ILLINOIS INDEPENDENT TAX TRIBUNAL

MERCK SHARP & DOHME CORP.	**)**	
(F/K/A SCHERING CORPORATION),	**)**	
	)	
Petitioner,	**)**	
v.	**)**	**No. 16 TT 177**
	)	
ILLINOIS DEPARTMENT OF REVENUE	**)**	**Judge Brian F. Barov**
	)	
Respondent.	**)**	

RESPONDENT'S ANSWER TO PETITION

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

THE PARTIES

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

   ANSWER: The Department admits the allegations in Paragraph 1.

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

   ANSWER: The Department admits the allegations in Paragraph 2.

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

   ANSWER: The Department admits the allegations in Paragraph 3.

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

   ANSWER: The Department admits the allegations in Paragraph 4.

5. Respondent is the Illinois Department of Revenue (the "Department").

   ANSWER: The Department admits the allegations in Paragraph 5.

JURISDICTION

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

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

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

BACKGROUND

7. The Department conducted an income tax audit of Schering with respect to the tax year ended December 31, 2001 (the "Tax Year").

   ANSWER: The Department admits the allegations in Paragraph 7.

8. As a result of the audit, the Department issued a Notice of Deficiency (the "Original Notice") for the Tax Year through which it assessed $2,340,474.00 of income tax, $1,220,189.00 of personal property tax replacement income tax (hereinafter, referred to collectively as "Tax"), interest of $4,663,605.43, and penalty of $500.00. A copy of the Original Notice is attached hereto as Exhibit A.

   ANSWER: A copy of the Original Notice is not a material allegation of fact, and therefore does not require an answer pursuant to Rule 310(b)(2). The Department admits that the Department issued a Notice of Deficiency dated March 22, 2016, to Merck Sharp & Dohme, Corp. for the period ending December 2001 in the amount of $8,224,768.43, of which $3,560,663.00 was the total net income and replacement tax due, a late-filing penalty of $500.00, and interest of $4,663,605.43. The Department states the Original Notice speaks for itself. The Department further states that an Amended Notice of Deficiency ("Amended Notice") was issued on July 26, 2016, which amended the Original Notice to include late estimated payment or underpayment penalty as allowed under 35 ILCS 735/3-3(b-10)(1), as well as updated interest through the date of the Amended Notice. A copy of the Amended Notice is attached to the Petition as Exhibit C.

9. Schering filed a petition with the Illinois Independent Tax Tribunal (the "Tribunal) protesting the Original Notice on May 18, 2016. Through its order dated May 20, 2016 (the "Order"), the Tribunal accepted Schering's petition with respect to the Original Notice. A copy of the Order is attached hereto as Exhibit B.

   ANSWER: The Department admits the allegations in Paragraph 9.

10. On July 26, 2016, the Department issued a second Notice of Deficiency (the "Notice") for the Tax Year through which it asserted $2,340,474.00 of income tax, $1,220,189.00 of personal property tax replacement income tax, interest of $4,742,086.09, and penalties of $961,879.02. The Notice is attached hereto as Exhibit C.

    ANSWER: The Department admits that it issued an amended Notice of Deficiency (the Amended Notice, as that term is defined in the Answer to Paragraph 8) for the Tax Year, through which it asserted $2,340,474.00 of income tax, $1,220,189.00 of personal property tax replacement income tax, interest of $4,742,086.09, and penalties of $961,879.02. The Department further admits that a copy of the Amended Notice is attached to the Petition as Exhibit C. The Department denies the remaining allegations in Paragraph 10.

11. Through the Notice, the Department asserted additional Tax [sic], interest, and penalties for the Tax Year on the same bases as it assessed Tax [sic], interest, and penalties through the Original Notice, but also asserted a late payment or underpayment penalty for the first time under 35 ILCS 735/3-3(b-10)(1).

    ANSWER: The Department denies that any additional tax was asserted on the Amended Notice. The Department admits that the Amended Notice amended the Original Notice to include late estimated payment or underpayment penalty as allowed under 35 ILCS 735/3-3(b-10)(1), as well as updated interest under 35 ILCS 735/3-2 through the date of the Amended Notice. The Department further states the Amended Notice speaks for itself. The Department denies the remaining allegations in Paragraph 11.

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

    ANSWER: The statements in Paragraph 12 contain legal conclusions, not material allegations of fact, and therefore do not require an answer pursuant to Rule 310(b)(2).

13. Through the Notice, the Department asserted that Schering and certain of Schering's subsidiary entities engaged in a unitary business in Illinois during the Tax Year.

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

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

    ANSWER: The Department denies the allegations in Paragraph 14.

ERRORS OF THE DEPARTMENT OF REVENUE

Error 1

15. Through the Notice, the Department violated Illinois law because the Department is barred from issuing a further or additional notice of deficiency for the Tax Year under 35 ILCS 5/906.

    ANSWER: The Department denies that 35 ILCS 5/906 applies to this matter, because there is no final decision on the Original Notice or the Amended Notice. The Department denies the allegations contained in Paragraph 15 and states further that statements contain legal conclusions, not material allegations of fact, and therefore do not require an answer pursuant to Rule 310(b)(2).

16. Because the Department is barred from issuing a further or additional notice of deficiency for the Tax Year under 35 ILCS 5/906, the Notice is void *ab initio* and should therefore be stricken.

ANSWER: The Department denies that 35 ILCS 5/906 applies to this matter, because there is no final decision on the Original Notice or the Amended Notice. The Department denies the allegations contained in Paragraph 16 and states further that statements contain legal conclusions, not material allegations of fact, and therefore do not require an answer pursuant to Rule 310(b)(2).

Error 2

17. Through the Notice, the Department erroneously asserted late payment or underpayment, late-filing, and double penalties under 35 ILCS 735/3-3(a-10), (b-10)(1) and (i) because Schering had reasonable cause for not filing tax returns or making tax payments by the payment due dates. 35 ILCS 735/3-8; Ill. Admin. Code § 700.400; see Security Life of Denver Insurance Company v. Illinois Department of Revenue, 14 TT 89 (Ill. Indep. Tax Tribunal 2016).

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

18. The Department's improper application of late payment or underpayment, late-filing, and double penalties under 35 ILCS 735/3-3(a-10), (b-10)(1) and (i) violated the Due Process Clause of the United States Constitution by arbitrarily and unreasonably penalizing Schering for a tax liability that was not known to Schering through no fault of its own and despite Schering's exercise of good faith in determining its tax liability. 35 ILCS 735/3-8; Ill. Admin. Code § 700.400; see Security Life of Denver Insurance Company v. Illinois Department of Revenue, 14 TT 89 (Ill. Indep. Tax Tribunal 2016).

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

Error 3

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

    ANSWER: The Department denies the allegations contained in Paragraph 19 and states further that statements contain legal conclusions, not material allegations of fact, and therefore do not require an answer pursuant to Rule 310(b)(2).

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

ANSWER: The Department denies the allegations contained in Paragraph 20 and states further that statements contain legal conclusions, not material allegations of fact, and therefore do not require an answer pursuant to Rule 310(b)(2).

Error 4

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

ANSWER: The Department denies the allegations contained in Paragraph 21 and states further that statements contain legal conclusions, not material allegations of fact, and therefore do not require an answer pursuant to Rule 310(b)(2).

Error 5

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

ANSWER: The Department denies the allegations contained in Paragraph 22 and states further that statements contain legal conclusions, not material allegations of fact, and therefore do not require an answer pursuant to Rule 310(b)(2).

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

ANSWER: The Department denies the allegations contained in Paragraph 23 and states further that statements contain legal conclusions, not material allegations of fact, and therefore do not require an answer pursuant to Rule 310(b)(2).

Error 6

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

ANSWER: The Department denies the allegations contained in Paragraph 24.

RELIEF REQUESTED

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

25. Striking the Notice as invalid;

ANSWER: The Department denies the allegations contained in Paragraph 25, and asks that this Tribunal uphold the Original Notice and the Amended Notice.

26. Declaring and adjudging that all Tax [sic], penalties, and interest asserted through the Notice are invalid; and

ANSWER: The Department denies the allegations contained in Paragraph 26, and asks that this Tribunal uphold the Original Notice and the Amended Notice.

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

ANSWER: The Department denies the allegations contained in Paragraph 27 in so far as it seeks relief for the Petitioner, and asks that this Tribunal uphold the Original Notice and the Amended Notice in favor of the Department.

Respectfully submitted,

Illinois Department of Revenue

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

By: /s/ Daniel A. Edelstein
Daniel A. Edelstein
Special Assistant Attorney General

Date: September 30, 2016

Rebecca.Kulekowskis@Illinois.gov
Sean.Cullinan@Illinois.gov
Daniel.Edelstein@Illinois.gov

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

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ILLINOIS DEPARTMENT OF REVENUE	)	**Judge Brian F. Barov**
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CERTIFICATE OF SERVICE

Daniel A. Edelstein certifies that he is a Special Assistant Attorney General of the State of Illinois duly appointed by Lisa Madigan, Attorney General of the State of Illinois; that he is authorized to make this certificate; that on **September 30, 2016**, before the hour of 5:00 p.m. (C.S.T) he served a true and exact copy of the foregoing instrument entitled **RESPONDENT'S ANSWER TO PETITION** on the above Taxpayer/Petitioner by sending same as an attachment to an electronic mail message addressed to the following individuals at their designated email addresses:

Fahad.saghir@Alston.com
Richard.Kariss@Alston.com
Brian.Barov@illinois.gov

/s/ Daniel A. Edelstein

Daniel A. Edelstein
Special Assistant Attorney General
Illinois Department of Revenue
Office of Legal Services
100 W. Randolph St., 7-900
Chicago, IL 60601

Telephone: (312) 814-3120
Facsimile: (312) 814-4344
Email: Daniel.Edelstein@Illinois.gov