

**IN THE ILLINOIS INDEPENDENT TAX TRIBUNAL**

CSX TRANSPORTATION, INC.	)	
	)	
Petitioner,	)	
	)	
v.	)	No. 19 TT 130
	)	
THE ILLINOIS DEPARTMENT OF REVENUE,	)	
	)	
Defendant.	)	

**ANSWER**

NOW COMES the Department of Revenue of the State of Illinois (“Department”), through its attorney, Kwame Raoul, Attorney General of and for the State of Illinois and for its Answer to Taxpayer’s Amended Petition respectfully pleads as follows:

**PARTIES**

1. Petitioner is a Delaware C corporation with its principal place of business in Jacksonville, Florida. It is located at 500 Water Street, C-115, Jacksonville, Florida 32202.

**ANSWER:** The information contained in paragraph 1 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 1.

2. Petitioner is represented by Breen M. Schiller and David W. Machemer of Horwood Marcus & Berk Chartered, located at 500 West Madison Street, Suite 3700, Chicago, Illinois 60661. Breen M. Schiller can be reached at 312-606-3220 or bschiller@hmblaw.com and David W. Machemer can be reached at 312-242-3302 or dmachemer@hmblaw.com.

**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 as of the date the Amended

Petitioner was filed but believes that Breen Schiller is now with Eversheds, Sutherland at 900 N. Michigan, Suite 1000, Chicago, Illinois 60611 can be reached at 312-724-8521 or [breenschiller@eversheds-sutherland.com](mailto:breenschiller@eversheds-sutherland.com). The Department can neither admit nor deny whether David W. Machemer represents the Petitioner.

3. Petitioner's FEIN is 54-6000720.

**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. Petitioner is the designated agent of a unitary group of corporations filing an Illinois combined corporate income tax return.

**ANSWER:** The information contained in paragraph 4 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 information contained in paragraph 5 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 5.

## **NOTICES**

6. On July 8, 2019, the Department issued Notices of Deficiency ("Notices") to Petitioner in the amounts of \$8,743,332.14 and \$6,894,866.40 for the tax years ending December 2014 and December 2015 ("Years at Issue"), respectively. True and accurate copies of the Notices

are attached hereto as **Exhibit A**.

**ANSWER:** Department admits the factual allegations in Paragraph 6.

7. The adjustments made to the tax year ending December 2014 resulted in the Department's assessment of \$6,352,885.00 in tax, \$1,120,234.00 in interest \$1,270,516.00 in penalties, for a total amount due of \$8,743,332.14.

**ANSWER:** Department admits the factual allegations in Paragraph 7.

8. The adjustments made to the tax year ending December 2015, resulted in the Department's additional assessment of \$5,120,686.00 in tax, \$749,500.00 in interest, and \$1,024,436.00 in penalties, for a total amount due of \$6,894,622.00.

**ANSWER:** Department admits the factual allegations in Paragraph 8.

9. The Department's adjustments to the Years at Issue fall into one of three categories: (1) cross-group elimination of taxable income; (2) adjustment to the numerator of BOCT's Illinois sales factor; and (3) the adjustment of Petitioner's Veterans Jobs Credit.

**ANSWER:** Department admits the factual allegations in Paragraph 9.

### **JURISDICTION**

10. 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 ("Act"), 35 ILCS 5/201 et. seq.

**ANSWER:** Paragraph 10 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 Illinois Independent Tax Tribunal Act of 2012 (35 ILCS 1010/1-1, *et seq.*) and the Illinois Income Tax Act (35 ILCS 5/201 et. seq exist and are in effect and said statutes speak for themselves.

11. The amount of additional Corporate Income and Replacement Taxes, interest and penalties for the tax year in issue exceeds \$15,000 thereby vesting jurisdiction in the Illinois Independent Tax Tribunal.

**ANSWER:** Paragraph 11 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 that the amount of additional Corporate Income and Replacement Taxes, interest and penalties for the tax year in issue exceeds \$15,000 and the Illinois Independent Tax Tribunal has jurisdiction over this matter pursuant the Illinois Independent Tax Tribunal Act.

12. This Tribunal has jurisdiction over this matter pursuant to Sections 1-45 and 1-50 of the Tribunal Act because Petitioner timely filed this petition within 60 days of the Department's Notices.

**ANSWER:** Paragraph 12 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 that the Tribunal has jurisdiction over this matter pursuant the Illinois Independent Tax Tribunal Act of 2012 (35 ILCS 1010/1-1, *et seq.*).

### **BACKGROUND**

13. The tax involved herein is the Illinois corporate income and replacement tax imposed under the Illinois Income Tax Act (the "Act"), 35 ILCS §5/201, *et seq.*

**ANSWER:** Paragraph 13 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 that the tax involved herein is the Illinois corporate income and replacement tax and that the Illinois Income Tax Act, 35 ILCS §5/201, *et seq* exists and is in effect and said statute speaks for itself.

14. CSX Corporation (“CSX”) is a publicly held company that, during the Years in Issue, through its subsidiaries, engaged in four business segments: Rail, Intermodal, Domestic Container Shipping and International terminals.

**ANSWER:** Department admits the factual allegation that CSX is a publicly held company. Notwithstanding this objection or waiving, The Department lacks the knowledge or information sufficient to form a belief as to the truth or falsity of the allegations CSX was engaged in four business segments.

15. Petitioner is a transportation company and wholly owned subsidiary of CSX.

**ANSWER:** Department admits the factual allegations in Paragraph 15. Legal conclusion?

16. Petitioner is a Class I railroad which, through its subsidiaries, operates one of the largest rail networks in the United States.

**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. Petitioner provides rail freight transportation over a network of more than 22,000 “first main” track miles in twenty-three states, the District of Columbia and two Canadian provinces.

**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. The Baltimore and Ohio Chicago Terminal Railroad Company (“BOCT”), incorporated under the laws of the State of Illinois in 1910, is a wholly owned subsidiary of Petitioner.

**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. BOCT is a carrier represented by the National Railway Labor Conference.

**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 19.

20. BOCT's employees are represented by the National Railway Labor Conference.

**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 20. It is unclear if BOCT even had employees.

21. BOCT is a carrier that provides switching services for freight in interstate commerce.

**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 21.

22. BOCT performs intermediate and terminal switching services for Petitioner and third-party eastern and western carriers as well as third-party non-carrier customers.

**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 22.

23. BOCT has customers in both Illinois and Indiana.

**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 23.

24. BOCT performs switching services for the Canadian National Railroad ("CN") at CN's Kirk Yard located in Indiana.

**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 24.

25. BOCT has a direct freight customer located in Indiana.

**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 25.

26. During the Years at Issue, the majority of BOCT's sales are intercompany sales with Petitioner.

**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 26.

27. Petitioner enters into contracts with third-party customers to ship freight by rail over and across interstate lines.

**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 27. Indiana customers?

28. To the extent that switching services are required as part of the freight movement Petitioner will engage a switching entity, including BOCT, to perform those services.

**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. Petitioner records a sale to its third-party interstate customer and to the extent that BOCT performs any switching services, Petitioner records intercompany expenses with BOCT on a cost-plus contract basis.

**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 29.

30. BOCT records its intercompany sale with Petitioner and incurs the expense of the switching.

**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 30.

31. During the Years at Issue, BOCT incurs third-party switching expenses through third-party sales with common carriers, as well as third-party non-carrier customers.

**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 31.

32. During the Years at Issue, BOCT's revenue was earned from interstate freight movements.

**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 32.

33. CSX Intermodal Terminals, Inc. (“CSXIT”) is a standalone integrated intermodal company that links customers to railroads via trucks and terminals, providing coast-to-coast intermodal lift services.

**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 33.

34. During the Years in Issue, CSX filed a Federal Consolidated 1120 (“Federal Return”) including all of its subsidiaries.

**ANSWER:** Department admits the factual allegation that CSX filed a Federal Consolidated 1120 during the Years in Issue. Notwithstanding this objection or waiving same, The Department lacks the knowledge or information sufficient to form a belief as to the truth or falsity of the allegation that the Federal Return included *all* of its subsidiaries.

35. During the Years in Issue, for Illinois purposes CSX was required by statute to file two separate unitary combined Illinois corporate income and replacement tax returns. See 35 ILCS §5/1501(a)(27).

**ANSWER:** Paragraph 35 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 that the statute 35 ILCS §5/1501 (a) (27) exists and is in effect and said statute speaks for itself.

36. During the Years in Issue, Petitioner and its unitary transportation companies filed a combined Illinois corporate income and replacement tax return (“Transportation Group”).

**ANSWER:** Department admits the factual allegations in Paragraph 36.

37. One of the entities included in Petitioner’s combined Illinois corporate income and replacement tax return in each of the Years in Issue was BOCT.



**ANSWER:** Department admits the factual allegations in Paragraph 37.

38. During the Years at Issue, CSXIT filed a combined Illinois corporate income and replacement tax return including CSX's non-transportation companies ("Non-Transportation Group").

**ANSWER:** Department admits the factual allegations in Paragraph 38.

39. During the Years at Issue on its Federal Returns, CSX had intercompany eliminations under line 26 (other deductions) called intercompany service fees.

**ANSWER:** Department admits the factual allegations in Paragraph 39.

40. These eliminations were comprised of various intercompany transactions between members of its consolidated federal return and netted to zero at the federal level.

**ANSWER:** The Department admits the allegations contained in Paragraph 40.

41. During the Years at Issue, for Illinois purposes intercompany transactions within the Transportation Group were properly eliminated by Petitioner.

**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 41.

42. During the Years at Issue, for Illinois purposes intercompany transactions that occurred between members of CSX's Transportation and Non-Transportation Groups were not eliminated because they did not occur between members of the same Illinois unitary combined group.

**ANSWER:** The parties have entered into an agreement with regard to the issue of Cross-Group Eliminations. The Parties have further agreed that a response to this statement is not necessary.

43. The Non-Transportation Group was previously audited by the Department for the Years at Issue and no adjustments were made to transactions that occurred between CSX's unitary business groups.

**ANSWER:** The Department can neither admit nor deny the factual allegations contained in Paragraph 43.

### **CONTROVERSY**

44. Petitioner timely filed its 2014 Illinois unitary corporate income and replacement tax return on October 10, 2014 via efile.

**ANSWER:** Department admits the factual allegations in Paragraph 44.

45. Petitioner timely filed its 2015 Illinois unitary corporate income and replacement tax return on October 13, 2016 via efile.

**ANSWER:** Department admits the factual allegations in Paragraph 45.

46. In January 2018, Petitioner was contacted by the Department in order to commence a review of Petitioner's Illinois corporate income and replacement tax returns for the Years at Issue.

**ANSWER:** Department admits the factual allegations in Paragraph 46.

47. Upon audit, the Department forced a cross-group elimination of intercompany transactions that occurred between members of CSX's two separate Illinois unitary business groups; adjusted BOCT's Illinois sales factor; and reduced Petitioner's Veterans Jobs Credit.

**ANSWER:** The parties have entered into an agreement with regard to the issue of Cross-Group Eliminations. The Parties have further agreed that a response to this statement is not necessary.

48. Upon audit, the Department eliminated BOCT's total intercompany revenue with Petitioner from apportionable revenue and then added it back as one-hundred percent allocable revenue in the numerator and denominator of Petitioner's Illinois apportionment factor.

**ANSWER:** Department denies the factual allegations in Paragraph 48.

49. These adjustments resulted in the assessment of additional corporate income tax for the taxable years ending December 31, 2014 and December 31, 2015, in the following amounts: 6,352,885.00 in tax, \$1,120,234.00 in interest \$1,270,516.00 in penalties, for a total amount due of \$8,743,332.14; and \$5,120,686.00 in tax, \$749,500.00 in interest, and \$1,024,436.00 in

penalties, for a total amount due of \$6,894,622.00, respectively.

**ANSWER:** Department admits the factual allegations in Paragraph 49.

## **COUNT I**

### **The Department's Cross-Group Elimination is Not Supported by Law and Results in the Taxation of Income Twice.**

50. Petitioner realleges and reincorporates the allegations in paragraphs 1 through 49, inclusive, hereinabove.

**ANSWER:** Paragraph 11 contains a legal conclusion, not a material allegation of fact, and therefore does not require an answer pursuant to Rule 310(b)(2).

51. During the Years at Issue, an Illinois unitary group could not include members normally required to apportion business income using different formulas. 35 ILCS §5/1501(a)(27).

**ANSWER:** Paragraph 51 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 that the Illinois Income Tax Act, 35 ILCS §5/1501 (a) (27), exists and is in effect and said statute speaks for itself.

52. During the Years at Issue, pursuant to Section 304(d) of the Act, entities that furnish transportation services were required to use a special method of formulary apportionment. 35 ILCS §5/304(d).

**ANSWER:** Paragraph 52 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 that the Illinois Income Tax Act, 35 ILCS §5/304 (d), exists and is in effect and said statute speaks for itself.

53. Pursuant to Illinois law, taxpayers are required to eliminate items of income and deduction

arising from transactions between members of the same unitary business group in order to avoid distortion.

86 Ill. Admin. Code §100.5270(b)(1).

**ANSWER:** The parties have entered into an agreement with regard to the issue of Cross-Group Eliminations. The Parties have further agreed that a response to this statement is not necessary.

54. There is no corresponding authority in Illinois law requiring a taxpayer to eliminate items of income and deduction arising from transactions between members of two separate unitary business groups (hereinafter “Cross-Group Elimination”).

**ANSWER:** The parties have entered into an agreement with regard to the issue of Cross-Group Eliminations. The Parties have further agreed that a response to this statement is not necessary.

55. As required by Illinois law, CSX historically filed two separate Illinois unitary combined returns for its Transportation and Non-Transportation Group.

**ANSWER:** The Department objects as each tax years stand on their own. Notwithstanding this objection or waiving the same, the Department admits that CSX filed two separate Illinois unitary combined returns for its Transportation and Non-Transportation Group as to the Years in Issue.

56. During the Years at Issue, both the Transportation and Non-Transportation Groups properly eliminated intercompany transactions that occurred between members of the separate unitary business groups.

**ANSWER:** The parties have entered into an agreement with regard to the issue of Cross-Group Eliminations. The Parties have further agreed that a response to this statement is not necessary.

57. The Non-Transportation Group was previously audited by the Department for the Years at Issue and no Cross-Group Elimination adjustments were made to transactions that occurred between members of the Transportation Group and members of the Non-Transportation Group.

**ANSWER:** The parties have entered into an agreement with regard to the issue of Cross-Group Eliminations. The Parties have further agreed that a response to this statement is not necessary.

58. The Department's forced Cross-Group Elimination results in the add-back of cross-group expenses to Petitioner's returns without the benefit of the related reduction of cross-group income because the related cross group income occurred in the Non-Transportation Group and no Cross-Group Elimination adjustments were made to the Non-Transportation Group upon audit.

**ANSWER:** The parties have entered into an agreement with regard to the issue of Cross-Group Eliminations. The Parties have further agreed that a response to this statement is not necessary.

59. Effectively, the Department is taxing the Non-Transportation Group's cross-group expenses twice; once as a denied expense to the Transportation Group; and second, as cross-group income reported on the Non-Transportation Group returns because no corresponding cross-group elimination entry was made. This results in a permanent Illinois tax cost to Petitioner.

**ANSWER:** The parties have entered into an agreement with regard to the issue of Cross-Group Eliminations. The Parties have further agreed that a response to this statement is not necessary.

60. The Department's elimination of cross-group intercompany transactions is not supported by law and should be disallowed.

**ANSWER:** The parties have entered into an agreement with regard to the issue of Cross-Group Eliminations. The Parties have further agreed that a response to this statement is not necessary.

**WHEREFORE,** Petitioner prays that the Court enter an Order that:

- a) finds and declares the Notices of Deficiency valid;
- b) enters judgment in favor of the Department and upholds the Notices of Deficiency;
- c) grants such further relief as the Court deems appropriate under the circumstances.

## COUNT II

### **The Department erred in its Adjustment of BOCT's Apportionment Methodology.**

61. Petitioner realleges and reincorporates the allegations in paragraphs 1 through 60, inclusive, hereinabove.

**ANSWER:** The information contained in paragraph 61 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).

62. Pursuant to the Act, corporations that are members of the same unitary business group are treated as one taxpayer. 35 ILCS §5/502(e).

**ANSWER:** Paragraph 62 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 that the Illinois Income Tax Act, 35 ILCS §5/202 (e), exists and is in effect and said statute speaks for itself.

63. The term “unitary business group” is defined, in relevant part, to mean, “a group of persons related through common ownership whose business activities are integrated with, dependent upon and contribute to each other...in no event, however, will any unitary business group include members which are ordinarily required to apportion business income under different subsections of Section 304...If a unitary business group would, but for the preceding sentence, include members that are ordinarily required to apportion business income under different subsections of Section 304, then for each subsection of Section 304 for which there are two or more members, there shall be a separate unitary business group composed of such members...” 35 ILCS §5/1501(a)(27).

**ANSWER:** Paragraph 63 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 that the Illinois Income Tax Act, 35 ILCS §5/1501(a)(27), exists and is in effect and said statute speaks for itself.

64. Section 304(d) of the Act sets forth Illinois' special apportionment method of formulary apportionment for entities that furnish "transportation services." 35 ILCS §5/304(d).

**ANSWER:** Paragraph 64 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 that the Illinois Income Tax Act, 35 ILCS §5/304 (d), exists and is in effect and said statute speaks for itself.

65. During the Years at Issue, "business income derived from providing transportation services other than airline services shall be apportioned to this State by using a fraction, (a) the numerator of which shall be (i) all receipts from any movement or shipment of people, goods, mail, oil, gas, or any other substance (other than by airline) that both originates and terminates in this State, plus (ii) that portion of the person's gross receipts from movements or shipments of people, goods, mail, oil, gas, or any other substance (other than by airline) that originates in one state or jurisdiction and terminates in another state or jurisdiction, that is determined by the ratio that the miles traveled in this State bears to total miles everywhere and (b) the denominator of which shall be all revenue derived from the movement or shipment of people, goods, mail, oil, gas, or any other substance (other than by airline)." 35 ILCS §5/304(d)(3).

**ANSWER:** Paragraph 65 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 that the Illinois Income Tax Act, 35 ILCS §5/304 (d)(3), exists and is in effect and said statute speaks for itself.

66. Upon audit, the Department adjusted the numerator of BOCT's sales factor re-characterizing intercompany revenues as intrastate rather than interstate, which resulted in allocating one-hundred percent of its income to Illinois.

**ANSWER:** Department denies the factual allegations in Paragraph 66.

67. BOCT performs intermediate and terminal switching services for customers in both Illinois and Indiana.

**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 67.

68. BOCT is a carrier represented by the National Railway Labor Conference.

**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 68.

69. BOCT's employees are represented by the National Railway Labor Conference.

**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 69. It is unclear if BOCT had employees.

70. BOCT is a carrier that provides switching services for freight in interstate commerce.

**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 70.

71. BOCT performs intermediate and terminal switching services for Petitioner and third-party common carriers, as well as third-party non-carrier customers.

**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 71.

72. BOCT had customers in both Illinois and Indiana.

**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 72.



73. BOCT performs switching services at CN's Kirk Yard located in Indiana.

**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 73.

74. BOCT derives its income from providing transportation services, specifically switching services.

**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 74.

75. Pursuant to Illinois law, Petitioner's Illinois Transportation Group is required to apportion its income according to the special apportionment methodology for transportation service providers codified at 35 ILCS §5/304(d)(3).

**ANSWER:** Paragraph 75 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 that the Illinois Income Tax Act, 35 ILCS §5/304(d)(3), exists and is in effect and said statute speak for itself.

76. The Department had previously audited Petitioner's Illinois Transportation Group and determined that BOCT was properly included in the Transportation Group.

**ANSWER:** The Department objects as each tax years stand on their own. Notwithstanding this objection or waiving the same, the Department admits that there was an audit in prior years.

77. During the Years at Issue, BOCT was part of Petitioner's Illinois Transportation Group and required to source its income pursuant to the special apportionment methodology as provided in 35 ILCS §5/304(d)(3).

**ANSWER:** Paragraph 77 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 that the Illinois Income Tax Act, 35 ILCS §5/304(d)(3), exists and is in effect and said statute speaks for itself.

78. Accordingly, the proper section to apportion BOCT's income to Illinois is 35 ILCS §5/304(d)(3) and not 35 ILCS §5/304(a)(3)(c).

**ANSWER:** Paragraph 78 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 that the Illinois Income Tax Act, 35 ILCS §5/304(d)(3) and 35 ILCS §5/304(a)(d)(3), exists and is in effect and said statute speaks for itself.

79. The Department's use of 35 ILCS §5/304(a)(3)(c) was erroneous.

**ANSWER:** The Department denies Paragraph 79.

80. The Department's apportionment of one hundred percent of BOCT's income to Illinois when it has customers in more than one state and is part of Petitioner's Transportation Group was erroneous.

**ANSWER:** The Department denies Paragraph 80.

81. Accordingly, the Department erred in its adjustment of BOCT's Illinois sales factor numerator.

**ANSWER:** The Department denies Paragraph 81.

**WHEREFORE,** Petitioner prays that the Court enter an Order that:

- a) finds and declares that the Department properly adjusted the numerator of BOCT's Illinois sales factor to include receipts for activities were performed in Illinois;
- b) finds and declares the Notice of Deficiency valid;

- c) enters judgment in favor of the Department and upholds the Notice of Deficiency;
- d) grants such further relief as the Court deems appropriate under the circumstances.

### **COUNT III**

#### **The Department's Inclusion of Receipts from Intercompany Transactions Unfairly Represents Petitioner's Illinois Activities**

82. Petitioner realleges and reincorporates the allegations in paragraphs 1 through 81 inclusive, hereinabove.

**ANSWER:** The information contained in paragraph 82 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).

83. By Department regulation, income and deductions attributable to intercompany transactions between members of a unitary business group are eliminated from combined income when necessary to avoid distortion of either the numerator or denominator of the apportionment factor. 86 Ill. Admin. Code § 100.5270(b)(1).

**ANSWER:** Paragraph 83 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 that 86 Ill. Admin. Code § 5270(b)(10), exists and is in effect and said regulation speaks for itself.

84. Distortion occurs when an apportionment methodology unfairly reflects a taxpayer's activities in a state.

**ANSWER:** Paragraph 84 contains a legal conclusion, not a material allegation of fact, and therefore does not require an answer pursuant to Rule 310(b)(2).

85. Forcing a taxpayer to use a distortive apportionment methodology violates the U.S. Supreme Court's requirements for apportionment methodologies. *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 (1983).

**ANSWER:** Paragraph 85 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 that the Supreme Court case *Container Corp. of America v. Franchise Tax Board* exists and the case speaks for itself.

86. During the Years at Issue, BOCT and Petitioner were both part of the Illinois Transportation Group.

**ANSWER:** Paragraph 86 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 that Petitioner filed with BOCT as part of its Illinois Transportation Group.

87. As members of the same unitary combined filing group, BOCT and Petitioner were required by Illinois law to eliminate intercompany transactions.

**ANSWER:** Paragraph 87 contains a legal conclusion, not a material allegation of fact, and therefore does not require an answer pursuant to Rule 310(b)(2).

88. Upon audit, the Department incorrectly allocated one hundred percent of BOCT's intercompany sales with Petitioner to the numerator and denominator of the Transportation Group's apportionment factor as intrastate (non-apportionable) Illinois receipts.

**ANSWER:** The Department denies Paragraph 88.

89. Department's adjustments were erroneous as BOCT's intercompany receipts with Petitioner are required by law to be eliminated from the Transportation Group's Illinois combined return.

**ANSWER:** The Department denies Paragraph 89.

90. Department's adjustment does not accurately reflect Petitioner's taxable activity within the State as it assigns one hundred percent of BOCT's intercompany sales as one- hundred percent Illinois allocable revenue attributable to Petitioner; and therefore, results in distortion.

**ANSWER:** The Department denies Paragraph 90.

91. The Department cites to no Illinois authority for this adjustment.

**ANSWER:** The Department denies Paragraph 91.

92. Accordingly, the Department's adjustment was erroneous and not supported by law.

**ANSWER:** The Department denies Paragraph 92.

93. Accordingly, the Department's adjustment was erroneous and not supported by law.

**ANSWER:** The Department denies Paragraph 93.

**WHEREFORE,** Petitioner prays that the Court enter an Order that:

- a) finds and declares the Notices of Deficiency valid;
- b.) enters judgment in favor of the Department and upholds the Notice of Deficiency;
- c.) grants such further relief as the Court deems appropriate under the circumstances.

#### **COUNT IV**

**The Department's Bifurcation of Petitioner's Third-Party Interstate Invoices is Unsupported by Law and Does not Accurately Represent Petitioner's Activity in the State.**

94. Petitioner realleges and reincorporates the allegations in paragraphs 1 through 94, inclusive, hereinabove.

**ANSWER:** The information contained in paragraph 94 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).

95. Petitioner is in the business of providing interstate railway services across the Eastern United States.

**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 95.

96. Petitioner enters into contracts with third-party customers to ship freight by rail over and across interstate lines.

**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 96.

97. To the extent that switching services are required as part of the freight movement, Petitioner engages a switching entity, including BOCT, to perform those services.

**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 97.

98. Pursuant to Illinois law, switching services are defined as ancillary transportation services. 86 Ill. Admin. Code §100.9715(c).

**ANSWER:** Paragraph 98 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 that 86 Ill. Admin. Code §100.9715(c) exists and is in effect that that the regulation speaks for itself.

99. Pursuant to Illinois law and as agreed by the Department in previous audit cycles, BOCT's switching services are transportation services and part of Petitioner's interstate transaction.

**ANSWER:** Paragraph 99 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 that 86 Ill. Admin. Code §100.9715(c) exists and is in effect that that the regulation

speaks for itself.

100. United State Supreme Court jurisprudence provides that instrumentalities of interstate commerce remain interstate in nature from the beginning of the transaction until they come to rest. *Michelin Tire Corp. v. W.L. Wages*, 423 U.S. 276 (1976).

**ANSWER:** Paragraph 100 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 that the case of *Michelin Tire Corp. v. W.L. Wages*, 423 U.S. 276 (1976). exists and is the case speaks for itself.

101. During the Years at Issue, Section 304(d) of the Act set forth Illinois' special apportionment method for entities that furnish "transportation services." 35 ILCS §5/304(d).

**ANSWER:** Paragraph 101 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 that 35 ILCS §5/304(d) exists and is in effect that that the statute speaks for itself.

102. During the Years at Issue, "business income derived from providing transportation services other than airline services shall be apportioned to this State by using fraction, (a) the numerator of which shall be (i) all receipts from any movement or shipment of people, goods, mail, oil, gas, or any other substance (other than by airline) that both originates and terminates in this State, plus (ii) that portion of the person's gross receipts from movements or shipments of people, goods, mail, oil, gas, or any other substance (other than by airline) that originates in one state or jurisdiction and terminates in another state or jurisdiction, that is determined by the ratio that the miles traveled in this State bears to total miles everywhere and (b) the denominator of which shall be all revenue derived from the movement or shipment of people,

goods, mail, oil, gas, or any other substance (other than by airline).” 35 ILCS §5/304(d)(3).

**ANSWER:** Paragraph 102 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 that 35 ILCS §5/304(d)(3) exists and is in effect that that the statute speaks for itself.

103. Accordingly, during the Years at Issue Petitioner was required to apportion its interstate railway income pursuant to 35 ILCS §5/304(d)(3).

**ANSWER:** Paragraph 103 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 that 35 ILCS §5/304(d)(3) exists and is in effect that that the statute speaks for itself.

104. However, upon audit, instead of following 35 ILCS §5/304(d)(3) the Department attempted to bifurcate Petitioner’s single interstate third-party transaction invoices into two separate transactions: (1) an intrastate transaction (BOCT’s intercompany receipts with Petitioner; and (2) an interstate transaction (Petitioner’s receipts with third-party customers).

**ANSWER:** The Department denies Paragraph 104.

105. The Department’s attempted bifurcation results in an inaccurate measure of Petitioner’s apportionable Illinois receipts because the Department wrongly assumes that there is a dollar for dollar correlation between Petitioner’s third-party transaction and BOCT’s intercompany transaction with Petitioner.

**ANSWER:** The Department denies Paragraph 105.

106. This assumption is incorrect and produces erroneous results.

**ANSWER:** The Department denies Paragraph 106.

107. As a result of this incorrect assumption, the Department allocated one hundred percent of BOCT’s intercompany switching receipts to Illinois as Petitioner’s and apportioned the remaining



balance as Petitioner's third-party receipts.

**ANSWER:** The Department denies Paragraph 107.

108. This adjustment resulted in BOCT's total intercompany sales being included as one-hundred percent Illinois allocable revenue in Petitioner's Illinois apportionment factor.

**ANSWER:** The Department denies Paragraph 108.

109. There is no Illinois authority, nor does the Department cite to any Illinois authority, that provides it the ability to bifurcate a single third-party interstate transaction into separate parts for apportionment purposes.

**ANSWER:** The Department denies Paragraph 109.

110. BOCT's switching services are interstate in nature and maintain their interstate character until the railway services activity ceases.

**ANSWER:** The Department denies Paragraph 110.

111. Accordingly, the Department erroneously allocated one hundred percent of BOCT's intercompany sales with Petitioner to the numerator and denominator of Petitioner's Illinois apportionment factor when: (1) BOCT's revenues are interstate in nature; (2) the majority of BOCT's revenues with Petitioner are intercompany and are required to be eliminated from Petitioner's Illinois combined return; and results in the Department incorrectly re-characterizing BOCT's intercompany interstate revenue as intrastate revenue attributable to Petitioner.

**ANSWER:** The Department denies Paragraph 111.

**WHEREFORE,** Petitioner prays that this Tribunal enter an Order that:

- a) finds and declares that the Department's audit adjustment properly allocated BOCT's receipts to Illinois in Petitioner's apportionment formula;
- b) finds and declares the Notices of Deficiency valid;

c) enters judgment in favor of the Department and upholds the Notices of Deficiency; grants such further relief as the Court deems appropriate under the circumstances.

## COUNT V

### **The Department's Notices are Without Effect Because the Department Did Not Supply a Basis for the Deficiency in Regard to its Adjustment to Petitioner's Sales Factor.**

112. Petitioner realleges and reincorporates the allegations in paragraphs 1 through 111, inclusive, hereinabove.

**ANSWER:** The information contained in paragraph 112 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).

113. In the "Explanation of Adjustments," the Department states that it, "adjusted the factor to include receipts, other than receipts from the sales of tangible personal property, for which the majority of the income producing activities were performed in Illinois," and cites to 35 ILCS § 5/304 (a)(3)(c) and 86 Ill. Admin. Code §100.3370(c)(3) for the authority for this adjustment.

**ANSWER:** The Department admits that the language in the Department's "Explanations of Adjustments" speaks for itself.

114. The Illinois Taxpayer Bill of Rights requires the Department to furnish taxpayers with an explanation of the tax liabilities and penalties associated with a tax notice. 20 ILCS 2520/4(b).

**ANSWER:** Paragraph 114 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 that 20 ILCS §2520/4(b) exists and is in effect that that the statute speaks for itself.

115. The Illinois Income Tax Act requires that the Department not only explain what adjustments are made on a Notice of Deficiency, it is required to provide the reasons therefor. 35 ILCS 5/904(c).

**ANSWER:** Paragraph 115 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 that 35 ILCS §5/904(c) exists and is in effect that that the statute speaks for itself.

116. One of the primary issues in this case involve the adjustment to the numerator of Petitioner’s Illinois sales factor.

**ANSWER:** The Department admits Paragraph 116.

117. The citations provided by the Department in its “Explanation of Audit Adjustments” for support for its adjustment are inapplicable.

**ANSWER:** The Department denies Paragraph 117.

118. 35 ILCS §5/304(a)(3)(c) is inapplicable as it addresses the sourcing of sales that occur in taxable years ending before December 31, 2008.

**ANSWER:** The Department admits Paragraph 118.

119. 86 Ill. Admin. Code §100.3370(c)(3) is inapplicable as it addresses the sourcing of gross receipts from the “licensing, sale, or other disposition of a patent, copyright, trademark, or similar item of intangible personal property that are not excluded from the sales factor under subsection (a)(2)(F) are included in the numerator of the sales factor to the extent the item is utilized in this State during the year the gross receipts are included in gross income;” none of which are at issue.

**ANSWER:** The Department denies Paragraph 119.

120. The Department provides no authority, nor does any exist, that provides it the ability to allocate one hundred percent of BOCT’s intercompany switching receipts to Illinois attributed to Petitioner.

**ANSWER:** The Department denies Paragraph 120.

121. The Department failed to provide an accurate explanation of its adjustments that

resulted in one-hundred percent allocation of BOCT's intercompany receipts to Illinois attributed to Petitioner.

**ANSWER:** The Department denies Paragraph 121.

122. The Department did not comply with the Taxpayer Bill of Rights.

**ANSWER:** The Department denies Paragraph 122.

123. The Department did not comply with 35 ILCS 5/904(c).

**ANSWER:** The Department denies Paragraph 123.

124. Without providing an explanation as to its adjustments, the Department has deprived the Petitioner of a meaningful opportunity to protest the adjustments.

**ANSWER:** The Department denies Paragraph 124.

125. The Department has failed to establish its prima facie case.

**ANSWER:** The Department denies Paragraph 125.

126. Because the Notices do not comply with the Taxpayer Bill of Rights and 35 ILCS 5/904(c), depriving Petitioner of a meaningful opportunity to challenge the assessment, the Notice of Deficiency is invalid and should not be afforded a presumption of correctness.

**ANSWER:** The Department denies Paragraph 126.

**WHEREFORE,** Petitioner prays that this Tribunal enter an Order that:

- a) finds and declares that the Notice of Deficiency does complies with the Taxpayer Bill of Rights;
- b) finds and declares that the Notices of Deficiency did complies with 35 ILCS 5/904(c);
- c) finds and declare the Notices of Deficiency are invalid and presumptively correct;

- d) finds and declares that the Department established a prima facie case; and
- e) grants such further relief as the Tribunal deems appropriate under the circumstances.

#### **COUNT IV**

##### **The Department's Imposition of Penalties Should be Abated**

127. Petitioner realleges and reincorporates the allegations in paragraphs 1 through inclusive, hereinabove.

**ANSWER:** The information contained in paragraph 127 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).

128. On its Notices, the Department assessed penalties against the Petitioner in the amounts of \$1,270,516.00 for the taxable year ending December 31, 2014 and \$1,024,436.00 for the taxable year ending December 31, 2015. See Exhibit A.

**ANSWER:** Department admits the factual allegations in Paragraph 128.

129. Illinois law provides that penalties shall not apply if a taxpayer shows that its failure to pay tax at the required time was due to reasonable cause. 35 ILCS §734-8.

**ANSWER:** Paragraph 129 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 that 35 ILCS §734-8 exists and is in effect that that the statute speaks for itself.

130. The most important factor to be considered in a penalty abatement determination will be the extent to which a taxpayer made a good faith effort to determine its proper tax liability and to pay its proper tax liability in a timely fashion. 86 Ill. Admin. Code §700.400(b).

**ANSWER:** Paragraph 130 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 that 86 Ill. Admin. Code §700.400(b) exists and is in effect that that the regulation speaks for itself.

131. A taxpayer will be considered to have made a good faith effort to determine and pay its proper tax liability if it exercised ordinary business care and prudence in doing so. 86 Ill. Admin. Code §700.400(b).

**ANSWER:** Paragraph 131 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 that 86 Ill. Admin. Code §700.400(b) exists and is in effect that that the regulation speaks for itself.

132. Petitioner filed all of its corporate income and replacement tax returns for the Years at Issue in a timely fashion.

**ANSWER:** Department admits the factual allegations in Paragraph 132.

133. Petitioner, relying on Illinois law and prior audit determinations, exercised ordinary business care and prudence in determining its liability for the Years at Issue.

**ANSWER:** Department denies the factual allegations in Paragraph 133.

134. Petitioner, relying on Illinois law and prior audit determinations, exercised ordinary business care and prudence when it sourced its Transportation Group's income to Illinois according to 35 ILCS §5/304(d), the special apportionment methodology for transportation service companies.

**ANSWER:** Department denies the factual allegations in Paragraph 134.

135. Accordingly, the Department's assessed penalties should be waived for reasonable cause

**ANSWER:** Department denies the factual allegations in Paragraph 135.

**WHEREFORE,** Petitioner prays that the Court enter an Order that:

- a) finds and declares the Department's assessment of penalties valid;
- b) enters judgment in favor of Department and against the Petitioner and impose the penalty in its entirety;

c) grants such further relief as the Court deems  
appropriate under the circumstances.

Dated: December 8, 2020

Respectfully submitted,

**Kwame Raoul**  
Attorney General  
State of Illinois

s/Sean P. Cullinan  
Sean P. Cullinan,  
Special Assistant Attorney General

Lori Jordan  
Sean P. Cullinan  
Special Assistant Attorney General  
Illinois Department of Revenue  
100 W. Randolph St., Level 7-900  
Chicago, Illinois 60601  
Phone: 312-814-3842  
Phone: 312-814-3078  
[lori.jordan@illinois.gov](mailto:lori.jordan@illinois.gov)  
[sean.cullinan@illinois.gov](mailto:sean.cullinan@illinois.gov)