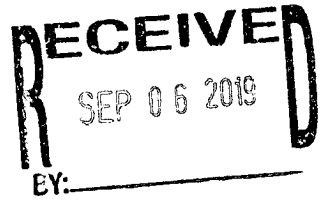


IN THE ILLINOIS INDEPENDENT TAX TRIBUNAL

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



PETITION

CSX Transportation, Inc. (“Petitioner”), by and through its attorneys, Horwood Marcus & Berk Chartered, complains of the Defendant, the Illinois Department of Revenue (“Department”), and alleges 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.
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.
3. Petitioner’s FEIN is 54-6000720.
4. Petitioner is the designated agent of a unitary group of corporations filing an Illinois combined corporate income tax return.

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.

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**.

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.

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.

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.

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.

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.

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.

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.

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.

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

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

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.

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 CSX.

19. BOCT is designated as an Eastern Railroad, and it is a carrier represented by the National Railway Labor Conference.

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

21. BOCT is a railroad common carrier that hauls freight in interstate commerce.

22. BOCT performs intermediate and terminal switching services for Petitioner and third party eastern and western trunk line carriers.

23. BOCT has customers in both Illinois and Indiana.

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

25. CSX Intermodal Inc. ("CSXI") is a standalone integrated intermodal company that links customers to railroads via trucks and terminals, providing coast-to-coast intermodal transportation.

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

27. 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).

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

29. 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.

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

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

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

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

34. 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.

35. 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.

CONTROVERSY

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

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

38. 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.

39. 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 the numerator of BOCT's Illinois sales factor; and reduced Petitioner's Veterans Jobs Credit.

40. 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.

COUNT I

The Department's Cross-Group Elimination is Not Supported by Law and

Results in the Taxation of Income Twice.

41. Petitioner realleges and reincorporates the allegations in paragraphs 1 through 40, inclusive, hereinabove.

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

43. 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).

44. 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).

45. 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”).

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

47. 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.

48. 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 the Transportation Group and members of the Non-Transportation Group.

49. The Department’s forced Cross-Group Elimination results in the add-back 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.

50. 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.

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

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

- a) finds and declares that for the Year at Issue, the Department's elimination of cross-group intercompany transactions is not supported by law and should be disallowed;
- b) finds and declares the Notices of Deficiency invalid;
- c) enters judgment in favor of Petitioner and orders Defendant to withdraw the Notices of Deficiency;
- d) enjoins the Department from taking any action to assess, lien, levy, offset or in any other way prosecute and collect the amount of the proposed additional tax invalidated by the Order this Tribunal.
- e) 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.

52. Petitioner realleges and reincorporates the allegations in paragraphs 1 through 51, inclusive, hereinabove.

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

54. 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).

55. 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).

56. 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).

57. Upon audit, the Department adjusted the numerator of BOCT’s sales factor that resulted in the sourcing one-hundred percent of its income to Illinois.

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

59. BOCT is designated as an Eastern Railroad, and it is a carrier represented by the National Railway Labor Conference.

60. BOCT’s employees are represented by the National Railway Labor Conference.

61. BOCT is a railroad common carrier that hauls freight in interstate commerce.

62. BOCT performs intermediate and terminal switching services for Petitioner and third party eastern and western trunk line carriers.

63. BOCT had customers in both Illinois and Indiana.

64. BOCT performs switching services at CN’s Kirk Yard located in Indiana.

65. BOCT derives its income from providing transportation services.

66. 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).

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

68. 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).

69. 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).

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

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

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

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

- f) finds and declares that for the Year at Issue, BOCT properly sourced its income to Illinois using the special apportionment method for entities that furnish "transportation services" codified at 35 ILCS §5/304(d);
- g) finds and declares that BOCT properly included as a member in Petitioner's Illinois Transportation Group;
- h) finds and declares that the Department erred in adjustment of the numerator of BOCT's Illinois sales 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;
- i) finds and declares the Notice of Deficiency invalid;

- j) enters judgment in favor of Petitioner and orders Defendant to withdraw the Notice of Deficiency;
- k) enjoins the Department from taking any action to assess, lien, levy, offset or in any other way prosecute and collect the amount of the proposed additional tax invalidated by the Order this Tribunal; and
- l) grants such further relief as the Court deems appropriate under the circumstances.

COUNT III

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

73. Petitioner realleges and reincorporates the allegations in paragraphs 1 through 72, inclusive, hereinabove.

74. 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.

75. 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).

76. 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).

77. One of the primary issues in this case involve the adjustment to the numerator of BOCT's Illinois sales factor.

78. The citations provided by the Department in its "Explanation of Audit Adjustments" for support for its adjustment are inapplicable.

79. 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.

80. 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.

81. The Department failed to provide an accurate explanation of its adjustments that resulted in one-hundred percent apportionment of BOCT's income to Illinois.

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

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

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

85. 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.

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

- a) finds and declares that the Notice of Deficiency does not comply with the Taxpayer Bill of Rights;
- b) finds and declares that the Notices of Deficiency did not comply with 35 ILCS 5/904(c)
- c) finds and declare the Notices of Deficiency are invalid and not presumptively correct; and
- d) grants such further relief as the Tribunal deems appropriate under the circumstances.

COUNT IV

The Department's Imposition of Penalties Should be Abated

86. Petitioner realleges and reincorporates the allegations in paragraphs 1 through 85, inclusive, hereinabove.

87. On its Notices, the Department assessed late payment 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.

88. Illinois law provides that late payment 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.

89. 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).

90. 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).

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

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

93. 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.

94. The Department's assessed late-payment penalties should be waived for reasonable cause.

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

- a) finds and declares the Department's assessment of penalties invalid;
- b) enters judgment in favor of Petitioner and against the Departments and orders the Department to abate the penalty imposed in its entirety; and

- c) enjoins the Department from taking any action to assess, lien, levy, offset or in any other way prosecute and collect the amount of penalty invalidated by this Tribunal.
- d) grants such further relief as the Court deems appropriate under the circumstances.

Respectfully submitted,

CSX Transportation, Inc.
Petitioner

By: Breen M. Schiller
One of Petitioner's Attorneys

Breen M. Schiller (bschiller@hmblaw.com)
David W. Machemer (dmachemer@hmblaw.com)
Horwood Marcus & Berk Chartered
500 W. Madison Street, Suite 3700
Chicago, IL 60661
(312) 606-3200

EXHIBIT A

Notice of Deficiency

for Form IL-1120, Corporation Income and Replacement Tax Return



July 8, 2019



Letter ID: L0875674480

Taxpayer ID: 54-6000720
Audit ID: A1923495936
Reporting period: December 2014
Total Deficiency: \$8,743,332.14
Balance due: \$8,743,332.14

CSX TRANSPORTATION INC
500 WATER ST
JACKSONVILLE FL 32202-4423

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

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

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

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

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

Note: If you are under bankruptcy protection, see the "Bankruptcy Information" section on the following page of this notice for additional information and instructions. If you have questions, call us at the telephone number shown below.

Sincerely,


David Harris
Director

ILLINOIS DEPARTMENT OF REVENUE
AUDIT BUREAU
PO BOX 19012
SPRINGFIELD IL 62794-9012
217 524-2230

Notice of Deficiency

for Form IL-1120, Corporation Income and Replacement Tax Return



July 8, 2019



Letter ID: L1992325680

Taxpayer ID: 54-6000720
Audit ID: A1923495936
Reporting period: December 2015
Total Deficiency: \$6,894,866.40
Balance due: \$6,894,866.40

CSX TRANSPORTATION INC
500 WATER ST
JACKSONVILLE FL 32202-4423

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

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

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

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

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

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Sincerely,


David Harris
Director

ILLINOIS DEPARTMENT OF REVENUE
AUDIT BUREAU
PO BOX 19012
SPRINGFIELD IL 62794-9012
217 524-2230

CERTIFICATE OF SERVICE

Undersigned counsel of record hereby certifies that she caused a copy of the foregoing **Petition** to be served by electronic mail and by enclosing the same in an envelope, properly addressed, first-class postage prepaid and deposited in the US Mail at 500 West Madison Street, Chicago, Illinois, 60661, before the hour of 5:00 p.m. on the 6th day of September, 2019.

James R. Reynolds
Illinois Department of Revenue
Office of Legal Services
100 W. Randolph St., 7-900
Chicago, IL 60601
James.R.Reynolds@Illinos.gov

