

**ILLINOIS INDEPENDENT
TAX TRIBUNAL**

GRAND TRUNK WESTERN RAILROAD)	
COMPANY FOR ITSELF AND AS SUCCESSOR)	
TO GRAND TRUNK WESTERN RAILROAD INC))	
Petitioner,)	15 TT 68
v.)	Chief Judge James M. Conway
THE STATE OF ILLINOIS)	
DEPARTMENT OF REVENUE,)	
Respondent.)	

ANSWER

NOW COMES the Department of Revenue of the State of Illinois (the “Department”), through its attorney, Lisa Madigan, Attorney General of and for the State of Illinois, and for its Answer to the Petition (the “Petition”) of Grand Trunk Western Railroad Company, for Itself and as Successor to Grand Trunk Western Railroad Inc. (the “Petitioner”), respectfully pleads as follows:

PARTIES

1. For the tax years ending December 31, 2007 and December 31, 2008 (“Years in Issue”), Petitioner was an Illinois corporation whose principal business address was 17641 Ashland Avenue, Homewood, Illinois.

ANSWER: The information contained in paragraph 1 is required by Illinois Independent Tax Tribunal Regulation (“Rule”) 310(a)(1)(A) (86 Ill. Adm. Code § 5000.310(a)(1)(A)) and is not

a material allegation of fact, and therefore does not require an answer pursuant to Rule 310(b)(2). Notwithstanding the above, the Department admits that Petitioner maintains an office in Homewood, Illinois.

2. Petitioner is represented by Fred O. Marcus, David A. Hughes and Samantha K. Breslow of Horwood Marcus & Berk Chartered, located at 500 West Madison St., Suite 3700, Chicago, Illinois 60661, who can be reached at 312-606-3210 or fmarcus@hmbllaw.com; 312-606-3212 or dhughes@hmbllaw.com; and sbreslow@hmbllaw.com or 312-606-3206 respectively.

ANSWER: The information contained in paragraph 2 is required by Rule 310(a)(1)(A) and is not a material allegation of fact, and therefore does not require an answer pursuant to Rule 310(b)(2). Notwithstanding the above, the Department admits the factual allegations contained in Paragraph 2.

3. Grand Trunk Western Railroad Company's FEIN is 38-3062329.

ANSWER: The information contained in paragraph 3 is required by Rule 310(a)(1)(A) and is not a material allegation of fact, and therefore does not require an answer pursuant to Rule 310(b)(2). Notwithstanding the above, the Department admits the factual allegations contained in Paragraph 3.

4. Grand Trunk Western Railroad Inc.'s FEIN was 01-0324809.

ANSWER: The information contained in paragraph 3 is required by Rule 310(a)(1)(A) and is not a material allegation of fact, and therefore does not require an answer pursuant to Rule 310(b)(2). Notwithstanding the above, the Department admits the factual allegations

contained in Paragraph 4.

5. The Department is an agency of the Executive Department of the State Government and is tasked with the enforcement and administration of Illinois tax laws. 20 ILCS 5/5-15.

ANSWER: The Department admits that the Department is an agency of the State of Illinois and that the Department is responsible for enforcing the Illinois Income Tax Act (35 ILCS 5/101 et seq.), which is relevant to the legal claims raised in the Petition. The term “tax laws” is ambiguous and therefore the Department denies all other allegations contained in Paragraph 5.

NOTICES

6. On February 11, 2015, the Department denied Petitioner’s claims for refund of \$452,823.00 and 940,922.00. The Notices of Claim Denial (“Notices”) are attached hereto as Exhibit A.

ANSWER: The Department admits the factual allegations contained in Paragraph 6.

JURISDICTION

7. Petitioner brings this action pursuant to the Illinois Independent Tax Tribunal Act (“Tribunal Act”), 35 ILCS 1010/1-1 to 35 ILCS 1010/1-100 and the Illinois Income Tax Act (“Illinois Income Tax Act”), 35 ILCS 5/101 et. seq.

ANSWER: Paragraph 7 contains a legal conclusion, not a material allegation of fact, and therefore does not require an answer pursuant to Rule 310(b)(2). Notwithstanding this objection or waiving same, the Department admits the statutes referred to in Paragraph 7 exist

and are in effect and states that such statutes speak for themselves.

8. The Tribunal has jurisdiction over this matter pursuant to Sections 1-45 and 1-50 of the Tribunal Act because Petitioner timely filed a protest within 60 days of both Notices.

ANSWER: Paragraph 8 contains a legal conclusion, not a material allegation of fact, and therefore does not require an answer pursuant to Rule 310(b)(2). Notwithstanding the above, the Department admits the sections of the Tribunal Act referred to in Paragraph 8 exist and are in effect and states that such Sections of the Tribunal Act speak for themselves.

BACKGROUND

9. Grand Trunk Western Railroad Company is a direct wholly-owned subsidiary of Grand Trunk Corporation (“Borrower”) and an indirect wholly-owned subsidiary of Canadian National Railway Company (“Parent”).

ANSWER: The Department admits the allegations contained in Paragraph 9.

10. Petitioner is a corporation organized under the laws of the State of Michigan.

ANSWER: The Department denies the allegations contained in Paragraph 10.

11. Parent is a corporation organized under Canadian law whose shares are publicly traded on both the Toronto and New York stock exchanges.

ANSWER: The Department lacks the knowledge or information sufficient to form a belief as to the truth or falsity of the allegations contained in Paragraph 11.

12. On September 1, 2008 Grand Trunk Western Railroad Inc. was merged with and into its sister company St. Clair Tunnel Company (“SCTC”), a Michigan corporation.

ANSWER: The Department admits that on September 1, 2008 Grand Trunk Western Railroad Inc. was merged with and into St. Clair Tunnel Company (“SCTC”); the Department lacks the knowledge or information sufficient to form a belief as to the truth or falsity of the remaining allegations contained in Paragraph 12.

13. SCTC was the surviving company in the merger and immediately changed its name to Grand Trunk Western Railroad Company.

ANSWER: The Department admits the allegations contained in Paragraph 13.

14. Grand Trunk Western Railroad Inc. was the designated agent for Petitioner’s unitary business group for tax years through December 31, 2007.

ANSWER: The Department admits that Grand Trunk Western Railroad Inc. was the designated agent for the Petitioner’s unitary business group for the tax year ending December 31, 2007; the Department lacks the knowledge or information sufficient to form a belief as to the truth or falsity of the remaining allegations contained in Paragraph 14.

15. Grand Trunk Western Railroad Company was the designated agent for Petitioner’s unitary business group for tax years through 2008 and after.

ANSWER: The Department admits that Grand Trunk Western Railroad Company was the designated agent for the Petitioner’s unitary business group for the tax years ending December 31, 2008 and December 31, 2009; the Department lacks the knowledge or information sufficient to form a belief as to the truth or falsity of the remaining allegations contained in

Paragraph 15.

16. Parent obtains publicly issued long-term debt financing to serve its capital needs and the needs of the Borrower, allowing for more favorable interest rates on the debt incurred.

ANSWER: The Department lacks the knowledge or information sufficient to form a belief as to the truth or falsity of the allegations contained in Paragraph 16.

17. Some of the funds obtained by Parent in the capital markets from unrelated creditors are provided to Borrower through intercompany debt financing to meet Borrower's debt capital needs.

ANSWER: The Department lacks the knowledge or information sufficient to form a belief as to the truth or falsity of the allegations contained in Paragraph 17.

18. Interest paid by Borrower to Parent provides funds for Parent's payment of interest on Parent's debt to unrelated third parties.

ANSWER: The Department lacks the knowledge or information sufficient to form a belief as to the truth or falsity of the allegations contained in Paragraph 18.

19. Petitioner filed a combined Illinois corporation income and replacement tax return for the Years in Issue, and Borrower was included in each combined return as a member of Petitioner's Illinois unitary business group.

ANSWER: The Department admits the allegations contained in Paragraph 19.

20. During the Years in Issue, Borrower incurred and paid interest on indebtedness to Parent.

ANSWER: The Department admits the allegations contained in Paragraph 20.

21. On its original timely-filed unitary returns for the Years in Issue, Petitioner reported this interest as an addition modification on Schedule 80/20, Related-Party Expenses.

ANSWER: The Department admits the allegations contained in Paragraph 21.

22. Borrower's interest paid to Parent is exempt from add-back pursuant to Illinois Income Tax Act ("Act") Section 203(b)(2)(E-12)(ii) (35 ILCS 5/203(b)(2)(E-12)(ii)).

ANSWER: The Department denies the allegations contained in Paragraph 22.

23. Petitioner subsequently filed amended returns for the Years in Issue to reverse the Schedule 80/20 related-party interest addition and requested a refund relating to this adjustment.

ANSWER: The Department admits the allegations contained in Paragraph 23.

24. The Department denied Petitioner's refund claims on February 11, 2015.
Exhibit A.

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

COUNT I

The Interest Paid by Borrower to Parent is Exempt from Add-back

25. Petitioner realleges and incorporates by this reference the allegations made in paragraphs 1 through 24.

ANSWER: The Department incorporates and repeats its answers to paragraphs 1 through 24 as if fully set forth herein.

26. The Act requires a taxpayer to make an addition modification in an amount equal to the amount otherwise allowed as a deduction in computing base income for interest paid, accrued, or incurred directly or indirectly, to a foreign person who would be a member of the same unitary business group but for the fact that the foreign person's business activity outside the United States is 80% or more of the foreign person's total business activity. 35 ILCS 2/203(b)(2)(E-12).

ANSWER: Paragraph 26 contains a legal conclusion, not a material allegation of fact, and therefore does not require an answer pursuant to Rule 310(b)(2). Notwithstanding this objection or waiving same, the Department admits the statute referred to in Paragraph 26 exists and is in effect and states that such statute speaks for itself.

27. The Act states that interest paid to a related party is exempt from add-back if the taxpayer can establish, based on a preponderance of the evidence, both of the following: (a) the related person, during the same taxable year, paid, accrued or incurred the interest to an unrelated third party; and (b) the transaction giving rise to the interest expense between the

taxpayer and the related party did not have as a principal purpose the avoidance of Illinois income tax, and is paid pursuant to a contract or agreement that reflects an arm's-length interest rate and terms. 35 ILCS 2/203(b)(2)(E-12)(ii).

ANSWER: Paragraph 27 contains a legal conclusion, not a material allegation of fact, and therefore does not require an answer pursuant to Rule 310(b)(2). Notwithstanding this objection or waiving same, the Department admits the statute referred to in Paragraph 27 exists and is in effect and states that such statute speaks for itself.

28. During the Years in Issue, the interest received by the Parent from the Borrower was paid or accrued to an unrelated third party.

ANSWER: The Department lacks the knowledge or information sufficient to form a belief as to the truth or falsity of the allegations contained in Paragraph 28.

29. There is a direct correlation between the amount of intercompany debt of Borrower to Parent for each year and the incremental long-term debt to third parties incurred by Parent for each year.

ANSWER: Paragraph 29 contains a legal conclusion, not a material allegation of fact, and therefore does not require an answer pursuant to Rule 310(b)(2). To the extent an answer is required, the Department denies the factual allegations contained in Paragraph 29.

30. The principal purpose of Borrower's intercompany financing arrangement was to provide Borrower access to debt capital using the financial strength and borrowing power of its Parent in a way that achieved market and administrative efficiencies for the entire unitary

group.

ANSWER: Paragraph 30 contains a legal conclusion, not a material allegation of fact, and therefore does not require an answer pursuant to Rule 310(b)(2). To the extent an answer is required, the Department denies the factual allegations contained in Paragraph 30.

31. Borrower incurred interest on the intercompany debt to Parent at a rate of \$66 million per year while Parent incurred interest to third parties on its incremental debt at a rate of \$78 million per year.

ANSWER: The Department lacks knowledge or information sufficient to form a belief as to the truth or falsity of the allegations contained in Paragraph 31.

32. The related party borrowing did not generate any greater Illinois tax deductions nor any lower Illinois tax liability for Petitioner than would have resulted from unrelated third party debt.

ANSWER: The Department denies the allegations contained in Paragraph 32.

33. The intercompany debt transaction did not have as a principal purpose the avoidance of Illinois income tax.

ANSWER: Paragraph 33 calls for a legal conclusion, is not a material allegation of fact, and therefore does not require an answer pursuant to Rule 310(b)(2).

34. Petitioner did not identify the interest as deductible until the Department initiated an audit of the Petitioner's return for the Years in Issue.

ANSWER: The Department lacks knowledge or information sufficient to form a belief as to the truth or falsity of the allegations contained in Paragraph 34.

35. Petitioner did not amend its returns or file refund claims attempting to deduct the interest in question until the Department audited its returns for the Years in Issue.

ANSWER: The Department admits that the Petitioner's amended returns for the tax years ending December 31, 2007 and December 31, 2008 (the "Years in Issue") were filed, after the Department initiated its audit of the Petitioner's returns for the Years in Issue, to reverse the addition modifications on the Petitioner's Schedules 80/20, corresponding to the interest that Grand Trunk Corporation incurred and paid on indebtedness to Canadian National Railway Company. The Department denies the remaining allegations contained in Paragraph 35.

36. Parent issued third party debt at arm's-length interest rates of 6.20%, 6.71%, 5.85%, and 6.38%, whereas Borrower's intercompany debt to Parent was issued at interest rates of 6.15% and 6.51%.

ANSWER: The Department lacks the knowledge or information sufficient to form a belief as to the truth or falsity of the allegations contained in Paragraph 36.

37. The intercompany debt between Borrower and Parent is supported by an arm's-length interest rate and terms.

ANSWER: Paragraph 37 calls for a legal conclusion, is not a material allegation of fact, and therefore does not require an answer pursuant to Rule 310(b)(2).

38. Petitioner is entitled to a refund because the interest paid by Borrower to Parent is exempt from add-back pursuant to the exception provided by the Act Section 203(b)(2)(E-12)(ii) (35 ILCS 5/203(b)(2)(E-12)(ii)).

ANSWER: The Department denies the allegations contained in Paragraph 38.

39. The Department's denial of Petitioner's refund claims for the Years in Issue was in error.

ANSWER: The Department denies the allegations contained in Paragraph 39.

WHEREFORE, the Department respectfully requests this Tribunal to:

- (a) deny each prayer for relief in Count I of the Petition;
- (b) find that the Notices of Denial correctly reflect the Petitioner's Illinois income;
- (c) enter judgment in favor of the Department and against the Petitioner;
and
- (d) grant any further relief this Tribunal deems just and appropriate.

Dated: May 22, 2015

Respectfully submitted,

LISA MADIGAN
Attorney General
State of Illinois

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)	
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AFFIDAVIT OF KIMBERLY HARTON
PURSUANT TO TRIBUNAL RULE 5000.310(b)(3)

Under penalties as provided by Section 1-109 of the Code of Civil Procedure, 735 ILCS § 5/1-109, I, Kimberly Harton, being first duly sworn on oath, depose, and state as follows:

1. I am currently employed by the Illinois Department of Revenue.
2. My current title is Revenue Auditor III.
3. I reviewed the Illinois income tax audits of Grand Trunk Western Railroad Company, for Itself and as Successor to Grand Trunk Western Railroad Inc. (the "Petitioner"), for the tax years ending December 31, 2007 and December 31, 2008.
4. I lack the requisite knowledge to either admit or deny the allegations alleged in the Petitioner's Petition, Paragraphs 11, 12, 14-18, 28, 31, 34, and 36.
5. I am an adult resident of the State of Illinois and can truthfully and competently testify to the matters contained herein based upon my own personal knowledge.

Under penalties as provided by law pursuant to Section 1-109 of the Code of Civil Procedure, the undersigned certifies that the statements set forth in this instrument are true and correct, except as to matters therein stated to be on information and belief and as to such matters the undersigned certifies as aforesaid that she verily believes the same to be true.

Kimberly A. Harton
Kimberly Harton
Revenue Auditor III
Illinois Department of Revenue

Date: 5/20/15