SUMMARY**

Now comes the State of Illinois, Department of Revenue (the “Department”), by its duly authorized representatives, Rickey A. Walton, Jennifer Kieffer and Jonathan Pope, Special Assistant Attorneys General, and moves, pursuant to Section 2-1005 of the Illinois Code of Civil Procedure (735 ILCS 5/2-1005), for summary judgment on Counts I, II and IV of Innophos Holding, Inc.’s Petition filed in the instant matter. In support of said motion, the Department hereby submits its Memorandum of Law.

**I. INTRODUCTION**

The Department correctly applied Section 304(a)(3)(B)(ii) of the Illinois Income Tax Act (“IITA”) when it computed the Petitioner’s sales factor by including in the numerator of the sales factor sales Petitioner made to purchasers in states in which Petitioner was not taxable for the Years at Issue. Moreover, the applicable case law supports the Department’s position. In

contrast, the methodology Petitioner used to compute its sales factor is completely contrary to the unequivocal language of the applicable statute, specifically 35 ILCS 5/304(a)(B)(ii). In particular, Petitioner ignored the mandate in IITA § 304(a)(3)(B)(ii) requiring a taxpayer to include in the numerator of its sales factor sales derived from selling tangible personal property to purchasers in states where the taxpayer is not taxable.

Moreover, Public Act 098-0478 that amended IITA § 304(f) has absolutely no bearing on the application of IITA § 304(a)(3)(B). Instead, P.A. 098-0478 was enacted to reconcile IITA § 304(f) with IITA § 304(a)(3)(C-5). Specifically, in 2008, the Legislature amended the IITA to require taxpayers, for tax years beginning on and after December 31, 2008, to use a market-based approach to apportion income from intangible property and services as set forth in IITA § 304(a)(3)(C-5)(iii) and (iv), respectively. 35 ILCS 5/304(a)(3)(C-5)(iii) & (iv). Subsequently, in 2013, the Legislature amended IITA § 304(f) to add language to permit or require alternative apportionment if the regular apportionment formulae (i.e., the formulae set forth in IITA §§ 304(a)(3)(C-5)(iii) & (iv)) do not accurately reflect the Illinois “market” for the taxpayer’s goods and services. 35 ILCS 5/304(f). However, neither the 2008 nor the 2013 IITA amendments altered, in any way, the requirements of IITA 304(a)(3)(B)(ii) that control the computation of the sales factor when the taxpayer, such as the Petitioner in the instant matter, sells tangible personal property. 35 ILCS 5/304(a)(3)(B)(ii). Accordingly, the 2013 amendment to IITA § 304(f) did not affect the apportionment requirements for tangible personal property. Therefore, this Tribunal should reject the Petitioner’s attempts to suggest otherwise as well as its attempt to avoid its tax liability by “boot strapping” one section of the IITA to the public act that amended

another IITA section when the two IITA sections were not designed to operate in the distorted manner that Petitioner suggests.

Next, Petitioner erroneously argues that the Department was required to seek alternative apportionment before including in the numerator of its sales factor sales from states in which it was not taxable. Petitioner's Motion, p.12. Alternative apportionment was not necessary because the Petitioner was required to use the regular statutory apportionment formula, which accurately reflects Petitioner's business activity in Illinois. 35 ILCS 5/304(a)(3)(B)(ii). Therefore, Petitioner's argument regarding the Department's failure to seek alternative apportionment under IITA § 304(f) is a *non sequitur*, and therefore must be rejected.

Similarly, inasmuch as the Department was not required to seek alternative apportionment, the Department was not required to follow the procedures set forth in Department's Regulation § 100.3380(c) ("Reg. § 100.3380(c)"). Therefore, Petitioner's assertion that it was denied procedural due process is without merit. Assuming, *arguendo*, that the Department was, by some strange twist, required to seek alternative apportionment, and therefore follow the procedures contained in Reg. 100.3380(c), no due process violation has occurred because Petitioner has been given notice of the Department's adjustments to its tax returns and is now being afforded an opportunity to be heard, the two hallmarks of procedural due process. A hearing prior to government action is required only when certain rights are involved, none of which are at issue in the instant matter. Accordingly, the Department did not violate the Petitioner's procedural due process rights.

## II. FACTS

The Department does not dispute the "Facts" (a. through h.) alleged on Page 2 of Petitioner's Motion for Summary Judgment. Department herein provides additional undisputed facts.

1. Petitioner manufactures specialty phosphates (i.e., specialty salts and specialty acids, purified phosphoric acid, and technical sodium tripolyphosphate and other products. Dept's Exhibit 1, p.2.
2. Petitioner's headquarters were located in Cranbury, New Jersey during the Years at Issue. Dept's Exhibit 6?
3. The Department conducted an audit of Petitioner's Illinois Corporation Income and Replacement Tax Returns ("IL-1120s") for the tax years ending December 31, 2009 and December 31, 2010 (the "Years at Issue"). Dept's Exhibit 1, p.1.
4. During the Years at Issue, Petitioner operated a manufacturing plant in Chicago Heights, Illinois. Dept's Exhibit 5, p.21.
5. During each of the Years at Issue, Petitioner shipped merchandise from its Chicago Heights plant to purchasers in Illinois and forty-one other states and certain foreign countries. Dept's Exhibit 1, pp.8-9.
6. Petitioner filed corporate income tax returns in sixteen of the forty-one other states to which it shipped merchandise from Chicago Heights to purchasers in those other states. Dept's Exhibit 1, pp.8-9.
7. For those sales of goods Petitioner shipped from Chicago Heights to purchasers in other states where Petitioner did not have nexus, did not file a corporate income tax return, or did not provide sufficient support (collectively "throwback" sales), the Department

included those sales in the numerator of Petitioner's Illinois sales factor. Dept's Exhibit 1, pp. 2 and 8-9.

8. For tax year ending December 31, 2009, after including the "throwback" sales in the numerator of Petitioner's sales factor, the Petitioner's Illinois income tax increased by \$969,893 and the replacement tax increased by \$505,153. Dept's Exhibit 6, p.3-4.
9. On September 11, 2014, the Department issued Petitioner a Notice of Deficiency setting forth a deficiency of \$1,402,309.49 for tax year ending December 31, 2009. Dept's Exhibit 6, p.1.
10. For tax year ending December 31, 2010, after including the "throwback" sales in the numerator of Petitioner's sales factor, the Petitioner's Illinois income tax increased by \$916,853 and the replacement tax increased by \$477,528. Dept's Exhibit 6, p.9-10.
11. On September 11, 2014, the Department issued Petitioner a Notice of Deficiency setting forth a deficiency of \$1,125,416.59 for tax year ending December 31, 2010. Dept's Exhibit 6, p.7.
12. 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.

### **III. ISSUE**

The issue in this matter is whether the sales of tangible personal property Petitioner made to purchasers in states where it was not taxable are "in this State," and therefore should be thrown back to Illinois and included in the numerator of Petitioner's sales factor. Petitioner argues that the amendment P.A. 098-0478 made to IITA § 304(f) required the Department to

seek alternative apportionment before applying the “throwback” rule contained in IITA § 304(a)(3)(4)(ii) to sales of tangible personal property Petitioner made to purchasers in states where Petitioner was not taxable. Further, and in the alternative, Petitioner argues that Petitioner’s due process rights were violated because (i) the Department did not seek alternative apportionment before adjusting the numerator of Petitioner’s sales factor pursuant to IITA § 304(a)(3)(B)(ii), and (ii) Petitioner was prevented from petitioning for alternative apportionment, before it filed its original returns, under the new standard in IITA § 304(f) - “market for the person's goods, services, or other sources of business income,” - which was created by P.A. 098-0478. For the following reasons, Department argues that it properly determined Petitioner’s sales factor according to the statutory method proscribed in IITA § 304(a), that Department was not required to seek alternative apportionment pursuant to IITA § 304(f) because Department employed the statutory method, and that Petitioner’s due process rights have not been violated because Petitioner does not have a property right in a petition for alternative apportionment, and even if it did, it may still employ at least one method to request alternative apportionment.

#### **IV. ARGUMENT**

A motion for summary judgment is appropriate if the pleadings, depositions, and admissions on file, together with the affidavits, if any, show that there is no genuine issue of material fact and that the moving party is entitled to judgment as a matter of law. 735 ILCS 5/2-1005(c). A motion for summary judgment is particularly appropriate when only a question of law is involved. *First of America Bank, Rockford, N.A. v. Nestch*, 166 Ill.2d 165 (1995). A question of statutory construction or interpretation presents a question of law that is ripe for a summary judgment motion. *Rice v. Board of Trustees of Adams County*, 326 Ill.App.3d. 1120,

(4<sup>th</sup> Dist. 2002); *Northwest Airlines, Inc. v. Department of Revenue*, 295 Ill.App.3d 889, 892(1998). In the case at bar, the parties agree that only questions of law exist with respect to Counts I, II and IV of the Petition. Therefore, summary judgment is appropriate here. *Nestch*, 166 Ill.2d 165.

On a motion for summary judgment, the movant with the burden of proof at trial must establish every essential element of its claim. *Bob Hamric Chevrolet, Inc. v. U.S. I.R.S.*, 849 F. Supp. 500, 507 (W.D.Tex.1994) (citing *Celotex Corp. v. Catrett*, 477 U.S. 317, 322-23 (1986)). The moving party without the burden of proof need only point to the absence of evidence on an essential element of the opposing party's claims. *Id.* One of the principal purposes of the summary judgment rule is to isolate and dispose of factually unsupported claims or defenses. *Celotex Corp. v. Catrett*, 477 U.S. at 323-24. Where a party will have the burden of proof on an element essential to its case at trial and does not, after adequate time for discovery, make a showing sufficient to establish the existence of that element, there can be no genuine issue as to any material fact since a complete failure of proof concerning an essential element of the party's case necessarily renders all other facts immaterial. *Id.* at 322-23. *See also Rotzoll v. Overhead Door Corp.*, 289 Ill.App.3d 410, 420 (4th Dist. 1997) (“*Celotex* held that a defendant satisfies its initial burden of production when it ‘point[s] out’ there is an absence of evidence to support the plaintiff's position.”). There is no genuine issue of material fact in this matter. Petitioner has not produced any evidence that supports the positions in its motion. Further, the relevant court decisions support the Department's interpretation of IITA §§ 304(a)(3)(B) and 304(f). Accordingly, this Tribunal should deny Petitioner's motion for summary judgment with respect

to Counts I, II and IV of its Petition and grant the Department's motion for summary judgment with respect to Counts I, II and IV.

### **COUNT I.**

#### **A. Petitioner was required to compute its sales factor in accordance with IITA § 304(a)(3)(B)(ii), which was not affected by the enactment of Public Law 098-0478.**

This Tribunal should summarily reject Petitioner's interpretation of IITA §§ 304(a)(3)(B) and 304(f) because such interpretation simply cannot be reconciled with the express language in the foregoing statutory provisions. The term "market" that P.A. 098-478 added to IITA § 304(f) relates to the term "marketplace" that P.A. 095-0233 added to IITA § 304(a)(3)(C-5), which involves the apportionment of sales derived from intangible property and services. The term "market" in IITA § 304(f) has absolutely no bearing on the apportionment of income derived from the sale of tangible personal property, the issue in the current matter. Accordingly, this Tribunal should reject Petitioner's interpretation of IITA §§ 304(a)(3)(B) and 304(f) because such interpretation would render the language in IITA § 304(a)(3)(B) superfluous, which is a violation of the basic principles of statutory interpretation. *Caterpillar Tractor v. Lenckos*, 84 Ill. 2d 102, 114 (1981).

1. The Department correctly interpreted, and thereafter applied the terms of IITA § 304(a)(3)(B) in determining the deficiency shown in the Notice of Deficiency.

The Department's interpretation of IITA § 304(a)(3)(B)(ii) is consistent with the plain meaning of the statutory language, which is the best measure of the legislative intent. When construing a statute, Illinois courts follow the primary rule of statutory construction, namely to "ascertain and give effect to the true intent of the legislature." *In re App. County Collector of DuPage County*, 187 Ill.2d 326, 332 (1999); *Baker v. Cowlin*, 154 Ill.2d 193, 197 (1992). The

statutory language is the best measure of the legislature's intent. *Illinois Graphics Co. v. Nickum*, 159 Ill.2d 469, 479 (1994). If the legislature's "intent can be ascertained from the statutory language, it must be given effect without resort to other aids for construction." *Id.* The language in IITA § 304(a)(3)(B)(i) and (ii) is precise in that a taxpayer must include in the numerator of its sales factor sales derived from the sale of tangible personal property to Illinois purchasers and purchasers in states where the taxpayer is not taxable. 35 ILCS 5/304(a)(3)(B)(i) and (ii). A court cannot "depart from the plain statutory language by reading into it exceptions, limitations, or conditions that conflict with the expressed intent of the legislature," or "utilize extrinsic aids of statutory interpretation unless the statutory language is unclear or ambiguous." *Brunton v. Kruger*, 2015 IL 117663, ¶24 (internal citations omitted).

In 1984, the U.S. Supreme Court employed a statutory construction test that has become the standard for statutory interpretation. *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-843(1984). In *Chevron*, the Court held:

When a court reviews an agency's construction of the statute which it administers, it is confronted with two questions. First, always, is the question whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress. If, however, the court determines Congress has not directly addressed the precise question at issue, the court does not simply impose its own construction on the statute, as would be necessary in the absence of an administrative interpretation. Rather, if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute.

*Id.* Illinois courts have adopted the *Chevron* test. *Illinois Bell Telephone Co. v. Illinois Commerce Com'n*, 362 Ill.App.3d 652, 657 (4th Dist. 2005); *Board of Trustees of University of*

*Illinois v. Illinois Educ. Labor Relations Bd.*, 2012 IL App (4th) 110836, ¶ 24; *United States Liability Ins. Co. v. Dep't of Ins.*, 2014 IL App (4th) 121125, ¶ 23.

Consideration must also be given to the purpose to be attained by the statute. *Canteen Corp. v. Dep't of Revenue*, 123 Ill.2d 95, 103 (1988). The purpose of IITA §304(a)(3) is to apportion to Illinois only that portion of a unitary enterprise's income derived from the part of the interstate business conducted in Illinois. *Caterpillar*, 84 Ill. 2d at 114. Interpreting IITA §§ 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. *Id.* Accordingly, this Tribunal should reject Petitioner's interpretation of IITA §§ 304(a)(3)(B) and 304(f) because such interpretation is contrary to the language of the foregoing sections of the IITA.

- a. The Department correctly included "throwback" sales in the numerator of Petitioner's sales factor as required by IITA § 304(a)(3)(B)(ii).

Sections 304(a) and 304(f) of the IITA are clear and unambiguous. As a seller of tangible personal property, Petitioner was required to compute its sales factor as provided for in IITA § 304(a)(3)(B)(ii) for the Years at Issue. Petitioner was a non-resident that derived its business income from Illinois and numerous other states and foreign countries during the Years at Issue. Dept's Exhibit 1, p.4 & 8-9. Pursuant to IITA § 304(a):

For tax years ending on or after December 31, 1998 . . . persons other than residents who derive business income from this State and one or more other states shall compute their *apportionment factor* by weighting their property, payroll, and sales factors as provided in subsection (h) of this Section.

35 ILCS 5/304(a) (emphasis added). For tax years ending on or after December 31, 2000, the apportionment factor for persons who apportion their business income to Illinois under subsection 304(a) shall equal the *sales factor*. 35 ILCS 5/304(h)(3). In Illinois, “the *sales factor* is a fraction, the numerator of which is the total sales of the person *in this State* during the taxable year, and the denominator of which is the total sales of the person everywhere during the taxable year.” 35 ILCS 5/304(a)(3)(A) (emphasis added). Sales of tangible personal property are “in this State” if:

- (i) The property is delivered or shipped to a purchaser, other than the United States Government, within this States regardless of the f.o.b. point or other conditions of the sale; or
- (ii) The property is shipped from an office, store, warehouse, factory or other place of storage in this State and . . . *the person is not taxable in the state of the purchaser . . . .*

35 ILCS 5/304(a)(3)(B)(ii) (emphasis added).

Based on the foregoing statutory provisions, sales derived from tangible personal property are “*in this State*” (i.e., in Illinois) if (i) the property is delivered or shipped to purchasers in Illinois; or (ii) the property is shipped from Illinois to a purchaser in a state where the taxpayer is not taxable. 35 ILCS 5/304(a)(3)(B). Illinois courts have consistently held that the phrase sales “in this State” includes sales derived from tangible personal property shipped from Illinois and sold to purchasers in states where a taxpayer is not taxable, and therefore must be ‘thrown back’ to Illinois and included in the numerator of the taxpayer’s sales factor. *Hartmarx Corp.*, 309 Ill. App. 3d 959, 965 (1st Dist. 1999); *Beatrice Cos., Inc. v. Whitley*, 292 Ill. App. 3d 532, 536(1<sup>st</sup> Dist. 1997); *Dover Corp., et al. v. Dept. of Revenue*, 271 Ill. App. 3d

700, 708 (1<sup>st</sup> Dist. 1995). The rule embodied in 35 ILCS 5/304(a)(3)(B)(ii) is referred to as the “throwback rule.” *Hartmarx*, 309 Ill. App. 3d at 965.

The Illinois appellate court first addressed the application of the “throwback” rule of IITA § 304(a)(3)(B)(ii) in *Dover*. Although the main issue in *Dover* was whether the taxpayer was taxable in the other state, the application of the “throwback” rule was still central to the court’s decision. 271 Ill. App. 3d at 707. The taxpayer in *Dover* objected to the inclusion of “throwback” sales in the numerator of its sales factor because the taxpayer argued that it was taxable in the other states where it sold tangible personal property, thereby precluding the application of the “throwback” rule.<sup>1</sup> *Id.* at 704. The taxpayer did not file a return or pay income taxes in the other state. *Id.* at 708. The court agreed with the Department that the taxpayer was required to file a tax return and pay taxes to the other state to satisfy the definition of “taxable” in such state. *Id.* at 708. The court noted that the Department’s interpretation of the term “taxable” accomplished the purpose of formulary apportionment, namely “to have 100% of the taxpayer’s income taxable by the states having jurisdiction to do so” thereby preventing “nowhere” sales. *Id.* at 707. The court held that sales of tangible personal property the taxpayer made to purchasers in the other state were “in this State,” and therefore were thrown back to Illinois and included in the numerator of the taxpayer’s sales factor. *Id.* at 708.

Within four years of its decision in *Dover*, the Illinois Appellate Courts decided *Beatrice* and *Hartmarx* affirming the principle that sales of tangible personal property are “in this State,” and therefore are subject to the application of the “throwback” rule. *Hartmarx*, 309 Ill. App. 3d

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<sup>1</sup> The tax years involved in *Dover* were 1984 and 1985, at which time Illinois still used the 3-factor apportionment formula consisting of property, payroll and sales, which was double-weighted. *See* 35 ILCS 5/304(a). Therefore, in *Dover*, the sales made to purchasers in states where the taxpayer was not taxable were thrown back and included in the sales factor. In the current matter, for the Year at Issue, Illinois uses only the sales factor for apportionment.

at 966; *Beatrice*, 292 Ill. App. 3d at 536. In *Beatrice*, decided two years after *Dover*, a taxpayer put forth the same arguments as the taxpayer in *Dover*, namely that a member of its unitary group that sold tangible personal property was “taxable” in another state because other members of the unitary group were taxable in that other state, and therefore sales in those other states should not be thrown back to Illinois. 292 Ill. App. 3d at 534. Since the *Dover* decision was directly on point, the taxpayer was forced to argue that the *Dover* decision was wrongly decided because the members of a unitary group should be treated as one taxpayer, and therefore no member’s sales should be thrown back to Illinois as long as any member of the unitary group was taxable in the other state. *Id.* Despite the taxpayer’s new argument, the *Beatrice* court held that the individual member’s sales derived from the sale of tangible personal property shipped from Illinois to purchasers in a state where the member was not taxable should be thrown back to Illinois and included in the numerator of the member’s sales factor. *Id.* 536. As in *Dover*, the court in *Beatrice* acknowledged that the “failure to apply the throwback rule in the manner advanced by the Department would result in a ‘nowhere’ tax on the Illinois sales.” *Id.* at 538.

In *Hartmarx*, two members of a taxpayer’s unitary group shipped tangible personal property from Illinois and sold such property to purchasers in states where they were not taxable. 309 Ill. App. 3d at 963. The taxpayer alleged that since other members of its unitary group were taxable in the other states, sales of tangible property sold by the two members at issue should not be thrown back to Illinois and included in the numerator of the taxpayer’s sales factor. The court in *Hartmarx* stated that sales of tangible property shipped from Illinois to purchasers in a state where a taxpayer is not taxable are “in this State” pursuant to IITA § 304(a)(3)(B), and therefore must be apportioned to Illinois. 309 Ill. App. 3d at 965. Therefore, the court held that the

“throwback” rule applies to sales of tangible personal property shipped from Illinois to a purchaser in a state where an entity was not taxable even if other members of that entity’s unitary group were taxable in the other state. 309 Ill. App. 3d at 965. Like the court in *Dover*, the *Hartmarx* court concluded that applying the “throwback” rule in the manner described above prevents “nowhere” sales as prescribed by the legislature. *Id.* at 966.

The statute and applicable case law unequivocally establish that Petitioner was required to include in the numerator of its sales factor sales from tangible personal property it shipped from Illinois to purchasers in states where it was not taxable. In the case at bar, Petitioner sold *tangible* personal property, and therefore it was required to compute its sales factor in the manner set forth in IITA § 304(a)(3)(B), which required Petitioner to include in the numerator of its sales factor all of its sales “in this State.” The sales Petitioner derived from tangible property it sold to purchasers in Illinois were “in this state,” and therefore Petitioner was required to include those sales in the numerator of its sales factor. 35 ILCS 5/304(a)(3)(B)(i). Similarly, Petitioner’s sales of tangible personal property shipped from Illinois to purchasers located in states where Petitioner was *not taxable* were also “in this State.” *Hartmarx*, 309 Ill. App. 3d at 965; 35 ILCS 5/304(a)(3)(B)(i). Therefore, like the taxpayers in *Hartmarx*, *Beatrice* and *Dover*, Petitioner was required to “throwback” to Illinois sales of goods shipped from Illinois to purchasers in states where Petitioner was not taxable, and thereafter include those sales in the numerator of its Illinois sales factor. *Id.*; *Beatrice*, 292 Ill. App. 3d at 536. Apportioning the sales of tangible personal property in the manner set forth in 35 ILCS 5/304(a)(3)(B)(ii), including application of the “throwback” rule, avoids “nowhere” sales. *Hartmarx*, 309 Ill. App. 3d at 965-66; *Beatrice*, 292 Ill. App. 3d at 536. The avoidance of “nowhere” sales is consistent with the Illinois

Supreme Court's conclusion that "the purpose of article 3 of the [IITA] 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 having jurisdiction to tax it." *GTE Automatic Electric, Inc. v. Allphin*, 68 Ill.2d 326, 335, 369 N.E.2d 841 (1997); *Dover*, 271 Ill. App. 3d at 707. Accordingly, this Tribunal should adopt the Department's interpretation of IITA §§ 304(a)(3)(B) and 304(f), which would accomplish the legislative intent of avoiding "nowhere" sales, and is consistent with the holdings in the applicable judicial decisions. *Panhandle Eastern Pipeline Co., et al., v. Hamer*, 2012 IL App (1<sup>st</sup>) 113559, ¶¶ 31-32.

- b. The language of the 2013 Spring Legislative Agenda does not support the Petitioner's interpretation of IITA § 304(f).

Petitioner argues that the Department's Omnibus Income Tax Proposal in its 2013 Spring Legislative Agenda supports the Petitioner's interpretation of P.A. 098-0478 and IITA § 304(f). One must assume that the Petitioner argues that the language of 304(f) itself is ambiguous, because only then may a court look beyond the language of the statute to other aids of construction, such as the Department's Legislative Agenda. *Illinois Graphics Co. v. Nickum*, 159 Ill.2d 469, 479 (1994). Petitioner misconstrues the language in the Department's "2013 Spring Legislative Agenda" ("Legislative Agenda"). TP's Exhibit A. Petitioner contends that the Department, via the Legislative Agenda, indicated that the word "market" in the amendments to IITA § 304(f) applies to tangible personal property as well as intangible property and services. Petitioner's Motion, pp.10-11. A review of the Legislative Agenda and IITA § 304(f) quickly reveals that Petitioner's interpretation is incorrect.

Before P.A. 098-0478 was enacted, IITA § 304(f) permitted or required alternative apportionment only if the statutory formula did not fairly or accurately reflect a taxpayer's

*business activities* in Illinois. 35 ILCS 5/304(f), eff. 1982. In 2008, P.A. 095-0233 amended the IITA by adding IITA § 304(a)(3)(C-5) that changed the focus of the apportionment of sales of intangible property and services from the taxpayer's business activities in Illinois to the location of the taxpayer's customer – i.e. the Illinois market. Even though P.A. 095-0233 added a market-based apportionment approach in IITA § 304(a)(3)(C-5), P.A. 095-0233 did not amend IITA § 304(f) to provide a provision permitting or requiring alternative apportionment if IITA § 304(a)(3)(C-5) did not fairly or accurately reflect the Illinois market for a taxpayer's intangible goods and services. Therefore, as shown in its Legislative Agenda, the Department encouraged the legislature to make the above described change. TP's Exhibit A. And, the legislature did just that. P.A. 098-0478 amended IITA § 304(f) by adding language permitting or requiring alternative apportionment when IITA § 304(a)(3)(C-5) does not fairly or accurately represent the Illinois market for intangible goods and services. P.A. 098-0478. The "market" language in IITA §§ 304(a)(3)(C-5) and 304(f) takes into account the fact that income from intangible property and services is sourced using the location of the customer, not the taxpayer's business activities. 35 ILCS 5/304(a)(3)(C-5) & 304(f). The Legislative Agenda makes this point by stating that:

**D. Correct Alternative Apportionment Standard**

Sub-sections a, b, c & d of IITA Section 304 were previously amended to address this<sup>2</sup> but it failed to change sub-section f. IITA Section 304(f) allows alternative apportionment when the statutory formula does not *fairly reflect the taxpayer's business activities in Illinois*. This does not mesh well with the current sales factor provisions, which apportion income according to customer location rather than where the taxpayer is engaged in business activities. We should amend this provision to allow alternative apportionment when the statutory formula does not fairly reflect the market for the *taxpayer's goods or services* in Illinois.

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<sup>2</sup> Although use of the pronoun "this" creates ambiguity, the Department asserts that "this" is the sale of intangible goods and services. See 35 ILCS 5/304(a)(3)(C-5).

TP's Exhibit A (emphasis added).

The Legislative Agenda acknowledges that IITA 304(f) did not include language permitting or requiring alternative apportionment when the regular formula did not accurately reflect the Illinois market for the taxpayer's intangible goods and services. As a result, the Legislative Agenda states that IITA 304(f) (before the amendment adding the term "market") did not "mesh well" with the statute that sourced income from intangible property and services according to the "customer location rather than where the taxpayer is engaged in business activities." Therefore, the Legislative Agenda indicates that IITA § 304(f) should be amended to allow alternative apportionment "when the statutory formula does not fairly reflect the market for the taxpayer's *goods or services* in Illinois." Petitioner's Motion, pp. 5 (emphasis added). The phrase "goods or services" referenced in the Legislative Agenda refers to intangible goods and services, the exact items IITA § 304(f) was amended to accommodate. See 35 ILCS 5/304(a)(3)(C-5). Accordingly, the Legislative Agenda correctly indicates that the Department recommended amending IITA § 304(f) to add language expressly permitting or requiring alternative apportionment when the statutory formula (i.e., IITA § 304(a)(3)(C-5)) does not fairly reflect the "market" for the taxpayer's intangible goods and services in Illinois. Petitioner's assertions insinuating otherwise are contrary to the language in the Legislative Agenda and the applicable statutes (i.e., IITA §§ 304(a)(3)(C-5) and 304(f)).

Notwithstanding the foregoing, assuming, *arguendo*, that Petitioner's interpretation of the Legislative Agenda is correct, the meaning of the term "market" in IITA §304(f) is based on the language in the statute, not the wording in the Legislative Agenda. At best, the Legislative

Agenda could be analogized to the preamble of a statute. Illinois courts have held that the rules governing statutory interpretation apply equally to regulations:

Administrative rules and regulations have the force of law and must be construed under the same standards that govern the construction of statutes. Therefore, the primary objective of interpreting a regulation is to ascertain and give effect to the drafters' intent. The best indication of the drafters' intent is the regulation's language, given its plain and ordinary meaning. Where the regulation's language is clear, it must be applied as written; however, if the language is susceptible of more than one interpretation, the court may look beyond the language to consider the regulation's purpose. Regulatory intent must be ascertained from a consideration of the entire scheme, its nature, its object, and the consequences resulting from different constructions. A court should not construe a regulation in a manner that would lead to consequences that are absurd, inconvenient, or unjust.

*People v. Wilhelm*, 346 Ill. App. 3d 206, 208 (2nd Dist. 2004) (internal citations omitted). The Illinois Supreme court has clearly stated that “a preamble is not part of the act itself and has no substantive legal force.” *People v. McCarty*, 223 Ill. 2d 109, 128 (2006) (internal citations omitted). Furthermore, “[t]o the extent that any *express* language in the statute contradicts a preamble, the statutory language controls.” *Id.* (alteration and emphasis in original). Surely, if the language of a preamble to a statute is not part of the statute, and therefore is not controlling, the language in a Legislative Agenda cannot possibly be controlling. Therefore, even if Petitioner’s interpretation of the language in the Legislative Agenda is correct, the language in IITA §§ 304(a)(3)(C-5) and 304(f) is controlling, not the language of the Legislative Agenda.

c. Applying IITA §§ 304(a)(3)(B) and 304(f) according to the Department’s interpretation will not produce impermissible “windfalls.”

Petitioner contends that the IITA does not prevent or cure “windfalls” created by “nowhere” sales for all taxpayers and that someone, presumably the Department, erroneously believes that “throwback cures an illusory windfall.” Petitioner’s Motion, p.11. Petitioner’s argument regarding “windfalls” is a “red herring” that should be summarily dismissed. Although

an apportionment formula may not be precise, it is a good estimate of the business activity a unitary group conducts in a state. *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159, 169-70, 103 S.Ct. 2933, 2942, 77 L.Ed.2d 545 (1983). Members of a unitary group are so interdependent that it is “relatively impossible for one state to determine the net income generated by a particular subsidiary’s activities” within any given state. *Hartmarx*, 309 Ill. App. 3d at 964. To address this problem, the apportionment formula was developed to source the income of an enterprise that conducts business in two or more states. 35 ILCS 5/304(a). Therefore, the overarching purpose of the apportionment formula is “to permit the fair determination of the portion of business income that is attributable to the business activity in Illinois by the reporting member of the unitary group.” *Caterpillar*, 84 Ill.2d at 121.

Recognizing that apportionment formulae are not perfect, no court has ever held that an apportionment formula must be designed to prevent or cure all overlaps or gaps in apportionment. *See e.g., Nashville, Chattanooga & St. Louis Ry. v. Browning*, 310 U.S. 362, 365-366, 60 S.Ct. 968, 970, 84 L.Ed. 1254 (1940) (“Basic to the accommodation of the conflicting state and national interests is realization that by its very nature the problem is incapable of precise and arithmetical solution.”). In fact, the U.S. Supreme Court has acknowledged that it is practically impossible for a state’s apportionment formula to achieve perfect apportionment because of the size and complexity of business entities, and thus has concluded that a “rough approximation rather than precision is sufficient.” *Illinois Central Ry. V. State of Minnesota*, 309 U.S. 157, 161, 60 S. Ct. 419, 422, 84 L.Ed. 670 (1940). *See also Moorman Mfg. Co. v. G.D. Bair*, 254 N.W. 2d 737, 744 (Iowa 1977), *aff’d* 437 U.S. 267, 98 S.Ct. 2340 (1978) (Apportionment formulae, “owe their very existence to the absence of exact alternatives for

dividing the tax base of a unitary business, cannot be expected to achieve precision.”). The Supreme Court will *not* invalidate an apportionment formula merely because it taxes some value outside of the taxing state. *Container*, 463 U.S. at 169-70, 103 S.Ct. at 2942. Therefore, Petitioner’s arguments regarding the IITA’s failure to prevent or cure “windfalls” for all taxpayers is not valid nor does it lead to the conclusion Petitioner seeks, namely that IITA § 304(f) should be retroactively applied so that Petitioner is allowed to exclude from the numerator of its sales factor sales of tangible personal property Petitioner made to purchasers in states where it was not taxable.

Petitioner also contends that the ‘prevention of windfall’ theory espoused by various Illinois courts is based on a “flawed tautology” because at no time have states utilized the same apportionment formula for income tax. Petitioner’s Motion, p.10. Petitioner, once again, misconstrues the requirements for a constitutionally acceptable apportionment formula. Petitioner correctly asserts that at no time have states utilized the same apportionment formula for income tax. Petitioner’s Motion, p.10. However, no statute or court has ever required states to use the same apportionment formula to prevent “nowhere” sales, and therefore prevent the mythical “windfalls’ to which Petitioner alludes. A state is required to design an apportionment formula so that, when applied by every state in which the taxpayer conducts business, it will tax 100% of the taxpayer’s income, no more or no less. *Container Corp.*, 463 U.S. at 169.

Notwithstanding the foregoing, a court will prevent a state from applying its apportionment formula to a particular taxpayer if that taxpayer can demonstrate by clear and cogent evidence that the formula taxes income “out of all appropriate proportion” to the taxpayer’s business conducted in the taxing state. *Norfolk & Western Ry. Co. v. State of Tax*

*Commission, et al.*, 390 U.S. 317, 325(1968); *Hans Rees' Sons, Inc. v., State of North Carolina, ex rel., Maxwell*, 283 U.S. 123, 135,(1931). When the statutory formula results in taxation by a state of income “out of all appropriate proportion” to the taxpayer’s business conducted in the taxing state, it is considered unconstitutional distortion. *Hans Rees’*, 283 U.S. 123, 135. In *Hans Rees*, the Court invalidated North Carolina’s apportionment formula as applied to the taxpayer in that case because, on average, the formula taxed 80% of the taxpayer’s income even though the taxpayer conducted, on average, only 17% of its business in that state. 283 U.S. at 134-35, 51 S.Ct. at 389. Despite its decision in *Hans Rees’*, the Court affirmed a state’s right to select an apportionment formula, and held that any resulting tax assessment based on such formula will be struck down only when the taxpayer satisfies, with clear and cogent evidence that the formula taxes income “out of all appropriate proportion” to the taxpayer’s business conducted in the taxing state. *Id.* at 135.

In the current matter, Petitioner has not produced any evidence that the apportionment formula in IITA § 304(a)(3)(B)(ii) produces results that are ‘out of all appropriate proportion’ to its business activity conducted in Illinois. Further, Petitioner did not raise unconstitutional distortion in its Petition. Accordingly, Petitioner’s argument regarding “nowhere” sales, including the resulting “windfalls” that Petitioner alleges will be created, should be dismissed because such argument is clearly contrary to the prevailing case law indicating that apportionment formulae are not precise and only need to provide a rough approximation of the taxpayer’s business activity in the taxing state. *Container Corp.*, 463 U.S. at 169-70, 103 S.Ct. at 2942; *Illinois Central Ry.*, 309 U.S. at 161, 60 S. Ct. at 422.

2. The *Hartmarx* decision supports the Department's interpretation of IITA §§ 304(a)(3)(B)(ii) and 304(f).

The Petitioner's reliance on the holding in *Hartmarx* to support its assertion that the Department was required to seek alternative apportionment is misplaced because that decision supports the Department's interpretation of IITA § 304(a)(3)(B)(ii). Petitioner contends that the IITA, as amended by P.A. 098-0478, "now comports to the view the taxpayer advocated in *Hartmarx*." Petitioner's Motion, p.9. Petitioner's assertion is erroneous because it is contrary to the express language of the applicable statutes. As the Department discusses in Count II, Sections B(2), (3) and (4), *infra.*, IITA § 304(C-5), as amended by P.A. 098-0478, focuses on the "market" for the sale of intangible property and services. 35 ILCS 5/304(a)(3)(C-5). Therefore, P.A. 098-0478 amended IITA § 304(f) to include language expressly permitting or requiring alternative apportionment if allocation and apportionment under IITA §§ 304(a) through (e) and (h) does not accurately reflect the Illinois market for the taxpayer's goods and services. 35 ILCS 5/304(f). The amendment adding the language regarding the Illinois "market" to IITA § 304(f) relates to the "market" for intangible property and services, not the tangible personal property that Petitioner sold during the Years at Issue. *Id.* Accordingly, this Tribunal should reject Petitioner's assertion that the IITA now comports with the view the taxpayer advocated in *Hartmarx*, and as reflected in Petitioner's IL-1120s for the Years at Issue.

Assuming, *arguendo*, that P.A. 098-0478 did make a substantive change in the standard for requesting alternative apportionment for sales of tangible personal property – that "business activity" is not the same as or encompassed by "market for the person's goods, services, or other sources of business income," as Petitioner suggests - the onus is still on the taxpayer to petition for alternative apportionment pursuant to Regulation 100.3390 if the taxpayer desires to deviate

from the statutory method in IITA § 304(a)(3)(B)(ii). Petitioner has not petitioned for such alternative apportionment. Thus, the issue is not ripe for this Tribunal. 35 ILCS 1010/1-45. See Count IV, Section 4, page 46, *infra*.

Finally, 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. Petitioner’s Motion, p.10. Since Petitioner did not include a uniformity argument in its Petition, the uniformity argument is not properly before this Tribunal. Further, to support a uniformity challenge, Petitioner must show that the difference between itself and the taxpayers in the other industries is less than the minimal difference needed to justify different treatment. *Geja Café v. Metropolitan Pier & Exposition Authority*, 153 Ill.2d 239, 252-53 (1992). Petitioner has not produced any facts evidencing the lack of a real or substantial difference between itself and the taxpayers in the other industries that are not subject to the throwback rule and that such difference bears no “reasonable relationship to the object of the legislation or to public policy.” *Searle Pharmaceuticals, Inc. v. Dept. of Revenue*, 117 Ill.2d 454, 468 (1987). Moreover, the foregoing types of industries are different than companies such as Petitioner that sell tangible personal property. Income derived from these industries is, for the most part, already sourced based on the “market.” For instance, insurance companies apportion their income based on premium in the state over total premiums. 35 ILCS 5/304(b). Financial organizations apportion their income based on a fraction, the numerator of which is fees, interest, commissions, dividends and similar items derived from customers in Illinois and the denominator of which is total income. 35 ILCS 5/304(c). Accordingly, it is not necessary to include a “throwback” provision in the apportionment formula for the industries identified

above. For the reasons stated herein, Petitioner's argument regarding uniformity should be dismissed.

## COUNT II

### **B. The Department was not required to invoke alternative apportionment before using IITA § 304(a)(3)(B)(ii) to adjust Petitioner's returns for the Years at Issue.**

The formula set forth in IITA § 304(a)(3)(B)(ii) accurately reflects Petitioner's business activity in Illinois. Neither the retroactive application of P.A. 098-0478 nor the substantive amendments P.A. 098-0478 made to IITA §304(f) affected the apportionment rules for tangible personal property contained in IITA § 304(a)(3)(B)(ii). Therefore, the Department was not required to invoke alternative apportionment before using IITA § 304(a)(3)(B)(ii) to apportion Petitioner's sales of tangible personal property for the Years at Issue.

1. Petitioner's interpretation of IITA § 304(f) and P.A. 098-0478 is not consistent with the express language of the IITA § 304(a)(3)(B), and therefore should be rejected.

Despite the unequivocal language in IITA § 304(a)(3)(B) regarding the computation of a taxpayer's sales factor as well as the meaning of the phrase "in this State" contained in IITA § 304(a)(3)(B)(ii) and the applicable judicial decisions, Petitioner erroneously maintains that it was not required to compute its sales factor in the manner prescribed by the aforementioned statute because P.A. 098-0478 changed the requirements for computing the numerator of the sales factor for a taxpayer that sells tangible personal property. (Petitioner's Motion, p.5). Petitioner's interpretation of P.A. 098-0478 cannot be reconciled with the plain language of IITA § 304(a)(3)(B) or the terms of P.A. 098-0478, and therefore should be rejected.

Further, interpreting P.A. 098-0478 in the manner advocated by Petitioner violates the principle that a statute cannot be repealed by implication. *Abruzzo v. City of Park Ridge*, 374 Ill

App. 3d 743, 749 (1<sup>st</sup> Dist. 2007). As the Illinois Supreme Court stated in *Moore v. Green*, “[f]or a later enactment to operate as a repeal by implication of an existing statute, there must be such a manifest and total repugnance that the two cannot stand together.”

*Moore v. Green*, 219 Ill.2d 470, 479 (2006). Such is not the case in the instant matter because the terms of the differing provisions are expressly clear, P.A. 098-0478 amended IITA § 304(f) to add language that would permit or require alternative apportionment when the regular apportionment formulae do not accurately reflect the Illinois market for a taxpayer’s intangible goods and services. 35 ILCS 5/304(f). A brief analysis of the applicable provisions of the IITA and the public acts that amended those IITA provisions demonstrates the fallacy of Petitioner’s argument.

2. Sourcing of sales from intangibles property and services before December 31, 2008.

For tax years ending before December 31, 2008 (i.e., before the effective date of P.A. 095-0233), income derived from the sale of *intangible* property and services were considered “in this State,” and therefore were included in the numerator of a taxpayer’s sales factor if:

- (i) The income-producing activity [was] performed in this State; or
- (ii) The income-producing activity [was] performed both within and without this State and a greater proportion of the income-producing activity [was] performed within this State than without this State, based on performance costs.

35 ILCS 5/304(a)(3)(C).

Determining whether sales were “in this State” under the foregoing methodology (referred to as the “cost of performance”) was an arduous and cumbersome task, requiring a taxpayer to first identify the activities that produced its various streams of income. Thereafter, the taxpayer was required to determine the states in which the activities occurred, in whole or in

part, and then identify the direct costs incurred to perform those activities (i.e., the costs of performance or performance costs) in each state in which each activity occurred, in whole or in part. 35 ILCS 5/304(a)(3)(C). Further, a taxpayer was required to identify and compute the direct costs that generated the taxpayer's various streams of income. 86 Ill. Admin. Code § 100.3700(c)(3). Similarly, when auditing a tax return on which income was apportioned using the cost of performance method, the Department was required to perform the same computation and make the same determinations as a taxpayer when auditing returns on which taxpayers sourced sales derived from intangible property and services for tax years ending before December 31, 2008.

Moreover, under the cost of performance sourcing rules, income from intangible property and services was apportioned to Illinois, and thereafter included in the numerator of the taxpayer's sales factor only if more than 50% of the direct costs of generating such income were incurred in Illinois, which was difficult if not impossible standard to meet. 35 ILCS 5/304(a)(3)(C). Disputes often arose between taxpayers and the taxing authority regarding what constitutes a "direct cost." *See e.g., General Motors Corp. v. Commonwealth of Virginia*, 268 Va. 289, 293, 602 S.E.2d 123 (2004) (Court held that the regulation requiring taxpayers to exclude costs incurred by third parties on behalf of the taxpayer in the computation of costs of performance improperly narrowed the scope of the statute under which only direct costs of performance were included in the apportionment formula). Similarly, disputes also arose regarding what constitutes a "direct cost."<sup>3</sup> In many instances, due to the nature of cost of performance and the problems regarding direct costs, the numerator of the taxpayer's sales factor

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<sup>3</sup> Marilyn Wethekam, *The Complexities in Sourcing Receipts from the Sale of Other Than Tangible Personal Property*, *Journal of State Taxation*, pp.39-40, Sep-Oct 2010. Copy attached as Dept's Exhibit 5.

was greatly diminished and, in some cases, reduced to zero, which Petitioner seems to acknowledge in its motion. Petitioner's Motion, p.10.

3. Sourcing of income derived from the sale of intangible property and services on or after December 31, 2008.

Recognizing the difficulty in complying with and enforcing the cost of performance methodology contained in IITA § 304(a)(3)(C), the Illinois Legislature, in 2008, enacted P.A. 095-0233 that, among other things, amended IITA § 304(a)(3) for tax years ending on or after December 31, 2008 to replace the cost of performance methodology with a "market-based" methodology for determining whether sales derived from intangible property and services are "in this State" for tax years ending *on or after* December 31, 2008. Dept's Exhibit 2, p.117. Public Act 095-0233 states, in relevant part, that:

(C-5) For taxable years ending on or after December 31, 2008, sales, other than sales governed by paragraphs (B), (B-1), and (B-2), are in this State if the purchaser is in this State or *the sale is otherwise attributable to this State's marketplace*. The following examples are illustrative:

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- (iii) *Sales of intangible personal property are in this State* if the purchaser realizes benefits from property in this State. If the purchaser realizes benefit from the property both within and without this State, the gross receipts from the sale shall be divided among those states in which the taxpayer is taxable in proportion to the benefit in each state. If the proportionate benefit in this State cannot be determined, the sale shall be excluded from both the numerator and the denominator of the sales factor.
- (iv) *Sales of services are in this State* if the benefit of the service is realized in this State. If the benefit of the service is realized both within and without this State, the gross receipts from the sale shall be divided among those states in which the taxpayer is taxable in proportion to the benefit of service realized in each state. If the proportionate benefit in this State cannot be determined, the sale shall be excluded from both the numerator and the denominator of the sales factor. The Department may adopt rules prescribing whether the benefit of specific types of service, including, but

not limited to, telecommunications, broadcast, cable, advertising, publishing, and utility service, is realized. (emphasis added).

Dept's Exhibit 2, P.A. 095-0233, pp.117-118.

The provisions P.A. 095-0233 added to the IITA in 2008 created a new methodology for apportioning sales derived from intangible property and services. Dept's Exhibit 2, p.117-118. Specifically, for tax years ending on or after December 31, 2008, sales derived from intangible property and services are apportioned based on the Illinois "marketplace" for the taxpayer's goods and services. Dept's Exhibit 2, p.117-118. Under P.A. 095-0233, sales of intangible property are in the Illinois "marketplace" if (i) the purchaser realizes a benefit from the property in Illinois, or (ii) the purchasers realizes a benefit from the property in Illinois and in one or more other states, in which case a pro rata share of the sales are considered in the Illinois "marketplace." Dept's Exhibit 2, P.A. 095-0233, pp.117-118 (35 ILCS 5/304(a)(3)(C-5)(iii)). Similarly, sales of services are in the Illinois "marketplace" if the service is realized in Illinois or the service is realized in Illinois and one or more other states, in which case a pro rata share (based on gross receipts) are considered in the Illinois "marketplace." Dept's Exhibit 2, p.118 (35 ILCS 5/304(a)(3)(C-5)(iv)). Sales of intangible property and services that are in the Illinois "marketplace" are "in this State," and therefore must be included in the numerator of a taxpayer's sales factor. *Hartmarx*, 309 Ill. App. 3d at 965. Dept's Exhibit 2, pp.117-118 (P.A. 095-0233). Therefore, for tax years beginning on or after December 31, 2008, P.A. 095-0233 amended the IITA to require taxpayers to source income from the sale of intangible property and

services to Illinois based on the Illinois market for the taxpayer's goods and services.<sup>4</sup> Dept's

Exhibit 2, pp.117-118.

- a. The amendments P.A. 098-0478 made to IITA § 304(f) were designed to allow a taxpayer to request or the Director to permit or require alternative apportionment when the apportionment formulas in IITA § 304(a) through (e) and (h) did not accurately reflect the Illinois "marketplace for the taxpayer's goods and services."

P.A. 098-0478 did not affect the application of IITA § 304(a)(3)(B)(ii) with respect to the sourcing of sales from *tangible* personal property for the Years at Issue. Instead, P.A. 095-0478 added language to IITA § 304(f) that expressly authorized a taxpayer to request or the Director to permit or require alternative apportionment if the regular apportionment formula did not accurately reflect the Illinois market for the taxpayer's goods and services. 35 ILCS 5/304(f).

For tax years ending on or after December 31, 2008 but prior to the enactment of P.A. 098-0478, if the regular apportionment formula (i.e., IITA § 304(a)(3)(C-5)) did not accurately reflect the Illinois market for the taxpayer's intangible goods or services, the taxpayer could request or the Director could permit or require alternative apportionment. 35 ILCS 5/304(f). Specifically, for tax years ending on or after December 31, 2008 (but prior to the enactment of P.A. 098-0478), IITA § 304 (f) stated, in part, that:

(f) Alternative allocation. If the allocation and apportionment provisions of subsections (a) through (e) and of subsection (h) do not fairly represent the extent of a person's business activity in this State, the person may petition for, or the Director may, without a petition, permit or require, in respect of all or any part of the person's business activity, if reasonable:

- (1) Separate accounting;

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<sup>4</sup> P.A. 095-0233 also amended the IITA, for tax years ending on or after December 31, 2008, to require a financial organization (as defined in 35 ILCS 5/1501(a)(8)) to include in the numerator of its apportionment factor income from "sources in this State or otherwise attributable to this State's *marketplace*. Dept's Exhibit 2, pp.124-125 (35 ILCS 304(c)(3)) (emphasis added). Accordingly, once again, the main focus of P.A. 095-0233 was to change the computation of the numerator of the apportionment factor for certain taxpayers by including in that computation sales made to the Illinois "marketplace," which involved intangible property and services.

- (2) The exclusion of any one or more factors;
- (3) The inclusion of one or more additional factors which will fairly represent the person's business activities in this State; or
- (4) The employment of any other method to effectuate an equitable allocation and apportionment of the person's business income.

35 ILCS 5/304(f) (eff. 01-01-2006); *See also* Dept's Exhibit 2, pp.134-135. Although a taxpayer could seek or the Director could permit or require alternative apportionment, the version of IITA § 304(f) (as shown above) that existed for tax years beginning on or after December 31, 2008 but prior to January 1, 2014 did not expressly allow a taxpayer to seek or authorize the Director to permit or require alternative apportionment if IITA 304(a)(3)(C-5) did not accurately reflect the Illinois market for the taxpayer's intangible goods or services. 35 ILCS 5/304(a)(3)(C-5).

Recognizing that IITA § 304(f) needed amending, in 2013, the Legislature enacted P.A. 098-0478 that, among other things, amended IITA §304(f) to include language specifically authorizing alternative apportionment when the apportionment formulae in IITA § 304(a) through (e) and (h) did not accurately reflect the Illinois "market" for a taxpayer's intangible goods or services. After enactment of P.A. 098-0478, IITA § 304(f) stated that:

- (f) Alternative allocation. If 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, or, *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, the person may petition for, the Director may, without a petition, permit or require, in respect of all or any part of the person's business activity, if reasonable:
  - (1) Separate accounting;
  - (2) The exclusion of any one or more factors;
  - (3) The inclusion of one or more additional factors which will fairly represent the person's business activities or market in this State; or
  - (4) The employment of any other method to effectuate an equitable allocation and apportionment of the person's business income.

35 ILCS 5/304(f) (eff. 01-01-2014). (emphasis added). *See also* P.A. 098-0478 (Dept's Exhibit 4, pp.48-49).

The foregoing provision (enacted in 2013) was made retroactive to tax years beginning on or after December 31, 2008 because that is when the changes to 35 ILCS 5/304(a)(3)(C-5) in P.A. 095-0233 were effective. Unlike the version of IITA § 304(f) that existed prior to the enactment of P.A. 098-0478, the version of IITA § 304(f) as amended by P.A. 098-0478 (as shown above) includes language expressly allowing a taxpayer to request or the Director to permit or require alternative apportionment if using IITA § 304(a)(3)(C-5) does not accurately reflect the Illinois "market" for the taxpayer's intangible goods and services. Therefore, after the enactment of P.A. 098-0478, for tax years ending on or after December 31, 2008, if the regular apportionment or allocation provisions (in this case, IITA § 304(a)(3)(C-5)) does not accurately reflect the Illinois "market" for the taxpayer's intangible goods and services, the taxpayer can seek and the Director of Revenue can permit or require alternative apportionment. 35 ILCS 5/304(a)(3)(C-5).

Although P.A. 098-0478 retroactively applies to tax years beginning on or after December 31, 2008, it did not change the rules for sourcing sales of tangible personal property. Rather, P.A. 098-0478 added language to 35 ILCS 5/304(f) to take into account the provisions P.A. 095-0233 added to IITA § 304(a)(3)(C-5) to accommodate the new "market" methodology for determining whether sales were considered "in this State" when such sales were derived from *intangible* property and services. In other words, when P.A. 095-0233 amended the IITA to add language to require sales of intangible property and services to be apportioned based on the taxpayer's Illinois "market" or "marketplace," it was then necessary to amend IITA § 304(f) to

add language permitting or requiring alternative apportionment when the regular apportionment provisions did not accurately reflect the Illinois “market” for the taxpayer’s goods and services. *See* P.A. 095-0233 (which was incorporated into 35 ILCS 5/304(f)). Accordingly, after P.A. 098-0478 was enacted, IITA § 304(f) was consistent with IITA § 304(a)(3)(C-5) in that IITA § 304(f) expressly permitted or required alternative apportionment if IITA § 304(a)(3)(C-5) did not accurately reflect the Illinois market for the taxpayer’s intangible goods and services.

Various state income tax professionals have acknowledged that Illinois (via P.A. 098-0478) and other states have recently adopted statutes changing the methodology for apportioning income derived from the sale of intangible property and services. These tax professionals recognize that certain states, including Illinois, no longer use the cost of performance method to apportion income from intangible property and service.<sup>5</sup> Instead, the various commentators indicate that these states have adopted a market-based approach for apportioning income from intangibles and services.<sup>6</sup> Accordingly to one commentator, states switched from cost of performance to market-based apportionment so that the “economic benefit of the service or intangible is appropriately captured.”<sup>7</sup> Another commentator stated that “[n]early every market-based sourcing provision proposed by the IDOR follow a hierarchy for determining where a service is received or an intangible is used. . . .”<sup>8</sup> This commentator explains that, if the taxpayer is a dealer, income from intangible property is sourced to Illinois if the customer is “in this State”

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<sup>5</sup> *See e.g.*, Evan Gallagher, *The Shift from Cost of Performance to Market-based Sourcing*, Beyond the Numbers, Jul-Aug 2014 (Dept’s Exhibit 7, p.1); Anchin, Block & Anchin LLP, *New State Apportionment Rules for Receipts from Services*, Apr. 3, 2014 (Dept’s Exhibit 8, p1).

<sup>6</sup> Evan Gallagher, *The Shift from Cost of Performance to Market-based Sourcing*, Beyond the Numbers, Jul-Aug 2014 (Dept’s Exhibit 7, p.1).

<sup>7</sup> Anchin, Block & Anchin LLP, *New State Apportionment Rules for Receipts from Services*, Apr. 3, 2014 (Dept’s Exhibit 7, p.1).

<sup>8</sup> Michael J. Wynne, *et al.*, *The Illinois Conversion to Market-Sourcing for Income Apportionment Begins to Take Shape*, Alert -08-0133, Aug 2008 (Dept’s Exhibit 9, p.1).

and, if the taxpayer is a non-dealer, income from intangible property will be sourced using the cost of performance approach.<sup>9</sup> Based on the foregoing, under the market-based approach, “receipts from *services and intangibles* are assigned to the state in which the customer, or customer’s *marketplace*, is located: where the ‘economic benefit’ was received.”<sup>10</sup> (emphasis added).

The Illinois apportionment statute follows the “economic benefit” method for determining where to source income from intangible property and services. For example, under the current version of IITA § 304(a)(3)(C-5)(iv), sales of services are apportioned to Illinois if the “services are received in this State.” 35 ILCS 5/304(a)(3)(C-5)(iv). Similarly, sales from intangibles are in Illinois if the customer is in this State. 35 ILCS 5/304(a)(3)(C-5)(iii)(a). The customer is “in this State” if he is a resident of Illinois (for individuals, trusts or estates) and or is commercially domiciled in Illinois (i.e., for corporations). *Id.* For both services and intangible property, the income is apportionment based on the location of the customer, which is where the economic benefit is received. 35 ILCS 5/304(a)(3)(C-5)(iii) & (iv). Accordingly, the Illinois statute now uses the market-based approach to apportion income from intangible property and services as various commentators have indicated. Accordingly, the Department’s position with respect to the shift to market-based apportionment for income from intangible property and sales is supported by independent third parties who agree that the changes P.A. 098-0478 made to the IITA addressed a shift to market-based apportionment income derived from intangible property and services.

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<sup>9</sup> *Id.* at p.2.

<sup>10</sup> Anchin, Block & Anchin LLP, *New State Apportionment Rules for Receipts from Services*, Apr. 3, 2014 (Dept’s Exhibit 8, p.1).

- b. The enactment of P.A. 098-0478 did not require the Department to invoke alternative apportionment before apportioning Petitioner's income under IITA § 304(a)(3)(B)(ii).

Petitioner erroneously asserts that, after the enactment of P.A. 098-0478, the Department was required to seek alternative apportionment before using IITA § 304(a)(3)(B)(ii) to apportion sales from tangible personal property. Petitioner's argument ignores the plain language of IITA § 304(a)(3)(B)(ii), misconstrues the language in P.A. 098-0478 (which became the revised IITA § 304(f) that is at issue in this matter) and is inconsistent with the judicial decisions regarding "throwback" sales (e.g., *See Hartmarx, supra.*, Count I, Section A(1)(a)).

The fallacy of Petitioner's argument involves its misinterpretation of the word "market" that P.A. 098-0478 added to IITA § 304(f) (the version shown in Dept's Exhibit 4, pp.48-49). Petitioner's incorrectly assumes that sales of tangible personal property to purchasers in states where Petitioner was not taxable are *not* "in this State." Petitioner mistakenly believes that its Illinois "market" includes only purchasers located in Illinois, and therefore it should include only the sales from its Illinois purchasers in the numerator of its sales factor. As a result, Petitioner concludes, albeit erroneously, that its "original 2009 and 2010 returns fairly reflect [its] Illinois market for its goods." Petitioner's Motion, p.11. This Tribunal should reject Petitioner's argument because the term "market" in IITA § 304(f) relates to the term "marketplace" in IITA § 304(a)(3)(C-5), the IITA section used to apportion sales derived from intangible property and services, not tangible personal property. See Count II, Sections B(2) and (3), *supra*. Moreover, with respect to sales of tangible personal property, the legislature has defined the Illinois market to include sales to states where the taxpayer is not taxable. 35 ILCS 5/304(a)(3)(B)(ii).

4. Using IITA § 304(a)(3)(B)(ii) to apportion Petitioner's income does not result in taxation of extraterritorial values.

Contrary to Petitioner's assertion, the Department's Notice of Deficiency does not establish that IITA § 304(a)(3)(B)(ii) taxes extraterritorial values. Despite the language in IITA § 304(a)(3)(B)(ii) and the applicable case law, Petitioner continues argue that the Department is precluded from including "throwback" sales in the numerator of Petitioner's sales factor. As previously discussed, sales of tangible personal property shipped from Illinois to purchasers in states where Petitioner was *not* taxable are sales "in this State." *Hartmarx*, 309 Ill. App. 3d at 965. Therefore, Petitioner's sales of tangible personal property that are "in this State" must be included in the numerator of Petitioner's sales factor, and thereafter apportioned to Illinois even though such sales were made to purchasers in other states. *Id.* The foregoing methodology prevents gaps in taxation, the stated intent of the Illinois legislature. *GTE*, 68 Ill.2d at 339. Even as recently as 2012, Illinois courts continued to hold that "taxation gaps are to be avoided." *Panhandle Eastern*, 2012 IL. App. (1<sup>st</sup>) 113559, ¶31. Accordingly, this Tribunal should reject Petitioner's assertion that IITA § 304(a)(3)(B)(ii) should not be applied in the current matter because failing to do so would create gaps in taxation, which are to be avoided.

In additional support of its argument that the Department was required to seek alternative apportionment before applying IITA § 304(a)(3)(B)(ii), Petitioner states that the Department should not use a "provision intended to measure 'business activity' in a formula intended to measure the 'market.'" Petitioner's Motion, p.13. Petitioner's argument is incorrect because the Department did not use a "provision intended to measure business activity" in a formula that was designed to measure the "market." The Department correctly applied the provisions of § 304(a)(3)(B)(ii) to apportion Petitioner's sales of *tangible* personal property to

Illinois because the Illinois market for the sale of tangible personal property includes goods shipped from Illinois to a location where Petitioner is not taxable (i.e., “throwback” sales). The Department was not required to apportion Petitioner’s income from the sale of tangible personal property with IITA § 304(a)(3)(C-5), which is only used to apportion income from intangible property and services based on the taxpayer’s Illinois “market.” Therefore, the Department did not use a provision intended to measure business activity (i.e., IITA § 304(a)(3)(B)(ii)) to measure the market.

Further, Petitioner’s assertion that the application of IITA § 304(a)(3)(B)(ii) in the instant matter “results in taxation of extraterritorial values” appears to be a constitutional challenge to the “throwback” rule. However, as discussed in Count I, Section A(1)(c), *supra.*, the U.S. Supreme Court has “long realized the practical impossibility of a state’s achieving a perfect apportionment of expansive, complex business activities . . . and has declared that ‘rough approximation rather than precision’ is sufficient.” *Moorman Mfg. Co.*, 254 N.W.2d at 744 (*quoting Illinois Central Ry.*, 309 U.S. at 161). Therefore, the Supreme Court will not strike down a state’s apportionment formula merely because it might tax some income that did not originate in the taxing state. *Container Corp.*, 463 U.S. at 169-70. Instead, the taxpayer must establish by clear and cogent evidence that the apportionment formula taxes income out of all appropriate proportion to the business transacted in the taxing state (i.e. unconstitutional distortion). *Id.* at 170. In the instant matter, Petitioner has not adduced any evidence showing that applying IITA § 304(a)(3)(B)(ii) to the facts in this case produces results that are out of all appropriate proportion to its business activities in Illinois. Nor has Petitioner pleaded

unconstitutional distortion. Therefore, Petitioner's argument regarding taxation of extraterritorial values should be dismissed.

Inasmuch as the Department was not required to seek alternative apportionment before applying IITA § 304(a)(3)(B)(ii) in the current matter, it was not required to follow the procedures set forth in the Department's Regulation 86 Ill. Admin. Code § 100.3390 ("Reg. § 100.3390"). The Department addresses the Petitioner's arguments regarding the procedures for invoking alternative apportionment in Section Count IV, *infra*. Further, Petitioner's 2009 and 2010 corporate income tax returns do not constitute a petition for alternative apportionment. As discussed in Count IV, *infra.*, a petition for alternative apportionment can only be made by following the procedures set forth in the Department's Reg. § 100.3390, which Petitioner has not followed. Moreover, while this Tribunal has jurisdiction to review a Department determination, only the Director of Revenue can permit or require alternative apportionment. 86 Ill. Admin. Code § 100.3390(b).

Based on the foregoing, the Department moves this Tribunal to deny Petitioner's request for summary judgment with respect to Count II and grant the Department's motion for summary judgment on Count II because the retroactive application of P.A. 098-0478 did not change Petitioner's requirement to use IITA § 304(a)(3)(B)(ii) to apportion income it derived from the sale of its tangible personal property. The Department was not required to invoke alternative apportionment before applying IITA § 304(a)(3)(B)(ii) and the Petitioner has not produced any evidence suggesting that the application of IITA § 304(a)(3)(B)(ii) produces results out of all appropriate proportion to the business activity it conducted in Illinois during the Years at Issue.

## **COUNT IV**

Petitioner's objective in Count IV, in the alternative, is to convince the Tribunal that the Tribunal may and should exercise authority under IITA § 304(f) and grant Petitioner alternative apportionment relief. Petitioner is not entitled to alternative apportionment because the regular apportionment formula, i.e., IITA § 304(a)(3)(B)(ii), accurately reflects Petitioner's business activity and market in Illinois and Petitioner has not adduced any evidence demonstrating otherwise. Assuming, *arguendo*, that Petitioner was entitled to alternative apportionment, Petitioner failed to timely petition for such relief and inappropriately attempts to do so now. In support of this objective, Petitioner relies on a procedural due process claim. Substantively, Count IV is not really a procedural due process argument, but rather, a way to slip in an untimely IITA § 304(f) alternative apportionment request for relief, which it is not entitled to claim because Petitioner was required to apportion its sales under IITA § 304(a)(3)(B)(ii). Procedural due process and alternative apportionment are discussed herein.

### **A. Petitioner does not have a due process right to the alternative apportionment procedures prescribed in IITA § 304(f).**

Petitioner has failed to demonstrate how it has or will be denied procedural due process. The two main issues in procedural due process law are *when* process is due (i.e., whether a person receives notice and hearing before or after an alleged deprivation) and *what* process is due (i.e., the type of notice and hearing required). See *Cleveland Bd. of Educ. v. Loudermill*, 470 U.S. 532, 541-542 (1985); *Morrissey v. Brewer*, 408 U.S. 471, 480-481 (1972). According to Petitioner, because it allegedly could not have petitioned for alternative apportionment at the time of filing its returns because P.A. 98-478 did not yet exist, but now that it does exist and its amendments to IITA § 304(f) are applied retroactively, Petitioner should now be permitted to

seek alternative apportionment. Otherwise, as the argument seems to go, Petitioner missed its opportunity to petition with the Department and its procedural due process rights are therefore violated. *See* Petitioner's Motion, pp.14-16. Thus, Petitioner is not arguing that it should have received a hearing prior to the alleged deprivation. Instead, Petitioner seeks the opportunity to be heard now as to its alternative apportionment claim. The question here is therefore, not when, but *what* process is due.

"Illinois courts have consistently held that, under due process of law, a person is entitled to receive a fair hearing before a fair tribunal." *Van Harken v. City of Chicago*, 305 Ill.App.3d 972, 983 (1st Dist. 1999) *citing Colquitt v. Rich Township High School, District No. 227*, 298 Ill.App.3d 856, 865 (1998). "However, procedural due process in an administrative proceeding does not require a proceeding in the nature of a judicial proceeding, but is satisfied by a form of procedure that is suitable and proper to the nature of the determination to be made and conforms to fundamental principles of justice." *Id.* A fair hearing includes "the opportunity to be heard, the right to cross-examine adverse witnesses, and impartiality in ruling upon the evidence . . . ." *Lakeland Const. Co., Inc. v. Dep't of Revenue*, 62 Ill.App.3d 1036, 1040 (2d Dist. 1978) *citing Gigger v. Board of Fire and Police Com'rs*, 23 Ill.App.2d 433, 437-439 (1960).

To be successful, Petitioner's due process claim necessarily requires Petitioner to have been denied a right in seeking an alternative apportionment method. Procedural due process claims concern the constitutionality of the specific procedures employed to deny a person's life, liberty, or property. *East St. Louis Federation of Teachers, Local 1220 v. East St. Louis School District No. 189 Financial Oversight Panel*, 178 Ill.2d 399, 415 (1997). Procedural due process is meant to protect persons not from the deprivation, but from the mistaken or unjustified

deprivation of life, liberty, or property. *Id.* Thus, Petitioner's due process claim must fit into one of these categories: deprivation of life, liberty, or property.

Although Petitioner does not specify, Petitioner must believe it has a property interest at stake, as it certainly cannot claim that the Department has deprived Petitioner of a life or liberty interest. To demonstrate a procedural due process violation of a property right, a person must establish that there is "(1) a cognizable property interest; (2) a deprivation of that property interest; and (3) a denial of due process." *Khan v. Bland*, 630 F.3d 519, 527 (7th Cir. 2010) (citing *Hudson v. City of Chi.*, 374 F.3d 554, 559 (7th Cir. 2004)). "Property interests are not created by the Constitution, 'they are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law . . .'" *Cleveland Bd. of Educ.*, 470 U.S. at 538 (citing *Board of Regents*, 408 U.S. at 577 (1972)). "The Fourteenth Amendment's procedural protection of property is a safeguard of the security of interests that a person has already acquired in specific benefits." *Roth*, 408 U.S. 564 at 576. "To have a property interest in a benefit, a person clearly must have more than an abstract need or desire for it. He must have more than a unilateral expectation of it. He must, instead, have a legitimate claim of entitlement to it." *Roth*, 408 U.S. at 577. "A legitimate claim of entitlement may arise from statute, regulation, municipal ordinance, or express or implied contract." *Jaffe*, ¶ 26. "A legitimate claim of entitlement to warrant a due process hearing occurs only when the statutes or regulations in question establish a framework of factual conditions delimiting entitlements which are capable of being explored at a due process hearing." *Khan v. Bland*, 630 F.3d 519, 527 (7th Cir. 2010) (quoting *Fincher v. South Bend Heritage Found.*, 606 F.3d 331, 334 (7th Cir.2010) (internal quotations and citations omitted). "A property interest of constitutional magnitude

exists only when the state's discretion is 'clearly limited' such that the plaintiff cannot be denied the interest 'unless specific conditions are met.' ” *Khan*, 630 F.3d at 527 (quoting *Brown v. City of Michigan City, Ind.*, 462 F.3d 720, 729 (7th Cir.2006) (internal quotations and citation omitted)). Courts have held that an individual does not have a procedural due process right to a specific procedure or process. *Farmer v. Lane*, 864 F.2d 473, 478 (7th Cir. 1988) (“Although we look to the procedural guarantees granted by contract, ordinance, statute or regulation in assessing whether a property interest exists, the right to those procedural guarantees is not itself a property right.”) *Fleury v. Clayton*, 847 F.2d 1229, 1231 (7th Cir.1988) (“There is neither a ‘liberty’ or a ‘property’ interest in procedures themselves....”); *Olim v. Wakinekona*, 461 U.S. 238, 250 (1983) (“Process is not an end in itself. Its constitutional purpose is to protect a substantive interest to which the individual has a legitimate claim of entitlement.” The State may choose to require procedures to protect a substantive right, but such procedures do “not create an independent substantive right.”).

Here, taxpayer claims it has a right to petition for alternative apportionment pursuant to IITA § 304(f), as amended by P.A. 98-0478 for tax years 2009 and 2010. Thus, taxpayer claims that its ability to petition the Director for alternative apportionment is a “benefit” that rises to the level of a “legitimate claim of entitlement,” and is therefore, a property interest protected by procedural due process. However, the legislature’s grant of a means of petitioning the Department for an alternative apportionment method is simply a *procedure* to prevent the substantive due process violation of taxing income that is “out of all proportion” to the taxpayer’s business conducted in the taxing state, or, put another way, does not “fairly represent” the person's “business activities” or “market for goods and services” in Illinois. *Norfolk &*

*Western Ry. Co. v. State of Tax Commission, et al.*, 390 U.S. 317, 325-326 (1968); 86 Ill. Admin. Code § 100.3390(c); 35 ILCS 5/304(f). IITA § 304(f) merely provides a taxpayer with a means to prevent a deprivation of property (money in the form of taxes) before it pays the tax, or to remedy a prior payment of taxes where the amount of income taxed did not “fairly represent” the taxpayer’s Illinois business activity or market for goods and services. Even without IITA § 304(f), a taxpayer could always raise unconstitutional distortion to obtain an alternative apportionment method. *AT&T Teleholdings, Inc. v. Dep’t of Revenue*, 2012 IL App (1st) 110493, ¶ 44; *Miami*, 212 Ill.App.3d at 708; *Lakehead Pipe Line Co., Inc. v. Dep’t of Revenue*, 192 Ill.App.3d 756, 762–63 (1st Dist.1989); *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159, 170 (1983); *Moorman Manufacturing Co. v. Bair*, 437 U.S. 267, 272, (1978).

Because the ability to petition the Director for an alternative apportionment method does not rise to the level of a property interest, procedural due process does not guarantee Petitioner the right to seek or obtain an alternative apportionment method. Instead, as explained below, Petitioner was provided the opportunity under Illinois law to seek an alternative apportionment method. Petitioner did not avail itself of that opportunity and is foreclosed from doing so in this proceeding.

**B. Although Petitioner failed to avail itself of the process provided, the process was, and still is, available, therefore, due process is satisfied.**

Assuming, *arguendo*, procedural due process guaranteed Petitioner the right to submit a petition, that right only exists to the extent provided by an independent source (e.g., Illinois law). *Cleveland Bd. of Educ.*, 470 U.S. at 538 (“Property interests are not created by the Constitution, ‘they are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law . . . .’” (citing *Board of Regents*, 408 U.S. at 577

(1972)). The “independent source” that grants a limited right to petition for alternative apportionment is IITA § 304(f), as supplemented by Section 100.3390 of the Illinois Administrative Code. Section 304(f) of the IITA provides that if the allocation and apportionment provisions of IITA § 304(a) through (e) and (h) do not fairly represent the extent of the person’s business activity in this State, the person may petition for an alternative method. 86 Ill. Admin. Code § 100.3390(a). Reg. § 100.3390(e) provides the petition procedures for seeking alternative apportionment and states as follows:

e) Timely Filed Petitions. A taxpayer petition for use of a separate accounting method or any other alternative apportionment method will not be considered by the Director unless such petition has been timely filed. A taxpayer who petitions the Director for an alternative apportionment formula does so subject to the Department's right to verify, by audit of the taxpayer's return and supporting books and records within the applicable statute of limitations, the facts submitted as the basis of the petition. A petition for alternative allocation or apportionment is timely filed if the petition is filed:

- 1) 120 days prior to the due date of the tax return (including extensions) for which permission to use such alternative method is sought. A taxpayer who does not petition more than 120 days prior to the due date of the original return must file the return and pay tax according to the statutorily approved allocation or apportionment method.
- 2) as an attachment to a return amending an original return which was filed using the statutory allocation and apportionment rules. A taxpayer who has not filed a petition for alternative apportionment under subsection (e)(1) above, or whose subsection (e)(1) petition has been rejected, may thereafter file such petition with an amended return and the Department will consider the petition along with any other issues raised in the claim for refund pursuant to the procedures set forth at Section 100.9110 of this Part.
- 3) as part of a protest to a notice of deficiency issued as a result of the audit of the taxpayer's return and supporting books and

*records; provided that the audit adjustments being protested result in the need for the petition for alternative apportionment.* Alternative apportionment may not be raised in a protest to a notice of deficiency if such petition could have been submitted under subsection (e)(1) or (e)(2) above (i.e., the petition for an alternative apportionment formula is not necessitated by the proposed adjustments made to the taxpayer's return during the course of the audit).

86 Ill. Admin. Code § 100.3390(e) (emphasis added). Thus, there are three ways to file a petition for alternative apportionment. The petition procedures provided in Reg. § 100.3390 are the exclusive means by which a taxpayer may petition for alternative apportionment. 86 Ill. Admin. Code § 100.3390(b). Any attempt to invoke alternative apportionment by a method or procedure other than as specified in Reg. § 100.3390 is not a valid petition under IITA § 304(f). *Id.* The Director has sole and exclusive authority to grant a petition for an alternative apportionment formula. *Id.*

Under the first option, pursuant to Reg. § 100.3390(e)(1), Petitioner could have petitioned before the original return was due. It is undisputed that Petitioner did not file a 304(f) petition 120 days prior to the due date of the tax return. Petitioner claims it was “ineligible” to file a petition before filing its returns. Petitioner’s Motion, p.15. Petitioner’s belief that it was previously ineligible but is now eligible is based on its misunderstanding of IITA § 304(f), as thoroughly discussed in response to Counts I and II, *supra.*, and therefore not repeated here.

Irrespective of what effect P.A. 98-478 may or may not have had upon IITA § 304(f), the standard in satisfying the burden of proof in alternative apportionment has remained constant: the question is whether “the application of the statutory formula will lead to a grossly distorted result in a particular case . . . .” 86 Ill. Admin. Code § 100.3390(c). Thus, if Petitioner believed at the time it filed its returns that application of the statutory formula caused gross distortion (i.e.,

did not “fairly represent”) as applied to its circumstances, Petitioner was free to file a petition for alternative apportionment. Petitioner chose not to do so and instead now relies on an unpersuasive due process claim.

Petitioner’s argument with respect to Reg. § 100.3390(e)(2), the second method of petitioning, is precisely the same as with respect to Reg. § 100.3390(e)(1), meaning Petitioner has not made a Reg. § 100.3390(e)(2) specific argument. *See* Petitioner’s Motion, p.15. However, Taxpayer could have and may still file a petition for alternative apportionment in accordance with subsection (e)(2) of Regulation 100.3390. Although Taxpayer’s original return was not filed pursuant to the statutory method in IITA 304(a), Department has applied subsection (e)(2) to allow Taxpayer’s to file a petition for alternative apportionment so long as the taxpayer has filed any return – either original or amended – pursuant to the statutory method in 304(a) through (e) and (h). Dep’t of Revenue, General Information Letter No. IT-2010-0028-GIL, October 26, 2010. In General Information Letter IT-2010-0028, the taxpayer had petitioned for alternative apportionment after the due date of the return and had not filed its original return according to the statutory method. The Department stated:

In order to file a timely petition under Regulations Section 100.3390(e), you should first file an amended Form IL-1120-ST-X using the statutorily prescribed apportionment formula to compute and pay the required amount of Illinois tax. You may then file a second amended return including your petition for alternative apportionment as the basis of a claim for refund.

IT 10-0028-GIL, page 3, ¶1.<sup>11</sup> Additionally, Petitioner could pay the deficiency in the notices at issue (thereby agreeing to the statutory method) and then file a refund claim with a petition for

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<sup>11</sup> In the case at bar, Petitioner signed a Form IL-872 extending the date for issuing the Notice of Deficiency to February 15, 2015, and the date for filing an amended return to six months thereafter. Therefore, to date, this method is still available to Petitioner. (Dept’s Exhibit 10).

alternative apportionment. This method is still available to Petitioner. It is undisputed that Petitioner has not availed itself of this process. Thus, Petitioner chose not to exercise the second option.

Petitioner was not able to petition under Reg. § 100.3390(e)(3), the third and final option. Under this option, a taxpayer may petition as part of its protest of a deficiency, “provided that the audit adjustments being protested result in the need for the petition for alternative apportionment.” Here, Petitioner alleges that it was P.A. 98-478 and its retroactive effect that triggered the need for an alternative apportionment method. In other words, it was not the audit, as required in Reg. § 100.3390(e)(3). Further, Reg. § 100.3390(e)(3) provides “[a]lternative apportionment may not be raised in a protest . . . if such petition could have been submitted under . . . (e)(1) or (e)(2) above (i.e., the petition for an alternative apportionment formula is not necessitated by the proposed adjustments made to the taxpayer's return during the course of the audit).” Here, Petitioner could have timely filed under Reg. § 100.3390(e)(1) or (e)(2) but chose not to do so. Accordingly, consistent with the Reg. § 100.3390(e)(3) language, Petitioner’s petition was not necessitated by the audit; instead, the petition is allegedly necessitated by P.A. 98-478.

In sum, irrespective of P.A. 98-478, Petitioner could have timely petitioned for an alternative apportionment method. Petitioner failed to do so and should not be permitted to now circumvent the exclusive methods for petitioning under the guise of a procedural due process claim.

**C. Section 100.3390 of the Illinois Administrative Code, which provides the exclusive methods of petitioning for an alternative apportionment method, is valid on its face and may not be contravened.**

Here, in Count IV, the Tribunal is asked to decide whether Petitioner may seek IITA § 304(f) alternative apportionment outside the clear and valid regulations adopted by the Department. The Department's Reg. § 100.3390, is valid on its face and the Tribunal should therefore apply it as plainly written. "Administrative regulations have the force and effect of law and are interpreted with the same canons as statutes." *Hartney Fuel Oil Co. v. Hamer*, 2013 IL 115130, ¶ 38. "Additionally, administrative agencies enjoy wide latitude in adopting regulations reasonably necessary to perform the agency's statutory duty." *Id.* Pursuant to its authority to adopt regulations, the Department has adopted precise and detailed procedures delineating how a taxpayer may petition for alternative apportionment, and those "are the *exclusive means* by which a taxpayer may petition for an alternative apportionment formula." 86 Ill. Admin. Code § 100.3390(b) (emphasis added). "Pursuant to Section 304(f), the Director has *sole and exclusive authority* to grant a petition for an alternative apportionment formula." *Id.* (emphasis added).

If the Department's regulations interpreting and applying IITA § 304(f) have somehow missed the mark, the General Assembly is free to manifest any displeasure by revising the statute accordingly. The General Assembly has declined to do so. The General Assembly has authorized the Department to promulgate and enforce rules and regulations relating to the administration and enforcement of the Illinois Income Tax Act "as it may deem appropriate." 35 ILCS 5/1401(a). Thus, "[t]he legislature kn[ows] that interpretation [is] inevitable, and it [is] with this knowledge that the power to make regulations [is] given to the Department." *Illinois*

*Bell Tel. Co. v. Allphin*, 95 Ill. App. 3d 115, 125 (1981). Pursuant to its authority granted by the General Assembly, the Department promulgated 86 Ill. Admin. Code § 100.3390 in an effort to effectuate its obligation to administer IITA § 304(f).

There is no reason to believe that the Department's interpretation and application of IITA § 304(f), as effectuated through Reg. § 100.3390, is inconsistent with the General Assembly's intent. Reg. §100.3390 set forth the procedures for requesting alternative apportionment under IITA § 304(f) and became effective November 1, 1993. IITA § 304(f) has been amended many times since the adoption of Reg. §100.3390. At no point has the General Assembly revised the statute so as to alter the Department Director's authority under the statute as explained in detail in Reg. §100.3390. If the General Assembly desired to extend such authority to the Tribunal, and beyond the realm of the Department, it easily could have done so when it enacted the relevant provisions giving life to the Tribunal. To boot, as discussed above, the General Assembly recently amended IITA § 304(f), but chose not to do so in such a way that would alter the applicability of Reg. § 100.3390(b). *See* P.A. 98-478, § 5, eff. Jan. 1, 2014. Petitioner now seeks to vicariously amend the statute by extending the Department's authority to the Tribunal.

**D. The present matter provides Petitioner with a fair hearing before a fair Tribunal thereby satisfying Petitioner's right to procedural due process.**

As stated above, procedural due process requires "a fair hearing before a fair tribunal." *Van Harken v. City of Chicago*, 305 Ill.App.3d 972, 983 (1st Dist. 1999) *citing Colquitt v. Rich Township High School, District No. 227*, 298 Ill.App.3d 856, 865 (1998). "However, procedural due process in an administrative proceeding does not require a proceeding in the nature of a judicial proceeding, but is satisfied by a form of procedure that is suitable and proper to the nature of the determination to be made and conforms to fundamental principles of justice." *Id.* A

fair hearing includes “the opportunity to be heard, the right to cross-examine adverse witnesses, and impartiality in ruling upon the evidence . . . .” *Lakeland Const. Co., Inc. v. Dep't of Revenue*, 62 Ill.App.3d 1036, 1040 (2d Dist. 1978) *citing Gigger v. Board of Fire and Police Com'rs*, 23 Ill.App.2d 433, 437-439 (1960).

Assuming, *arguendo*, Petitioner has a due process right, the instant matter, wherein Petitioner requests this Tribunal accept its petition for alternative apportionment, whether the Tribunal decides it may decide upon the merits of the petition or not, constitutes being “heard.” Petitioner has not argued, nor should it, that this Tribunal will somehow shortchange or deprive Petitioner of a fair and impartial process. Procedural due process is therefore satisfied. The procedural due process analysis is truly that simple. However, whether the Tribunal should actually grant Petitioner’s request for alternative apportionment is a separate issue, and is answered in the negative, as discussed *infra*.

For any of the above reasons, the Tribunal should deny Petitioner’s motion for summary judgment with respect to Count IV, and instead rule in favor of the Department.

**E. This Tribunal does not have jurisdiction to hear the merits of Petitioner’s proposed alternative apportionment method in the instant matter.**

Compliance with the petition procedures prescribed in Reg. § 100.3390(e) is critical, in part, because the General Assembly only gave the Tribunal jurisdiction to adjudicate determinations made by the Department as evidenced in a notice (here, the NOD). The General Assembly in creating the Tribunal’s jurisdiction provided that “the Tax Tribunal shall have original jurisdiction over all determinations of the Department reflected on a Notice of Deficiency . . . .” 35 ILCS 1010/1-45(a). Thus, a taxpayer may not petition the Tribunal for relief against a Department determination that does not exist. Because Petitioner now raises the

IITA § 304(f) issue for the first time, the Department did not have an opportunity to make a determination with respect to Petitioner's alternative apportionment petition, and therefore it is not a protestable issue. Accordingly, the Tribunal simply does not have jurisdiction to adjudicate this question. 35 ILCS 1010/1-45(a). Had the General Assembly seen fit, it could have amended IITA § 304(f) to allow taxpayers to petition the Tribunal for relief. Instead, it maintained the long-standing interpretation in Reg. § 100.3390 that a taxpayer must petition the Director for permission to use an alternative apportionment method.

To be clear, the Department has not intended to claim or imply that no taxpayer may petition the Tribunal with respect to an IITA § 304(f) petition. Generally, if a taxpayer timely petitions the Department for alternative apportionment in accordance with Reg. § 100.3390, and should the Director decline to adopt the taxpayer's proposed alternative method, the Department has then made a determination and the proposed alternative apportionment method would therefore be included in a protestable notice. Here, the Department asserts that this particular taxpayer, Petitioner, may not do so for the reasons already provided.

Taxpayer cites *Miami Corporation v. Department of Revenue*, 212 Ill. App. 3d 702 (1991) as authority for its assertion that this Tribunal can and should "declare that Petitioner's original 2009 and 2010 returns provide a fair reflection of the Illinois market . . . pursuant to section 304(f)." Taxpayer's Motion for Summary Judgment, pg. 15. In *Miami*, the taxpayer filed its original return using a method other than the statutory method in 304(a) through (e) and (h). *Id.* at 705-6. Department issued Miami a Notice of Deficiency. Miami paid the Notice of Deficiency. Miami then timely filed a claim for refund (amended return). Department denied the claim for refund, and issued Miami a Notice of Claim Denial. Miami protested the Notice of

Claim Denial. A hearing was held before the Department's administrative hearings division. The ALJ held that Miami was required to use the statutory method. *Id.* at 706. Miami appealed. The circuit and appellate courts overturned the ALJ's decision.

In *Miami*, the reviewing courts had jurisdiction to review the taxpayer's petition for alternative apportionment because the Department had issued a Notice of Claim Denial to the taxpayer denying its use of an alternative method in its amended return (refund claim). In the case at bar, Petitioner is attempting to skip this step. Instead of filing a petition for alternative apportionment pursuant to 100.3390 and therein making a showing that the statutory method in 304(a) grossly distorts Petitioner's Illinois apportionable income, Petitioner asks this Tribunal to omit such a determination. As a remedy to the alleged denial of procedural due process, Petitioner asks this Tribunal to order the Department to accept Petitioner's original returns (which used an alternative apportionment method) without determining whether the statutory method does "not accurately and fairly reflect business activity in Illinois" or leads "to a grossly distorted result." 86 Ill. Admin. Code § 100.3390(c). Such a request ignores the regulation and settled law, which holds that the party who desires to use an apportionment formula that differs from the ones set forth in § 304(a)-(e) and (h) of the IITA has the burden to show by clear and cogent evidence that the income attributed to the State is in fact out of all appropriate proportions to the business transacted in that State, or has led to a grossly distorted result. *AT & T Teleholdings, Inc. v. Dep't of Revenue*, 2012 IL App (1st) 110493, ¶ 44; *Miami*, 212 Ill.App.3d at 708; *Lakehead Pipe Line Co., Inc. v. Dep't of Revenue*, 192 Ill. App. 3d 756, 762-63 (1st Dist.1989); *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159, 170 (1983); *Moorman Manufacturing Co. v. Bair*, 437 U.S. 267, 272, (1978). Additionally, as this Tribunal

held in its Order denying Summary Judgment in docket number 14-TT-229, to require the Department to accept Petitioner's figures as reported and preclude it as a matter of law from questioning those figures "would turn the law on its head as a taxpayer has the burden of proving clearly it is entitled to" the relief sought. Order of the Illinois Independent Tax Tribunal, Docket No. 14-TT-229, June 30, 2015.

Should this Tribunal hold that the retroactive amendment of Section 304(f) deprived Petitioner of procedural due process to petition for alternative apportionment, the appropriate remedy is to provide Petitioner with the procedure it was denied. *Dargis v. Sheahan*, 526 F.3d 981, 989 (7th Cir. 2008) (proper remedy was to provide a hearing); *Gilbert v. Homar*, 520 U.S. 924, 930 (1997) ("[W]here it would be impractical to provide predeprivation process, postdeprivation process satisfies the requirements of the Due Process Clause."). A court should not consider the merits of the underlying action. *Dargis*, 526 F.3d at 989. Here, Petitioner claims that its due process was denied when it could not file a petition for alternative apportionment. Thus, if this Tribunal finds that this process was due and denied, the proper remedy for Petitioner is to allow Petitioner to file a petition for alternative apportionment with the Director (which it could do by paying the tax in the Notice, filing an amended return (claim for refund) and attaching a petition for alternative apportionment). 86 Ill. Admin. Code § 100.3390(e)(2).

**F. In the alternative, if this Tribunal finds against the Department on all the above legal arguments concerning Count IV, Petitioner's proposed alternative apportionment method is not ripe for summary judgment.**

Finally, should this Tribunal find that the procedure for petitioning for alternative apportionment in IITA § 304(f) is a property right that was deprived by the retroactive effect of

P.A. 98-0478, and that the proper remedy is for this Tribunal to hear the merits of Petitioner's alternative apportionment argument, then this Tribunal must hold that the issue is not ripe for summary judgment. To receive an alternative apportionment method, the Petitioner must show that the income attributed to Illinois is out of all proportion to the business activity in Illinois. *Moorman Manufacturing Co. v. Bair*, 437 U.S. 267, 272 (1978); 86 Ill. Admin. Code § 100.3390(c) ("The party (the Director or the taxpayer) seeking to utilize an alternative apportionment method has the burden o[f] going forward with the evidence and proving by clear and cogent evidence that the statutory formula results in the taxation of extraterritorial values and operates unreasonably and arbitrarily in attributing to Illinois a percentage of income which is out of all proportion to the business transacted in this State. In addition, the party seeking to use an alternative apportionment formula must go forward with the evidence and prove that the proposed alternative apportionment method fairly and accurately apportions income to Illinois based upon business activity in this State."). This is a mixed question of law and fact, for which Petitioner has provided no facts to show that its original returns meet the above standard. Additionally, Petitioner has not made the necessary showing through documentary evidence to meet its burden of proof. *Mel-Park Drugs, Inc. v. Dep't of Revenue*, 218 Ill. App. 3d 203, 217 (1st Dist. 1991) ("To overcome the Department's prima facie case, a taxpayer must present more than its testimony denying the accuracy of the assessments, but must present sufficient documentary support for its assertions.") For these reasons, if this Tribunal finds against the Department in Count IV, the Tribunal should deny Petitioner's motion for summary judgment and order the parties to proceed with discovery.

#### IV. CONCLUSION

For the reasons stated above, the Department respectfully moves this Tribunal to grant the Department's Motion for Summary Judgment and Response to Petitioner's Motion for Summary Judgment and deny Petitioner's Motion for Summary Judgment regarding Counts I, II and IV as set forth in Petitioner's petition filed in this matter.

Respectfully submitted,

**LISA MADIGAN**  
**ATTORNEY GENERAL, STATE OF ILLINOIS**  
By:

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Date: August 10, 2015

ILLINOIS INDEPENDENT TAX TRIBUNAL  
CHICAGO, ILLINOIS

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**THE DEPARTMENT OF REVENUE  
OF THE STATE OF ILLINOIS**

v.

**Innophos Holdings, Inc.  
Petitioner**

**Docket No. 14-TT-214**

**James M. Conway,  
Administrative Law Judge**

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**CERTIFICATE OF SERVICE BY ELECTRONIC MAIL TRANSMISSION**

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The undersigned Representative for the Illinois Department of Revenue (the "Department") certifies that, on August 10, 2015, he served the Department's Motion for Summary Judgment and Response to Petitioner's Motion for Summary Judgment on the individuals identified above, two of Petitioner's attorneys, at the electronic mail address shown above.

Respectfully submitted,

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