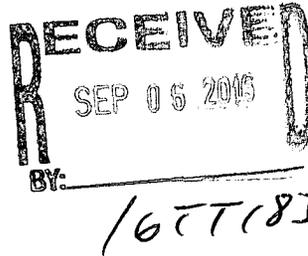


ILLINOIS INDEPENDENT TAX TRIBUNAL

NATIONAL INDEMNITY COMPANY,)
FEIN: 47-0355979)
)
Petitioner,)
)
v.)
)
ILLINOIS DEPARTMENT OF)
REVENUE,)
)
Respondent.)



PETITION

Petitioner National Indemnity Company (“National Indemnity” or “Petitioner”), by and through its attorneys, hereby petitions the Illinois Independent Tax Tribunal (the “Tribunal”), to review and modify a Notice of Deficiency issued by the Illinois Department of Revenue (the “Department”), for the reasons set forth below.

NATURE OF ACTION

1. This petition requests that the Tribunal review certain aspects of the Department’s determination as to Petitioner’s Illinois Corporation Income and Replacement Tax (collectively, “Corporate Income Tax”) liability for its taxable year ending on December 31, 2010 (the “Audit Period”). On July 7, 2016, the Department issued a Notice of Deficiency to Petitioner for 2010 (hereinafter, “NOD,” attached hereto as Exhibit A).

2. During the Audit Period, National Indemnity was the common parent of a group of unitary corporations filing a combined Illinois income tax return on Form IL-1120. National Indemnity made certain errors on its original Corporate Income Tax return for 2010. During the audit, the auditor sought to correct those errors, but in so doing made one adjustment that overstated National Indemnity’s apportionment factor numerator (i.e., its “Illinois” sales) and

failed to make a second adjustment that would have increased National Indemnity's apportionment factor denominator (i.e., its "everywhere" sales). Petitioner seeks relief from this Tribunal with respect to these two issues.

PARTIES

3. Petitioner, a Nebraska company, headquartered in Omaha, Nebraska, is the parent company of a group of affiliated insurance companies that comprise a unitary business group of insurance companies domiciled in states other than Illinois.

4. The Illinois Department of Revenue is the Illinois agency charged with the administration and enforcement of Illinois' Corporate Income Tax.

JURISDICTION

5. The Tribunal has jurisdiction over Petitioner and this petition pursuant to 35 ILCS 1010/1-45 and 35 ILCS 5/908.

BACKGROUND

6. National Indemnity is in the business of offering – both directly and through affiliates – insurance and reinsurance to customers throughout the United States, including Illinois. On October 17, 2011, National Indemnity filed its Corporate Income Tax return for 2010, reporting \$256,441 in Illinois Corporate Income Tax liability for that year.

7. As above, National Indemnity acknowledges that it made an error in calculating the *numerator* of its Illinois apportionment factor. Specifically, in calculating its "Illinois" sales, it failed to include the premiums for reinsurance assumed in respect of property or risk in Illinois. Additionally, National Indemnity made an error on its original return in calculating the *denominator* of its apportionment factor. In calculating its "everywhere" sales, National Indemnity failed to include reinsurance premiums assumed from its affiliates.

8. In 2015, the Department conducted an audit of National Indemnity for the year 2010. The Department completed that audit on or around January 4, 2016, and, on July 7, 2016, issued its NOD to Petitioner.

9. In the “Explanation of Adjustments” of its NOD, the Department stated: “We adjusted your insurance company apportionment factor to reflect the correct premiums written. [35 ILCS 5/304(b)].” (NOD, Exh. A, at 5.) While page 5 of the NOD erroneously appears to list a “\$0.00” impact relating to that adjustment, earlier pages of the notice evidence the substantial impact that the auditor’s adjustments had in this regard.

10. In adjusting National Indemnity’s apportionment factor numerator, the Department’s auditor calculated National Indemnity’s reinsurance premiums in respect of property or risk in Illinois pursuant to the “commercial domicile” method for apportionment set forth in 86 Ill. Adm. Code 100.3420(e)(2)(A). This resulted in revised “Illinois” sales of \$126,196,338 for 2010.

11. In making this adjustment, had the auditor instead used the “look-through” method for calculating National Indemnity’s reinsurance premiums in respect of property or risk in Illinois available under 86 Ill. Adm. Code 100.3420(e)(2)(B), National Indemnity’s “Illinois” sales would have been only \$58,361,159, a difference of more than \$67 million from the \$126,196,338 calculated by the auditor.

12. With respect to National Indemnity’s error in calculating the denominator of its Illinois apportionment factor, the Department’s auditor properly reduced National Indemnity’s “everywhere” sales by removing one of the companies from Petitioner’s unitary business group, but failed to include the group’s reinsurance premiums assumed from affiliates.

13. If the substantial additional reinsurance premiums assumed from National

Indemnity's affiliates had been included in the denominator, National Indemnity's "everywhere" sales would have increased from \$6,579,456,199 to \$7,742,368,199 – resulting in a further reduction of National Indemnity's Corporate Income Tax liability as calculated by the auditor.

COUNT I

Petitioner is Entitled to Use the "Look-Through" Method to Calculate its "Illinois" Sales, Thereby Reducing the Corporate Income Tax Liability Assessed by the Department

14. Petitioner incorporates in this Count I the allegations of paragraphs 1-13 of this Petition.

15. The Department regulation addressing the apportionment of business income of insurance companies, 86 Ill. Adm. Code 100.3420, at subsection (e)(2) addresses the calculation of reinsurance premium for property or risk in Illinois, for companies whose principal source of premiums written consists of premiums for reinsurance accepted. It states:

- 2) Property or risk in this State. An insurance company may determine the amount of *premiums written for reinsurance accepted in respect of property or risk in this State* by consideration of each premium written, or the premiums may, at the election of the company, be determined on the basis of:
 - A) *the proportion which premiums written for reinsurance accepted from companies commercially domiciled in Illinois bears to premiums written for reinsurance accepted from all sources; or*
 - B) *the proportion which the sum of the direct premiums written for insurance upon property or risk in this State by each ceding company from which reinsurance is accepted bears to the sum of the total direct premiums written by each such ceding company for the taxable year.*

16. Thus, reinsurance companies have the option of calculating their Illinois-based reinsurance premiums either by looking to the commercial domicile of the insurance companies to which the taxpayer provided reinsurance (the "commercial domicile" method) or,

alternatively, by looking through each such insurance company to the proportion which the sum of the direct premiums written for insurance upon property or risk located in Illinois by such company bears to the sum of the total direct premiums written by such company for the taxable year (the “look-through” method).

17. National Indemnity acknowledges that it erroneously calculated the numerator (i.e., “Illinois” sales) of its insurance company apportionment factor for 2010, in not including the proper amount of Illinois premiums. In calculating its adjustment for this error, however, the auditor utilized the “commercial domicile” method for determining “premiums written for reinsurance accepted in respect of property or risk in this State.” This calculation resulted in \$126,196,338 of “Illinois” sales for National Indemnity in 2010.

18. If the auditor had instead applied the “look-through” method for calculating National Indemnity’s reinsurance premiums “in respect of property or risk in this State,” National Indemnity’s “Illinois” sales would have instead totaled only \$58,361,159.

19. As National Indemnity was entitled to elect either method for calculating its Illinois reinsurance premiums for 2010, it is entitled to elect either method for *correcting* its return with respect to such premiums.

20. Calculating National Indemnity’s Illinois sales as \$58,361,159, as opposed to \$126,196,338, results in a significant reduction of its assessed deficiency (even without considering the necessary adjustments to its apportionment factor denominator addressed in Count II).

WHEREFORE, National Indemnity prays this Tribunal to:

(a) find and declare that National Indemnity is entitled to a reduction of the Department’s calculated increase of the Illinois sales component of its apportionment factor for premiums written for reinsurance accepted in respect of property or risk in this State in the amount of \$67,835,179 (i.e., increasing its Illinois sales to \$58,361,159, as opposed to

\$126,196,338);

(b) order the Department to amend and adjust its Notice of Deficiency to National Indemnity using \$58,361,159 for National Indemnity's "Illinois sales," and thus to reduce National Indemnity's Corporate Income Tax liability accordingly; and

(c) grant such other relief as the Tribunal deems reasonable and proper.

COUNT II

Petitioner is Entitled to a Reduction of the Department's Assessed Liability Through Increasing the "Everywhere" Sales Component of Its Apportionment Factor to Include Reinsurance Premiums Assumed From Affiliates

21. Petitioner incorporates in this Count II the allegations of paragraphs 1-20 of this Petition.

22. As above, when National Indemnity filed its original 2010 Corporate Income Tax return, it failed to include in the denominator of its apportionment factor (*i.e.*, its "everywhere" sales), reinsurance premiums assumed from its affiliates. During the audit, this omission was not corrected by the auditor.

23. National Indemnity reported its "everywhere" sales on its 2010 Corporate Income Tax Return as \$6,867,887,705. In the NOD, the auditor carried forward this number for "everywhere" sales, and reduced it – as a result of removing one of the companies from National Indemnity's unitary business group – to \$6,579,456,199. However, National Indemnity subsequently realized that \$1,162,912,000 in additional reinsurance premiums assumed from its affiliates in 2010 had been omitted from its "everywhere" sales. As such, the denominator of its 2010 apportionment factor should have been \$7,742,368,199.

24. Using the correct "everywhere" sales number results in significantly reducing National Indemnity's Corporate Income Tax liability (even without adjusting the numerator of its apportionment factor as outlined in Count I).

WHEREFORE, National Indemnity prays this Tribunal to:

(a) find and declare that National Indemnity is entitled to increase the “everywhere” sales component of its apportionment factor for 2010 by \$1,162,912,000, for additional premiums written for reinsurance by certain affiliates that year, resulting in an overall “everywhere” sales total of \$7,742,368,199;

(b) order the Department to amend and adjust its Notice of Deficiency to National Indemnity using \$7,742,368,199 for National Indemnity’s “everywhere” sales, and thus to reduce National Indemnity’s Corporate Income Tax liability accordingly; and

(c) grant such other relief as the Tribunal deems reasonable and proper.

COUNT III

In the Alternative, the Penalties Assessed Against Petitioner Should Be Abated.

25. Petitioner incorporates in this Count III the allegations of paragraphs 1-24 of this Petition.

26. Section 3-8 of the Uniform Penalty and Interest Act (35 ILCS 735/3-8), entitled “No penalties if reasonable cause exists,” provides in relevant part that: “The penalties imposed under the provisions of Sections 3-3, 3-4, 3-5, and 3-7.5 of this Act shall not apply if the taxpayer shows that his failure to file a return or pay tax at the required time was due to reasonable cause. Reasonable cause shall be determined in each situation in accordance with the rules and regulations promulgated by the Department.”

27. For the reasons articulated in Counts I-II, the Department should amend both the “Illinois” and “everywhere” sales numbers calculated for National Indemnity’s 2010 apportionment factor in the NOD, thus greatly reducing National Indemnity’s Corporate Income Tax liability. If, however, this Tribunal determines that such adjustments are not appropriate, Petitioner pleads in the alternative that – for all of the reasons set forth in Counts I-II above – it had more than a reasonable basis for failing to pay a significant portion of the liability alleged in

the NOD. Accordingly, Petitioner is entitled to abatement of the late-payment penalty assessed by the Department with respect to that portion of its underlying Corporate Income Tax liability.

WHEREFORE, National Indemnity prays this Tribunal to:

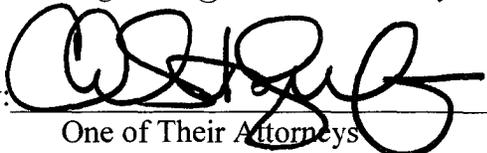
- (a) find and declare that National Indemnity is entitled to abatement of a significant portion of the Corporate Income Tax liability assessed in the Notice of Deficiency; and
- (b) grant such other relief as the Tribunal deems reasonable and proper.

NATIONAL INDEMNITY COMPANY

FEIN: 47-0355979
1314 Douglas Street, Suite 1400
Omaha, NE 68102-1944

Donald F. Wurter, President
Telephone: (402) 916-3200
Email: dfwurster@nationalindemnity.com

Henry Grether, Tax Counsel
Telephone: (402) 916-3267
Email: hmgrether@nationalindemnity.com

By: 
One of Their Attorneys

Tracy D. Williams
Charles K. Schafer
Richard M. Silverman
SIDLEY AUSTIN LLP
One South Dearborn
Chicago, IL 60603
Telephone: 312-853-7000
Facsimile: 312-853-7036
tdwilliams@sidley.com
cschafer@sidley.com
rsilverman@sidley.com

Notice of Deficiency

for Form IL-1120, Corporation Income and Replacement Tax Return **1314 DOUGLAS JUL 14 2016**



July 7, 2016



Letter ID: L0223457168

NATIONAL INDEMNITY CO
ATTN: HENRY GREYER
3024 HARNEY ST
OMAHA NE 68131-3535

Taxpayer ID: 47-0355979
Audit ID: A1749370880
Reporting period: December 2010
Total Deficiency: \$5,991,809.37
Balance due: \$5,991,809.37

We have audited your account for the reporting period listed above. The attached statement explains the computation of your deficiency and the balance due. Illinois law requires that we notify you of this deficiency and your rights.

If you agree to this deficiency, pay the total balance due as soon as possible to minimize penalty and interest assessed. Make your check payable to the "Illinois Department of Revenue", write your taxpayer ID on your check, and mail a copy of this notice along with your payment.

If you do not agree, you may contest this notice by following the instructions listed below.

- If the amount of this tax deficiency, exclusive of penalty and interest is more than \$15,000, or if no tax deficiency is assessed, but the total penalties and interest is more than \$15,000, file a petition with the Illinois Independent Tax Tribunal within 60 days of this notice. Your petition must be in accordance with the rules of practice and procedure provided by the Tribunal (35 ILCS 1010/1-1, et seq.).
- In all other cases, file a protest with us, the Illinois Department of Revenue, within 60 days of the date of this notice. If you file a protest on time, we must reconsider the proposed deficiency, and if requested, grant you or your authorized representative and administrative hearing. An administrative hearing is a formal legal proceeding conducted pursuant to the rules adopted by the Department and is presided over by an administrative law judge. Submit your protest on Form EAR-14, Format for Filing a Protest for Income Tax, (available on our website at tax.illinois.gov). If we do not receive your protest within 60 days, this deficiency will become final. A protest of this notice does not preserve your rights under any other notice.
- In any case, you may instead, under Sections 2a and 2a.1 of the State Officers and Employees Money Disposition Act (30 ILCS 230/2a, 230/2a.1), pay the total liability under protest using Form RR-374, Notice of Payment Under Protest (available on our website at tax.illinois.gov), and file a complaint with the circuit court for a review of our determination.

If you do not protest this notice or pay the assessment total in full, we may take collection action against you for the balance due which, may include levy of your wages and bank accounts, filing of a tax lien, or other action.

If you have questions, call us at the telephone number shown below.

Sincerely,

Constance Beard

Director

ILLINOIS DEPARTMENT OF REVENUE

AUDIT BUREAU

PO BOX 19012

SPRINGFIELD IL 62794-9012

(217) 524-5292

Bankruptcy Information

If you are currently under the protection of the Federal Bankruptcy Court, contact us and provide the bankruptcy number and the bankruptcy court. The bankruptcy automatic stay does not change the fact you are required to file tax returns.

Taxpayer Bill of Rights

- You have the right to call the Department of Revenue for help in resolving tax problems.
- You have the right to privacy and confidentiality under most tax laws.
- You have the right to respond, within specified time periods, to Department notices by asking questions, paying the amount due, or providing proof to refute the Department's findings.
- You have the right to appeal Department decisions, in many instances, within specified time periods, by asking for Department review, by filing a petition with the Illinois Independent Tax Tribunal, or by filing a complaint in circuit court.
- If you have overpaid your taxes, you have the right, within specified time periods, to file for a credit (or, in some cases, a refund) of that overpayment.

The full text of the Taxpayers' Bill of Rights is contained in the Illinois Compiled Statutes, 20 ILCS 2520/1 et seq.

Statement

Date: July 7, 2016
 Name: NATIONAL INDEMNITY CO
 Taxpayer ID: 47-0355979
 Letter ID: L0223457168

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

Computation of deficiency	Reporting period: 31-Dec-2010
Income or loss	
Federal taxable income	\$4,080,993,098.00
Net operating loss deduction	\$270,030.00
State Municipal and other interest excluded	\$721,982.00
Income tax and replacement tax deduction	\$3,707,488.00
Other additions	\$104,644.00
Base income or loss	
Treasury interest income & other exempt obl.	\$17,057,782.00
Foreign dividends subtraction	\$461,629,800.00
Other subtractions	\$104,644.00
Total subtractions	\$478,792,226.00
Base income or net loss	\$3,607,005,016.00
Income allocable to Illinois	
Non-business income or loss	\$0.00
Non-unitary partnership bus. income or loss	\$0.00
Business income or loss	\$3,607,005,016.00
Apportionment formula	
Total sales everywhere	\$6,579,456,199.00
Total Illinois sales	\$126,196,338.00
Apportionment factor	0.019180
Business income/loss apportionable to IL	\$69,182,356.00
Nonbusiness income/loss allocable to IL	\$0.00
Non-unitary part. business income app. to IL	\$0.00
Base income or net loss allocable to IL	\$69,182,356.00
Net income	
Base income or net loss	\$69,182,356.00
IL net loss deduction (NLD)	\$0.00
Net income	\$69,182,356.00
Net replacement tax	
Replacement tax	\$1,729,559.00
Recapture of investment credits	\$0.00
Replacement tax before credits	\$1,729,559.00
Replacement tax investment credits	\$0.00
Net replacement tax	\$1,729,559.00
Net income tax	
Income tax	\$3,320,753.00

Statement

Date: July 7, 2016
Name: NATIONAL INDEMNITY CO
Taxpayer ID: 47-0355979
Letter ID: L0223457168

Computation of deficiency

Reporting period: 31-Dec-2010

Recapture of investment credits	\$0.00
Income tax before credits	\$3,320,753.00
Income tax investment credits	\$0.00
Net income tax	\$3,320,753.00
Refund or balance due	
Net replacement tax	\$3,016,553.00
Net income tax	\$1,729,559.00
Total net income and replacement tax due	\$4,746,112.00
Minus tax previously assessed	-\$256,441.00
Total tax deficiency	\$4,489,671.00
UPIA-5 late-payment penalty (Audit)	\$897,934.20
Plus interest on tax through July 7, 2016	\$604,204.17
Total deficiency	* \$5,991,809.37

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

Computation of balance due

Reporting period: 31-Dec-2010

Balance due	* \$5,991,809.37
-------------	------------------

Explanation of Audit Adjustments

Income Tax



July 7, 2016



Letter ID: L0475921168

Taxpayer ID: 47-0355979

Account ID: 00376-07680

Audit ID: A1749370880

Reporting period: December 2010

NATIONAL INDEMNITY CO
ATTN: HENRY GREYER
3024 HARNEY ST
OMAHA NE 68131-3535

Explanation of adjustments for tax period ending 12/31/2010

We adjusted your Illinois net income or loss by changing the unitary group to exclude taxpayers conducting 80 percent or more of their business activities outside the United States.

[35 ILCS 5/1501(a)(27)] See attached list of the members of your unitary business group.

We adjusted your insurance company apportionment factor to reflect the correct premiums written.

[35 ILCS 5/304(b)]

	<u>Return Impact</u>	<u>Tax impact</u>
We adjusted your Illinois net income or loss by changing the unitary group to exclude taxpayers conducting 80 percent or more of their business activities outside the United States. [35 ILCS 5/1501(a)(27)] See attached list of the members of your unitary business group.	\$39,653,543.00	\$4,489,671.00
We adjusted your insurance company apportionment factor to reflect the correct premiums written. [35 ILCS 5/304(b)]	\$0.00	\$0.00

Unitary Member List

Date: July 7, 2016
Letter ID: L0475921168
Name: NATIONAL INDEMNITY CO
Taxpayer ID: 47-0355979
Account ID: 00376-07680
Audit ID: A1749370880
Reporting period: December 2010
Tax period ending: 12/31/2010

<u>Name</u>	<u>FEIN</u>	<u>Status</u>
NATIONAL INDEMNITY COMPANY	47-0355979	
NATIONAL FIRE & MARINE INSURAN	47-6021331	
COLUMBIA INSURANCE COMPANY	47-0530077	
NATIONAL INDEMNITY COMPANY OF	59-2266845	
NATIONAL INDEMNITY COMPANY OF	41-0971481	
NATIONAL LIABILITY & FIRE INSU	36-2403971	
WESCO FINANCIAL INSURANCE COMP	47-0685686	
BERKSHIRE HATHAWAY ASSURANCE C	26-1599479	
UNIONE ITALIANA REINSURANCE CO	13-2953213	
FINIAL REINSURANCE COMPANY	06-1325038	
SEAWORTHY INSURANCE COMPANY	52-1658500	
PHILADELPHIA REINSURANCE CORPO	23-1620930	
AMERICAN CENTENNIAL INSURANCE	51-0400307	
COMMERCIAL CASUALTY INSURANCE	95-4077789	
ATLANTA INTERNATIONAL INSURANC	13-2668999	
CITADEL INSURANCE COMPANY	74-1595285	
FFG INSURANCE COMPANY	75-2344200	
STONEWALL INSURANCE COMPANY	63-0202590	New
BERKSHIRE HATHAWAY LIFE INSURA	47-0766667	
FIRST BERKSHIRE HATHATWAY LIFE	91-1933661	