ILLINOIS INDEPENDENT TAX TRIBUNAL

TODD CHRISTOPHER, as representative for T. CHRISTOPHER HOLDING COMPANY,	)	
Petitioner,	)	20TT54
v.	)	
ILLINOIS DEPARTMENT OF REVENUE,	)	
Respondent.	)	

PETITION

NOW COMES Petitioner, Todd Christopher, as representative for T. Christopher Holding Company ("Petitioner"), by his attorneys, Michael K. Moyers, David C. Blickenstaff, and Joseph N. Blumberg of Schiff Hardin LLP, and hereby petitions the Illinois Independent Tax Tribunal (this "Tribunal") to review and cancel a Notice of Deficiency for tax year 2016 (described below). In support of its Petition, Petitioner states as follows:

INTRODUCTION

1. Todd Christopher ("Mr. Christopher"), an individual residing in the State of Florida, is the representative of T. Christopher Holding Company, a now-dissolved Florida corporation (the "Holding Company"), as Petitioner.

2. The Holding Company was a Florida corporation. The Holding Company's current mailing address is P.O. Box 860, c/o J. Loeck, AYCO, Saratoga Springs, NY 12866. The Holding Company's Taxpayer Identification Number was 46-3538737. Petitioner's Illinois Audit

Identification number is A433887872. Petitioner's Illinois Account Identification number is 10163-28192.

3. Mr. Christopher is the former President, the authorized representative, and a transferee of the assets of the Holding Company.

4. Petitioner is represented by Michael K. Moyers, David C. Blickenstaff, and Joseph N. Blumberg of Schiff Hardin LLP, located at 233 S. Wacker Drive, Suite 7100, Chicago, IL 60606, who can be reached at (312) 258-5593 or mmoyers@schiffhardin.com, (312) 258-5637 or dblickenstaff@schiffhardin.com, and (312) 258-5616 or jblumberg@schiffhardin.com, respectively.

5. On April 18, 2019, Respondent issued a Notice of Audit Initiation for tax year 2016.

6. On March 6, 2020, Respondent issued a Notice of Audit Results (EDA-143) together with Auditor's Report (EDA-93), which are attached hereto as Exhibit A (the "Auditor's Report). The Auditor's Report recharacterized the Holding Company's gains derived from the 2016 Sale (described below) as business income, and asserted that the Holding Company was subject to liability to the State of Illinois for unpaid Illinois Personal Property Tax Replacement Income Tax (the "Replacement Tax") apportioned against those gains by applying the Operating Company's sales factor to that purported business income.

7. On April 9, 2020, Respondent issued a Notice of Deficiency (the "Notice of Deficiency") to Petitioner for tax year 2016, which is attached hereto as Exhibit B.

8. The Notice of Deficiency states that Petitioner is liable for the following balance as a result of outstanding liabilities:

Letter ID	Period	Total Deficiency	Balance Due
CNXXX172231928X2	31-DEC-2016	$4,231,161.55	$4,231,161.55

9. This Tribunal has jurisdiction over this matter under the Illinois Independent Tax Tribunal Act of 2012, 35 ILCS 1010/1-1, *et seq.*, and Section 100.3390 of the Illinois Department of Revenue Regulations (the "Regulations").

RELEVANT FACTS

10. The Holding Company was incorporated in Florida on August 9, 2013.

11. Throughout its existence (effective as of August 16, 2013), the Holding Company elected to be taxed as a Subchapter S corporation under Section 1362(a) of the Internal Revenue Code of 1986, as amended (an "S corporation").

12. The Holding Company was conceived of, and formed, solely as a passive holding company to facilitate the administration, and actual sale, of equity interests in Vogue International LLC (the "Operating Company") that were owned by Mr. Christopher and trusts for the benefit of his family. The Holding Company allowed Mr. Christopher to consolidate his family's ownership interests in the Operating Company so that the Holding Company alone could vote and administer this investment.

13. The Holding Company provided benefits, both before and after the sale of interests in the Operating Company at issue in this case, which were entirely separate from the

business activities of the Operating Company. Specifically, the family's consolidated ownership allowed the Holding Company to serve as a single representative for negotiating and consummating a sale of interests in the Operating Company. In addition, the Holding Company structure allowed Mr. Christopher's family to make intrafamily transfers of equity interests in the Holding Company for estate planning purposes without directly impacting the ownership structure of the Operating Company or requiring the consent of unrelated third parties owning an interest in the Operating Company. The Holding Company had no operational or business function and had no reason to exist other than to consolidate ownership and management of equity interests in the Operating Company for Mr. Christopher's family. Indeed, as discussed below, the Holding Company was promptly dissolved following the sale of all of the family's remaining equity interests in 2016, which is the transaction at issue in this case.

14. Prior to 2013, all interests in the Operating Company were held by Mr. Christopher, individually, and a grantor retained annuity trust (the "GRAT") for the ultimate benefit of his children.

15. Prior to 2013, the Operating Company (then named Todd Christopher International, Inc.) was a Florida corporation that had elected to be taxed as an S corporation.

16. The Operating Company's primary business activity was the development, marketing, and wholesale distribution of hair and skin care products. These products were distributed under the Operating Company's "OGX" and "FX" brands, and were sold to retailers throughout the United States, including Walmart, CVS, Walgreens, Target, Rite-Aid, and Ulta.

17. The Operating Company's headquarters were in Clearwater, Florida. All back-office and management operations, including marketing, executive operations, accounting, finance, and sales order processing occurred at the Florida headquarters.

18. The Operating Company had approximately 60-65 employees. None of these persons were employed in Illinois.

19. Prior to 2013, Mr. Christopher had been in numerous discussions with potential buyers about a sale of an interest in the Operating Company.

20. In September of 2013, the Operating Company rebranded its shampoo and hair care products under the "OGX" brand name.

21. The "OGX" brand name was a registered trademark (the "Trademark") owned by Christopher & Christopher LLC (the "Family LLC"), a Florida limited liability company that had elected to be treated as an S corporation.

22. As discussed, the Holding Company was incorporated in the State of Florida on August 9, 2013. The Holding Company's bylaws were drafted in accordance with, and governed by, Florida law. The Holding Company's office, business address, and registered agent were in Florida.

23. On August 16, 2013, Mr. Christopher and the GRAT contributed 100% of the shares of the Operating Company to the Holding Company in exchange for shares of the Holding Company. Mr. Christopher's and the GRAT's ownership interests in the Holding Company were identical to their interests in the Operating Company before the transaction.

24. In 2013, the Operating Company was reorganized to effectuate the transfer of the Trademark from the Family LLC to the Operating Company in exchange for an equity interest in the Operating Company. On August 29, 2013, a Certificate of Conversion was filed with the Secretary of State of Florida, converting the Operating Company to a Florida limited liability company (then named Todd Christopher International LLC), and Articles of Organization were simultaneously filed with the Secretary of State of Florida.

25. On September 5, 2013, the Family LLC contributed the Trademark to the Operating Company in exchange for a 1.5% equity interest in the Operating Company. Following this contribution, the Family LLC owned a 1.5% equity interest in the Operating Company, and the Holding Company owned a 98.5% equity interest in the Operating Company.

26. In September of 2013, the Holding Company began discussions with The Carlyle Group ("Carlyle") about a potential sale of an equity interest in the Operating Company. Various transactions were discussed, but it was ultimately decided that Carlyle would purchase a 49% equity interest in the Operating Company.

27. On January 7, 2014, (i) Carlyle Partners VI Vogue Holdings, L.P., a Delaware limited partnership, (ii) CP VI Coinvestment A, L.P., a Delaware limited partnership, (iii) CP VI Coinvestment B, L.P., a Delaware limited partnership, and (iv) Mr. Christopher, as "Seller Representative" for the Operating Company, the Family LLC, and the Holding Company, entered into a purchase agreement (the "2014 Purchase Agreement"). The 2014 Purchase Agreement, and the negotiation, was facilitated by Goldman Sachs in the State of New York. The 2014 Purchase Agreement was governed by Delaware law.

28. On February 6, 2014, pursuant to the terms of the 2014 Purchase Agreement, the Operating Company filed a Certificate of Formation and a Certificate of Conversion with the Secretary of State of Delaware, as well as a Plan of Conversion with the Florida Department of State, thereby converting the Operating Company to a Delaware limited liability company named Vogue International LLC. Accordingly, the Operating Company's new operating agreement was drafted in accordance with, and pursuant to, Delaware law. The Company's business address and operations remained in Florida. The Operating Company was, for federal income tax purposes, taxed as a partnership from 2014 through the transaction at issue in this case.

29. On February 14, 2014, pursuant to the terms of the 2014 Purchase Agreement, Carlyle purchased an aggregate 49% equity interest in the Operating Company from the Holding Company and the Family LLC for $400,000,000 (the "2014 Sale"). The proceeds from the 2014 Sale were distributed to the Holding Company and the Family LLC in proportion to the interests acquired from each. The Family LLC sold a 0.735% equity interest in the Operating Company (49% of its 1.5% equity interest in the Operating Company) to Carlyle. The Holding Company sold a 48.265% equity interest in the Operating Company (49% of its 98.5% equity interest in the Operating Company) to Carlyle. Subsequently, the Operating Company's equity structure was recapitalized to consist of junior A units, representing 51% of the Operating Company's equity interests, and preferred B units representing 49% of the Operating Company's equity interests. Following the closing of the sale to Carlyle, the interests of the Operating Company were held as follows: (a) 0.7650% (junior A units) by the Family LLC, (b) 50.2350% (junior A units) by the Holding Company, and (c) 49.0000% (preferred B units) by Carlyle (through its affiliated entities.)

30. As of August 1, 2014, the members of the Operating Company entered into a Second Amended and Restated Operating Agreement of the Operating Company (the "Operating Agreement"). Pursuant to Article 11 of the Operating Agreement, all business of the Operating Company was managed by a Board of Managers, which consisted of six Managers. Pursuant to subsection 11.1(a) of the Operating Agreement, Members, in their capacity as such, were prohibited from participating in the day-to-day operation of the business affairs of the Company. The Holding Company did not serve on the Board of Managers.

31. The Holding Company's equity owners are not and have never been domiciled in Illinois, nor were they ever physically located in Illinois. They were not governed by, nor did they receive benefits from or protections under, Illinois law. The Holding Company was not organized pursuant to, or governed by, Illinois law.

32. The Operating Company's equity owners are not and have never been domiciled in Illinois, nor were they ever physically located in Illinois. They were not governed by, nor did they receive benefits from or protections under, Illinois law. The Operating Company was not organized pursuant to, or governed by, Illinois law.

33. In 2016, pursuant to a certain Purchase Agreement and Plan of Merger dated as of June 1, 2016 (the "2016 Purchase Agreement"), the Holding Company sold its entire remaining equity interest in the Operating Company to Johnson & Johnson Consumer Inc., a New Jersey corporation (the "2016 Sale"). The 2016 Purchase Agreement was governed by Delaware law.

34. Following the closing of the 2016 Sale, the Holding Company distributed all of its assets, consisting of sale proceeds from the disposition of Florida-situs intangible personal property, to Mr. Christopher and the GRAT.

35. Following the closing of the 2016 Sale, on December 28, 2016, the Holding Company voluntarily dissolved. The Holding Company filed Articles of Dissolution and a Notice of Corporate Dissolution with the Florida Department of State. Mr. Christopher, as former President of the Holding Company, is authorized to wind up the affairs of the Holding Company upon its dissolution, pursuant to Florida law.

36. The Holding Company was at all times a passive holding company. As described above, the Holding Company was organized for non-business family estate planning purposes. The Holding Company did not engage in a trade or business. The Holding Company had no employees or payroll in any jurisdiction. It owned no real or tangible personal property. The Holding Company's assets consisted of intangible property in the form of equity interests in investments located entirely and solely in Florida.

37. During its existence, the Holding Company did not have any connection to Illinois. In the transaction at issue in this case – the 2016 Sale – the Holding Company sold Florida-situs intangible personal property, consisting of equity interests in a Florida-headquartered business governed by Delaware law (and previously Florida law), to a New Jersey entity, pursuant to a purchase agreement governed by Delaware law.

38. Respondent has similarly audited the 2014 Sale (Audit ID A553835008), which is before this Tribunal in case number 19 TT 131 (Judge Brian F. Barov).

APPLICABLE LAW

A. Illinois Replacement Tax.

39. The Replacement Tax is imposed on the privilege of earning or receiving income in or as a resident of Illinois. It is applicable to corporations, partnerships, and trusts for each taxable year, pursuant to Section 201(c) of the Illinois Income Tax Act, 35 ILCS 5/101 *et seq.* ("IITA").

40. 35 ILCS 5/201(c) imposes the Replacement Tax "measured by net income on every corporation (including S corporations), partnership, and trust, for each taxable year…. Such taxes are imposed *on the privilege of earning or receiving income in or as a resident of this State.*" (Emphasis added.)

41. The Replacement Tax, an Illinois state income tax, is imposed on a taxpayer's "net income" at a flat rate of 1.5% (with respect to S corporations). 35 ILCS 5/201(d).

42. "Net income" is defined as "that portion of [a taxpayer's] base income for such year *which is allocable to this State under the provisions of Article 3*, less [the standard exemption and specified deductions]." 35 ILCS 5/202 (emphasis added).

43. In the case of an S corporation, "base income" means the taxpayer's federal taxable income with certain Illinois-specific adjustments that are not relevant to this case. 35 ILCS 5/203(e). More specifically, "base income" is the "taxable income of such corporation determined in accordance with Section 1363(b) of the Internal Revenue Code, except that taxable income shall take into account those items which are required by Section 1363(b)(1) of the Internal Revenue Code to be separately stated; . . . ." 35 ILCS 5/203(e)(2)(G).

44. The Replacement Tax would apply to the entire base income of a taxpayer with its "commercial domicile" in Illinois. 35 ILCS 5/303(b)(3).

45. However, a nonresident taxpayer's "base income" is only allocable to Illinois to the extent that it constitutes allocable "business income" within the meaning of Section 1501(a) of the IITA. 35 ILCS 5/301(c).

46. The IITA defines "business income" as "all income that may be treated as apportionable business income under the Constitution of the United States." 35 ILCS 5/1501(a)(1). Conversely, "nonbusiness income" is defined as "all income other than business income or compensation." 35 ILCS 5/1501(a)(13).

B. Determination of Business Income.

47. Because the IITA defines "business income" as "all income that may be treated as apportionable business income under the Constitution of the United States," the statutory determination of "business income" incorporates Constitutional limitations on Respondent's power to tax income of a nonresident taxpayer under these facts.

48. It is a fundamental concept of property law that intangible personal property is deemed to be located in the State of the owner's domicile, under the principle of *mobilia sequuntur personam* (movable property follows the person). *Blodgett v. Silberman*, 277 U.S. 1 (1928).

49. "The Due Process and Commerce Clauses forbid the States to tax extraterritorial values." *MeadWestvaco Corp. v. Illinois Dept. of Revenue*, 553 U.S. 16, 19 (2008).

50. In order to fall within the definition of "business income" under the IITA, Respondent's imposition of the Replacement Tax on a non-resident taxpayer must satisfy tests under both the Due Process Clause of the Fifth Amendment to the U.S. Constitution, as applied to the States under the Fourteenth Amendment to the U.S. Constitution, and the Commerce Clause of Article One of the U.S. Constitution. Though these tests overlap in some respects, the U.S. Supreme Court has established that the fundamental concerns of the Commerce Clause are distinct from that of the Due Process Clause.

51. The Due Process Clause requires "some definite link, some minimum connection, between a state and the person, property, or transaction it seeks to tax." *Miller Brothers Co. v. Maryland*, 347 U.S. 340, 344-345 (1954).

52. The Commerce Clause prevents burdening interstate commerce through state overreach, in part by limiting the States' taxing jurisdiction. Specifically, the Commerce Clause forbids states from levying taxes that discriminate against interstate commerce or that burden it by subjecting activities to multiple or unfairly apportioned taxation. *Mead*, 553 U.S. at 24.

i. Due Process Clause.

53. The Due Process Clause limits the States' authority to tax nonresidents.

54. As applied to State taxation of nonresidents, the Due Process Clause requires that there be "some definite link, some minimum connection, between a state and the person, property, or transaction it seeks to tax." *Miller Brothers v. Maryland*, 347 U.S. 340, at 344-45 (1954).

55. In addition, there must be a "rational relationship between the tax and the 'values connected with the taxing State.'" *Mead*, 553 U.S. at 24.

56. "The broad inquiry subsumed… is 'whether the taxing power exerted by the State bears fiscal relation to the protection, opportunities, and benefits given by the State' – that is, 'whether the state has given anything for which it can ask return.'" *Id.* at 24-25 (citing *ASARCO Inc.* v. *Idaho Tax Comm'n*, 458 U. S. 307, 315 (1982)).

57. The Court in *Quill Corp. v. North Dakota,* 504 U.S. 298 (1992), discussed the concept of "economic nexus": "Applying [due process nexus principles], we have held that if a foreign corporation purposefully avails itself of the benefits of an economic market in the forum State, it may subject itself to the State's in personam jurisdiction even if it has no physical presence in the State." *Quill*, 504 U.S. at 307, *rev'd on other grounds South Dakota v Wayfair, Inc, et al,* 585 U.S. ___; 138 S. Ct. 2080 (2018).

58. The U.S. Supreme Court has further explained the requirement that, "in the case of an activity, there must be a connection to the activity itself, rather than a connection only to the actor the State seeks to tax." *Allied-Signal, Inc. v. Director, Div. of Taxation*, 504 U.S. 768, 778 (1992).

59. The State's power to tax an individual's or corporation's activities is justified by the "protection, opportunities, and benefits, the State confers on these activities." *Id.* at 779 (citing *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435 (1940)).

60. The relevant inquiry is whether the taxpayer has received any benefit or protection from the State or its laws *in connection with a transaction* for which the State can ask a return. *Mead*, 553 U.S. at 24-25.

ii. Commerce Clause.

61. The analysis required by the Commerce Clause is similar to that required by the Due Process Clause. The Commerce Clause, however, is focused on preventing burdens on interstate commerce caused by state overreach. The Commerce Clause forbids the States to levy taxes that discriminate against interstate commerce or that burden it by subjecting activities to multiple or unfairly apportioned taxation. *See id*. at 24.

62. As with the Due Process Clause, "the broad inquiry subsumed… is 'whether the taxing power exerted by the State bears fiscal relation to the protection, opportunities, and benefits given by the State' – that is, 'whether the State has given anything for which it can ask return.'" *Id*. at 24-25.

63. The U.S. Supreme Court has established a 4-prong test for state taxation under the Commerce Clause. The tax must pass all four prongs to be valid. The prongs, as described in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977), and applied in both *Quill* and *Wayfair*, are as follows:

a. Substantial Nexus: There must be a clear enough connection (nexus) between a state and a potential taxpayer to impose a tax. This was the focus of the U.S. Supreme Court's analysis in *Quill* and *Wayfair*:

The "substantial nexus" prong asks whether the "tax applies to an *activity* with a substantial nexus with the taxing State. Such a nexus is established when the taxpayer … 'avails itself of the substantial privilege of carrying on business in that jurisdiction.'" *Wayfair,* 138 S. Ct. at 2099 (emphasis added).

b. Nondiscrimination: The tax cannot discriminate against interstate commerce in favor of intrastate commerce. *Id.* at 2091.

c. Fair Apportionment: The state may only tax activity that is fairly apportioned to the state. *Id.*

d. Fair relationship: The tax must have a fair relationship to services provided by the state. *Id.*

64. Since *Complete Auto,* the Supreme Court has explained that the underlying rationale of the fair apportionment prong of *Complete Auto* is to prohibit a state from taxing *value* or *activity* outside the state's border.

65. In *Mobil Oil Corp v Comm'r of Taxes,* 445 U.S. 425, 439; 100 S. Ct. 1223 (1980), the Court expounded on the "fair apportionment" prong of *Complete Auto* and stated that "the linchpin of apportionability in the field of state income taxation is the unitary-business principle. In *Allied-Signal, Inc. v Director, Division of Taxation,* 504 U.S. 768, 784 (1992), the Supreme Court explained that the unitary business principle is a constitutional restraint "on a State's power to tax *value* earned outside its borders."

iii. Unitary Business Principle.

66. The "unitary business principle" is the mechanism by which a State may determine the proper apportionment of statutorily and constitutionally legitimate taxes. The unitary business principle thus becomes relevant only after the income in question has been determined to be "business income" in the hands of some recipient. As further explained below, if the income in question is not "business income" in the hands of any taxpayer, then the unitary business principle has no application to the case.

67. The unitary business principle prevents a change in corporate form from allowing a parent company to evade taxation on business income earned by or from its subsidiaries. The unitary business principle is an inquiry as to whether the nexus of the tax-generating entity with the taxing State can be attributed to the taxpaying entity by virtue of the fact that the "business" of the two entities is indistinguishable but for corporate form. *See Allied-Signal*, 504 U.S. at 780.

68. "The unitary business rule is a recognition of … the States' wide authority to devise formulae for an accurate assessment of a corporation's intrastate value or income and the necessary limit on the States' authority to tax value or income that cannot fairly be attributed to the taxpayer's activities within a State." *Id.*

69. The constitutionality of the tax, as applied, must be established before the unitary business principle becomes relevant. Where there is "no dispute that the taxpayer has done some business in the taxing State," then the inquiry shifts from "whether" the State may tax to "what" the State may tax. *Mead*, 553 U.S. at 25. "Conversely, if the value the State wished to tax

derived from a 'discrete business enterprise,' then the State could not tax even an apportioned share of that value." *Id.* at 26.

70. If the income is determined to be business income, then the unitary business principal inquiry begins. The factors to be considered in determining whether two distinct business entities should be treated as a unitary business are (1) functional integration, (2) centralization of management, and (3) economies of scale. *Id.* at 783.

71. The Court in *Mead* indicated that the question of "operational" vs. "investment" function is not a new, separate means by which to justify apportionment. *Mead*, 553 U.S. at 29. Courts have periodically evaluated whether the relationship between two distinct business entities served an investment function rather than an operational function in evaluating the presence of a unitary business. The Court in *Allied-Signal* determined that a state cannot apportion taxes to an out-of-state entity based on the activities of a subsidiary that serves only an investment, as opposed to an operational, function for its parent. *Allied-Signal*, 504 U.S. at 787.

iv. Case Law.

72. A number of federal and state courts have addressed the application of the Due Process Clause nexus requirements in the context of a State that seeks to tax a nonresident taxpayer (like the Holding Company) that sells an equity interest in a business entity (like the Operating Company) based solely on the latter's sales, operations, or other contacts with the State. A summary of the relevant cases follows.

73. *Allied-Signal*, 504 U.S. 768 (1992): The issue addressed in *Allied-Signal* was whether a state (New Jersey) could tax a share of the gain realized by a Michigan-based manufacturing company (a Delaware corporation) from the sale of 20.6% interest in a subsidiary

engaged in a distinct line of business. The Court ruled in favor of the taxpayer, holding that the gain from the sale was not apportionable by New Jersey. *Allied-Signal*, 504 U.S. at 790.

74. The facts in *Allied-Signal* are as follows: Allied-Signal was the successor-in-interest to Bendix Corporation ("Bendix"). Bendix was a multinational enterprise with operations in all 50 states and internationally, whose business activities were concentrated in automotive, aerospace, industrial/energy, and forest products. Bendix was a Delaware corporation, domiciled in Michigan. All of Bendix's corporate functions were based and controlled in Michigan, and no corporate activities were carried on in New Jersey. Bendix's primary activities in New Jersey were the development and manufacture of aerospace products. *Id*. at 774-75. In the late 1970s, Bendix acquired a 20.6% interest in ASARCO, a New Jersey corporation and a leading producer of nonferrous metals. Aside from holding the equity interest in ASARCO, Bendix did not engage in any business activity in New Jersey or elsewhere that involved any business or activity in which ASARCO was engaged. *Id*. at 775. Bendix did hold two seats on ASARCO's 14-member board. *Id*. In 1981, Bendix sold its ASARCO stock and realized a capital gain of $211.5 million. *Id*. at 773. Bendix used the proceeds of the sale to attempt a takeover of a business engaged in the aerospace industry. *Id*. at 794. New Jersey imposes an income tax on corporations doing business in the state. Bendix challenged New Jersey's inclusion of the gain attributable to its sale of ASARCO stock in its "entire net income" on the grounds that New Jersey could not constitutionally include investment income, with no connection to Bendix's New Jersey activities, in its apportionable tax base. *See id*. at 776.

75. The Court held in *Allied-Signal* that the gain from the sale of equity interests in ASARCO was not apportionable by New Jersey. *Id*. at 790. It held that there was no unitary business, and also found that Bendix's investment in ASARCO failed the "operational function

test." *Id*. at 787, 789-90. The Court stated that a State may not "tax a nondomiciliary corporation's income… if it is derived from unrelated business activity which constitutes a discrete business enterprise." *Id*. at 772. The Court further expounded upon the elements of a "unitary business," finding that "The hallmarks of an acquisition that is part of a taxpayer's unitary business continue to be functional integration, centralization of management, and economies of scale." *Id*. at 789. In the case of a capital transaction, such as the sale of a corporation's equity interest in a subsidiary, the Court determined that "the capital transaction must serve an operational rather than an investment function" to be indicative of a unitary business. *Id*. at 787. The Court thus found that ASARCO and Bendix were not a unitary business, and that the sale of interests in ASARCO served an investment rather than an operational function. Accordingly, the gain was not apportionable by New Jersey.

76. *Mead*, 553 U.S. 16 (2008): The Court in *Mead* similarly held for the taxpayer under facts that were much more favorable to the State of Illinois than are present in this case. The significance of *Mead* as compared to *Allied-Signal* is in affirming the unitary business principle and clarifying that the operational-function test is not a separate test by which a unitary business can be established.

77. In *Mead*, the State of Illinois sought to impose its income tax on capital gain realized by Mead, an Ohio corporation. Mead sold its Lexis business division and realized capital gain as a result of the sale. *Id*. at 20. Lexis maintained its business domicile in Illinois. *Id*. at 21. The trial court found that Lexis and Mead were not a unitary business due to a lack of functional integration, centralized management, and economies of scale. On appeal, the Illinois Appellate Court found that Lexis served an operational function in Mead's business, and held that the income

was subject to Illinois apportionment on that basis, but the appellate court did not address whether Mead and Lexis' businesses were unitary as grounds for apportionment. *Id*. at 23.

78. The Court in *Mead* vacated the Illinois Appellate Court's judgment against the taxpayer, and the case was remanded. *Id*. at 32. The U.S. Supreme Court held that the State courts erred in upholding apportionment on the basis that Lexis served an operational purpose in Mead's business, despite finding that no unitary business existed. *Id*. at 30. The determination of a unitary business remains the test for determining upon what value a State may properly apportion taxes. *Id*. "Where… there is no dispute that the taxpayer has done some business in the taxing State," the Court explained, "the inquiry shifts from whether the State may tax to what it may tax." *Id*. at 25. The unitary business principle was developed to answer this question. It permits the State to "tax an apportioned sum of the corporation's multistate business if the business is unitary.… If the value the State wished to tax derived from a 'unitary business' operated within and without the State, the State could tax an apportioned share of the value of the business [rather than isolate the attributable in-State value]. If, however, the value the State wished to tax derived from a 'discrete business enterprise' [out-of-state], then the State could not tax even an apportioned share of that value." *Id*. at 25. Furthermore, the Court clarified that the "operational function" inquiry (as discussed in Allied-Signal) does not modify the unitary business principal by adding new, additional grounds for apportionment. *Id*. at 28.

79. *Corrigan v. Testa*, 73 N.E.3d 381 (Ohio 2016): The Ohio Supreme Court in *Corrigan* applied the rules of *Mead* and *Allied-Signal* to find in favor of the taxpayer in a case with facts more favorable to the State than those present in the case at issue.

80. In *Corrigan*, the State of Ohio sought to impose taxes on Mr. Corrigan for capital gains arising from his sale of a controlling interest in Mansfield Plumbing, LLC (the "LLC"). The LLC was an operating company in the business of producing sanitary supplies. It had plants in Texas and California, and conducted business in all 50 states, including Ohio. Its commercial domicile was located in Ohio. *Corrigan*, 73 N.E.3d at 384.

81. In 2000, Mr. Corrigan, a Connecticut resident, acquired a 79.29% membership interest in the LLC. Mr. Corrigan became the primary co-owner, and member of the board of managers, of the LLC. From 2000 to 2004, Mr. Corrigan was allocated a distributive share of the income or loss generated by the LLC (in this case losses) and reported these on his Ohio non-resident income tax returns. *Id*. at 387. In 2004, Mr. Corrigan sold his interest in the company and realized a capital gain of $27,563,977. He treated the entire amount as gain allocable outside Ohio because he was not domiciled in Ohio. *Id*. at 385. However, the Ohio statute at issue purported to tax gain realized on sale of interests in a pass-through entity for which the seller held greater than a 20% interest. *Id*. at 384.

82. The Ohio Supreme Court held that while the Ohio statute was not facially invalid, it was unconstitutional as applied to Mr. Corrigan as a violation of the restraints imposed on state taxing jurisdiction under the Due Process Clause. The Court explained that while the "constraints imposed by the Due Process Clause and the Commerce Clause are distinct, they partially overlap…. Under both the Due process Clause and the Commerce Clause, the bedrock principle is 'that a State may not tax value earned outside its borders.'" *Id*. at 386, citing *Allied-Signal*, 504 U.S. at 769.

83. In the ordinary course, the *Corrigan* Court explained, the capital gain from the sale of intangible personal property would be taxed only in the taxpayer's state of domicile. *Id*. at 388. In addition to a State's connection with the person to be taxed, "in the case of a tax on an activity, there must be a connection to the activity itself, rather than a connection only to the actor the State seeks to tax." *Id*. at 389. The court determined that the distributive share of the company's income to Corrigan was taxable in Ohio, because that income was generated by Ohio business activity. *Id*. at 390. Capital gain, however, is generated by the sale of intangible property rather than by business activity, and thus does not avail the taxpayer of Ohio's protections and benefits "in any direct way." *Id*. at 390-391. The court rejected the State's "investee apportionment" analysis and distinguished between the taxation of a dividend from a domiciliary corporation (imposed on the corporation, and more directly related to corporate earnings) and that on capital gains (imposed directly on a nonresident investor). *Id*. at 394.

ERROR I

Replacement Tax Does Not Apply to the Holding Company's Own Income

84. The Replacement Tax is distinct from "regular" Illinois income tax, for which liability "passes through" to the owners of a partnership or S corporation. The Replacement Tax is imposed on the business entity itself, for the "privilege of earning or receiving income in or as a resident of" Illinois.

85. This difference in how the Replacement Tax is imposed, together with the reference in 35 ILCS 5/201(c) to the tax being levied on the privilege of "earning or receiving income in Illinois," raises a question of whether the Replacement Tax statute applies on its face to the Holding Company.

86. The Holding Company was never domiciled in Illinois. The Holding Company has never earned or received income in Illinois. Rather, as a member of the Operating Company, the Holding Company was allocated pass-through income earned and received by the Operating Company. A portion of such pass-through income may be allocable to Illinois, as described in *Corrigan*, but the gains derived from the Holding Company's sale of its intangible equity interest in the Operating Company is not. *See Corrigan*, 73 N.E.3d at 390.

87. In a case of first impression, the Illinois Appellate Court held in *Borden Chemicals and Plastics, L.P. v. Zehnder*, 312 Ill. App. 3d 35 (1st Dist. 2000), that the Replacement Tax can be imposed on a non-resident limited partner (that itself was an entity) based solely on pass-through operating income it was allocated from a partnership operating in Illinois. However, this decision focused exclusively on the taxpayer's constitutional arguments and not on the purposes and statutory language of the Replacement Tax. Furthermore, *Borden Chemicals* is consistent with the court's analysis in *Corrigan*, which differentiated between pass-through income of a resident operating business and income derived from the sale of intangible personal property. *Corrigan*, 73 N.E. 3d at 390.

88. In this case, Respondent seeks to impose Replacement Tax on capital gain income realized directly by the Holding Company as a result of its sale of an equity interest in the Operating Company, not pass-through operating income that was earned by the Operating Company. In 2016, the Holding Company paid Illinois Replacement Tax on pass-through operating income it received as a member of the Operating Company; the Operating Company itself did not pay any Replacement Tax.

89. The Holding Company does not dispute that the Replacement Tax applies to pass-through income it received from the Operating Company. The Holding Company disputes Respondent's imposition of the Replacement Tax on income earned directly by the Holding Company from the 2016 Sale of intangible personal property because the transaction did not in any way involve "earning or receiving income in or as a resident of Illinois" as provided by the IITA.

90. Gains derived from the Holding Company's 2016 Sale of an intangible equity interest is income earned solely by the Holding Company, and is not subject to the Illinois Replacement Tax based upon the plain language of 35 ILCS 5/201(c). The Holding Company was not an Illinois resident and did not earn or receive income in Illinois. The income at issue is not pass-through income earned or received in Illinois. Illinois had no connection of any kind to the transaction giving rise to the income at issue in this case.

91. Illinois has no authority under the plain text of the statute to impose a tax on a Florida corporation for capital gains received from the sale of interests in the Operating Company (a Delaware LLC) to a New Jersey corporation in a transaction neither negotiated in nor governed by the law of Illinois.

92. Accordingly, the Replacement Tax statute, on its face, does not apply to income earned directly by the Holding Company and unrelated to the pass-through operating income allocable to Illinois it received from the Operating Company.

WHEREFORE, the Petitioner prays for judgment to be entered against Respondent and cancelation of the Notice in its entirety.

ERROR II

Income at Issue is Nonbusiness Income under the IITA Regulations

93. Alternatively, in the event that Error I is denied, this Tribunal must determine what portion, if any, of the gain at issue is "business income" allocable to Illinois.

94. The IITA asserts Illinois' taxing power over business income to the maximum extent permitted by the U.S. Constitution. Thus the characterization of the Holding Company's gain from the sale of its equity interest in the Operating Company as business or non-business income turns on the constitutional analysis of whether the income in question may be subjected to Illinois' taxing power. 35 ILCS 5/301(c), 5/1501(a)(1).

95. Prior to any constitutional analysis (*see* Error III), however, the Regulations indicate that Respondent's own position is that the income earned in this situation is nonbusiness income.

96. The IITA provides that capital gains realized by a nonresident taxpayer from the sale of an intangible asset (such as the Holding Company's equity interest in the Operating Company) are not allocable to Illinois if the gain constitutes nonbusiness income (unless the taxpayer has its commercial domicile in Illinois). 35 ILCS 5/303(b)(3). Neither the Holding Company nor the Operating Company had its commercial domicile in Illinois. Accordingly, the gain from the Holding Company's sale of an equity interest in the Operating Company is apportionable by Illinois only if such gain constitutes "business income."

97. Section 100.3010 of the Regulations contains "rules and examples for determining whether particular income is business or nonbusiness income." These regulations

indicate that sales of intangibles by a non-resident taxpayer of an investment in a non-resident company are nonbusiness income. Section 100.3010 provides the following examples of business income:

a. Rents from real and *tangible* personal property.

b. Gains or losses from the sale of real or *tangible* personal property.

c. Interest.

d. Dividends.

e. Patent and copyright royalties.

98. Notably absent from Section 100.3010 of the Regulations are gains or losses from the sale of *intangible* personal property. Instead, such sales of intangibles are expressly covered by Section 100.3220 of the Regulations, which relates to the allocation of non-business income under Section 303 of the IITA. Section 100.3220 of the Regulations provides as follows with respect to nonresidents:

> "Intangible Personal Property. Capital gains and losses from sales or exchanges of intangible personal property [by a non-resident] are allocated to Illinois if the taxpayer has its commercial domicile in Illinois at the time of the sale or exchange."

99. Here, the taxpayer (the Holding Company) is a non-resident, and had no presence, much less commercial domicile, in Illinois. Under Section 100.3220 of the Regulations, therefore, capital gains from the sale of intangible personal property by the Holding Company are not allocable to Illinois.

100. Respondent's own Regulations therefore provide that the Holding Company's proceeds from the sale of intangible personal property are not within the statutory definition of business income. For the reasons explained below (*see* Error III), this interpretation is the logical and correct application of the Constitutional principles on which the definition of "business income" is based under the IITA.

WHEREFORE, the Petitioner prays for judgment against Respondent and cancelation of the Notice in its entirety.

ERROR III

Income at Issue is Not "Business Income" as Defined in the IITA

101. A Constitutional inquiry should be unnecessary in this case because the income at issue is not subject to Replacement Tax under the IITA or the Regulations for the reasons set forth above. However, in the event that this Tribunal determines that neither the IITA nor the Regulations are dispositive of this case, then this Tribunal must determine whether the income at issue meets the statutory definition of "business income" by reference to Constitutional principles incorporated into the statute.

A. Overview – No Transactional Nexus.

102. Petitioner is not aware of any reported decision within the United States in which a state has been permitted to tax a non-resident taxpayer on gain from the sale of an equity interest in a non-resident company based solely on the company's sales factor within that state. More has always been required, be it a real property interest in that state, a business headquarters

or significant management functions performed in that state, or some unique characteristic of the intangible in question that gives rise to the required nexus ("Transactional Nexus").

103. Here, neither the Holding Company nor the Operating Company had a commercial domicile, an office, or owned any significant property in Illinois. In addition, the shareholders of the Holding Company are not, and have never been, Illinois residents. Upholding Respondent's power to tax the gain at issue in this case would be inconsistent with judicial precedents and represent a vast expansion of State taxing powers.

104. Respondent did not provide Petitioner with separate audit findings with respect to the 2016 Audit, but Respondent has indicated its intention to apply the same arguments from the 2014 Audit to the 2016 Audit. In the 2014 Audit, Respondent's audit findings erroneously state two tests as applicable to determine the constitutionality of the tax: the unitary business test and the operational vs. investment function test. Respondent's analysis of the tax issues is incorrect.

105. As an initial matter, Respondent must first establish that the income at issue is business income before the unitary business test becomes relevant. The unitary business test is not invoked unless the income is first determined to be business income. *Mead*, 553 U.S. at 25. Only if income is first determined to be business income is the unitary business test relevant to determine whether that income is apportionable to Illinois by virtue of the relationship between the Holding Company and the Operating Company.

106. Respondent cannot establish that this income is business income because of the lack of Transactional Nexus. Accordingly, the income is not subject to Replacement Tax and the unitary business test is not relevant.

B. Due Process Analysis.

107. The Holding Company's gain from the sale of its membership interest in the Operating Company lacks the required nexus with Illinois to support taxation consistent with the Due Process Clause.

108. In 2016, Petitioner paid Illinois Replacement Tax on its distributive share of pass-through operating income, allocable to Illinois from the Operating Company's business activity, as determined by the Operating Company's sales factor.

109. There is no connection between the State of Illinois and the transaction between the Holding Company and Johnson & Johnson Consumer Inc. that gave rise to the income at issue.

110. The Holding Company did not receive any benefits or protections from Illinois in connection with the transaction that would support taxation of the transaction.

111. *Allied-Signal* involved a Michigan parent company that itself conducted business in New Jersey. At the outset, that fundamental fact – the parent company conducting business in the taxing State – is not present in this case. Rather the Holding Company was a Florida corporation that conducted no business in Illinois. Indeed, the Holding Company acted as a passive holding company and did not engage in or conduct business activities anywhere.

112. *Mead* involved an Ohio parent company that conducted business in Illinois and sold its equity interest in an Illinois-based subsidiary. Again, this factor is not present in this case because the Holding Company did not conduct business activity in Illinois (or anywhere else), and the Operating Company was not domiciled in Illinois. Even with the presence of these factors

in *Mead*, the taxpayer prevailed and the U.S. Supreme Court held that there was insufficient nexus with Illinois to permit the State to tax the parent company's gain from the sale of its subsidiary.

113. Without any of these crucial links to Illinois, there is no nexus with Illinois in the present case that could support taxation of Petitioner's sale of its equity interest in the Operating Company consistent with the Due Process Clause. Illinois cannot simply bypass the requirement of minimum contacts required by the Due Process Clause and skip directly to the unitary business test analysis.

114. Notably, in *Allied-Signal*, the parent company conceded that it was in the business of buying and selling operating businesses, using proceeds from such activities to acquire new interests. *Allied-Signal*, 504 U.S. at 794. Here, as described above, the Holding Company had no such function. Its sole purpose was to consolidate the management and administration of equity interests in the Operating Company consistent with the family's estate planning goals. It was formed shortly before the 2014 Sale, held only the Operating Company interest prior to the 2016 Sale, and did not redeploy the proceeds from the 2014 Sale or the 2016 Sale into other business activities. The Holding Company conducted no activities other than as an investor in the Operating Company. Indeed, following the Holding Company's sale of its remaining equity interests in 2016, the Holding Company dissolved.

115. Similarly, in *Corrigan*, the taxpayer held a 79.29% membership interest in the business, the business was headquartered in Ohio, and the taxpayer spent over 100 hours a year physically present in Ohio for board meetings and management meetings. *Corrigan*, 73 N.E.3d at 385. In the present case, the Holding Company lacked any such connections.

116. Therefore, the transaction at issue, as well as the Holding Company, lacked the minimum contacts required for Illinois to subject the transaction to taxation under the Due Process Clause. As a result, the income at issue cannot be apportioned to Illinois under applicable constitutional limitations and does not constitute "business income" as defined in the IITA. The Holding Company did not have a physical presence in Illinois, nor did its interest holders, nor did any of the parties to the transaction.

C. Commerce Clause Analysis.

117. The Operating Company's Illinois sales factor in 2016 bears no rational relationship to the transaction at issue. Therefore, Illinois cannot impose its income tax on the 2016 Sale without violating the Commerce Clause. A nonresident's sale of an equity interest in a nonresident company having no Illinois domicile or presence does not "bear[] a fiscal relation to the protection, opportunities, and benefits given by the state." *Mead*, 553 U.S. at 24-25.

118. Respondent's expansive view of its taxing authority would allow it to impose a tariff on the sale of equity interests in any business that conducts retail sales in Illinois. Respondent's attempt to tax the gain on this sale would interfere with interstate commerce. Specifically, the Commerce Clause forbids the states from levying taxes through overreach that burden interstate commerce by subjecting activities to multiple or unfairly apportioned taxation. *Id.* at 24. The taxing power Respondent has attempted to assert against Petitioner in the present case would interfere with Petitioner's right to choose a jurisdiction of domicile, and would subject similar transactions to taxation by any State in which the target company has sales.

119. The Holding Company had no nexus with Illinois, nor did the transaction at issue. The value received from the Holding Company's sale of its equity interest in the Operating

Company was not derived from any activity having a substantial nexus with Illinois, nor did the Holding Company avail itself of the substantial privilege of carrying on business in Illinois.

120. The Holding Company's gains derived from the sale of its equity interest in the Operating Company are not fairly apportionable to Illinois because there is no substantial nexus between Illinois and the transaction at issue. Furthermore, the Operating Company's sales factor is not a fair representation of the Holding Company's activity within Illinois. The Holding Company had no activity in or connection with Illinois.

121. Respondent's attempt to impose the Replacement Tax on the transaction at issue is not supported by any of the benefits and burdens provided by Illinois. Again, neither the transaction nor the parties to the transaction had any connection with the State of Illinois, nor did any party to the transaction avail itself of the benefits and protections of Illinois in connection with the transaction.

D. Unitary Business and Operational/Functional Analysis.

122. Respondent seeks to apply the unitary business principle – a doctrine of substance over form – as a mechanism for extending its taxing authority to gains with no discernible Illinois nexus.

123. The unitary business principle is not invoked where the transaction itself has no connection to the State attempting to subject it to taxation. The facts of this case should not require a unitary business analysis. Leading cases illustrate that the unitary business principle only applies in one of two situations, neither of which are present here:

a. Downstream application: To tax non-resident subsidiaries of a resident parent company. *Allied-Signal,* 504 U.S. 768; or

b. Upstream application: To tax the non-resident parent company's sale of a resident subsidiary. *Mead*, 553 U.S. 16.

124. Here, Illinois seeks a greatly expanded upstream application of the unitary business doctrine – to tax a non-resident taxpayer's sale of an interest in a non-resident subsidiary. A critical distinction is that neither company has commercial domicile in Illinois. Instead of a protectionist function for which the unitary business principle is designed, Illinois seeks to inappropriately apply the unitary business principle as an expansionist tax device. The taxpayers prevailed in both *Allied-Signal* and *Mead*, where nexus with the taxing state was far stronger than in the present case. This underscores that the lack of nexus between the transaction or the parties to the transaction and the State of Illinois prohibits Respondent from subjecting the transaction to tax. Applying the unitary business test to these facts is not supported by any case and would violate the nexus requirements of the Due Process Clause and the Commerce Clause.

125. Furthermore, Respondent's asserted power to tax the sale of an equity interest in a non-resident business by a non-resident taxpayer would discriminate against the taxpayer's right to select the jurisdiction, and thus the benefits and burdens of such jurisdiction, for organizing and conducting a business. The Commerce Clause prevents such discrimination.

126. Respondent's asserted taxing authority in this case would subject sales of equity interests throughout the United States to multiple and duplicative taxation if the underlying entity had any sales in Illinois. A taxpayer's state of domicile may properly tax the entire sale of intangible equity interests and need not credit the taxpayer for taxes paid to a sister State. For

example, Illinois would impose tax on the entire gain from the sale of an intangible by a taxpayer having a commercial domicile in Illinois. 35 ILCS 5/303(b)(3). It is both unreasonable and unconstitutional for Illinois to subject a nonresident, non-domiciliary corporation's sale of intangible property to taxation where Illinois has no connection to the parties or the transaction. Respondent's own Regulations support this conclusion.

127. Respondent is attempting to impose Replacement Tax on sales of intangibles both by taxpayers with commercial domicile in Illinois and, contrary to its own Regulations, taxpayers without a commercial domicile in Illinois. Respondent's position in this case would impose a system of redundant taxation that is prohibited by the Commerce Clause. Because the Commerce Clause would bar such taxation, the capital gains at issue in this case cannot fall within the definition of "business income" for purposes of 35 ILCS 5/1501(a)(1). The unitary business test is inapplicable if the income is not first determined to be "business income." *Mead*, 553 U.S. at 25.

128. Even if the unitary business test were applicable, Respondent cannot establish a unitary business relationship between the Holding Company and the Operating Company because (a) the Holding Company did not conduct any trade or business activities and (b) the hallmarks of a unitary business are not present here, for the following reasons:

a. "Functional integration" refers to business-to-business relationships indicating that parts make up the whole, rather than discrete lines of business. The indicia of "functional integration" are not present here:

i. The Holding Company had no operational functions. The Holding Company had no assets or activities other than its passive interest in the Operating Company. As previously discussed, the Holding Company was a passive entity established purely as an estate planning vehicle to facilitate the sale of an equity interest in the Operating Company and intrafamily transactions related to such equity interests.

ii. The Holding Company performed no functions.

iii. The Holding Company made no contribution to, and had no impact upon, the operations of the Operating Company.

b. Centralized management may exist where, for example, officers of a parent company are engaged in the operational and management functions of subsidiary divisions, or where functions such as financing, advertising, or legal counsel are shared between multiple divisions or subsidiaries rather than independently by each. Here, the indicia of "centralized management" are not present:

i. The Holding Company was not a Manager of the Operating Company and did not participate in the day-to-day management of the Operating Company. From August 1, 2014, through the 2016 Sale, the Operating Company was managed by a Board of Managers. The Operating Agreement prohibited Members from participating in the

day-to-day operation of the business affairs of the Operating Company.

ii. Further, as described above, the Holding Company did not perform any management functions of its own. The Holding Company did not itself have any operational activities that required management, thus there were no functions that could have been shared by the Holding Company and the Operating Company.

c. "Economies of scale" is shown where a business's cost advantages lead to expanded production. In a unitary business structure, examples of "economies of scale" include spreading costs among the businesses, or leveraging the resources of the businesses to reduce overall costs. For example, an operating company could save costs by using the back-office personnel of a sister or parent company, or by sharing the costs between the two. Another example would be the ability to purchase large quantities at a discount by leveraging the purchasing power of the sister or parent companies. Here, indicia of "economies of scale" are not shown:

i. The Holding Company produced nothing. It was not possible for the Holding Company to achieve any cost advantages by virtue of its relationship with the Operating

Company. The Operating Company contributed nothing to improve the efficiency of the Holding Company.

ii. The Holding Company had no resources that could be leveraged to save costs for the Operating Company. The Holding Company was a vehicle designed to passively hold equity interests in the Operating Company.

iii. The Holding Company performed no activities, owned no assets, had no personnel, and owned no other subsidiaries that could lead to economies of scale.

iv. There was no establishment of any economies of scale at any time before (or after) the transaction.

129. The relationship between the Holding Company and the Operating Company does not satisfy any of the possible factors in the unitary business analysis.

130. Further, the operational vs. investment function test clearly is not met here, because the Holding Company's sole purpose was to serve as a passive structure to facilitate the Christopher family's investment and estate planning objectives. The Operating Company performed no operational functions in connection with the Holding Company's purpose, and the Holding Company performed no operational function related to the Operating Company. The Holding Company did not invest in any other operating companies and did not own any other subsidiaries. At the time that it sold the Operating Company, the Holding Company's sole asset was its equity interest in the Operating Company.

131. The Holding Company did not redeploy the proceeds from the 2014 Sale or the 2016 Sale of equity interests in the Operating Company into any other businesses. As such, the capital transactions served no operational function and thus cannot be subject to apportionment. *See Allied-Signal*, 504 U.S. at 787.

132. The connection between the Holding Company and the Operating Company in the instant case is far more attenuated than the relationship between the parent and subsidiary corporations in *Allied-Signal* or *Mead*. Even so, the taxpayers prevailed in *Allied-Signal* and *Mead*. Accordingly, these cases are controlling, and a unitary business relationship cannot be found to exist between the Holding Company and the Operating Company under established Constitutional jurisprudence.

133. Specifically, Illinois "may not tax a nondomiciliary corporation's income… if it is derived from unrelated business activity which constitutes a discrete business enterprise." *Allied-Signal*, 504 U.S. at 780. The Operating Company was in the business of manufacturing, marketing, and selling hair-care products as a discrete business enterprise. The Holding Company had no such business, nor any business at all. If the U.S. Supreme Court could not find a unitary business or operational function in *Allied-Signal*, where a parent company actively and continuously bought and sold subsidiaries, then Respondent cannot establish that the Holding Company's sale of its interest in the Operating Company satisfies the unitary business test in the present case. Similarly, Respondent cannot establish that the transaction giving rise to the income at issue served "an operational rather than an investment function." *Id*. at 787.

134. The Court in *Mead* distinguished between an investment that serves as part of a "unitary business" due to operational benefits provided to the parent by the subsidiary in which

the parent has invested, and investments that serve a purely investment function. The operational function of an investment may indicate that a unitary business is present. Because the Holding Company does not engage in any operational business functions by virtue of its role as a passive investment vehicle, it cannot be "unitary" with any underlying operating subsidiary. Therefore, the Holding Company's interest in the Operating Company serves a purely investment-related function and the two cannot constitute a unitary business.

135. For these reasons, the capital gains at issue in this case could not be treated as apportionable business income under of the Constitution of the United States, and thus the income here is not within the definition of "business income" for purposes of 35 ILCS 5/1501(a)(1).

WHEREFORE, the Petitioner prays for judgment against Respondent and cancelation of the Notice in its entirety.

ERROR IV

Income at Issue Should Be Excluded from the Illinois Apportionment Factor

136. Even assuming that the income at issue in this case were determined to be business income, it would be inappropriate to use the Operating Company's Illinois sales apportionment factor as the basis for allocating that income to Illinois.

137. If this Tribunal determines that the income at issue constitutes apportionable business income, then Petitioner hereby petitions for relief under Section 100.3380 and Section 100.3390 of the Regulations and requests that this Tribunal hold that the income generated by the

Holding Company's sale of an equity interest in the Operating Company is not apportionable to Illinois under Section 304 of the IITA.

138. Specifically, the Operating Company's sales factor should be excluded from the determination of what business income of the Holding Company is apportionable to Illinois. Gain generated by the Holding Company's sale of an equity interest in the Operating Company does not derive from operating income generated by the Operating Company through its sales activities, and is unrelated to the Operating Company's conduct of its business in the ordinary course. Accordingly, the Operating Company's sales factor does not fairly represent the extent of the Holding Company's activity or market within Illinois.

139. The basic rule of Section 304 of the IITA is that non-business income is allocated to a corporation's state of commercial domicile. Business income is allocated, or "apportioned," between the various states with which a corporation has nexus.

140. Under the IITA, gain from the sale of intangible personal property would be taxable by Respondent only if "(a) the taxpayer is a dealer in the intangible, or (b) if the income-producing activity of the taxpayer is performed both within and without this State, if a greater proportion of the income-producing activity of the taxpayer is performed within this State than in any other state, based on performance costs." Neither factor exists in the present case: the Holding Company was not a dealer in the equity interests that were sold, and no part of the Holding Company's "income-producing activity" occurred in Illinois. Nor did the greater proportion of the Holding Company's or the Operating Company's "income-producing activity" occur in Illinois. IITA Section 304(a)(3)(C-5)(iii).

141. Again, Respondent's own regulations undercut the position it has taken in this case. The Regulations governing calculations of the sales factor provide that "gross receipts from an incidental or occasional sale of stock in a subsidiary will [also] be excluded." Regulations Section 100.3380(c)(2).

142. "The Director has determined that, in the instances described in this Section, the apportionment provisions provided in subsections (a) through (e) and (h) of IITA Section 304 do not fairly represent the extent of a person's business activity or market within Illinois." Regulations Section 100.3380.

143. The Regulations go on to list several reasons why this sale should not be included in business income. In particular, "intangibles representing the value of customer relationships" will not reflect the market for the taxpayer's goods or other ordinary sources of business. Regulations Section 100.3380(c)(2)(C).

144. Also highly relevant, "in the case of sales of assets that are made in connection with a partial or complete withdrawal from the market in the state in which the assets are located, including the gross receipts from those sales in the sales factor would increase the business income apportioned to that state when the taxpayer's market in that state has decreased." Regulations Section 100.3380(c)(2)(D).

145. Here, as discussed above, the Holding Company had only one subsidiary/operating company, and the sale of the business itself cannot logically constitute a sale in furtherance of the business. This is particularly true when the objective of the sale of an interest in the business is only to raise cash for personal purposes, rather than to invest in business operations.

146. Petitioner notes that in a General Information Letter (designed to provide general information to taxpayers), Respondent favorably analyzed a scenario in which members of a pass-through private equity fund sell some of the units (not assets) of a fund that has operations in the state of Illinois. 17-0001-GIL 01/09/2017. Respondent analyzed IITA Section 304(a)(3)(C-5)(iii) (discussed above) and determined that "in the case of capital gain or loss from the sale or exchange of intangible personal property, such gain or loss is allocated to Illinois only if the taxpayer's commercial domicile is Illinois."

147. For these reasons, and the reasons discussed in Error III, the sale of an intangible equity interest in a non-resident operating company by a non-resident taxpayer should not be subject to apportionment based on the sales factor of the non-resident operating company.

WHEREFORE, the Petitioner prays for judgment against Respondent and cancelation of the Notice in its entirety.

CONCLUSION AND RELIEF REQUESTED

WHEREAS, for the reasons contained herein, Petitioner respectfully requests that the tax liabilities set forth in the Notices be canceled; that the penalties set forth in the Notices be abated; and that this Tribunal enter such other and further relief as it deems appropriate.

Respectfully submitted,

Joseph N. Blumberg
Counsel for Petitioner
Schiff Hardin LLP
233 S. Wacker Drive, Suite 7100
Chicago, IL 60606
(312) 258-5616
Fax: (312) 258-5600
jblumberg@schiffhardin.com

ILLINOIS INDEPENDENT TAX TRIBUNAL

TODD CHRISTOPHER, as representative for	)
T. CHRISTOPHER HOLDING COMPANY	)
	)
Petitioner,	)
	)
v.	)
	)
ILLINOIS DEPARTMENT OF REVENUE,	)
	)
Respondent.	)

I hereby certify that on Friday, May 22, 2020, I served the T. Christopher Holding Company's Petition upon Respondent, the Illinois Department of Revenue, by sending it via FedEx to the following address:

Illinois Department of Revenue
Office of Legal Services
100 W. Randolph Street, 7-900
Chicago, IL 60601

Joseph N. Blumberg
Counsel for Petitioner
Schiff Hardin LLP
233 S. Wacker Drive, Suite 7100
Chicago, IL 60606
(312) 258-5616
Fax: (312) 258-5600
jblumberg@schiffhardin.com

<u>EXHIBIT A</u>

Auditor’s Report

Notice of Audit Results

Auditor's Report(s)

#BWNKMGV
#CNXX XX61 6152 7524#
T CHRISTOPHER HOLDING COMPANY LLC
ATTN: J LOECK AYCO
PO BOX 860
SARATOGA SPRINGS NY 12866-0860

March 6, 2020

Letter ID: CNXXXX6161527524

Taxpayer ID:	46-3538737
Account ID:	10163-28192
Audit ID:	A433887872
Return type:	IL-1120-ST
Audit periods:	01/2016 - 12/2016

Enclosed, find the auditor's report(s), showing the amount of tax, penalty, and interest we have determined is due for the periods shown above. If you agree with these amounts shown on the auditor's report(s), sign and return with your payment to the address shown below. By signing the auditor's report(s), you grant the Department permission to offset underpayments against overpayments, if applicable. Note, if you sign and return all enclosed auditor's report(s) or pay the net results due, you waive the right to seek review by the Informal Conference Board (ICB).

A summary of the audit results are listed below.

Audit Results

	YEAR 1	Total for audit period
Tax period ending	12/31/2016	
Interest Computed through	12/27/2019	
Tax	$3,144,796.00	$3,144,796.00
Penalty	$471,720.00	$471,720.00
Interest	$413,049.00	$413,049.00
Total Due	$4,029,565.00	$4,029,565.00

If you do not pay the amount due within 30 days from the "Date of Issuance," March 6,2020, shown on auditor's report(s), or take advantage of your ICB rights, you may incur additional late payment penalties and interest. If you do not sign the report(s) or pay the amount shown due, a Notice of Deficiency, explaining your rights to protest the liability and request an administrative hearing, will be issued.

Mail your payment and the signed auditor's report(s) to:

INCOME TAX AUDIT PERFECTION
ILLINOIS DEPARTMENT OF REVENUE
PO BOX 19012
SPRINGFIELD IL 62794-9012

If you are operating under the protection of the Federal Bankruptcy Court, contact us and provide the bankruptcy number and the bankruptcy court. The bankruptcy automatic stay does not change the fact that you are required to file tax returns. For those under the bankruptcy protection, this notice is not an attempt to collect tax debt. Illinois law requires issuance of this notice to advise you of an amount due or a missing return that must be filed.

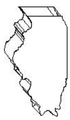
Sincerely,

Tammera Wadas
Revenue Auditor

ILLINOIS DEPARTMENT OF REVENUE
100 RANDOLPH, MC 7-300
CHICAGO IL 60601

312 636-3055
312 814-7224 fax

tammera.wadas@illinois.gov



Illinois Department of Revenue

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EDA-93 IL-1120-ST Auditor's Report

Taxpayer name:	T CHRISTOPHER HOLDING COMPANY LLC	Tax period ending:	12/31/2016
FEIN:	46-3538737	Interest through date:	12/27/2019
Account ID:	10163-28192	Earliest statute date:	10/15/2020
Audit period:	1/1/2016 through 12/31/2016	Audit ID:	A433887872

Type of change: ☐ Math error
Amended change: ☐ Federal ☐ State
If this is a federal change, the finalization date is_____________.

Original return receive date: 9/12/2017
Amended receive date:
Docket number:

		Column A (original or adjusted)	Column B (net change)	Column C (corrected amounts)
Step 1: Ordinary income or loss				
1	Ordinary income or loss, or equivalent from federal Schedule K	17,464,956	0	17,464,956
2	Net income or loss from all rental real estate activities	-12	0	-12
3	Net income or loss from other rental activities	-2	0	-2
4	Portfolio income or loss	1,796,066,470	0	1,796,066,470
5	Net IRC Section 1231 gain or loss	-203	0	-203
6	All other items of income or loss that were not included in the computation of income or loss on Page 1 of U.S. Form 1120-S. Identify: ______	330,649	0	330,649
7	Add Lines 1 through 6. This is your ordinary income.	1,813,861,858	0	1,813,861,858
Step 2: Unmodified base income or loss				
8	Charitable contributions	4	0	4
9	Expense deductions under IRC Section 179	0	0	0
10	Interest on investment indebtedness	1,412	0	1,412
11	All other items of expense that were not deducted in the computation of ordinary income or loss on Page 1 of U.S. Form 1120-S. Identify: ______	557,600	0	557,600
12	Add Lines 8 through 11.	559,016	0	559,016
13	Subtract Line 12 from Line 7. This is your unmodified base income or loss.	1,813,302,842	0	1,813,302,842
14	Write your unmodified base income from Line 13.	1,813,302,842	0	1,813,302,842
Step 3: Income or loss				
15	State, municipal, and other interest income excluded from Line 14	2,543,441	0	2,543,441
16	Illinois replacement tax and surcharge deducted in arriving at Line 14	0	0	0
17	Illinois Special Depreciation addition	0	0	0
18	Related-Party Expenses addition	0	0	0
19	Distributive share of additions	34,605	0	34,605
20	Amount of loss distributable to shareholder subject to replacement tax	0	0	0
21	Other additions	0	0	0
22	Add Lines 14 through 21. This is your income or loss.	1,815,880,888	0	1,815,880,888
Step 4: Base income or loss				
23	Interest income from U.S. Treasury and other exempt federal obligations	0	0	0
24	Share of income distributable to shareholder subject to replacement tax	0	0	0
25	River Edge Redevelopment Zone Dividend subtraction	0	0	0
26	River Edge Redevelopment Zone Interest subtraction	0	0	0
27	High Impact Business Dividend subtraction	0	0	0
28	High Impact Business Interest subtraction	0	0	0
29	Contribution subtraction	0	0	0
30	Illinois Special Depreciation subtraction	0	0	0
31	Related-Party Expenses subtraction	0	0	0
32	Distributive share of subtractions	16,501	0	16,501
33	Other subtractions	0	0	0
34	Total subtractions. Add Lines 23 through 33.	16,501	0	16,501
35	Base income or loss. Subtract Line 34 from Line 22.	1,815,864,387	0	1,815,864,387
Step 5: Income allocable to Illinois *(Complete this step if any amount on Line 35 is derived outside Illinois.)*				
36	Nonbusiness income or loss	1,796,066,253	-1,796,066,253	0
37	Bus. inc (loss) included in Line 35 from non-unitary partn, partns Sch UB, S corporation, trusts, or estates	0	0	0
38	Add Lines 36 and 37.	1,796,066,253	-1,796,066,253	0
39	Business income or loss. Subtract Line 38 from 35.	19,798,134	1,796,066,253	1,815,864,387
40	Total sales everywhere. This amount cannot be negative.	115,201,095	0	115,201,095
41	Total sales inside Illinois. This amount cannot be negative.	3,538,242	0	3,538,242
42	Apportionment factor. Divide Line 41 by Line 40. *(carry to six decimals)*	0.030714		0.030714
43	Business income or loss apportionable to IL. Multiply Line 39 by 42.	608,080	55,164,379	55,772,459
44	Nonbusiness income or loss allocable to Illinois	0	0	0
45	Bus. inc (loss) apportion IL from non-unitary partn, partns Sch UB S corporations, trusts, or estates	0	0	0
46	Base income or loss allocable to Illinois. Add Lines 43 through 45.	608,080	55,164,379	55,772,459

Step 6: Net income		Column A (original or adjusted)	Column B (net change)		Column C (corrected amounts)
47 Base income or net loss from Line 35 or Line 46	47	608,080	55,164,379	47	55,772,459
48 Discharge of Indebtedness adjustment	48	0	0	48	0
49 Adjusted base income or loss. Add Lines 47 and 48.	49	608,080	55,164,379	49	55,772,459
50 Illinois net loss deduction. If Line 49 is zero or negative, write "0".	50	0	0	50	0
51 Income after NLD. Subtract Line 50 from Line 49.	51	608,080	55,164,379	51	55,772,459
Step 7: Net replacement tax					
52 Replacement tax. Multiply Line 51 by applicable rate.	52	9,121	827,466	52	836,587
53 Recapture of investment credits	53	0	0	53	0
54 Replacement tax before investment credits. Add Lines 52 and 53.	54	9,121	827,466	54	836,587
55 Investment credits	55	0	0	55	0
Legal settlement amount					
56 Net replacement tax. Subtract Line 55 from 54. Write "0" if negative.	56	9,121	827,466	56	836,587
57 Compassionate Use of Medical Cannabis Pilot Program Act Surcharge.	57	0	0	57	0
58 Pass-through withholding payments from Schedule B, Step 1, Line 8.	58	25,113	2,317,330	58	2,342,443
59 Total net replacement tax and surcharge. Add Lines 56, 57, and 58.	59	34,234	3,144,796	59	3,179,030
Step 8: Replacement tax and surcharge, penalty and interest					
60 Net replacement tax and surcharge from Line 56 payments from Line 59	60	34,234	3,144,796	60	3,179,030
61 Penalties					
a Late-filing or nonfiling penalty	61a	0	0	61a	0
b Late-payment penalty	61b	0	314,480	61b	314,480
c Audit late-payment penalty	61c	0	157,240	61c	157,240
d Fraud or negligence penalty	61d	0	0	61d	0
62 Total penalties. Add Lines 61a through 61d.	62	0	471,720	62	471,720
63 Interest on replacement tax and surcharge	63	0	413,049	63	413,049
64 Total replacement tax and surcharge, penalty, and interest. Add Lines 60, 62, and 63.	64	34,234	4,029,565	64	4,063,799

Step 9: Payments and account balance

65 Payments		
a Credit carryforward from previous year	65a	0
b Form IL-505-B payments	65b	45,000
c Payment with original return	65c	0
d Subsequent payments	65d	0
e Credit from another period	65e	0
f Pass-through withholding payments	65f	0
g Gambling withholding	65g	0
h Form IL-516-I prepayments	65h	0
i Form IL-516-B prepayments	65i	0
66 Total payments and credits. Add Lines 65a through 65i.	66	45,000
67 Credits transferred to another period	67	0
68 Refunds and credit carryforward	68	10,766
69 Total credits out and refunds. Add Lines 67 and 68.	69	10,766
70 Net payments available. Subtract Line 69 from Line 66.	70	34,234
71 Amount due or refund. Subtract Line 70 from Line 64	71	4,029,565

If applicable, additional penalty and interest will be billed at a later date when the audit is processed.

Waiver of Restrictions - By signing and filing, the undersigned agrees to

- waive the restriction provided in the IITA, Section 903(b),
- immediate assessment and collection of the deficiencies (increase in tax and penalties) listed above, with interest as provided by law,
- accept the overpayment (decrease in tax and penalties) shown above with interest on such overpayments as provided by law, and
- waive the right to seek review by the Informal Conference Board.

Note: This waiver constitutes a valid claim for refund or credit for any overpayment shown above if it is properly signed and filed within the period established by law for making such claim. A date receipted copy of it must be received from the Department as proof of filing.

Under penalties of perjury, I state that I have examined this return, and, to the best of my knowledge, it is true, correct, and complete. By signing this return, I waive the right to seek review by the Informal Conference Board.

Signature of taxpayer or authorized representative | Title | Date

OFFICIAL USE ONLY

Auditor comments

EXHIBIT B

Notice of Deficiency

Notice of Deficiency

for Form IL-1120-ST, Small Business Corporation Replacement Tax Return

April 9, 2020

Letter ID: CNXXX13119919843

Taxpayer ID:	46-3538737
Audit ID:	A433887872
Reporting period:	December 2016
Total Deficiency:	$4,231,161.55
Balance due:	$4,231,161.55

#BWNKMGV
#CNXX X131 1991 9843#
T CHRISTOPHER HOLDING COMPANY LLC
ATTN: J LOECK AYCO
PO BOX 860
SARATOGA SPRINGS NY 12866-0860

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

IDR-393 (R-05/19)

Bankruptcy Information

If you are currently under the protection of the Federal Bankruptcy Court, contact us and provide the bankruptcy case number and the bankruptcy court. The bankruptcy automatic stay does not change the fact you are required to file tax returns. For those under the bankruptcy protection, this notice is not an attempt to collect tax debt. Illinois law requires issuance of this notice to advise you of an amount due or a missing return that must be filed.

Taxpayer Bill of Rights

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

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

Statement

Date: April 9, 2020
Name: T CHRISTOPHER HOLDING COMPANY LLC
Taxpayer ID: 46-3538737
Letter ID: CNXXX13119919843

Computation of deficiency	**Reporting period: 31-Dec-2016**
Minus tax previously assessed	-$34,234.00
Total tax deficiency	$3,144,796.00
UPIA-5 late-payment penalty (Audit)	$628,959.20
Plus interest on tax through April 9, 2020	$457,406.35
Total deficiency	* $4,231,161.55

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

Computation of balance due	**Reporting period: 31-Dec-2016**
Balance due	* $4,231,161.55

IDR-393 (R-05/19)

Explanation of Audit Adjustments

Income Tax

#BWNKMGV
#CNXX X172 2319 28X2#
T CHRISTOPHER HOLDING COMPANY LLC
ATTN: J LOECK AYCO
PO BOX 860
SARATOGA SPRINGS NY 12866-0860

April 9, 2020

Letter ID: CNXXX172231928X2

Taxpayer ID: 46-3538737
Account ID: 10163-28192
Audit ID: A433887872
Reporting period: December 2016

Explanation of adjustments for tax period ending 12/31/2016	Return Impact	Tax impact
We re-characterized as business income the interest income you earned from the investment of working capital. [86 IL Adm. Code 100.3010(c)(4)]	-$826,301.00	$381.00
We re-characterized as business income the rent income you received from property previously used in your business operations. [86 IL Adm. Code 100.3010(c)(2)]	$14.00	$0.00
We re-characterized as business income the royalty income you received from copyrights and patents that originated or were acquired for use in the regular course of your trade or business operations. [86 IL Adm. Code 100.3010(c)(6)]	-$5.00	$0.00
We re-characterized as business income the amount of gain (or loss) you received from the sale of property previously used in your trade or business operations. [86 IL Adm. Code 100.3010(c)(3)]	-$1,792,842,295.00	$825,980.00
We re-characterized as business income dividends claimed as non-business income because the stock with respect to which the dividends were received, is held or is acquired in the regular course of your trade or business operations or where the purpose for acquiring or holding the stock is related or attendant to such trade or business operations. [86 IL Adm. Code 100.3010(c)(5)]	-$2,397,666.00	$1,105.00
We have determined the correct amount of pass-through withholding payments required for your non-resident partners, shareholders, or beneficiaries. [35 ILCS 5/709.5]	$2,317,330.00	$2,317,330.00

Interest on tax and penalty, if applicable, has been computed as allowed by Illinois law. [35 ILCS 735/3-2]

We are imposing a penalty because you did not pay the amount required to be shown due on your return by the due date for payment. Once an audit has been initiated, the late payment penalty is assessed at 15 percent of the late payment. Failure to pay the amount due or invoke protest rights within 30 days from the "Date of Issuance" on the auditor's report issued with the EDA-143-I-APT, Notice of Audit Results, has resulted in this penalty increasing to 20 percent. [35 ILCS 735/3-3(b-20)(2)]