

to impute both property and payroll for purposes of the 80/20 Test, this Tribunal must grant summary judgment in IBM's favor.

Illinois tax law expressly provides that an entity whose business activity outside the United States is 80% or more of that entity's total business activity (commonly referred to as an "80/20 Company") cannot be included in an Illinois unitary combined return. 35 Ill. Comp. Stat. 5/1501(a)(27)(A). To determine whether an entity is an 80/20 Company, Illinois tax law requires the comparison of that entity's United States business activity to worldwide business activity, and analyzes that entity's property and payroll ("80/20 Test"). 35 Ill. Comp. Stat. 5/1501(a)(27)(A); Ill. Admin. Code tit. 86, § 100.9700(c).

IBM correctly determined that IBM World Trade Corporation ("WTC"), a wholly-owned subsidiary of IBM, constituted an 80/20 Company that must be excluded from IBM's Illinois unitary combined returns for the tax years ended December 31, 2007 and December 31, 2008 ("Years at Issue"). IBM provided sufficient support for WTC's 80/20 Test calculation both in its tax returns and throughout the audit. *See* Affidavit attached as Exhibit A.

There are no material facts in dispute related to the issue in IBM's Motion. As such, summary judgment is appropriate here. 735 Ill. Comp. Stat. 5/2-1005. The Department does not have legal authority to impute property and payroll for purposes of the 80/20 Test. Therefore, this Tribunal must grant IBM's Motion.

II. ARGUMENT

A motion for summary judgment is appropriate where the pleadings, affidavits, and other documents on file show that there is no genuine issue as to any material fact on a particular issue and that the moving party is entitled to judgment as a matter of law. 735 Ill. Comp. Stat. 5/2-1005(c). IBM has put forth sufficient evidence demonstrating that WTC is an 80/20

Company. As a matter of law, the Department does not have the legal authority to impute property or payroll for purposes of determining whether an entity is classified as an 80/20 Company. There are no additional facts that need to be considered in order to make a determination regarding whether the Department is entitled to impute property and payroll from IBM to WTC for purposes of determining whether IBM is an 80/20 Company. Accordingly, as discussed below, IBM's Motion is proper and IBM is entitled to summary judgment.

A. IBM's Motion is Proper

The Department asserts that IBM's Motion is legally insufficient. The Department is incorrect. Moreover, even if IBM's Motion is treated as a Motion for Judgment on the Pleadings, as argued by the Department, IBM still prevails.

i. IBM's Motion is legally sufficient

First, Illinois law expressly provides that, “[a]ny time after the opposite party has appeared or after the time within which he or she is required to appear has expired, a plaintiff may move with or without supporting affidavits for a summary judgment in his or her favor for all or any part of the relief sought.” 735 Ill. Comp. Stat. 5/2-1005(a). The Department filed an Answer and, thus, has appeared in this case. Accordingly, IBM was specifically permitted by statute to file a Motion for Summary Judgment.

Second, the Department's statement that “a proper Motion for Summary Judgment must contain either an Affidavit attesting to the undisputed material facts, or the Petition must be verified,” is incorrect. Opposition, ¶ 3. As referenced above, the statute governing Motions for Summary Judgment specifically provides that a plaintiff is *not* required to provide an affidavit in support of a Motion for Summary Judgment. *See* 735 Ill. Comp. Stat. 5/2-1005(a) (“a plaintiff may move *with or without supporting affidavits* for a summary judgment in his or her favor for

all or any part of the relief sought.” (emphasis added)). In addition, there is nothing in the statute governing Motions for Summary Judgment requiring a plaintiff to have filed a verified Petition as a prerequisite for filing a proper Motion for Summary Judgment. *See* 735 Ill. Comp. Stat. 5/2-1005. Similarly, the case law the Department cites in support of its statement does not require an affidavit or a verified Petition for a Motion for Summary Judgment. IBM has, however, submitted an Affidavit with this Reply that addresses the contentions in the Affidavits submitted with the Department’s Response. A copy of the Affidavit is attached as Exhibit A.

Finally, the case law the Department relies upon actually supports the sufficiency of IBM’s Motion for Summary Judgment. The Department cites *Tomkins v. France*, 21 Ill.App.2d 227 (1st Dist. 1959) and *State Farm Fire & Casualty Co. v. Kleckner*, 194 Ill. App. 3d 371 (2d Dist. 1990) to articulate the difference between a Motion for Summary Judgment and a Motion for Judgment on the Pleadings. Opposition, ¶ 2. These cases both indicate that a Motion for Judgment on the Pleadings asserts that the movant is entitled to judgment solely on the basis of the pleadings, while a Motion for Summary Judgment may be based on affidavits, deposition transcripts, and other documents in order to establish the absence of a factual issue. *See Tomkins*, 21 Ill.App.2d at 230-231; *State Farm*, 194 Ill. App. 3d at 375. IBM is not relying solely on the pleadings. Rather, in addition to the admissions made by the Department in its Answer, IBM is relying on documents that the Department prepared after an extensive audit of IBM (*i.e.*, the Department’s own workpapers) to demonstrate the absence of a factual issue. The Department’s workpapers illustrate that without imputing property and payroll from IBM to WTC, WTC is an 80/20 Company. A copy of the Department’s workpapers was attached to both IBM’s Petition and IBM’s Motion. The Department did not contest the validity of its

workpapers in its Answer or in its Opposition. Accordingly, IBM's Motion is properly classified as a Motion for Summary Judgment.

- ii. Even if IBM's Motion is treated as a Motion for Judgment on the Pleadings, IBM prevails

The Department asserts that if IBM's Motion is treated as a Motion for Judgment on the Pleadings, the Department may rely on its Answer to establish a triable issue of fact, and that its Answer raises triable issues of fact "as to WTC's U.S. business activity." Opposition, p. 6. However, the Department's Answer *does not* raise a triable issue of fact in the context of IBM's Motion, which focuses on whether the Department had the legal authority to impute both property and payroll for purposes of the 80/20 Test pursuant to 35 Ill. Comp. Stat. 5/1501(a)(27)(A). IBM's Motion, even if construed as a Motion for Judgment on the Pleadings, raises a pure legal issue. There are no facts that need to be determined to rule on the legal issue as to whether the Department had the legal authority to impute both property and payroll for purposes of the 80/20 Test. Accordingly, even if IBM's Motion is treated as a Motion for Judgment on the Pleadings, IBM prevails.

B. IBM put forth sufficient undisputed evidence demonstrating that WTC is an 80/20 Company

The Department improperly asserts that IBM failed to provide any documentation demonstrating that WTC met the 80/20 Test. IBM provided support for its position that WTC is an 80/20 Company both in its tax returns and throughout the audit. *See* Exhibit A. The figures IBM provided regarding WTC's property and payroll were reflected in the Department's 80/20 workpapers, which also included property and payroll that the Department imputed, or allocated, from IBM to WTC. Without the imputed, or allocated, property and payroll, the Department's

workpapers demonstrate that WTC is an 80/20 Company. There is no additional documentation that IBM needs to provide to demonstrate that WTC is an 80/20 Company.

Moreover, the absence of certain documentation regarding WTC's property and payroll in the U.S. further supports IBM's position. IBM cannot provide documentation regarding property and payroll that does not exist. IBM has provided to the Department all relevant information regarding WTC's property and payroll. *See* Exhibit A.

Because IBM provided sufficient documentation supporting that WTC was an 80/20 Company, the Department resorted to unverified websites to conceive information to recharacterize WTC's proper status as an 80/20 Company. *See* Answer ¶¶ 40, 87. The Department cannot conjure inaccurate information simply because the Department does not like the result of the supporting documentation IBM provided.

The Department improperly asserts that IBM failed to present documentation showing the correctness of WTC's property and payroll factors. *Opposition*, p. 22. As reflected in the Department's own workpapers, which IBM presented with its Petition and its Motion, if the Department cannot impute property and payroll to WTC, WTC constitutes an 80/20 Company.

C. The Department does not have legal authority to impute property and payroll from one company to another for the 80/20 Test

Whether the Department has the legal authority to impute both property and payroll from one company to another for purposes of the 80/20 Company determination is a pure legal question. Illinois statutes expressly mandate which entities are included in a combined return, and how to determine if an entity is an excluded 80/20 Company. Illinois tax law provides no authority to deviate from these statutory mandates. The Department cannot impute property or payroll from one entity to another to disregard the statutory classification of an entity as an 80/20 Company in contravention of Illinois tax law.

Illinois tax law expressly limits the composition of a unitary combined return to a water's-edge combined filing methodology. 35 Ill. Comp. Stat. 5/1501(a)(27)(A). A taxpayer must compute each unitary entity's business activity to determine whether it is included in the Illinois water's-edge unitary combined group return. Illinois tax law expressly provides that an 80/20 Company cannot be included in the Illinois unitary combined return. 35 Ill. Comp. Stat. 5/1501(a)(27)(A). An Illinois unitary combined group does not include a unitary entity if its business activity outside the United States is 80% or more of its total business activity, *i.e.*, an 80/20 Company, as set forth in Illinois statute. *Id.*; *see also Dover Corp. v. Illinois Dep't of Revenue*, No.98 L 50170 (Ill. Cir. Ct. Cook Jan. 14, 2000) (granting summary judgment excluding an 80/20 Company as a matter of law).

Illinois tax law requires the taxpayer to compare United States business activity to worldwide business activity for each entity, *i.e.*, the 80/20 Test. 35 Ill. Comp. Stat. 5/1501(a)(27)(A); Ill. Admin. Code tit. 86, § 100.9700(c). The 80/20 Test involves two fractions—property and payroll. 35 Ill. Comp. Stat. 5/1501(a)(27)(A); Ill. Admin. Code tit. 86, § 100.9700(c). Pursuant to Illinois statute, the numerators of the fractions represent that entity's property and payroll from sources within the United States, and the denominators of the fractions represent that entity's respective worldwide property and payroll. 35 Ill. Comp. Stat. 5/1501(a)(27)(A); Ill. Admin. Code tit. 86, § 100.9700(c) (emphasis added). The taxpayer must compute each entity's property and payroll fractions using the calculation set forth in Illinois statute. Ill. Admin. Code tit. 86, § 100.9700(c). A taxpayer must average the two fractions to arrive at its business activity fraction. *Id.* **No Illinois statute or regulation provides the**

authority for the Department or a taxpayer to deviate from the statutory 80/20 Test calculation.¹

Illinois tax law provides that, for purposes of the 80/20 Test, the property and payroll to be measured is that of the entity being analyzed—not property or payroll of some other entity. 35 Ill. Comp. Stat. 5/304(a)(1)(A), (a)(2)(A); Ill. Admin. Code tit. 86, §§ 100.3350(a), (d)-(f), 100.3360(a); *see Ill. Dep't of Revenue v. Shanghai, Inc.*, IT 02-1 (Office of Admin. Hearings Feb. 7, 2002).

i. The Department misinterprets *Zebra*

Illinois statutes expressly mandate which entities are included in a combined return, and how to determine if an entity is an excluded 80/20 Company. In its Opposition, the Department fails to identify any statute that allows it to deviate from these statutory requirements. Rather, the Department focuses on IBM's reference to the Department's Office of Administrative Hearings decision in *Shanghai* and the Illinois First District Appellate Court's decision in *Zebra Technologies Corp. v. Topinka*, 344 Ill.App.3d 474 (1st Dist. 2003). The Department asserts that *Shanghai* was overruled by *Zebra*, and that *Zebra* "established the Department's right to allocate property and payroll" for purposes of making an 80/20 Company determination. Opposition, p. 18. The Department is incorrect.

Zebra did not expressly overrule, or even address, *Shanghai*. Moreover, *Zebra* is distinguishable from *Shanghai* and this case.

The Department's economic substance challenge was essential in *Zebra*. In *Zebra*, the court focused on whether *Zebra* supported that its two Bermuda-based subsidiaries were 80/20 Companies. *Zebra* transferred all of its intellectual property to its subsidiaries, which then

¹ *See Ill. Dep't of Revenue v. Shanghai, Inc.*, IT 02-1 (Office of Admin. Hearings Feb. 7, 2002) (stating that "[n]one of the Department's regulations... expressly authorize the reallocation the Department proposes here." (emphasis added)).

licensed the intellectual property back to Zebra and its affiliated companies and charged a royalty. *Zebra*, 344 Ill. App. 3d at 478. The subsidiaries employed only one individual to manage the business affairs for the companies. *Id.* at 478. Instead of the contractually required quality control being performed by the subsidiaries, it was performed by Zebra, and the subsidiaries did not pay Zebra for the services. *Id.* at 483. The Department challenged the economic substance of the subsidiaries. *Id.* at 484-85. The court determined that, because Zebra knew the extent to which the contractually obligated quality control activity was conducted in the U.S., it could have calculated the percentage of the activities conducted within and without the U.S. in order to show compliance with the 80/20 Test. *Id.* at 484. Accordingly, even though the court found that all of the subsidiaries' property was located outside of the U.S., it held that Zebra did not produce the payroll evidence necessary to show that the subsidiaries constituted 80/20 Companies. *Id.* Although the court did not expressly reach the economic substance argument, it was crucial because based on the relationship between Zebra and the subsidiaries, it was clear that Zebra was performing substantial, uncompensated activities to support the subsidiaries that had virtually no economic substance.

There is no economic substance challenge in this case.² IBM provided documentation that illustrated WTC's substantial property and payroll outside the U.S. *See* Exhibit A. IBM does not provide substantial, uncompensated activities to support WTC. Rather, WTC supports itself through hundreds of employees that perform its operational activities—almost exclusively outside the U.S. *See* Exhibit A; Answer, ¶ 23. WTC compensates IBM for research and development costs pursuant to a Cost Share Agreement. *See* Answer, ¶¶ 16, 18. Because there

² The Department has never challenged WTC's economic substance, and has informally conceded that WTC does have economic substance (including on the March 31, 2015, status call with the Tribunal).

is no economic substance challenge in this case, the Department cannot rely on *Zebra* as authority to impute property and payroll from one entity to another for the 80/20 Test.

In *Shanghai*, the Administrative Law Judge recognized that there was no authority that allowed the Department to transform one entity's employees into another entity's employees merely because they perform minor services for the latter. The Administrative Law Judge also determined that there was no authority in Illinois that allowed the Department to impute, or allocate, property from one entity to another. The Administrative Law Judge stated that there was no authority that when one company hires another to perform services for it, the hiring company can be considered to be renting or leasing whatever property the hired company uses when performing such services. Ultimately, the Administrative Law Judge determined that the Department did not have the authority to reallocate to one company property or payroll that is properly allocable to another company, and concluded that the entity in question was an 80/20 Company.

Furthermore, *Zebra* addressed only the payroll factor of the subsidiaries at issue—it did not address the property factor. In *Zebra*, all of the subsidiaries' property was determined to be located in Bermuda. Therefore, *Zebra* cannot stand for the proposition that the Department may impute, or allocate, property from one entity to another.

The Department does not have authority to impute, or allocate, property and payroll for the 80/20 Test. No Illinois statute or regulation provides the authority for the Department or a taxpayer to deviate from the statutory 80/20 Test calculation. The only authority the Department cites, *Zebra*, is inapplicable absent an economic substance challenge. Furthermore, *Zebra* did not allow the Department to allocate property for the 80/20 Test. Therefore, the Department cannot impute, or allocate, property and payroll from IBM to WTC for the 80/20 Test.

D. There are no material facts in dispute because this Motion presents a pure legal question

There are no additional facts necessary for this Tribunal to determine whether the Department has the legal authority, pursuant to Illinois statute, to impute property and payroll from IBM to WTC for purposes of the 80/20 Test.

The Department's workpapers demonstrate that it imputed, or allocated, property and payroll from IBM to WTC for purposes of determining whether WTC is an 80/20 Company. Whether the Department is entitled to impute property and payroll from IBM to WTC for purposes of determining whether WTC is an 80/20 Company is purely a question of law. If the Department does not have the authority to impute, or allocate, property and payroll from one entity to another, the Department's own workpapers demonstrate that WTC is an 80/20 Company.

Accordingly, because the Department does not have the authority to impute, or allocate, property and payroll from IBM to WTC, WTC constitutes an 80/20 Company. Therefore, this Tribunal must grant IBM's Motion for Summary Judgment.

III. CONCLUSION

For the reasons stated above and in IBM's Motion, IBM respectfully requests that this Tribunal find there are no genuine issues of material fact related to the issue of whether the Department has the legal authority to impute payroll and property from one entity to another for purposes of the 80/20 Test and, therefore, that IBM is entitled to judgment as a matter of law. IBM respectfully requests this Tribunal grant IBM's Motion for Summary Judgment and eliminate the Department's Notices.

Respectfully submitted,

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