

**ILLINOIS INDEPENDENT TAX TRIBUNAL
CHICAGO, ILLINOIS**

T-Systems North America Inc.,)	
)	
Petitioner,)	
)	
v.)	No. 18 TT 62
)	
Illinois Department of Revenue,)	
)	
Respondent.)	

NOTICE OF FILING

TO: David J. Kupiec	Natalie Martin
Kupiec & Martin	Kupiec & Martin
600 W. Van Buren, #202	600 W. Van Buren, #202
Chicago, Illinois 60607	Chicago, Illinois 60607
 Email: dkupiec@kupiecandmartin.com	Email: nmartin@kupiecandmartin.com

The undersigned representative for the Illinois Department of Revenue (the “Department”) certifies that, on July 18, 2019, she filed the Department’s Answer to Petitioner’s Petition with the Illinois Independent Tax Tribunal.

/s/ Valerie A. Puccini
Valerie A. Puccini

CERTIFICATE OF SERVICE

The undersigned representative for the Illinois Department of Revenue certifies that, on July 18, 2019, she served the Department’s Answer to Petitioner’s Petition filed with the Illinois Independent Tax Tribunal on the individuals identified above, at the email addresses shown above.

/s/ Valerie A. Puccini
Valerie A. Puccini

Illinois Department of Revenue
100 West Randolph Street Level 7-900
Chicago, IL 60601
(312) 814-4558
Valerie.a.puccini@illinois.gov

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CHICAGO, ILLINOIS**

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ANSWER TO PETITION

NOW COMES, the Department of Revenue of the State of Illinois (the “Department”), through its attorneys, Sean P. Cullinan and Valerie A. Puccini, and for its Answer to Petitioner’s Petition pleads as follows:

INTRODUCTION

1. Petitioner is a Corporation. The Taxpayer ID associated with Petitioner is 13-3571176.

ANSWER: The allegations in Paragraph 1 are not material allegations of fact, and therefore do not require an answer. To the extent an answer is required, the Department admits the factual allegations in Paragraph 1.

2. The Corporation was formed under the laws of Delaware.

ANSWER: The allegations in Paragraph 2 are not material allegations of fact, and therefore do not require an answer. To the extent an answer is required, the Department admits the factual allegation in Paragraph 2.

3. Petitioner is located at 1901 Butterfield Rd, Suite 700, Downers Grove, IL 60515-5403. The phone number is 630-493-6100.

ANSWER: The allegations in Paragraph 3 are not material allegations of fact, and therefore do not require an answer. To the extent an answer is required, the Department admits the factual allegations in Paragraph 3.

4. The Department issued to Petitioner the Notices under dispute on April 11, 2018, for the tax periods ending December 31, 2013 and December 31, 2014 (hereinafter “tax years at issue”), assessing tax, penalty and interest deficiencies of \$135,368.92 and \$326,680.52. A copy of the Notices is attached.

ANSWER: The Department admits that the Notices of Deficiency (“Notices”) were issued on April 11, 2018 for the tax periods ending December 31, 2013 and December 31, 2014. The Department denies that the Notices were issued in the amounts of \$135,368.92 for 2013 and \$326,680,52 for 2014 alleged in Paragraph 4 and states that on the face of the Notices, the balance due for 2013 is \$90,194.92 and the balance due for 2014 is \$229,533.65.

JURISDICTION

5. The Tax Tribunal has jurisdiction pursuant to the Illinois Independent Tax Tribunal Act of 2012, 35 ILCS 1010, because the alleged tax liability in question from the Illinois Income Tax Act (hereinafter “IITA”) in the aggregate exceeds, \$15,000, exclusive of penalties and interest, and because Petitioner has remitted the \$500 filing fee and filed this Petition within 60 days of the Notices of Deficiency.

ANSWER: The allegations in Paragraph 5 are not material allegations of fact, and therefore do not require an answer. To the extent an answer is required, the Department admits the factual allegations in Paragraph 5.

BACKGROUND AND RELEVANT FACTS

6. Petitioner is a Corporation operating in Illinois.

ANSWER: The allegations in Paragraph 6 are not material allegations of fact, and therefore do not require an answer. To the extent an answer is required, the Department admits the factual allegation in Paragraph 6.

7. Petitioner operates information and communication technology (“ICT”) systems for multinational corporations and public-sector institutions. The services Petitioner offers include: corporate voice solutions, Ethernet WAN solutions, business Internet access, IP-VPN, LAN solutions, leased links/dedicated lines, managed VoIP networks, and voice solutions. Petitioner also provides application management, corporate performance management, CRM solutions, desktop suite services and solutions, security services and solutions, service-oriented architecture services, systems integration, and z/OS storage management suite.

ANSWER: The Department lacks sufficient information to either admit or deny the factual allegations contained in Paragraph 7 and demands strict proof thereof.

8. Petitioner was founded in 1990 and has offices in Illinois, Texas, Arizona, New York, Florida and Michigan. Petitioner operates as a subsidiary of T-Systems International GmbH (hereinafter “Petitioner’s Foreign Parent” or “Foreign Parent”).

ANSWER: The Department lacks sufficient information to either admit or deny the factual allegations contained in Paragraph 8 and demands strict proof thereof.

9. Petitioner's main operation is network hosting services, including providing SAP to mid-market and larger companies via three data centers located in Phoenix, AZ, Jacksonville, FL and Houston, TX.

ANSWER: The Department lacks sufficient information to either admit or deny the factual allegations contained in Paragraph 9.

10. Petitioner has both US and international sales.

ANSWER: The Department lacks sufficient information to either admit or deny the factual allegations contained in Paragraph 10 and demands strict proof thereof.

11. The majority of Petitioner's foreign sales relate to services performed for Petitioner's Foreign Parent which are ordered from the Foreign Parent's office in Germany.

ANSWER: The Department admits the Petitioner performed services for Petitioner's foreign parent which are ordered from the foreign parent's office in Germany. The Department lacks sufficient information to either admit or deny the remaining factual allegations contained in Paragraph 11.

12. The services provided to Petitioner's Foreign Parent include services related to networking sales, where Petitioner provides the US portion of the network to a third party.

ANSWER: The Department lacks sufficient information to either admit or deny the factual allegations contained in Paragraph 12 and demands strict proof thereof.

13. Petitioner invoices the Foreign Parent at the Foreign Parent's location in Germany for all these services.

ANSWER: The Department lacks sufficient information to either admit or deny the factual allegations contained in Paragraph 13 and demands strict proof thereof.

14. The Foreign Parent then invoices the third-party customer as part of the overall contract agreement between the third party and the foreign parent.

ANSWER: The Department lacks sufficient information to either admit or deny the factual allegations contained in Paragraph 14 and demands strict proof thereof.

15. Petitioner's Foreign Parent is not required to file a US tax return, cannot file as part of Petitioner's Illinois unitary return pursuant to the 80/20 provisions of the IITA and is not required to file any other state income tax returns.

ANSWER: Paragraph 15 states a legal conclusion, not a material allegation of fact, therefore, no answer is required. To the extent an answer is required, the Department lacks sufficient information to either admit or deny the factual allegations contained in Paragraph 15 and demands strict proof thereof.

16. Petitioner's Foreign Parent files a tax return in Germany.

ANSWER: The Department lacks sufficient information to either admit or deny the factual allegations contained in Paragraph 16 and demands strict proof thereof.

17. Petitioner files as part of a consolidated US tax return.

ANSWER: The Department admits the factual allegation contained in Paragraph 17.

18. Petitioner files as part of an Illinois unitary income tax return. The aforementioned US and Illinois unitary income tax return was timely filed (with Petitioner included for the 2013 and 2014 tax years at issue).

ANSWER: The Department admits the factual allegation contained in Paragraph 18.

19. Petitioner is not required to file a foreign tax return.

ANSWER: The Department lacks sufficient information to either admit or deny the factual allegations contained in Paragraph 19 and demands strict proof thereof.

20. As part of the Illinois unitary return, Petitioner included other income and income from all of its sales, including sales to its Foreign Parent, as part of its Illinois taxable income.

ANSWER: The Department lacks sufficient information to either admit or deny the factual allegations contained in Paragraph 20.

21. Petitioner also included receipts from the other income and all sales in its Illinois apportionment according to greater income-producing activity and market-based sourcing methodologies.

ANSWER: Paragraph 21 states a legal conclusion, not a material allegation of fact, therefore, no answer is required. To the extent an answer is required, the Department lacks sufficient information to either admit or deny the factual allegations contained in Paragraph 21.

22. The other income amount at issue is comprised of various income generating transactions.

ANSWER: The term “various” is vague and ambiguous. The Department lacks sufficient information to either admit or deny the factual allegations contained in Paragraph 22.

23. Each separate other income stream was sourced to Illinois and other states based on the cost of performance methodology.

ANSWER: Paragraph 23 states a legal conclusion, not a material allegation of fact, therefore, no answer is required. To the extent an answer is required, the Department lacks sufficient information to either admit or deny the factual allegations contained in Paragraph 23.

24. The Department conducted an audit of the Petitioner's income tax returns for the tax periods ending December 31, 2013 and December 31, 2014.

ANSWER: The Department admits the factual allegations contained in Paragraph 24.

25. The auditor adjusted the sales factor denominator to "exclude sales of services to customers in states in which the Petitioner was not taxable."

ANSWER: Paragraph 25 states a legal conclusion, not a material allegation of fact, therefore, no answer is required. To the extent an answer is required, the Department admits that the auditor adjusted the sales factor to reflect additional throw out sales, adjusted the sales factor to include numerator receipts and adjusted the Illinois net loss deduction as set forth in the Notices of Deficiency.

26. Pursuant to this change, the sales factor denominator was decreased to exclude the sales provided to the third parties and invoiced to the parent.

ANSWER: The Department admits that the auditor adjusted the sales factor to reflect additional throw out sales, adjusted the sales factor to include numerator receipts and adjusted the Illinois net loss deduction as set forth in the Notices of Deficiency. The Department lacks sufficient information to either admit or deny the remaining factual allegations contained in Paragraph 26.

27. The auditor also adjusted the sales factor numerator to include in Petitioner's Illinois receipts what the auditor contends were receipts "for which the majority of the income-producing activities were performed in Illinois."

ANSWER: The Department admits that the auditor adjusted the sales factor to reflect additional throw out sales, adjusted the sales factor to include numerator receipts and adjusted the Illinois net loss deduction as set forth in the Notices of Deficiency. The Department lacks sufficient information to either admit or deny the remaining factual allegations contained in Paragraph 27.

28. Pursuant to this change, the auditor included certain other income receipts in the numerator of the Illinois sales factor.

ANSWER: The Department admits that because of insufficient information was given to the auditor, the auditor adjusted the Illinois numerator as reflected in the Notices of Deficiency.

29. The Department issued a Notice of Deficiency on April 11, 2018 for the audit period ending December 31, 2013 assessing a deficiency of \$135,368.92 including additional tax of \$113,110, penalty of \$13,306.94 and interest of \$8,951.98.

ANSWER: The Department admits it issued Notices of Deficiency April 11, 2018 for the reporting period December 2013 and the Notice of Deficiency speaks for itself.

30. The Department issued a Notice of Deficiency on April 11, 2018 for the audit period ending December 31, 2014 assessing a deficiency of \$326,680.52 including additional tax of \$262,617, penalty of \$43,336.69 and interest of \$20,726.83.

ANSWER: The Department admits it issued Notices of Deficiency April 11, 2018 for the reporting period December 2014 and the Notice of Deficiency speaks for itself.

ERROR I – PETITIONER’S SALES OF SERVICES AT ISSUE SHOULD NOT BE “THROWN-OUT” PURSUANT TO 35 ILCS 5/304(a)(3)(C-5)(iv) BECAUSE PETITIONER IS REQUIRED TO INCLUDE SUCH SALES IN THE SALES FACTOR PURSUANT TO 35 ILCS 5/304(a)(3)(C-5)(iv) AND 35 ILCS 5/303(f)

31. Petitioner re-alleges and reincorporates paragraphs 1-30 of the Petition herein.

ANSWER: The Department restates and realleges its answers in Paragraphs 1 through 30 as if fully set forth herein.

32. As indicated in the facts above, Petitioner has sales of services to customers located in foreign countries in addition to sales of services to customers located throughout the United States.

ANSWER: The term “customers” is not defined and is vague and ambiguous. The Department lacks sufficient information to either admit or deny the factual allegations contained in Paragraph 32.

33. Petitioner’s 2013 and 2014 Illinois income tax returns at issue correctly include Petitioner’s total service sales in Petitioner’s sales factor denominator pursuant to 35 ILCS 5/304.¹

ANSWER: The Department denies the allegations in Paragraph 33.

34. Petitioner sourced the sales of services at issue to the required State pursuant to the provisions of 35 ILCS 5/304(a)(3)(C-5)(iv) using of the following required determination order: 1) the fixed place of business the service is received; 2) the

¹ Petitioner did not include any of the sales of services at issue in its Illinois sales factor numerator for the years at issue as such services were not received in Illinois.

location of the customer's office from which the service was ordered; or 3) the customer's office to which the service was billed.

ANSWER: Paragraph 34 states a legal conclusion, not a material allegation of fact, therefore, no answer is required. To the extent an answer is required, the Department admits the existence, force and effect of the Illinois Income Tax Act, (35 ILCS 5/101 *et seq.*) and states that such statute speaks for itself. The Department lacks sufficient information to either admit or deny the remaining factual allegations contained in Paragraph 34.

35. Petitioner filed state income tax returns in Illinois and other states for the tax years at issue as required by the laws of each State as the business activity of providing services subjects Petitioner to taxation in each jurisdiction.

ANSWER: The Department admits the Petitioner filed a state income tax return in Illinois for the tax years at issue. The term "other states" is not defined and is vague and ambiguous and the phrase "as required by the laws of each State", states a legal conclusion to which no answer is required. To the extent an answer is required, the Department lacks sufficient information to either admit or deny the factual allegations contained in Paragraph 35.

36. Many of the countries, including Germany the location of Petitioner's Foreign Parent, in which Petitioner sells services have entered into tax treaties with the United States which provide that United States incorporated companies are exempt from foreign tax under certain circumstances.

ANSWER: Paragraph 36 states a legal conclusion, not a material allegation of fact, therefore, no answer is required. To the extent answer is required, the phrases "Many of the countries" and "under certain circumstances" are not defined and are vague and ambiguous, therefore, the Department lacks sufficient knowledge and information to admit or deny the allegations in Paragraph 36.

37. Section 303(f) of the IITA expressly states that a taxpayer is taxable in another state if “that state has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the state does or does not.” 35 ILCS 5/303(f)(2).

ANSWER: Paragraph 37 states a legal conclusion, not a material allegation of fact, therefore no answer is required. To the extent an answer is required, the Department admits the existence, force and effect of the Illinois Income Tax Act (35 ILCS 5/101 *et seq.*) and states that such law speaks for itself.

38. Petitioner contends that the service sales at issue cannot be excluded from its sales factor denominator as the sales at issue were properly included in the denominator pursuant to the provisions of 35 ILCS 5/304 and Petitioner is taxable in another state pursuant to the provisions of 35 ILCS 5/303(f) and the tax treaties at issue.

ANSWER: Paragraph 38 states a legal conclusion, not a material allegation of fact, therefore no answer is required. To the extent an answer is required, the Department denies the allegations in Paragraph 38.

39. Based on the facts and statutory support provided above, Petitioner requests that the service sales at issue remain in Petitioner’s sales factor denominator and the Department’s assessment from this issue be withdrawn.

ANSWER: Paragraph 39 states a legal conclusion, not a material allegation of fact, therefore no answer is required. To the extent an answer is required, the Department denies the allegations in Paragraph 39.

ERROR II - 86 ILL. ADMIN. CODE SECTION 100.3200(a)(2)(C) AS AMENDED IN 2010 IS INVALID AS CONTRARY TO AND AN IMPROPER NARROWING OF 35 ILCS 5/303(f) AND AS APPLIED TO PETITIONER WHO HAS SERVICE SALES INTO COUNTRIES WITH TAX TREATIES

40. Petitioner re-alleges and reincorporates paragraphs 1-30 of the Petition herein.

ANSWER: The Department restates and realleges its answers in Paragraphs 1 through 30 as if fully set forth herein.

41. As indicated in the facts above, Petitioner has sales of services to customers located in foreign countries in addition to sales to customers located throughout the United States and files state income tax returns in Illinois and other states as required by the laws of each State.

ANSWER: Paragraph 41 states a legal conclusion to which no answer is required. The term “customers” is not defined and is vague and ambiguous. To the extent an answer is required, the Department lacks sufficient information to either admit or deny the factual allegations contained in Paragraph 41.

42. Many of the countries that Petitioner sells items into have tax treaties that provide that United States companies are exempt from foreign tax under certain circumstances.

ANSWER: Paragraph 42 contains a legal conclusion to which no answer is required. In addition, the phrases “many of the countries”, “sells items” and “under certain circumstances” are not defined and are vague and ambiguous. To the extent an answer is required, the Department lacks sufficient information to either admit or deny the factual allegations contained in Paragraph 42.

43. In August 2010, the Department amended Regulation Section 100.3200(a)(2)(C) to include the following provisions:

“In the case of any foreign country or political subdivision of a foreign country, the determination of whether a state has jurisdiction to subject the taxpayer to a net income tax will be determined as if the foreign country or political subdivision were a state of the United States or a political subdivision of a U.S. state. A person who is not required to pay net

income tax by a foreign country or political subdivision as the result of a treaty provision exempting certain persons, business activities or sources of income from tax is not subject to net income tax in that jurisdiction.”

ANSWER: Paragraph 43 states a legal conclusion, not a material allegation of fact, therefore no answer is required. To the extent an answer is required, the Department admits the existence, force and effect of the Illinois Income Tax Regulations (86 Ill. Adm. Code 100 *et seq.*) and states that such regulation speaks for itself.

44. The Illinois Register explains the aforementioned 2010 change as follows:
“updates the guidance on when a taxpayer is ‘taxable in another state’ for purposes of allocation and apportionment of income in order to properly incorporate the decision in Dover Corp. v. Dept. of Revenue, 271 Ill.App.3d 700 (1995).”

ANSWER: Paragraph 44 states a legal conclusion, not a material allegation of fact, therefore no answer is required. To the extent an answer is required, the Department admits the existence, force and effect of the Illinois Income Tax Regulations (86 Ill. Adm. Code *et seq.*) and case law cited therein and states that such regulation and case law speak for themselves.

45. The Illinois Register shows the following 2010 changes (additions in capital letters):

C) In the case of any foreign country or political subdivision OF A FOREIGN COUNTRY thereof, the determination of whether such state has jurisdiction to subject the taxpayer to a net income tax will be determined as if the foreign country or political subdivision were a state of the United States or a political subdivision OF A U.S. STATE thereof. A PERSON WHO IS NOT REQUIRED TO PAY NET INCOME TAX BY A FOREIGN COUNTRY OR POLITICAL SUBDIVISION AS THE

RESULT OF A TREATY PROVISION EXEMPTING CERTAIN PERSONS, BUSINESS ACTIVITIES OR SOURCES OF INCOME FROM TAX IS NOT SUBJECT TO NET INCOME TAX IN THAT JURISDICTION.

ANSWER: Paragraph 45 states a legal conclusion, not a material allegation of fact, therefore no answer is required. To the extent an answer is required, the Department admits the existence, force and effect of the Illinois Income Tax Regulations (86 Ill. Adm. Code 100 *et seq.*) and states that such regulation speaks for itself.

46. The Illinois Supreme Court has determined that an administrative rule may not broaden or narrow the scope of the statute's scope of taxation and administrative rules that are inconsistent with the statute under which they are adopted will be held invalid. Hartney Fuel Oil Co. v. Hamer, 2013 IL 115130 (November 21, 2013) citing Ex-Cell-O Corp. v. McKibbin, 383 Ill. 316, 320(1943) and Kean v. Wal-Mart Stores, Inc., 235 Ill. 2d 351, 366 (2009).

ANSWER: Paragraph 46 states a legal conclusion, not a material allegation of fact, therefore no answer is required. To the extent an answer is required, the Department admits the existence, force and effect of the Illinois Income Tax Act, (35 ILCS 5/101 *et seq.* and the Income Tax Regulations (86 Ill. Adm. Code 100 *et seq.*) and case law and states that such statute, regulation and case law speak for themselves.

47. As noted above, Section 303(f) of the IITA expressly states:

For purposes of allocation of income pursuant to this Section, a taxpayer is taxable in another state if that state has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the state does or does not. 35 ILCS 5/303(f)

ANSWER: Paragraph 47 states a legal conclusion, not a material allegation of fact, therefore no answer is required. To the extent an answer is required, the Department

admits the existence, force and effect of the Illinois Income Tax Act (35 ILCS 5/101 *et seq.*) and states that such statute speaks for itself.

48. Thus, IITA Section 303 clearly states that taxability is based on whether a state has jurisdiction not whether it exercises that jurisdiction. Based on the information provided above, the revisions to Regulation Section 100.3200(a)(2)(C) impermissibly narrows the language of the underlying Statute by requiring that a person pay tax in a particular jurisdiction even if a treaty exempts that taxation.

ANSWER: Paragraph 48 states a legal conclusion, not a material allegation of fact, therefore no answer is required. To the extent an answer is required, the Department admits the existence, force and effect of the Illinois Income Tax Act, (35 ILCS 5/101 *et seq.* and the Income Tax Regulations (86 Ill. Adm. Code 100 *et seq.*) and states that such statute and regulation speak for themselves.

49. Petitioner thereby contends that based on the aforementioned narrowing of the scope of Regulation Section 100.3200(a)(2)(C), the sales of services at issue remain in Petitioner's sales factor denominator and the Department's assessment from this issue be withdrawn pursuant to the sales factor provisions of the IITA.

ANSWER: Paragraph 49 states a legal conclusion, not a material allegation of fact, therefore no answer is required. To the extent an answer is required, the Department denies the allegations in Paragraph 49.

ERROR III – 86 ILL. ADMIN. CODE SECTION 100.3200(a)(2)(C) AS AMENDED IN 2010 IS INVALID AS IT VIOLATES THE FOREIGN COMMERCE CLAUSE

50. Petitioner realleges and reincorporates paragraphs 1-30 of the Petition herein.

ANSWER: The Department restates and realleges its answers in Paragraphs 1 through 30 as if fully set forth herein.

51. The Commerce Clause of the United States Constitution provides that:
“Congress shall have Power...to regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes.” Art I, Section 8, cl 3.

ANSWER: Paragraph 51 states a legal conclusion, not a material allegation of fact, therefore no answer is required. To the extent an answer is required, the Department admits the existence, force and effect of the Commerce Clause of the United States Constitution (“Commerce Clause”) and states that the Commerce Clause speaks for itself.

52. The United States Supreme Court has established a four-part test to analyze a tax impacting interstate commerce. Complete Auto Transit v. Brady, 430 U.S. 274 (1977). The second prong of that test finds that a tax may not discriminate against interstate commerce.

ANSWER: Paragraph 52 states a legal conclusion, not a material allegation of fact, therefore no answer is required. To the extent an answer is required, the Department admits the existence, force and effect of the cited case law and states that the case law speaks for itself.

53. The United States Supreme Court has held that a tax impacting foreign commerce must also meet the four-part test. Therefore, a State may not discriminate against foreign commerce. Japan Lines, Ltd, v. County of Los Angeles, 441 U.S. 434 (1979).

ANSWER: Paragraph 53 states a legal conclusion, not a material allegation of fact, therefore no answer is required. To the extent an answer is required, the Department admits the existence, force and effect of the cited case law and states that the case law speaks for itself.

54. As noted above, Illinois amended Regulation Section 100.3200(a)(2)(C) regarding sales in foreign commerce. This amendment unilaterally determined that:
“A person who is not required to pay net income tax by a foreign country or political subdivision as the result of a treaty provision exempting

certain persons, business activities or sources of income from tax is not subject to net income tax in that jurisdiction.”

ANSWER: Paragraph 54 states a legal conclusion, not a material allegation of fact, therefore no answer is required. To the extent an answer is required, the Department admits the existence, force and effect of the Illinois Income Tax Regulations (86 Ill. Adm. Code 100 *et seq.*) and states that such regulation speaks for itself.

55. This Regulation Section 100.3200(a) has the effect of treating foreign sales less favorably than domestic sales. A sale to a foreign country who does not impose a net income tax by virtue of a treaty is treated differently than a sale to a state who does not impose a net income tax. This differing treatment of Petitioner’s foreign sales is a direct violation of the Commerce Clause.

ANSWER: Paragraph 55 states a legal conclusion, not a material allegation of fact, therefore no answer is required. To the extent an answer is required, the Department denies the allegations in Paragraph 55.

56. Petitioner thereby contends that based on the aforementioned Commerce Clause violation resulting from the Department’s application of Regulation Section 100.3200(a)(2)(C), the service sales at issue remain in Petitioner’s sales factor denominator and the Department’s assessment from this issue be withdrawn.

ANSWER: Paragraph 56 states a legal conclusion, not a material allegation of fact, therefore no answer is required. To the extent an answer is required, the Department denies the allegations in Paragraph 56.

ERROR IV – INCLUDING THE INCOME FROM THE TRANSACTIONS AT ISSUE IN THE PETITIONER’S TAXABLE INCOME WHILE EXCLUDING THE SALES IN THE SALES FACTOR DENOMINATOR FAILS THE EXTERNAL CONSISTENCY TEST AND DOES NOT ALLOW THE REPRESENTATION OF THE TRANSACTIONS IN THE SALES FACTOR

57. Petitioner realleges and reincorporates paragraphs 1-30 of the Petition herein.

ANSWER: The Department restates and realleges its answers in Paragraphs 1 through 30 as if fully set forth herein.

58. It is a widely accepted principle that income to be included in the tax base is also included in the sales factor apportionment. The purpose is to provide equitable taxation in those states where the taxpayer derives the economic benefits of its presence. Goldberg v. Sweet, 488 U.S. 252 (1989). Allowing for taxation of the income without representation in the factor does not follow basic equity or fairness.

ANSWER: Paragraph 58 states a legal conclusion, not a material allegation of fact, therefore no answer is required. To the extent an answer is required, the Department admits the existence, force and effect of the cited case law and states that the case law speaks for itself.

59. The Department has not proposed a change to the Petitioner's base income to remove the income generated from the sale of services at issue. Moreover, receipts from the transactions at issue were properly included in the sales factor pursuant to Illinois statutory provisions. The only changes before us are reductions to the Petitioner's sales factor denominator.

ANSWER: The Department admits there was no change to Petitioner's base income. The remaining allegations contained in Paragraph 59 call for a legal conclusion for which no answer is required.

60. The service sales at issue were not received in the State of Illinois. The exclusion of the sales from the sales factor would cause income to be allocated to Illinois that is already being justly allocated to other jurisdictions.

ANSWER: Paragraph 60 states a legal conclusion, not a material allegation of fact, therefore no answer is required. To the extent an answer is required, the Department denies the allegations in Paragraph 60.

61. Based on the Petitioner's facts presented above and the express language of the IITA as supported by the Goldberg v. Sweet Opinion, the Petitioner properly sourced the sales of services at issue and the proposed tax assessment should be withdrawn.

ANSWER: Paragraph 61 states a legal conclusion, not a material allegation of fact, therefore no answer is required. To the extent an answer is required, the Department denies the allegations in Paragraph 61. To the extent an answer is required, the Department admits the existence, force and effect of the cited case law and states that the case law speaks for itself.

ERROR V - AS A COMPLETELY INDEPENDENT BASIS FOR OBJECTING TO THE NOTICES AT ISSUE BEYOND WHAT IS MENTIONED IN ERRORS I THRU IV ABOVE, PETITIONER SUBMITS THAT THE DUE PROCESS, EQUAL PROTECTION AND UNIFORMITY PROVISIONS OF THE UNITED STATES CONSTITUTION AND ILLINOIS CONSTITUTION PROHIBIT THE DEPARTMENT FROM EXCLUDING THE SALES OF SERVICES AT ISSUE FROM PETITIONER'S SALES FACTOR

62. Petitioner realleges and reincorporates paragraphs 1-30 of the Petition herein.

ANSWER: The Department restates and realleges its answers in Paragraphs 1 through 30 as if fully set forth herein.

63. Petitioner contends that the exclusion of the sales at issue from its sales factor is unconstitutional pursuant to the due process, equal protection and uniformity clause provisions.

ANSWER: The Department denies the allegations in Paragraph 63.

64. The United States Supreme Court explained in Mead that:

“The Commerce Clause and the Due Process Clause impose distinct but parallel limitations on a State's power to tax out-of-state activities. Mead citing Quill Corp. v. North Dakota, 504 U. S. 298, 305-306 (1992); Mobil Oil Corp., 445 U. S., at Miller Brothers Co. v. Maryland 451, n. 4 (STEVENS, J., dissenting); Norfolk & Western R. Co. v. Missouri Tax Comm'n, 390 U. S. 317, 325, n. 5 (1968). The Due Process Clause demands that there exist “ `some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax,” as well as a rational relationship between the tax and the “ `“values connected with the taxing State.”” Quill Corp., supra, at 306 (quoting, 347 U. S. 340, 344-345 (1954), and Moorman Mfg. Co. v. Bair, 437 U. S. 267, 273 (1978)). The Commerce Clause forbids the States to levy taxes that discriminate against interstate commerce or that burden it by subjecting activities to multiple or unfairly apportioned taxation. See Container Corp., 463 U. S., at 170-171; Armco Inc. v. Hardesty, 467 U. S. 638, 644 (1984). The “broad inquiry” subsumed in both constitutional requirements is “ `whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state’ ”—that is, “ `whether the state has given anything for which it can ask return.’” ASARCO Inc. v. Idaho Tax Comm'n, 458 U. S. 307, 315 (1982) (quoting Wisconsin v. J. C. Penney Co., 311 U. S. 435, 444 (1940)).

ANSWER: Paragraph 64 states a legal conclusion, not a material allegation of fact, therefore no answer is required. To the extent an answer is required, the Department admits the existence, force and effect of the cited case law and states that the case law speaks for itself.

65. Accordingly, Petitioner contends that denying its factor representation of the sales at issue from the properties is unconstitutional.

ANSWER: Paragraph 65 states a legal conclusion, not a material allegation of fact, therefore no answer is required. To the extent an answer is required, the Department denies the allegations in Paragraph 65.

66. Based on the Petitioner’s facts presented above and the express language of the IITA, the Petitioner properly sourced the sales at issue and the proposed tax assessments should be withdrawn in total.

ANSWER: Paragraph 66 states a legal conclusion, not a material allegation of fact, therefore no answer is required. To the extent an answer is required, the Department denies the allegations in Paragraph 66.

ERROR VI – THE ILLINOIS SALES FACTOR NUMERATOR SHOULD NOT BE ADJUSTED TO INCLUDE PETITIONER’S OTHER INCOME SALES PURSUANT TO 35 ILCS 5/304(a)(3)(C-5) AS THE MAJORITY OF INCOME-PRODUCING ACTIVITIES FOR SUCH TRANSACTIONS WERE PERFORMED OUTSIDE OF ILLINOIS

67. Petitioner re-alleges and reincorporates paragraphs 1-30 of the Petition herein.

ANSWER: The Department restates and realleges its answers in Paragraphs 1 through 30 as if fully set forth herein.

68. As indicated in the facts above, Petitioner reports “other income” items from activities conducted in Illinois, other states and foreign countries.

ANSWER: The terms “reports”, “other states” and “foreign countries” are not defined and are vague and ambiguous. The Department lacks sufficient information to either admit or deny the factual allegations contained in Paragraph 68.

69. Petitioner’s 2013 and 2014 Illinois income tax returns at issue correctly included Petitioner’s sales from the “other income” items in Petitioner’s sales factor numerator if the majority of the underlying income producing activity for that item was performed in Illinois pursuant to 35 ILCS 5/304(a)(3)(C-5).

ANSWER: Paragraph 69 states a legal conclusion, not a material allegation of fact, therefore no answer is required. To the extent an answer is required, the Department lacks sufficient information to either admit or deny the factual allegations contained in Paragraph 69.

70. Petitioner’s 2013 and 2014 Illinois income tax returns at issue did not include Petitioner’s sales from the “other income” items in Petitioner’s sales factor numerator if the majority of the underlying income producing activity for that item was performed in a State other than Illinois pursuant to 35 ILCS 5/304(a).

ANSWER: Paragraph 70 states a legal conclusion, not a material allegation of fact, therefore no answer is required. To the extent an answer is required, the Department

lacks sufficient information to either admit or deny the factual allegations contained in Paragraph 70.

71. The Department incorrectly adjusted Petitioner’s sales factor, citing 35 ILCS 5/304(a)(3)(C) and 86 IL Adm. Code 100.3370(c)(3), to include in Petitioner’s sales factor numerator receipts (other than receipts from sales of tangible personal property) for which the Department contends the majority of Petitioner’s income-producing activities were performed in Illinois.

ANSWER: The Department denies the allegations in Paragraph 71.

72. Article 3 of the IITA requires the apportionment of business income between Illinois and other States based on the Taxpayer’s business activities in each state. Moreover, Section 304(a)(3)(C-5)(iii) of the IITA expressly provides that the receipts from intangibles are located in Illinois if “the income-producing activity is performed both within and without this State and a greater proportion of the income-producing activity is performed within this State than without this State, based on performance costs.”

ANSWER: Paragraph 72 states a legal conclusion, not a material allegation of fact, therefore no answer is required. To the extent an answer is required, the Department admits the existence, force and effect of the Illinois Income Tax Act, (35 ILCS 5/101 *et seq.*) and states that such statute speaks for itself.

73. Illinois Regulation Section 100.3370 provides the following guidance and definitions concerning the terms “income producing activity” and “costs of performance”:

86ILAC100.3370(c)(3)(A) Income producing activity defined.

The term “income producing activity” applies to each separate item of income and means the transactions and activity directly engaged in by the person in the regular course of its trade or business for the ultimate

purpose of obtaining gains or profit. Such activity does not include transactions and activities performed on behalf of a person, such as those conducted on its behalf by an independent contractor. The mere holding of intangible personal property is not, of itself, an income producing activity.

ANSWER: Paragraph 73 states a legal conclusion, not a material allegation of fact, therefore no answer is required. To the extent an answer is required, the Department admits the existence, force and effect of the Illinois Income Tax Regulations (86 Ill. Adm. Code 100 *et seq.*) and states that such regulation speaks for itself.

74. More specifically, Regulation Section 100.3370(c)(3)(D)(iii) describes a situation very much on point to this matter where certain personal services not directly connected with the performance of the revenue service at issue are not includable in the cost of performance computation:

... Personal service not directly connected with the performance of the contract or other obligation, as for example, time expended in negotiating the contract, is excluded from the computations. ...

ANSWER: Paragraph 74 states a legal conclusion, not a material allegation of fact, therefore no answer is required. To the extent an answer is required, the Department admits the existence, force and effect of the Illinois Income Tax Regulations (86 Ill. Adm. Code 100 *et seq.*) and states that such regulation speaks for itself.

75. Based on these definitions, “income producing activity” applies to each separate item of income and consists of those activities “directly engaged in” by a person in the regular course of its trade or business.

ANSWER: Paragraph 75 states a legal conclusion, not a material allegation of fact, therefore no answer is required. To the extent an answer is required, the Department admits the existence, force and effect of the Illinois Income Tax Regulations (86 Ill. Adm. Code 100 *et seq.*) and states that such regulation speaks for itself.

76. Based on the information provided above, less than 50% of Petitioner's cost from the other income transactions are attributable to Illinois and the receipts from such transactions were correctly reported in Petitioner's sales factor denominator and should not be reported in Petitioner's sales factor numerator pursuant to the provisions of IITA Section 304 and Illinois Regulation Section 100.3370.

ANSWER: Paragraph 76 states a legal conclusion, not a material allegation of fact, therefore no answer is required. To the extent an answer is required, the Department admits the existence, force and effect of the Illinois Income Tax Act (35 ILCS 5/101 et seq.) and the Illinois Income Tax Regulations (86 Ill. Adm. Code 100 et seq.) and states that such statute and regulation speaks for themselves.

77. Accordingly, Petitioner requests that the "other income" sales at issue remain in Petitioner's sales factor denominator, not be included in Petitioner's sales factor numerator and that the Department's assessment from this issue be withdrawn.

ANSWER: Paragraph 77 does not contain a material allegation of fact to which an answer is required. To the extent an answer is required, the Department denies the allegations in Paragraph 77.

ERROR VII - ABATEMENT OF PENALTIES AND INTEREST PURSUANT TO REASONABLE CAUSE PROVISIONS OF REGULATION SECTION 700.400

78. Petitioner realleges and reincorporates paragraphs 1- 30 of the Petition herein.

ANSWER: The Department restates and realleges its answers in Paragraphs 1 through 30 as if fully set forth herein.

79. For the period ending December 2013, Petitioner requests the abatement under the reasonable cause provisions of Regulation 700.400 of \$13,306.94 of UPIA-5 late payment penalties and \$8,951.98 in interest.

ANSWER: The Department denies the allegations in Paragraph 79.

80. For the period ending December 2014, Petitioner requests the abatement under the reasonable cause provisions of Regulation Section 700.400 of \$43,336.69 of UPIA-5 late penalty payment penalties and \$20,726.83 of interest.

ANSWER: The Department denies the allegations in Paragraph 80.

81. Petitioner contends that in completing its 2013 and 2014 Illinois income tax returns it made a good faith effort to comply with the law and exercised ordinary business care and prudence as it followed Illinois statutory and regulatory provisions by including all of its sales receipts, including sales to its foreign parent, in its Illinois sales factor pursuant to Illinois statutes and regulations.

ANSWER: Paragraph 81 states a legal conclusion, not a material allegation of fact, therefore no answer is required. To the extent an answer is required, the Department denies the allegations in Paragraph 81.

82. Petitioner further contends that it was reasonable to source “other income” items outside of Illinois pursuant to the provisions of Illinois statutes and regulations.

ANSWER: Paragraph 82 states a legal conclusion, not a material allegation of fact, therefore no answer is required. To the extent an answer is required, the Department denies the allegations in Paragraph 82.

83. With respect to the other tax assessments reported in the Notices, Petitioner avers that the penalties originating from those items should also be abated as the Petitioner made a good faith effort to comply with the law and exercised ordinary business care in preparation of the 2013 and 2014 Illinois income tax returns.

ANSWER: Paragraph 83 states a legal conclusion, not a material allegation of fact, therefore no answer is required. To the extent an answer is required, the Department denies the allegations in Paragraph 83.

84. Finally, the Department’s Regulations on Reasonable Cause look to whether the Petitioner “made a good faith effort” and exercised “ordinary business care and prudence”. 86 Illinois Admin. Code Section 700.400. (35 ILCS 735-3/8.) As indicated above, Petitioner made every effort to comply with the Illinois income tax statutes and regulations and correctly determined that the Illinois taxable income and that its 2013 and 2014 income tax returns were prepared correctly as originally filed. The information provided above supports the abatement of all penalties and interest assessed on the Notices under the reasonable cause provisions.

ANSWER: Paragraph 84 states a legal conclusion, not a material allegation of fact, therefore no answer is required. To the extent an answer is required, the Department admits the existence, force and effect of the Uniform Penalty and Interest Act (35 ILCS 735/3-1 *et seq.*) and Illinois Income Tax Regulations (86 Ill. Adm. Code 700 *et seq.*) and states that such statute and regulation speak for themselves. The Department denies the allegations in Paragraph 84.

WHEREFORE, the Department prays this Tribunal enter an Order that:

- a. Denies each prayer for relief in Petitioner’s Petition;
- b. Find the Notices of Deficiency are correct as issued;
- c. Order judgment in favor of the Department and against Petitioners; and
- d. Grant any further relief this Tribunal deems just and reasonable.

Respectfully Submitted,
Illinois Department of Revenue

By: /s/ Valerie A. Puccini

Sean P. Cullinan
Valerie A. Puccini
Illinois Department of Revenue
Office of Legal Services
100 W. Randolph Street, 7-900
Chicago, IL 60601
Valerie.a.puccini@illinois.gov
Sean.cullinan@illinois.gov

VERIFICATION

The undersigned, being first duly sworn on oath states that he has reviewed the foregoing Department's Answer to Petitioner's Petition, that he is well acquainted with its contents, and under penalties as provided by law pursuant to 735 ILCS 5/1-109 of the Illinois Code of Civil Procedure, he certifies that the statements set forth in that instrument are true and correct, except as to allegations claiming lack of sufficient knowledge (Paragraphs 7-16, 19-23, 26-27, 32, 34-36, 41-42, 68-70) pursuant to 735 ILCS 5/2-610(b), which he verily believes to be true.

A handwritten signature in cursive script that reads "Joe Myers". The signature is written in black ink and is positioned above a horizontal line.

Joe Myers
Revenue Auditor Supervisor
Illinois Department of Revenue