IT 16-09
Tax Type: Income Tax
Tax Issue: Burden of Proof and Business/Non-Business (General)

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS

THE DEPARTMENT OF REVENUE	)	Docket No. XXX
OF THE STATE OF ILLINOIS	)	Tax Years 1992, 1994-2000
v.	)	
ABC BUSINESS,	)	John E. White,
Taxpayer	)	Administrative Law Judge

RECOMMENDATION FOR DISPOSITION

Appearances: Fred Marcus, Horwood Marcus & Berk, Chartered, appeared for *ABC Business*; Ronald Forman & Rebecca Kulekowskis, Special Assistant Attorneys General, appeared for the Illinois Department of Revenue.

Synopsis: This matter involves two Notices of Deficiency (NODs) the Illinois Department of Revenue (Department) issued to *ABC Business* (*ABC Business* or Taxpayer) to propose to assess Illinois income and replacement income tax regarding tax years ending (TYE) December 31, 1997 and December 31, 1999 (TYE 1997 and 1999). It also involves a Notice of Denial (Denial) the Department issued to Taxpayer, after reviewing the amended Illinois corporate income tax returns Taxpayer filed to request credits or refunds for Illinois tax claimed to have been overpaid in error regarding TYE 1992, and 1994-2000. The tax proposed in the NODs, and the credits or refunds Taxpayer requested, are based on a particular stream of interest income Taxpayer reported as nonbusiness income deductions on the original Illinois return Taxpayer filed for TYE 1997, and on the amended Illinois returns Taxpayer filed regarding TYE 1994-2000.

A hearing was held at the Department's offices in Chicago. The parties offered dozens of documents via stipulation, which Taxpayer supplemented with additional documents, and with the testimony of two fact witnesses and an opinion witness. After considering the evidence admitted at hearing, I am including in this recommendation findings of fact and conclusions of law. I recommend that the NODs and Denial be finalized as issued.

Findings of Fact:

Facts Regarding *ABC Business*'s Business

1. *ABC Business* is incorporated in Delaware and has its principal business address in Michigan. Stipulation Exhibits (Stip. Exs.) T-Z (copies of pages from the website of the United States Securities and Exchange Commission (SEC) regarding *ABC Business*'s forms 10-K for, respectively, TYE 1994 through 2000).
2. *ABC Business* has two principal business segments, Automotive and Financial Services. Stip. Ex. V, p. 2. *ABC Business*'s SEC form 10-K for TYE 1996 describes the two principal business segments as follows:

> General
>
> The Company's two principal business segments are Automotive and Financial Services. The activities of the Automotive segment consist of the design, manufacture, assembly and sale of cars and trucks and related parts and accessories. Substantially all of *ABC Business*'s automotive products are marketed through retail dealerships, most of which are privately owned and financed.
>
> The primary activities of the Financial Services segment consist of financing operations, vehicle and equipment leasing and rental operations, and insurance operations. These activities are conducted primarily through the following subsidiaries: *ABC Business* Motor Credit Company ("*ABC Business* Credit"), *DEF Business* ("*DEF Business*") and *XYZ Business* ("*XYZ Business*").
>
> ***
>
> Automotive Operations
>
> The worldwide automotive industry is affected significantly by a number of factors over which the industry has little control, including general economic conditions.

> In the United States, the automotive industry is a highly competitive, cyclical business characterized by a wide variety of product offerings. The level of industry demand (retail deliveries of cars and trucks) can vary substantially from year to year. In any year, demand is dependent to a large extent on general economic conditions, the cost of credit and of fuel. Industry demand also reflects the fact that cars and trucks are durable items, the replacement of which can be postponed.
>
> ***
>
> The profitability of vehicle sales is affected by many factors, including unit sales volume, the mix of vehicles and options sold, the level of "incentives" (price discounts) and other marketing costs, the costs for customer warranty claims and other customer satisfaction actions, the costs for government-mandated safety, emission and fuel economy technology and equipment, the ability to control costs and the ability to recover cost increases through higher prices. Further, because the automotive industry is capital intensive, it operates with a relatively high percentage of fixed costs which can result in large changes in earnings with relatively small changes in unit volume.
>
> ***

Stip. Ex. V, p. 2.

3. *ABC Business*'s automotive business is capital intensive. Stip. Ex. T, pp. 4 (bates stamp numbers 00197) ("… because the automotive industry is capital intensive, it operates with a relatively high percentage of fixed costs which can result in large changes in earnings with relatively small changes in unit volume."), 5 (bates stamp number 00199) ("Automotive capital expenditures were $X billion in 1994, up $X billion from 1993. During the next several years, the pace of spending for product change at *ABC Business* is expected to be at similar or higher levels."); Stip. Ex. U, p. 3 (bates stamp number 00202) ("In 1995, 1994 and 1993, $X billion, $X billion and $X billion, respectively, were charged to income of *ABC Business* and its consolidated subsidiaries for *ABC Business*-sponsored research and development of new products and services and the improvement of existing products and services. In addition, $X million, $X million and $X million were charged to income in 1995, 1994 and 1993, respectively, for customer-sponsored research and development activities."); Stip. Ex. V, p. 4 (bates stamp number 00206) ("Automotive capital expenditures were $X

billion in 1996, down $X million from 1995.”).

4. *ABC Business*’s working capital needs are determined by *ABC Business*’s Chief Financial Officer and treasurer, through a five year forward looking cash forecast, which is reviewed monthly. *ABC Business* Ex. FFF (copy of Expert Report of Jim Square, dated May 17, 2012), p. 11; Hearing Transcript (Tr.) p. 49 (testimony of *John Doe* (*John Doe*)).

5. During the years at issue and prior thereto, *ABC Business* had automotive debt in the following amounts:

Year	Average Debt
1992	XXX
1994	XXX
1995	XXX
1996	XXX
1997	XXX
1998	XXX
1999	XXX
2000	XXX

Tr. pp. 287-88 (testimony of *Bonnie Blue* (*Bonnie Blue*)),

Facts Regarding *ABC Business*’s Illinois Returns for the Years at Issue, and the Department’s Actions After Reviewing *ABC Business*’s Returns

6. *ABC Business* and its affiliates filed a single Illinois combined unitary return for each of the years at issue. *See* Stip. Exs. PP-VV (copies of pages from *ABC Business*’s amended Illinois returns for, respectively, TYE 1994-2000) (p. 1, top right side of each return).

7. On its original Illinois returns for TYE 1994-1996, and 1998-2000, *ABC Business* reported having no nonbusiness income deductions. *See* Stip. Exs. PP-RR, TT-VV (p. 2 of each return).

8. On its original return for TYE 1997, *ABC Business* reported having a nonbusiness income deduction that was not allocable to Illinois. *See* Stip. Ex. SS, p. 2.

9. *ABC Business* filed a form IL-1120-X, Amended Corporate Income and Replacement Tax

Return (amended Illinois return) with the Department regarding each of its TYE 1992, 1994-2000. Stip. Exs. PP-VV; *see* Stip. Ex. A (copy of the Department's Denial), p. 2 (referring to the amended return *ABC Business* filed regarding TYE 1992, on October 7, 2004).

10. *ABC Business* filed its amended Illinois returns for TYE 1992, and 1994-2000, on either September 8, 2004 or October 7, 2004. Stip. Ex. A, pp. 1-2; Stip. Exs. PP-VV (p. 2 of each return).

11. On its amended Illinois return for TYE 1994, *ABC Business* reported an increase in the amount of the deduction for nonbusiness income, from 0, as originally reported, to $XXX. Stip. Ex. PP, p. 2 (Part III, line 2a (column B)). This increase in the amount of the nonbusiness income deduction reduced *ABC Business*'s Illinois business income from $XXX, as originally reported, to $XXX. *Id*., p. 2 (lines 1-4 (columns A-C)).

12. On its amended Illinois return for TYE 1995, *ABC Business* reported an increase in the amount of the deduction for nonbusiness income, from 0, as originally reported, to $XXX. Stip. Ex. QQ, p. 2 (Part III, line 2a (column B)). This increase in the amount of the nonbusiness income deduction increased the amount of *ABC Business*'s Illinois business loss* from -XXX, as originally reported, to -XXX. *Id*., p. 2 (lines 1-4 (columns A-C)). *I use the term "business loss" here and elsewhere in these findings to mean that *ABC Business*'s business income for a given tax year was a negative number. *See* 35 ILCS 5/207(a) (net loss defined); 35 ILCS 5/1501(a)(1) (business income defined).

13. At or about the time *ABC Business* amended its original Illinois return for TYE 1995, to increase the amount of *ABC Business*'s Illinois business loss, *ABC Business* also filed an amended Illinois return for TYE 1992, in which it reported an increase in the Illinois net loss deduction available to use to decrease its Illinois income tax liability for that year. *See* Stip.

Ex. A, p. 2 ("The amended return filed to claim non business income resulting in a loss increase claimed for year ending 12/31/1995 is denied. Also, there is no additional loss available to be carried back from 12/1995 to year ending 12/31/[1992].").

14. On its amended Illinois return for TYE 1996, *ABC Business* reported an increase in the amount of the deduction for nonbusiness income, from 0, as originally reported, to $XXX. Stip. Ex. RR, p. 2 (Part III, line 2a (column B)). This increase in the amount of the nonbusiness income deduction reduced *ABC Business*'s Illinois business income from $XXX, as originally reported, to $XXX. *Id*., p. 2 (lines 1-4 (columns A-C)).
15. On its original Illinois return for TYE 1997, *ABC Business* reported a nonbusiness income deduction in the amount of $XXX. *See* Stip. Ex. SS, p. 2 (Part III, line 2a (column A)).
16. After reviewing *ABC Business*'s Illinois return for TYE 1997, the Department corrected it, by disallowing the nonbusiness income deduction *ABC Business* reported for that year. Stip. Ex. B, pp. 2-3. The NOD the Department issued to *ABC Business* for TYE 1997 provides, in part: "The Department finds that *ABC Business* … failed to establish that interest income earned on investments is nonbusiness income." *Id*., p. 2.
17. On its amended Illinois return for TYE 1998, *ABC Business* reported an increase in the amount of the deduction for nonbusiness income, from 0, as originally reported, to $XXX. Stip. Ex. TT, p. 2 (Part III, line 2a (column B)). This increase in the amount of the nonbusiness income deduction reduced *ABC Business*'s Illinois business income from $XXX, as originally reported, to $XXX. *Id*., p. 2 (lines 1-4 (columns A-C)).
18. On its amended Illinois return for TYE 1999, *ABC Business* reported an increase in the amount of the deduction for nonbusiness income, from 0, as originally reported, to $XXX. Stip. Ex. UU, p. 2 (Part III, line 2a (column B)).

19. On that same amended return for TYE 1999, *ABC Business* reported a decrease (of $XXX) in the amount of its “other” Illinois subtractions, for foreign dividends reported on schedule J. Stip. Ex. UU, p. 1 (line 5b, columns A-C)). *ABC Business* had originally reported that it had foreign dividends in the amount of $XXX. *Id*. This decrease in *ABC Business*’s other Illinois subtractions reduced its originally reported Illinois business loss of -XXX to a business loss of -XXX. *Id*. (line 7, columns A, C).

20. On its amended Illinois return for TYE 2000, *ABC Business* reported an increase in the amount of the deduction for nonbusiness income, from 0, as originally reported, to $XXX. Stip. Ex. VV, p. 2 (Part III, line 2a (column B)). This increase in the amount of the nonbusiness income deduction increased the amount of *ABC Business*’s Illinois business loss from -XXX, as originally reported, to -XXX. *Id*., p. 2 (lines 1-4 (columns A-C)).

21. On April 26, 2010, the Department issued its Denial of the refunds *ABC Business* claimed in the amended Illinois returns *ABC Business* filed regarding TYE 1992, and 1994-2000. Stip. Ex. A. It also issued to *ABC Business* the NODs proposing to assess Illinois income and replacement income tax regarding TYE 1997 and 1999. Stip. Exs. B-C (respectively, a copy of the NOD for TYE 1997 and 1999).

Facts Regarding the Income at Issue

22. During the years at issue, *ABC Business* regularly and actively managed the capital it held in the form of cash or cash equivalents (and hereafter, I will use the word cash to mean both cash and cash equivalents), in an effort to increase the income to be earned from that asset. Stip. Ex. E (copy of minutes of *ABC Business*’s Finance Committee meeting held on March 9, 1993), pp. 2-4 (text under headings of “Balance Sheet Strategy” and “1993 Annual Report on Financing Plans and Investments”); Stip. Ex. F (copy of minutes of *ABC Business*’s

Finance Committee meeting held on November 9, 1993), p. 2 (text under heading of "1993 Budget and Forward Year Outlook"); Tr. pp. 27, 49 (*John Doe*).

23. *ABC Business*'s finance committee and its board of directors considered *ABC Business*'s active management of the capital held as cash to be a strategic way of improving its balance sheet, as well as a means of supporting its automotive and other operations. *E.g.*, Stip. Ex. E, pp. 2-5; Tr. p. 49 (*John Doe*).

24. When implementing *ABC Business*'s strategy of actively managing its cash, *ABC Business* was a partner in three separate partnerships, each of which maintained a separate account, referred to by the parties as the *Service* Accounts, numbers *50*, *100* and *200* (hereafter collectively referred to as the *SAs*), into which each partnership deposited and withdrew different amounts during the years at issue. Stip. Exs. AA-DD (copies of, respectively, working trial balances of *SA 100*, *50*, and *200*); *ABC Business* Ex. FFF, pp. 10-11; Tr. pp. 39-40 (*John Doe*).

25. The minutes of *ABC Business*'s Finance Committee meeting held on March 9, 1993 provide, in pertinent part:

> <u>Balance Sheet Strategy</u>
>
> A proposed communication dated March 11, 1993, entitled "Balance Sheet Strategy," … signed by … and addressed to the Board of Directors, for submission to the Board at its meeting scheduled for that date, … was presented to the meeting. ***
>
> The communication stated that its purpose was to outline the Company's balance sheet strategy, which was based on four underlying objectives: (1) provide a good return to shareholders, (2) maintain liquidity to support the appropriate product cycle product plan, (3) build additional liquidity to withstand the next economic downturn, and (4) maintain access to the capital markets at competitive costs.
>
> The communication reported that the Company's automotive business had been weakened by economic downturns in most major markets and reviewed the effect of these economic conditions, record spending and other operating factors during the past four years. It was projected that the worldwide economic recovery would be slow, and the factors were outlines that would be

taken into account in developing the Company's balance sheet strategy. The communication discussed that strategy in three sections: (1) market expectations, (2) internal return objectives, and (3) capital structure.

Market Expectations. The communication noted the importance of maintaining the Company's access to the capital markets at competitive costs, indicating that this would depend on an improvement in its financial performance and the returns provided to its investors. In this section, the Company's dividend policy was reviewed and commented upon in the context of payout targets, periodic increases and sustainability. *** More detail on the rationale for the dividend policy was provided in Attachment I.

Internal Return Objectives. The communication explained that returns on equity, sales and assets were determined principally by a combination of the following factors: cost of capital; market expectations; rating agency issues; and the levels required to meet *ABC Business*'s dividend, capital investment and liquidity targets. The communication then discussed the Company's Automotive cost of capital, debt-to-equity ratios, and return on equity and referred to Attachment III for additional information.

Capital Structure. The communication covered the status and planned actions with respect to Automotive liquidity, stock buy-back, new equity, new Automotive debt, Automotive debt retirements, worldwide debt capacity, fixed assets, working capital and pension funding. Noting that balance sheet data were affected by accounting practices, the communication stated that a review of *ABC Business*'s major accounting policies and practices was planned for later this year with the Audit Committee.

The communication pointed out that the Operations were working on actions to improve profits by focusing on further cost and spending efficiencies, with specific Corporate targets being identified. It concluded by stating that the Operations were developing plans to improve profits and operating cash flows and that the status of these actions would be reported to the Board during the Budget, Business Plan and Operating Reviews during the year.

***

1993 Annual Report on Financing and Investments

A communication dated March 9, 1993, entitled "1993 Annual Report on Financing and Investments," … addressed to the members of the Finance Committee, together with an attached proposed communication with the same title …, dated March 11, 1993 and addressed to the Board of Directors, … was presented to the meeting. ***

Both communications noted that the Annual Report on Financing Plans and Investments each year reviewed cash and borrowing levels, returns on cash portfolios, and the status of credit facilities, and, if nece*SA*ry, as was the case with this year's report, sought approval for corporate borrowing and certain equity investments. The communication to the Finance Committee made reference to the attachments to the report for additional details on inter-Company loans, guarantees, equity investments and foreign exchange exposure.

The Finance Committee communication requested recommendations to the Board of Directors and the foreign operations, as applicable, for the following:

1. Authorization of a worldwide limit of up to $XX billion of new long term borrowings for U.S and foreign automotive operations, and the filing of registration statements with the Securities and Exchange Commission covering U.S. public debt offerings to be made by the foreign automotive operations or *ABC Business* Holdings, Inc within the $XX billion authority.

***

Stip. Ex. E, pp. 2-5.

26. The minutes of *ABC Business*'s Finance Committee meeting held on November 9, 1993 provide, in pertinent part:

***

1994 Budget and Forward Year Outlook

A presentation entitled "1994 Budget and Forward Year Outlook," scheduled for submission to the Board of Directors at its meeting on November 11, 1993 was presented to the meeting. …

The presentation highlighted and discussed projected 1993 results, 1994 budget profit before taxes compared with projected 1993, and automotive operating cash flow (after dividend payments) for the 1990-projected 1994 period.

It was indicated that the near-term outlook was favorable, with pre-tax profit for 1993 projected at $XX billion, an improvement of $XX billion from budget. For the 1993-1997 period, it was noted, operating cash flow was projected to improve to $XX billion, which would achieve the target of building a $XX billion net cash position by 1997 to prepare for the next cyclical downturn. The presentation advised that the forward year plan had been restructured to reflect slower economic growth and lower industry volumes, additional cost improvements, and the provision of resources to support growth initiatives.

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Stip. Ex. F, p. 2.

27. The minutes of *ABC Business*'s Finance Committee meeting held on December 7, 1993 provide, in pertinent part:

***

Dividend Strategy

A presentation entitled "Dividend Strategy Discussion Points[,"] scheduled for submission to the Board of Directors at its meeting on

> December 9, 1993 was presented to the meeting. …
>
> The presentation covered the appropriateness and timing of dividend increases. It recalled the Balance Sheet Strategy presentation made to the Board in March 1993 which recommended that regular dividend increases begin only after the Company's earnings recovery was on solid footing and the balance sheet had been strengthened. In that context, it noted that the Company's target of $XX billion of net cash (Automotive cash less Automotive debt) was projected to be achieved in 1997. It stated that the improvement from the $XX billion net cash projected for year-end 1993 was forecast primarily in the "out-years" of the plan period.
>
> The presentation then discussed timing considerations and market signals as well as concerns and expectations of shareholders, credit rating agencies, and others.
>
> ***
>
> At the conclusion of the discussion, upon motion duly made, seconded and unanimously carried, the Committee recommended that the Dividend strategy Discussion Points be submitted to the Board of Directors for consideration.
>
> ***

Stip. Ex. G, p. 2.

28. The minutes of *ABC Business*'s Board of Directors meeting held on November 14, 1996 provide, in pertinent part:

> ***
>
> <u>Automotive Debt Strategy and Plans</u>
>
> A slide presentation dated November 14, 1996, entitled "Automotive Debt Strategy and Plans," … was presented to the meeting. …
>
> The presentation discussed the present Automotive debt levels and proposed that Automotive debt levels for the Business Plan period be increased to $XX billion. The presentation explained that a rise in end-of-period Automotive levels for the Business Plan period to about $XX billion would result in a ratio of Automotive debt to total Company equity of XX% at year-end 1998, below the cycle-average objective of XX%.
>
> The presentation requested approval to increase the authorized level of new long-term borrowings from $X billion to $X billion which would allow the Company to take advantage of market opportunities and add debt to provide downturn protection. The proposed increase in authorization would be in place until reviewed in April 1997.
>
> After discussion, upon motion duly made, seconded and unanimously carried, the following resolutions were adopted:
>
> RESOLVED, That the resolutions set forth under the caption "RESOLUTIONS RELATING TO ISSUANCE OF DEBT SECURITIES AND LOAN AGREEMENTS" and attached to a communication addressed to members of the Board of Directors dated April 11, 1996, shall be and hereby are amended by deleting therefrom the figure "U.S. $XXX" wherever it

> appears in any of said resolutions and replacing such figure with the figure "U.S. $XXX."
>
> ***

Stip. Ex. K, p. 3.

29. From 2002 through the date of hearing, *John Doe* was *ABC Business*'s director of global trading. Tr. p. 27 (*John Doe*). At the time of hearing, *John Doe* had been employed at *ABC Business* for about 40 years. *Id.*, pp. 26, 32-33 (*John Doe*).
30. As *ABC Business*'s director of global trading, *John Doe* had responsibility for managing *ABC Business*'s cash on a global basis, and oversight of *ABC Business*'s derivative transactions. Tr. pp. 27, 49 (*John Doe*).
31. *John Doe* was involved in *ABC Business*'s decision to open the *SAs*. Tr. p. 36 (*John Doe*).
32. Using guidelines established by senior *ABC Business* management, *John Doe* was responsible for making the decisions as to the types of investments and the maturities of the securities and/or other instruments purchased, held and sold by each of the *SAs*. Tr. p. 49 (*John Doe*).
33. *John Doe* identified *SA 100* as the *ABC Business* Investment Partnership account, *SA 50* as the *ABC Business* Enhanced Partnership account, and *200* as the *ABC Business* Super Enhanced Partnership account. Tr. pp. 35-36 (*John Doe*); Stip. Exs. AA-FF.
34. *John Doe* described *ABC Business*'s purpose for creating *SA 100* as being to manage short-term investments on behalf of *ABC Business* and several smaller U.S. affiliates. Tr. p. 37 (*John Doe*). *John Doe* explained that the average maturity date for securities held in *SA 100* was three to four months. Tr. p. 38 (*John Doe*).
35. *John Doe* and *ABC Business* also referred to the *100* account as the liquidity or operating account. Tr. pp. 44, 46-47, 53-54, 93, 121-22, 187 (*John Doe*).
36. When describing how *ABC Business* used *SA 100* and the amounts held in and/or realized

from that account, *John Doe* explained as follows:

> Q. *** Could you -- let's start with the liquidity account, *100*. Could you explain what this account was used for, what it represents, what the purpose was in establishing the account?
> A. ***100* is the account that absorbed all of the day-to-day changes in cash that result from running a global automotive company.**
> **So, it is the account into which we would receive payments for the sale of vehicles. It is the account that would fund payments to our suppliers. It would fund payroll. It would fund all the various things that we had to pay out.**
> **Every day there would be a net of all of the ins and outs; and if the net was positive, money would be transferred to *Service*, and that cash would then be invested in securities.**
> **If the amount was negative, and we had a net need for the day, we would liquidate securities in *100*, and then send that cash from the sale of those investments out to our treasurer's account, which would then fund whatever the net needs were for the day.**
> **So, the key is this account was the account that absorbed all of the day-to-day volatility in cash that results as a matter of normal business operations of an automobile company.**
> Q. What types of investments were required in the liquidity account when the funds were invested?
> A. A variety of things. It would include investments such as deposits with changes, U.S. Treasury bills, U.S. Treasury notes, some municipal notes, some federal agency note, such as short-term issued by organizations such as Fannie Mae, Freddie Mac, the Home Loan Bank and so forth, high-quality investment grade corporate commercial paper, a variety of short-term investments such as that, all of which would typically have maturities well inside of six months.
>
> ***

Tr. p. 38 (*John Doe*) (emphasis added).

37. The fund balance in the *SA 100* account changed every day, because, as *John Doe* described:

> A. Because it is the account that absorbed all the day-to-day volatility of [*ABC Business*'s] North American Automotive business.
> Q. And when you say "volatility," what do you mean by that?
> A. I mean it's the account into which the company would remit funds that it received, for example, receipts from dealers.
> It's the account from which the company would fund outflows, such as supplier payments, payroll, whatever bill we had to pay, and that was a daily activity of the fund, of the company; and, therefore, would impact that account on a daily basis.
> Q. And by "inflows," you mean receipts?
> A. Yes.

Q. And "outflows" you mean disbursements?
A. Correct.
Q. What if on any given day the outflows exceeded the inflows, or if the disbursements exceeded the receipts?
A. We would sell securities in *100* to raise cash to fund that difference.

***

Tr. pp. 58-59 (*John Doe*).

38. *John Doe* described *ABC Business*'s purpose for creating *SA 50* as being to manage what he said *ABC Business* regarded as excess cash held by *ABC Business* and some of its smaller affiliates, to achieve a higher return on a portion of that cash by investing in securities that had a slightly longer maturity term. Tr. pp. 37-38 (*John Doe*). The average maturity date for securities held in *SA 100* was about one year. Tr. p. 38 (*John Doe*).

39. *John Doe* described *ABC Business*'s purpose for creating *SA 200*, the Super Enhanced Partnership, as being to earn a higher return on what he said *ABC Business* considered excess cash by investing in securities that had a longer average maturity than that in *SA 50*. Tr. p. 38. The average maturity date for securities held in *SA 200* was about two years. *Id*.

40. *John Doe* explained how *ABC Business* used the *SAs* to manage the interest rate risk associated with the cash held in those accounts:

Q. Could you -- you talked about managing risk.
Could you give us an example of what that risk might be, a shorter-term investment versus a longer-term investment?
A. Sure. The longer the term of an investment, the greater risk that you lock in and too low of a return for too long of a period of time, if interest rates rise.
So, for example, if I were to buy a two-year investment, and two years from now rates rose 2 percent, I would be able to roll over that two-year investment at a higher rate of return.
If instead I purchased a 30-year security at that point in time, and 2 years after purchasing that 30-year security, rates went up 2 percent, I couldn't take advantage of it. I'm stuck with that lower return for the entire remaining 28 years of the term of that investment.
The way the accounting principles work is you actually have to show that unrealized loss as a hi[t] to the income statements.
So, not only is it a real foregone economic opportunity, it actually depresses profits, because you have an unrealized risk on an investment, and

> market value without investment goes down, just as the market value of a bond mutual fund that an individual might buy would go down as a result of the rise in rates that we've seen over the course of the last year, for example.
> Q. Now, you talk in terms of interest rate risk and the management of interest rate risk.
>
> Could you explain -- first of all, did you manage interest rate risk through these accounts?
> A. Yes, we did.
> Q. Could you explain how did you that?
> A. Yes. Essentially what we did is we, based on a variety of analyses that was conducted, we concluded that over time, the right overall average maturity for our cash investments was about one year.
>
> To achieve that, we had a process whereby we would periodically evaluate what the mix was between those three investments. Each of them had a separate average maturity.
>
> The enhanced return account had its year maturity. I'm sorry, had a one-year maturity. The liquidity account had a three-month maturity roughly. The super enhanced account had a two-year maturity.
>
> If we were indifferent to how much money was in those accounts, our interest rate risk could be much higher or lower than what that one-year objective was.
>
> So, we had a process where we periodically evaluated the mix; and if the average maturity of all three of those buckets of cash was significantly greater than one year, for example, we will move money from the longer-term accounts to the shorter-term accounts, to bring that average maturity down.
>
> Conversely, if there was too much money in the liquidity account or the enhanced return account, and the average maturity was significantly less than one year, we would periodically move money upstream to the longer-term accounts, in order to maintain over time what was roughly a one-year average maturity.
>
> That process happened no more frequently than once a month. It was only done at month end, if we deem it necessary to do; and we would often go many months, quarters, even longer without actually having done anything.

Tr. pp. 51-54 (*John Doe*).

41. *John Doe* agreed that some portion of the cash in the *SAs* would be included within the definition of *ABC Business*'s working capital. Tr. p. 83 (*John Doe*). *John Doe* considered all of the funds held in the *SAs* to be liquid investments. Tr. pp. 117-18 (*John Doe*).

42. *John Doe* noted, from recollection, that the balances in all of the *SAs* diminished when *ABC Business* needed large amounts of cash, giving as examples *ABC Business*'s purchases of Z

and Y, and its value enhancement shareholder action. Tr. pp. 71-72, 87-88, 186-87 (*John Doe*).

43. *John Doe* recalled that *ABC Business* was a partner in the *SA* partnerships, and *ABC Business* Motor Credit was not. Tr. p. 40 (*John Doe*).

44. While *John Doe* conceded that, without looking at the partnership agreements, he could not be certain of the percentage of the amounts deposited into the *SAs* that was *ABC Business*'s, his recollection was that between 80 to 95% of the amounts deposited into the *SAs* was *ABC Business*'s. Tr. pp. 40-41, 92-93 (*John Doe*).

45. The partnership agreements for the *SA* partnerships were not offered as evidence. *See* Stip. Exs., *passim*; Tr. pp. 35-36, 95 (*John Doe*). As a result, *ABC Business* had no documentary evidence that might have corroborated *John Doe*'s testimony about who the partners in each partnership were, or the amounts each partner was entitled to, as its share of the income each of the *SAs* realized during any of the years at issue. Tr. pp. 35-36, 95 ("I don't think those documents exist, I don't believe, from that time period.") (*John Doe*).

46. *John Doe* estimated that the fund balance in the *SA 100* account could change (that is, increase or decrease) by 10 to 20 percent on any given day. Tr. pp. 93-94 (*John Doe*).

47. The total end of month fund balances of all of the *SAs* varied by even greater amounts than *John Doe* estimated. *ABC Business* Ex. FFF, App. 3. For example:

- From May through June of 1992, the month end fund balances of the *SAs* went from X billion to X billion, reflecting about a X% decrease. *ABC Business* Ex. FFF, App. 3 (10.155 – 7.84 = 2.871, 2.871/10.155 ≈ 28.27).

- From June through July of 1994, the month end fund balances went from X billion to X billion, reflecting about a X% decrease. *ABC Business* Ex. FFF, App. 3 (X – X = X, X ≈

X).

- From August through September of 1994, the month end fund balances went from X billion to X billion, reflecting about a X% increase. *ABC Business* Ex. FFF, App. 3 (X – X = X, X/X ≈ X).
- From June through July of 1995, the month end fund balances went from X billion to X billion, reflecting about a X% decrease. *ABC Business* Ex. FFF, App. 3 (X – X = X, 3X/X ≈ X).
- From June through July of 1996, the month end fund balances went from X billion to X billion, reflecting about a X% decrease. *ABC Business* Ex. FFF, App. 3 (X – X = X, X/X ≈ X).
- From July through August 2000, the month end fund balances went from X billion to X billion, reflecting about a X% decrease. *ABC Business* Ex. FFF, App. 3 (X – X = X, X/X ≈ X).

48. During the years at issue, *John Doe* reviewed records he arranged to have prepared which documented the actual daily balances for each of the *SAs*, but *ABC Business* did not keep all such daily records. Tr. pp. 100-01, 195-96 (*John Doe*), 291-93 (*Bonnie Blue*).
49. Some of the funds held in each of the *SAs* were the proceeds from *ABC Business*'s issuance and sale of corporate bonds. Tr. pp. 114-15 (*John Doe*); *see also, e.g.*, Stip. Ex. E (p. 5), K (p. 3) (referring to increasing amount of *ABC Business*'s automotive debt levels). *John Doe* did not know how much of *ABC Business*'s bond proceeds were deposited into and held by each *SA* for the years at issue. Tr. pp. 115-16 (*John Doe*).
50. The below table compares *ABC Business*'s average debt from automotive operations, with the total interest income *ABC Business* reported on line 5 of its federal form 1120 for each of

the years at issue:

Year	Average Debt	*ABC Business*'s interest income, reported on line 5 of federal form 1120	Interest income as % of average debt
1992	X	X	X%
1994	X	X	X%
1995	X	X	X%
1996	X	X	X%
1997	X	X	X%
1998	X	X	X%
1999	X	X	X%
2000	X	X	X%

Tr. pp. 287-89 (*Bonnie Blue*), *ABC Business* Ex. FFF, App. 3.

51. None of the balance statements show the amounts of *ABC Business*'s bond proceeds that were deposited into each *SA* during the months or years at issue. Tr. p. 117 (*John Doe*); *see* Stip. Exs. AA-FF.

52. Since the cash deposited into the *SAs* was fungible, *John Doe* did not believe it was possible to estimate how much of each *SA*'s fund balance was attributable to bond proceeds after a time, because the funds deposited into an account would not nece*ssa*rily be the same funds held in the account later. Tr. pp. 115-17 (*John Doe*).

Facts Regarding the Amounts *ABC Business* Reported as Nonbusiness Income on Its Illinois Returns, and the Amounts It Represented as Being Nonbusiness Income at Hearing

53. At hearing, *ABC Business* had and offered as stipulated exhibits copies of monthly balance statements for each of the *SAs*, for some of the years at issue. Stip. Exs. AA (copies of *Service* Working Trial Balance Sheets for *SA* nos. 151, 141 and 181 for 1997), BB (copies of *Service* Working Trial Balance Sheets for *SA* nos. 151, 141 and 181 for 1998), CC (copies of *Service* Working Trial Balance Sheets for *SA* nos. 151, 141 and 181 for 1999), DD (copies of *Service* Working Trial Balance Sheets for *SA* nos. 151, 141 and 181 for 2000).

54. *ABC Business* also had and offered as stipulated exhibits a copy of a schedule titled, Detail

Rates of Return (rates statement) ─ one for *SA* 151 and one *SA* 141. Stip. Exs. EE (copy of rates statement for *SA* no. 151), FF (copy of rates statement for *SA* no. 141).

55. Stipulated Exhibit EE provides information regarding the funds held within *SA* 151, for the months of June 1992 through November 1996. Stip. Ex. EE, pp. 1-2.

56. Stipulated Exhibit FF provides information regarding the funds held within *SA* 141, for the months of January 1994 through November 1996. Stip. Ex. FF, pp. 1-2.

57. The *Service* Working Trial Balance Sheets (hereafter, *SA* balance statements) do not identify the amounts of interest income realized by each *SA* for the months for which such statements pertained. Stip. Exs. AA-DD; Tr. pp. 282, 301 (*Bonnie Blue*), 449 (Square).

58. The rates statements do not identify the amounts of interest income realized from each *SA* for the months for which such statements pertained. Stip. Exs. EE-FF; Tr. pp. 282, 301 (*Bonnie Blue*), 449 (Square).

59. Neither the *SA* balance statements nor the rates statements identify the amounts of interest income that would accrue to the partners in each *SA* partnership for the months for which such statements pertained. Stip. Exs. EE-FF; Tr. pp. 98-102, 195 (*John Doe*); 282, 301 (*Bonnie Blue*).

60. In 2008, *Bonnie Blue* (*Bonnie Blue*), a senior audit analyst employed by *ABC Business* (Tr. p. 202 (*Bonnie Blue*)), was tasked with gathering records to support what she described as *ABC Business*'s calculation of an amount of interest income on investments that *ABC Business* had reported on its Illinois returns, as being non-unitary and not taxable by Illinois. Tr. pp. 206-07, 309 (*Bonnie Blue*); *ABC Business* Ex. FFF, App. 3.

61. *Bonnie Blue* worked on this assignment in the ordinary course of her duties for *ABC Business*, in anticipation of the Department's audit of the original and amended Illinois

corporate income tax returns *ABC Business* filed regarding the years at issue. Tr. pp. 206-07 (*Bonnie Blue*).

62. During the audit and at hearing, *ABC Business*'s calculation of the amount it contends was not apportionable by Illinois was based on a formula used in a state tax case involving the American Home Products (AHP) company. Stip. Ex. FFF, pp. 4, 10-11 & App. 3; Tr. pp. 210-13, 226 (*Bonnie Blue*).

63. When gathering records to support *ABC Business*'s AHP calculation, *Bonnie Blue* reviewed documents and data available to her from three general sources. Tr. pp. 208-210 (*Bonnie Blue*). One of the sources was hard copy records, which *ABC Business* kept in binders. Tr. p. 208 (*Bonnie Blue*); *see* Stip. Exs. AA-FF. The other two sources were computer entries kept on separate computer drives at *ABC Business*. Tr. pp. 208-210 (*Bonnie Blue*).

64. Some of the computer files *Bonnie Blue* reviewed included scanned documents, and others included databases and excel spreadsheets containing entries others had previously inputted. Tr. pp. 208-210 (*Bonnie Blue*).

65. At hearing, *Bonnie Blue* identified a document marked for identification as *ABC Business* Exhibit WW as an excel spreadsheet she prepared to support *ABC Business*'s position regarding this matter. Tr. pp. 210, 213 (*Bonnie Blue*). *Bonnie Blue* began to prepare that spreadsheet in 2008, and she last revised it in 2011. *Id*.

66. *Bonnie Blue* prepared the excel spreadsheet to show *ABC Business*'s AHP calculation. Tr. pp. 210-13, 226 (*Bonnie Blue*); *ABC Business* Ex. FFF, App. 3.

67. *ABC Business*'s opinion witness based his opinions, in large part, on *Bonnie Blue*'s spreadsheet, a virtually identical copy of which he attached to his expert report as Appendix 3 (App. 3). *ABC Business* Ex. FFF, pp. 13-14 (Summary of Opinions), 14-28 (nn. 38, 42-43,

49, 62, 65, 69, 71, 73) (Bases for Opinions) & App. 3.

68. *Bonnie Blue*'s spreadsheet contains a top part and a bottom part. *ABC Business* Ex. FFF, App. 3.

69. The top part of *Bonnie Blue*'s spreadsheet begins, at the left, with a column showing an itemized list of different types of instruments *ABC Business* held, with each type of instrument being identified on a separate row, and with the bottom most row titled, Total. *ABC Business* Ex. FFF, App. 3. Moving from left to right, each column contains entries showing amounts of interest income purported to have been realized from the different types of instruments identified in each row of the first column, for years 1992 through 2000. *Id.*; Tr. pp. 227-33, 236-37 (*Bonnie Blue*).

70. Graphically, the row and column headings included within the top part *Bonnie Blue*'s spreadsheet appear as follows:

	1992	1993	1994	1995	1996	1997	1998	1999	2000
U.S. Securities:									
T-Bills									
T-Notes									
Repo Securities									
Fed Gov zero coupon									
US Gov't Securities									
Fed Agencies (Excl. FNMAs)									
FNMA/FHLMC									
Municipal-taxables									
Municipals-Variable									
Municipals-Tax Exempt									
Time Deposits									
Other Securities:									
CD's									
Euro CD's									
Euro Bonds									
Commercial Paper									
World Bank Securities									
Canadian T-Bills									
Corporate Bonds, Ind Rev Bonds									
Sovereign For Debt									
Bonds Borrowed-Repo									
Canadian Commercial Paper									

Series Mutual Fund										
Other-MBS										
Transfer from *XYZ Business*										
Trust income										
Promissory Notes	*									
Bankers Acceptances	*									
Series Mutual Funds	*									
L.T. Notes	*									
Receivables	*									
Intercompany Receivables	*									
Tax Refunds	*									
Land Contracts	*									
Bank Accounts	*									
P'ship Trust Income	*									
Freight Claims	*									
Misc. Rounding, van pooling	*									
Superfund	*									
All other interest income										
Line 5 Form 1120										
Tax Exempt income not above										
Less interest from items other than market securities	*									
U.S. interest already deducted										
Total										

ABC Business Ex. FFF, App. 3.

71. *Bonnie Blue* had to create the top part of her spreadsheet because she could not find any books and records kept by *ABC Business* which identified the amounts of interest income each *SA* actually realized during each of the years at issue. Tr. pp. 233-34, 282, 301 (*Bonnie Blue*).

72. In *Bonnie Blue*'s spreadsheet, the row at the bottom left side of the top part, titled "Total[,]" reflects *ABC Business*'s best estimate of the aggregate amount of interest income realized by all of the *SAs* in existence during a particular year. *ABC Business* Ex. FFF, App. 3; Tr. pp. 233-34, 236-37 (*Bonnie Blue*), 548-49 (Square).

73. After the row titled, "Line 5 Form 1120[,]" *Bonnie Blue* made three calculations to arrive at the row titled, Total. *ABC Business* Ex. FFF, pp. 18-19 & App. 3; Tr. pp. 230-37 (*Bonnie Blue*).

74. First, and for TYE 1995-2000, she added to *ABC Business*'s Line 5 amount an amount titled, "Tax Exempt interest not above." *ABC Business* Ex. FFF, pp. 18-19 & App. 3; Tr. pp. 230-32 (*Bonnie Blue*). She did so because she determined that such interest amounts were taxable by Illinois but were not included within the amounts reported on Line 5 of *ABC Business*'s federal form 1120 for each particular year. Tr. pp. 230-32 (*Bonnie Blue*).

75. Next, *Bonnie Blue* subtracted from *ABC Business*'s Line 5 amount an amount titled, "Less interest from items other than market securities[.]" *ABC Business* Ex. FFF, pp. 18-19 & App. 3; Tr. pp. 232-34 (*Bonnie Blue*). *Bonnie Blue* marked this row with an asterisk, which *Bonnie Blue* also marked on other rows in the top part of her spreadsheet beginning with "Promissory Notes" through "Supefund[.]" *ABC Business* Ex. FFF, pp. 18-19 & App. 3; Tr. pp. 277 (*Bonnie Blue*). *Bonnie Blue* subtracted these amounts from *ABC Business*'s line 5 amount because she determined that the interest amounts were not realized from the liquid securities held in the *SAs*. *ABC Business* Ex. FFF, pp. 18-19 & App. 3; Tr. pp. 232-34 (*Bonnie Blue*).

76. Finally, *Bonnie Blue* subtracted from *ABC Business*'s Line 5 amount an amount titled, "U.S. interest already deducted[.]" *ABC Business* Ex. FFF, App. 3; Tr. p. 235 (*Bonnie Blue*). *Bonnie Blue* subtracted these amounts because she determined that *ABC Business* had realized such interest from federal securities, was therefore exempt from Illinois income tax, and had already been deducted on *ABC Business*'s Illinois returns when calculating its business income. Tr. p. 235 (*Bonnie Blue*).

77. Beginning with the row titled "U.S. Securities" through the row titled "all other interest income", *Bonnie Blue* obtained all of the numerical entries she included within the respective rows and columns of the top part of her spreadsheet from *ABC Business*'s computer files. Tr.

p. 263 (*Bonnie Blue*); *see ABC Business* Ex. FFF, App. 3.

78. *Bonnie Blue* described the entries she obtained from *ABC Business*'s computer files, and used in her spreadsheet, as being either hard-coded or formulas. Tr. p. 262 (*Bonnie Blue*). She explained that a hard coded entry was reflected in the computer files as a number, whereas a formula entry was reflected as a mathematical operation. *Id*., pp. 262-65, 268 (*Bonnie Blue*).

79. *Bonnie Blue* was aware of accounts in which *ABC Business* kept cash other than the cash in the *SAs*, but did not include such amounts in the top part of her spreadsheet. Tr. pp. 270-71 (*Bonnie Blue*); *see also ABC Business* Ex. FFF, pp. 20-21 ("As discussed in the background section of my report, the [*SAs*] do not represent the entire cash balance of *ABC Business* Automotive-U.S. … As such, the following cash portfolios were not included in *ABC Business*'s Calculation:***").

80. The bottom part of *Bonnie Blue*'s spreadsheet shows *ABC Business*'s AHP calculation, which is intended to measure, for each year, a percentage of the interest income realized by the *SAs* which, *ABC Business* claims, the United States Constitution prohibits Illinois from apportioning. *ABC Business* Ex. FFF, App. 3; Tr. pp. 237-46, 305 (*Bonnie Blue*).

81. *ABC Business*'s AHP calculation compares the single lowest month end fund balance total for a given year with the average end of month fund balance total for that year. *ABC Business* Ex. FFF, App. 3.

82. When making this calculation, *Bonnie Blue* first totaled the month end balances of the *SAs* in existence during each particular year at issue, and then divided by 12 to calculate the total average monthly balances. *ABC Business* Ex. FFF, p. 21 ("The *ABC Business* Calculation uses the month-end balances of the sum of [*SAs*] T1-51, T1-41 and T1-81.") & App. 3; Tr. pp. 244-45 (*Bonnie Blue*).

83. *ABC Business*'s AHP calculation then divides the single lowest month end balances of the *SAs* in existence during a given year by the average monthly balances of such *SAs* for that year, with the quotient being *ABC Business*'s AHP ratio for that particular year. *ABC Business* Ex. FFF, App. 3.

84. For example, regarding TYE 1992, *Bonnie Blue*'s spreadsheet shows that the average total month end fund balance of the *SAs* then in existence was XXX and the single lowest total month end balance was XXX. *ABC Business* Ex. FFF, App. 3. Thus, for TYE 1992, the *SAs*' single lowest month end fund balance total was XX% of the *SAs*' average month end balance total. *Id*. (X/X ≈ X).

85. *ABC Business*'s AHP calculation treats the *SAs*' lowest single month end fund balance total during a given year as the lowest actual balance of the *SAs* for that year. *ABC Business* Ex. FFF, App. 3; *but see* Tr. pp. 58-59 (*SA* 151 would daily fund operations such as supplier payments or payroll), 93-94 (*John Doe*) (balance in *SA 100* could change by 10 to 20 percent any given day).

86. Finally, *ABC Business*'s AHP calculation multiplies the AHP ratio arrived at for each year (in the bottom part of the spreadsheet) by the entry titled, "Total" (in the top part of the spreadsheet). *ABC Business* Ex. FFF, pp. 18-19 & App. 3; Tr. pp. 237-38 (*Bonnie Blue*).

87. Again using TYE 1992 as an example, since the *SAs*' lowest single month end balance total was X% of the average total month end balance, *ABC Business*'s AHP calculation asserts that that same percentage of the interest income realized by the *SAs* should be considered as having not been used in *ABC Business*'s automotive operations for that year, and must, therefore, be considered nonbusiness income, which Illinois may not apportion. *ABC Business* Ex. FFF, App. 3.

88. During the years at issue, *John Doe* had access to, and received daily records showing the actual fund balances of each of the *SAs* (Tr. pp. 87-88, 100-01 (*John Doe*)), but *ABC Business* did not keep all such books and records. Tr. pp. 195-96 (*John Doe*).

89. When preparing and revising her spreadsheet, *Bonnie Blue* did not speak with *John Doe* about the daily fund balance statements he caused to have prepared and reviewed during the years at issue. Tr. p. 298 (*Bonnie Blue*). While looking for documentation to support her spreadsheet, *Bonnie Blue* did find some daily balance statements regarding each of the *SAs*, but she did not analyze them to see, for example, whether the daily balances were less than the month end balance of each particular *SA*. Tr. pp. 291-93 (*Bonnie Blue*).

90. At the time of hearing, *ABC Business* had no regularly kept books and records which documented the amount of interest income each of the *SA* partnerships realized from each of the three *SAs* during any of the years at issue. *See* Stip. Exs., *passim*; Tr. pp. 269-70, 282, 301, 305 (*Bonnie Blue*), 449 (*John Doe*).

91. At the time of hearing, *ABC Business* had no regularly kept books and records which documented the amount of interest income that *ABC Business* and its Illinois unitary affiliates, as partners in each of the three *SA* partnerships, realized from each of the three *SAs* during any of the years at issue. *See* Stip. Exs., *passim*; Tr. pp. 92, 95 (*John Doe*), 269-70, 282, 301 (*Bonnie Blue*).

92. At the time of hearing, *ABC Business* offered no documents which identified the actual lowest monthly balances of any of the *SAs*, during any of the months and years at issue. Tr. pp. 87-88, 100-01, 195-96 (*John Doe*), 291-93 (*Bonnie Blue*).

Conclusions of Law:

I. Preliminary Matters

A. Statement of the Issue

In a pre-hearing order, the parties agreed that the issue is whether Taxpayer properly determined business income for the years at issue pursuant to § 1501(a)(1) of the Illinois Income Tax Act (IITA). Pre-hearing Order. But the real issue here involves the propriety of Taxpayer's reports of nonbusiness income deductions, not its reports of business income. *See ABC Business* Opening Brief (Taxpayer's Brief), p. 2 (Issue Presented for Review). All of *ABC Business*'s amended Illinois returns, which were filed in 2004, report that *ABC Business*'s original returns for TYE 1995-1996 and for TYE 1998-2000 were in error, because *ABC Business* had mistakenly reported that it had no nonbusiness income deduction for each particular year. *See* Stipulation Exs. PP-RR, TT-VV (p. 2 of each return); Stip. Ex. A, pp. 1-2. It was the Department's disallowance of the nonbusiness income deductions that formed the basis of the Denial the Department issued here (Stip. Ex. A), as well as the basis for the Department's determination to propose to assess a deficiency regarding *ABC Business*'s Illinois original return for TYE 1997. Stip. Ex. B. As a result, this recommendation will focus on whether *ABC Business* has supported its claims that it was entitled to the nonbusiness income deduction reported on its original return for TYE 1997, and to the same deductions reported on its amended returns for TYE 1994-1996, and for 1998-2000.

B. Illinois' Statutory Scheme Of Apportioning Business Income And Allocating Nonbusiness Income

Before proceeding further, some background will help explain how the IITA taxes non-residents that derive income from sources inside and outside Illinois. To begin, § 201(a) imposes a tax, measured by net income, on every individual, corporation, trust and estate, on the privilege of earning or receiving income in or as a resident of Illinois. 35 ILCS 5/201(a). Section 201(c) also imposes a personal property replacement income tax (hereafter, replacement tax) on every corporation (including Subchapter S corporations), partnership and trust, upon the same privilege, and which tax is also measured by net income. 35 ILCS 5/201(c).

Next, § 202 defines net income as that portion of a taxpayer's base income which is allocable to Illinois under the provisions of Article 3, less the standard exemption allowed by Section 204 and the deduction allowed by Section 207. 35 ILCS 5/202. So, when calculating net income, a taxpayer must first determine its base income, and then determine how much of that base income is allocable to Illinois under the provisions of Article 3 of the IITA. *Id.*; *see also* Stip. Exs. PP-VV (p. 2 of each amended return, Part III – Base income or loss allocable to Illinois).

Section 304 is the section within Article 3 of the IITA which prescribes how a non-resident is to allocate and/or apportion business income. 35 ILCS 5/304. As the court in Blessing/White, Inc. v. Zehnder, 329 Ill. App. 3d 714, 768 N.E.2d 332 (1st Dist. 2002) explained:

> Essentially, the IITA establishes two methods by which corporate income will be divided among Illinois and the other jurisdictions in which the taxpayer conducts business. These two methods are "apportionment" and "allocation," and the particular method by which the taxpayer's income will be divided turns upon whether the income is classified as "business income" or "nonbusiness income."
>
> ***

Blessing/White, Inc., 329 Ill. App. 3d at 718-19, 768 N.E.2d at 336. Where a non-resident earns business income from both inside and outside Illinois, the purpose of § 304's apportionment formula is to confine the taxation of the non-resident's business income to that portion which is attributable to the non-resident's business activities in Illinois. Caterpillar Tractor Co. v. Lenkos, 84 Ill. 2d 102, 123, 417 N.E.2d 1343, 1354 (1981); Caterpillar Financial Services Corp. v. Whitley, 288 Ill. App. 3d 389, 392-93, 680 N.E.2d 1082, 1083-84 (3d Dist. 1997).

As the amended returns admitted as Stipulated Exhibits PP-VV reflect, when a taxpayer reports having nonbusiness income, the amount of the nonbusiness income reported is deducted from the amount of the taxpayer's business income or loss. Stip. Exs. PP-VV (p. 2 of each amended return, Part III, lines 1-4). The remaining amount of business income (or loss) is then apportioned by a formula that compares the taxpayer's instate activities with its activities outside Illinois. *See id*. (p. 2, Part III, lines 5-8).[1]

If a taxpayer's nonbusiness income is allocable to a state other than Illinois, it is disregarded when calculating the taxpayer's Illinois income and replacement tax liabilities. *See id*. (p. 2, Part III, lines 1-8). On the other hand, if the nonbusiness income is allocable to Illinois, after the taxpayer has calculated its business income and its apportionment formula, the nonbusiness income is added back to the taxpayer's apportionable business income when calculating base income or net loss allocable to Illinois. *Id*. (lines 8-11). The mathematical operations just described are perhaps better illustrated by the first and last four lines of Part III of *ABC Business*'s amended Illinois return for TYE 1998, which reflect as follows:

***

Part III – Base income (loss) allocable to Illinois	**A** As originally reported or adjusted	**B** Net change increase or decrease (explain in Part V)	**C** Corrected amount
1 Base income (loss) from Part I, Line 7 (Unitary filers, refer to Schedule UB instructions.)	**1** X		**1** X
2 **a** Nonbusiness income (loss), net of deductions directly allocable to such income	**2a** ____	X	**2a** X
b Non-unitary partnership business income (loss) in Line 1	**2b** ____	____	**2b** ____
3 Total. Add Lines 2a and 2b.	**3** ____		**3** X
4 Business income (loss). Subtract Line 3 from Line 1.	**4** X		**4** X

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[1] During most of the years at issue, the Illinois apportionment formula took into account the relative amounts of the taxpayer's property, payroll, and sales. Beginning in tax years ending on and after December 31, 1998, Illinois amended § 304 of the IITA, and began a three year transition period in which it gradually changed its three factor apportionment formula to a single factor formula using sales, only. *See* P.A. 90-613 (effective July 8, 1998). That amendment and transition has nothing to do with the dispute between the parties here.

		A As originally reported or adjusted	B Net change increase or decrease (explain in Part V)	C Corrected amount
8	Business income (loss) apportionable to Illinois. For the entry in Column C, multiply Line 4, Column C, by the original average if unchanged, or the average as revised on Line 7a or 7b above. Be sure to explain in Part V any revision or correction of the factors originally reported, that is shown above.	8 X		8 X
9	Nonbusiness income (loss) allocable to Illinois	9 ______	______	9 ______
10	Partnership business income (loss) apportionable to Illinois	10 ______	______	10 ______
11	Base income or net loss allocable to Illinois. Add Lines 8 through 10. Write on Part IV, Line 1, Columns A and C.	11 X		11 X

***

Stip. Ex. TT, p. 2, Part III. The amounts reported on line 8, columns A and C, were calculated by multiplying *ABC Business*'s business income (reported on line 4, columns A and C, by the average apportionment formula (for this particular year, 0.032066) *ABC Business* reported on its original Illinois return, and repeated on line 7a of its amended return. *Id*.

C. Burden of Proof

Section 904 of the IITA provides that an NOD issued by the Department to a taxpayer, when admitted at a hearing, is "prima facie correct and shall be prima facie evidence of the correctness of the amount of tax and penalties due." 35 ILCS 5/904(a)-(b); A.R. Barnes & Co. v. Department of Revenue, 173 Ill. App. 3d 826, 527 N.E.2d 1048 (1st Dist. 1988). Here, the Department's NODs were admitted into evidence by stipulation. Stip. Exs. B-C.

Further, Illinois courts have held that, "… when a taxpayer … seeks to take advantage of deductions or credits allowed by statute, the burden of proof is on the taxpayer. Balla v. Department of Revenue, 96 Ill. App. 3d 293, 296, 421 N.E.2d 236, 238 (1st Dist. 1981). When acknowledging this burden, the Balla court cited to the Illinois supreme court's decision in Bodine Electric Co. v. Allphin, 81 Ill. 2d 502, 410 N.E.2d 828 (1980). In Bodine, a taxpayer claimed entitlement to a different deduction authorized by the IITA, for a net loss incurred in a later tax year. *Id*. at 503-04, 410 N.E.2d at 829. There, the supreme court noted its "agreement with the appellate court that '(t)he granting of a deduction for net operating losses is a privilege created by statute as a matter of legislative grace' [citation omitted] … and that 'the taxpayer is not entitled to a deduction unless clearly allowed by statute and the burden is on the taxpayer to show he is entitled to the deduction claimed.' " *Id.* at 512-13, 410 N.E.2d at 833. Here, *ABC Business* filed its amended Illinois returns to claim a statutory credit or refund, authorized by IITA § 909, after determining, in 2004, that it made a mistake of fact or law when it filed its original returns for TYE 1995, 1996, and for 1998 through 2000. Stip. Exs. PP-RR, TT-VV (p. 2 of each amended return). On the amended returns filed for all years at issue but TYE 1997, *ABC Business* reported that each of its original Illinois returns erroneously reported that *ABC Business* had no nonbusiness income deduction for each such year. *Id.* It was the nonbusiness income deductions, and the statutory refunds or credits *ABC Business* sought on its amended returns, which the Department Denied. Stip. Ex. A.

As a result, regarding both the NODs and the Denial, when considering whether some amount of the interest income realized by the *SAs* constituted nonbusiness income, or income that Illinois constitutionally may not apportion, *ABC Business* bears the burdens of production and persuasion. Container Corp. of America v. Franchise Tax Bd., 453 U.S. 159, 175, 103 S.Ct. 2933, 2946, 77 L.Ed.2d 545 (1983) ("As previously noted, the taxpayer always has the distinct burden of showing by clear and cogent evidence that [the state tax] results in extraterritorial values being taxed.") (internal quotation marks omitted); Texaco-Cities Service Pipeline Co. v. McGaw, 182 Ill. 2d 262, 268, 695 N.E.2d 481, 484 (1998) ("An entity claiming that its income is nonbusiness income bears the burden of clearly proving this fact."). Further, *ABC Business* has to satisfy its burden with documentary evidence closely identified with its books and records. PPG Industries, Inc. v. Department of Revenue, 328 Ill. App. 3d 16, 33, 765 N.E.2d 34, 48 (1^{st} Dist. 2002) (agreeing that "[taxpayer] had the burden of overcoming [the Department's] …

prima facie case through documentary evidence, meaning books and records, and not mere testimony."); Balla, 96 Ill. App. 3d at 296-97, 421 N.E.2d at 239 (uncontroverted testimony that was not corroborated with documentary evidence was insufficient to show that taxpayer, a divorced mother and custodial parent, was entitled to personal exemption deductions claimed for her three children).

II. *ABC Business* Has Not Produced Documentary Evidence, Closely Tied To Its Regularly Kept Books And Records, To Support The Nonbusiness Income Deductions Reported On Its Original Return For TYE 1997, And On Its Amended Returns For The Other Years

During the years at issue, § 1501(a)(1) of the IITA defined business income as: "income arising from transactions and activity in the regular course of the taxpayer's trade or business ***, and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations." 35 ILCS 5/1501(a)(1) (formerly Ill.Rev.Stat. ch. 120, ¶ 15-1501(a)(1)). Nonbusiness income was, and remains, defined as "all income other than business income or compensation." 35 ILCS 5/1501(a)(13) (formerly Ill.Rev.Stat. ch. 120, ¶ 15-1501(a)(13)). "A taxpayer's income is business income unless it is clearly classifiable as nonbusiness income." Borden, Inc. v. Department of Revenue, 295 Ill. App. 3d 1001, 1010, 692 N.E.2d 1335, 1341 (1st Dist 1998).

In 2004, after the years at issue, the Illinois General Assembly amended the IITA's statutory definition of business income, as follows:

***

> (1) Business income. The term "business income" means all income that may be treated as apportionable business income under the Constitution of the United States. Business income is net of the deductions allocable thereto. Such term does not include compensation or the deductions allocable thereto. For each taxable year beginning on or after January 1, 2003, a taxpayer may elect to treat all income other than compensation as business income. This election shall be made in accordance with rules adopted by the Department and, once made, shall be irrevocable.

***

P.A. 93-840, art. 25, § 25-5 (eff. June 30, 2004).

The one Illinois court to have addressed the 2004 amendment to the statutory definition of business income noted that the parties before it considered the amendment to apply only prospectively. Shakkour v. Hamer, 368 Ill. App. 3d 627, 632 n.3, 859 N.E.2d 49, 54 n.3 (1st Dist. 2006). The income tax regulation that was amended after the Illinois General Assembly changed the statutory definition of business income similarly treats the 2004 amendment as being not applicable for "transactions and activities occurring prior to July 30, 2004 (the effective date of Public Act 93-0840) …." 86 Ill. Admin. Code § 100.3010(a)(1) ("For transactions and activities occurring prior to July 30, 2004 (the effective date of Public Act 93-0840), business income is *income arising from transactions and activity in the regular course of a trade or business and includes income from tangible and intangible property constituting integral parts of a person's regular trade or business operations.* (See IITA Section 1501(a)(1), prior to amendment by Public Act 93-0840.) ***"). Here, however, the parties focus most of their respective arguments on the constitutional aspects of treating all of the interest income realized by the *SAs* as being apportionable by Illinois. *E.g.*, Department's Post-Hearing Brief (Department's Response), 12-14; *ABC Business* Motor Company and Affiliates Opening Brief (Taxpayer's Brief), pp. 2, 16-34.

While I agree that there are constitutional aspects to considering whether a state may impose tax on income earned by a non-resident outside the taxing state's border (e.g. Allied-Signal, Inc. v. Director, Division of Taxation, 504 U.S. 768, 112 S.Ct. 2251, 119 L.Ed.2d 533 (1992)), there are also equally significant evidentiary aspects of considering whether a taxpayer has borne its burden of showing that it is entitled to a particular deduction, exemption or credit claimed. *E.g.*, Container Corp. of America, 453 U.S. at 175, 103 S.Ct. at 2946; Texaco-Cities

Service Pipeline Co., 182 Ill. 2d at 268, 695 N.E.2d at 484; Balla, 96 Ill. App. 3d at 296-97, 421 N.E.2d at 239. Further, both Illinois and federal law caution against addressing constitutional issues where other bases for a decision are available. New York City Transit Authority v. Beazer, 440 U.S. 568, 582, 99 S.Ct. 1355, 1364, 59 L.Ed.2d 587 (1979) ("If there is one doctrine more deeply rooted than any other in the process of constitutional adjudication, it is that we ought not to pass on questions of constitutionality ... unless such adjudication is unavoidable."); In re E.H., 224 Ill.2d 172, 178, 863 N.E.2d 231, 234 (2006) ("We have repeatedly stated that cases should be decided on nonconstitutional grounds whenever possible, reaching constitutional issues only as a last resort."). After reviewing all of the evidence admitted at hearing, I conclude that *ABC Business* has not presented documentary evidence that is sufficient, under Illinois law, to show that it was entitled to the nonbusiness income deductions reported on its original return for TYE 1997, and on its 2004 amended returns for the other tax years at issue.

A. *ABC Business* Has No Books And Records Which Identify The Amounts Of Interest Income Each Individual *SA* Actually Realized During Each of the Years at Issue

ABC Business filed an original return for TYE 1997 on which it reported a nonbusiness income deduction. *See* Stip. Ex. SS, p. 2. It also filed amended returns, in 2004, for TYE 1994-1996, and 1998-2000, on which it reported that it erred when previously reporting that it had no nonbusiness income deductions on the original returns filed for those years. Stip. Exs. PP-RR, TT-VV (p. 2 of each return). On each of those amended returns, *ABC Business* reported having a nonbusiness income deduction. *Id*. The evidence *ABC Business* offered at hearing to support its reports of nonbusiness income deductions is based primarily on a spreadsheet *Bonnie Blue*, one of its employees, began to prepare in 2008, and completed in 2011. *ABC Business* Ex. FFF, *passim* & App. 3; Tr. pp. 206-07, 210, 213 (*Bonnie Blue*).

ABC Business's litigation position in this matter, as reflected within *Bonnie Blue*'s spreadsheet, has two related parts. *ABC Business* Ex. FFF, p. 17 ("The two overall components of the *ABC Business* Calculation are the AHP Ratio and the Adjusted Interest Income.") & App. 3; Tr. p. 222. The top part of the spreadsheet reflects *ABC Business*'s estimate of the total interest income realized by all of the *SAs* in existence during each of the years at issue. The bottom part of that spreadsheet reflects *ABC Business*'s estimate of the relative amounts of the funds held in the *SAs* that *ABC Business* claims to have used, and not used, in its unitary automotive operations during each of the years at issue. To take just one year as an example, in the top part of *Bonnie Blue*'s spreadsheet, *ABC Business* estimates that it realized $XXX from all of the *SAs* during TYE 1999. *ABC Business* Ex. FFF, App. 3. In the bottom part of the spreadsheet, *ABC Business* estimates that about X% of the funds held in the *SAs* were never used in its operations during that year. *Id*. Each of these propositions is a factual assertion for which evidence is required. *See, e.g.*, <u>PPG Industries, Inc.</u>, 328 Ill. App. 3d at 33, 765 N.E.2d at 48.

Regardless whether one agrees with the manner or method *ABC Business* used in the bottom part of *Bonnie Blue*'s spreadsheet, mathematically, the percentages it arrived at must be applied to (that is, multiplied by) a known quantity. *See ABC Business* Ex. FFF, App. 3. The quantity that has to be known in this case is the actual amount of interest income realized by each *SA* during a particular tax year. *Id*. But *ABC Business* does not know the value of any such quantity. It does not know how much interest income any of the *SAs* realized, for any of the years at issue, because it has no books and records which identify such amounts. Tr. pp. 233-34, 301 (*Bonnie Blue*), 449 (Square). The absolute best it could do was to make a rough estimate of such amounts, within the top part of *Bonnie Blue*'s spreadsheet. *ABC Business* Ex. FFF, p. 17 & App. 3; Tr. pp. 548-49, 553-54 (Square).

Here, *Bonnie Blue*'s spreadsheet was not admitted as a business record that *ABC Business* prepared, at or about the time it filed its original returns, to record the amount of the interest income each of the *SAs* realized for each given year. Tr. pp. 213-25, 567. Nor was it admitted as a summary of voluminous records, included within the record, which might otherwise identify such amounts. Tr. pp. 570-75. However, a virtually identical copy of *Bonnie Blue*'s spreadsheet was admitted into evidence as an appendix to Square's expert report. *ABC Business* Ex. FFF, pp. App. 3. That appendix was the document Square frequently cited as a basis for his opinions in this matter. *ABC Business* Ex. FFF, pp. 13-14 (Summary of Opinions), 14-28 (nn. 38, 42-43, 49, 62, 65, 69, 71, 73) (Bases for Opinions). In that respect, even though *Bonnie Blue*'s spreadsheet was not admitted as documentary evidence that identified the amounts of interest income each of the *SAs* actually realized during each of the years referred to on the exhibit (Tr. p. 575), Appendix 3 was admitted as one of the documents upon which Square based his opinions. *ABC Business* Ex. FFF, App. 3. Evidence can be admissible for one purpose, and not for another purpose. People v. Lucas, 132 Ill. 2d 399, 429, 548 N.E.2d 1003, 1015 (1989). Upon reflection, I further consider the copy of *Bonnie Blue*'s spreadsheet that is attached as an appendix to Square's report was also admissible for the limited purpose of demonstrating how *ABC Business* calculated its AHP formula in this case, and how it argues it should be applied. *See* Lucas, 132 Ill. 2d at 429, 548 N.E.2d at 1015.

But the inclusion of a copy of *Bonnie Blue*'s spreadsheet as an appendix to Square's report does not require me to treat *ABC Business*'s rough estimate as reflecting the actual amounts of interest income realized by each of the *SAs* during each of the years at issue. Tr. p. 575. All of *ABC Business*'s hearing witnesses confirmed that *ABC Business* has no regularly kept books and records which identify the amounts of interest income each *SA* actually realized.

Similarly, the witnesses made clear that *ABC Business* does not possess documents that are necessary to identify the amounts of interest income *ABC Business*, and its affiliates, realized as partners in each of the *SAs* in existence during each of the years at issue.

To begin, *Bonnie Blue* testified that, when she was gathering documents and data to use in the spreadsheet she began to prepare in 2008 (Tr. p. 213 (*Bonnie Blue*)) — which was four years after *ABC Business* filed its amended returns (Stip. Exs. PP-VV) — she could find no documents which identified the actual amounts of interest income each *SA* realized for each of the years at issue. Tr. pp. 233-34 (*Bonnie Blue*). As a result, she had to use information that was available to her to estimate the amount of the interest income that was attributable to all of the *SAs*. Tr. p. 301 (*Bonnie Blue*).

Square also testified that "the interest specifically attributable to the *Service* accounts wasn't available on a stand-alone basis." Tr. p. 449 (Square). Square agreed that the top part of *Bonnie Blue*'s spreadsheet constitutes *ABC Business*'s best estimate of what the aggregate or total interest income for all of the *SAs* in existence during each year at issue. Tr. pp. 548-49 (Square). And while Taxpayer argues that Square testified that the amount of the interest income earned from each *SA* during each tax year could be estimated (Taxpayer's Brief, p. 35), the transcript is a much better source for Square's testimony on this point. Tr. pp. 553-54 (Square). Specifically, Square was asked the following questions and gave the following answers:

> [Q]: How much [interest income] came from 81 during any given year?
> Pardon me, how much interest income came from account 81 during that given year?
> [A]: I don't know.
> [Q]: In fact, isn't it non-ascertainable?
> [A]: No one has asked us to do it. You can't calculate it exactly.
> You could estimate it very roughly by saying, well, here is the amount of cash in 81 over the years. We know that we earned about X percent of interest on 81 during the year; and, therefore, we can approximate or estimate the amount of interest income earned in 81 that year.

> It won't be exact, it won't be the right number, or at least it won't be the number you get on a bank account, but it would be an estimate.
>
> [Q]: How could you estimate how much of the total amounts listed in the row "Total" came from 81?
>
> [A]: It would be difficult because you've got a certain percentage of cash owned by different -- presumably different taxpayers in those accounts.
>
> [Q]: That's just a different problem. The problem is what are the separate amounts that would total the row entries under "Total?"
>
> So, for '92, it's only 41 and 51 [that were in existence], but what amounts make up 41 versus 51?
>
> [A]: So, it's very difficult. You can't tell, but what you do know is that for each year, the line items that go into 1120, line 5, there's a detail of whether they came from treasury bills, muni bonds, CDs and so forth.
>
> So, that's the granularity going into 1120. Unfortunately, the granularity ends at that point.
>
> The line items you are subtracting out, interest from other market securities and the interest otherwise deducted, you don't know what it came from, other than you would be pretty sure that the interest that's otherwise deducted came from tax exempt -- Illinois tax-exempt securities, treasury bills.
>
> It's below that line 5 of the 1120, you don't have any granularity as to what generated that interest income or what type of security.

Tr. pp. 553-54 (Square).

Additionally, *Bonnie Blue*'s spreadsheet does not take into account the fact that *ABC Business* was just one of the partners in each of the *SA* partnerships. *ABC Business* Ex. FFF, App. 3; Tr. pp. 35-36, 40-41, 92-93, 195 (*John Doe*), 269-71 (*Bonnie Blue*). *Bonnie Blue* acknowledged, at hearing, that the *SAs* were organized as partnerships, and that she did not know who the partners were in each of the three *SA* partnerships. Tr. p. 269 (*Bonnie Blue*). She acknowledged, further, that her spreadsheet did not identify how much of each *SA*'s funds might be *ABC Business*'s. *Id*., p. 270. Instead, she treated her estimate of the total interest income realized by all of the *SAs* as being *ABC Business*'s interest income. Tr. p. 271 (*Bonnie Blue*); *see ABC Business* Ex. FFF, App. 3; Tr. pp. 553-54 (Square).

John Doe confirmed that the *SA* balance statements reflected funds that belonged to each partnership, and not *ABC Business*'s share of such interest income. Tr. p. 195 (*John Doe*). *John*

Doe testified that, without referring to the partnership agreement created regarding each *SA*, he could not be sure of much of the interest income realized by each *SA* would have been treated as the income of *ABC Business*, and the affiliates included on *ABC Business*'s Illinois returns, who were partners in each such partnership. Tr. pp. 35-36, 40-41, 92-93 (*John Doe*). *John Doe* also testified that, as of the hearing date, he did not think that *ABC Business* had copies of the partnership agreements regarding each *SA*. Tr. p. 95 ("I don't think those documents exist, I don't believe, from that time period.") (*John Doe*).

ABC Business's final witness, Square, also referred to the lack of documents showing how much of each *SA* partnership account's funds were *ABC Business*'s in his report. Specifically, Square wrote, in a footnote, that: "It is my understanding that there may have been cash in the *Service* Accounts that was owned by *ABC Business* entities other than *ABC Business* Automotive – US; however, there is no information available to determine the portion of the month-end cash balances in the *Service* Accounts that may have been owned by *ABC Business* entities other than *ABC Business* Automotive – US." *ABC Business* Ex. FFF, p. 18 n.39. Of course, logically, Square's observation also means that there is no information available to determine the portion of the month-end cash balances that was owned by *ABC Business*, and its affiliates whom *ABC Business* included within its Illinois unitary business group.

In summary, this record makes clear that *ABC Business* has no books and records which identify the amounts of interest income that each of the *SAs* actually realized during each of the years at issue. The record further strongly suggests that *ABC Business* no longer has any of the partnership agreements that would be necessary to determine how much of the roughly estimated amounts of each *SA*'s interest income would accrue to *ABC Business*, and to the other *ABC Business* affiliates who are part of *ABC Business*'s Illinois unitary business group, as partners in each *SA* partnership. The evidence that *ABC Business* offered, therefore, is not and cannot be closely tied to books and records which document the actual amounts of interest income *ABC Business* (and the affiliates who are part of *ABC Business*'s Illinois unitary business group) realized as partners in each of the three *SA* partnerships that were in existence during the years at issue.

B. *ABC Business* Has No Books And Records Which Corroborate, Back Up, Or Support Many Of The Entries *ABC Business* Took Into Account When Estimating Interest Income Attributable To The *SAs* For The Years At Issue

The top part of *Bonnie Blue*'s spreadsheet lists different types of securities and other instruments held by *ABC Business* during the years at issue, which were taken into account regarding *ABC Business*'s report of interest income realized during each year on line 5 of *ABC Business*'s federal income tax return. *ABC Business* Ex. FFF, App. 3. *Bonnie Blue* explained that the amount of interest income reported on line 5 of *ABC Business*'s federal returns included all interest earned by *ABC Business*, and what the top part of her spreadsheet was intended to do was to identify only the interest income *ABC Business* realized from its cash investments in market securities, and which was taxable by Illinois. Tr. p. 232-33, 236 (*Bonnie Blue*).

Bonnie Blue testified that, when she was preparing the top part of her spreadsheet, the only data she had to corroborate, back up, or support many of the entries she used there were the entries she obtained from *ABC Business*'s computer files, which she copied, as hard-coded entries, into her spreadsheet. Tr. pp. 262, 263 ("So, for hard coded numbers, the entire top section, which I'm going to classify as the interest detail from the row U.S. securities through all other interest income for all years 1992 through 2000, all those numbers are hard coded."). *Bonnie Blue* acknowledged that she did not have any books and records that backed up, corroborated or supported the entries she marked with an asterisk on her spreadsheet, totaled in the row titled, "Less interest from items other than market securities *[,]" and then subtracted from *ABC Business*'s line 5 interest. Tr. pp. 278-79 (*Bonnie Blue*); *see ABC Business* Ex. FFF, App. 3. More specifically, she testified as follows:

> Q. … the lines that have the asterisk next to them, do you have any backup support to the amounts that comprise those numbers?
> A. This schedule was created based on a previous version[ ] of the schedule and the exhibits that you mentioned this morning that shows the detail. I don't remember the numbers.
> Q. Okay. So, my question is, for example --
> A. That is the detail.
> Q. Okay. So, the first asterisks says "Promissory notes"?
> A. Correct.
> Q. Where in these documents can I find the amounts that compromise that number?
> A. Your question is you would like to show --
> Q. The backup detail for those numbers.
> A. The backup for that one line?
> Q. Well, for all the lines, but we'll start with that one.
> A. Specifically for this question that line?
> Q. Uh-huh [Yes].
> A. I do not have detail really down below this level. The detail I have is the line 5, and then this level of detail, not below that. So, it's not summing up something below that.

Tr. pp. 278-79 (*Bonnie Blue*).

The record further shows that *Bonnie Blue* could find no books and records which corroborate, back up, or support the entries in the rows and columns that were totaled in the row titled, "U.S. interest already deducted[,]" and then subtracted from line 5 interest income. Tr. pp. 279-80 (*Bonnie Blue*). Specifically, *Bonnie Blue* was asked the following questions and gave the following answers:

> Q. What amounts comprise that U.S. interest already deducted number?
> A. The U.S. interest already deducted number we talked about yesterday comprised of the rows for all years, the very top of the detail of T bills, T notes, Federal Government zero coupons, U.S. government securities and then the federal agencies.
> Q. Okay. And so it does not include the repo securities; is that correct?
> A. That is correct.
> Q. For any of the years, do you have any of the backup detail for any of the numbers for the amounts on these lines that we just talked about?
> A. Your question is -- so, the detail making up the T bill total?

Q. Yes.
A. No, I did not.

Tr. p. 280 (*Bonnie Blue*).

In Square's report describing the amounts *Bonnie Blue* added and subtracted from the interest income amounts *ABC Business* reported on line 5 of its federal returns, he cites, as support for each such entry, his "[d]iscussion with *ABC Business* management." *ABC Business* Ex. FFF, p. 19 & nn.44-46. Square also confirmed that *ABC Business* did not have documents that would support the amounts *Bonnie Blue* added to the interest income *ABC Business* reported on line 5 of its federal returns, in the row titled, "Tax Exempt income not above." *ABC Business* Ex. FFF, p. 25 & App. 3. More specifically, Square wrote:

> From 1995 to 2000, federal tax exempt interest was added to the interest income per Line 5 of Form 1120 in the *ABC Business* Calculation, as it represents additional interest income which is taxable by the state of Illinois and not otherwise captured in the Line 5 Form 1120[footnote, *citing ABC Business* Ex. FFF, App. 3]. I reviewed all available *ABC Business* … federal tax returns, which covered the taxable years ended December 1992 through 1994, 1996 and 1999 through 2000. **Based on discussions with *ABC Business* Management, I understand this information for the taxable years ended December 1995 and 1997 through 2000 is no longer available, and thus cannot be verified.**[footnote, citing discussion with *ABC Business* Management].")

ABC Business Ex. FFF, p. 25 (emphasis added).

Bonnie Blue's spreadsheet was not admitted into evidence as a business record which documented the amounts of interest income realized by each of the *SAs* for each of the years at issue, or as a record which documented the amounts of interest income realized by *ABC Business* and its unitary affiliates, as partners in each respective partnership. Tr. pp. 213-25 (colloquy regarding offer of exhibit). The Department's objections to that exhibit were sustained for two reasons. First, although *Bonnie Blue* testified that she prepared the spreadsheet in the ordinary course of her duties at *ABC Business*, she also testified that she was directed to begin to prepare the spreadsheet, in 2008, to support *ABC Business*'s filing positions, in anticipation of the Department's audit of *ABC Business*'s business and Illinois returns for the years at issue (Tr. pp. 206-07 (*Bonnie Blue*)), which, again, were TYE 1994-2000. Tr. pp. 213-25, 567. Business records are considered reliable because of the regular, prompt, and systematic manner in which they are kept and the fact that they are relied upon in the operation of the business. <u>In re A.B., S.B., A.B., J.B., and T.B. v. C.B.</u>, 308 Ill. App. 3d 227, 719 N.E.2d 348, 356 (2d Dist. 1999). A business record is "admissible as evidence of the act, transaction, occurrence, or event [described in the record]." Illinois Supreme Court Rule § 236(a).

The party offering a document as a business record must demonstrate that the record was made in the regular course of business and at or near the time of the transaction. <u>Kimble v. Earle M. Jorgenson Co.</u>, 358 Ill. App. 3d 400, 414-15, 830 N.E.2d 814, 827-28 (1st Dist. 2005). The events or occurrences relevant here are the amounts of interest income that each of the *SAs* that was in existence during TYE 1994 realized during that year, and during each of the years thereafter, through 2000. Since *Bonnie Blue* began to prepare her spreadsheet in 2008, it was not a document that *ABC Business* "made in the ordinary course of business" to record any such amounts, at or near the time each such year ended. Similarly, and as the Department argued at hearing, *Bonnie Blue*'s spreadsheet could not have been a record that *ABC Business* made in the ordinary course of business to document the entries *ABC Business* included within the amended Illinois returns it filed in 2004. On this point, *ABC Business*'s counsel was clear that, when filed, *ABC Business*'s amended returns were not based on *Bonnie Blue*'s spreadsheet. Tr. p. 214 ("It's not [*ABC Business*'s] position that this document [*Bonnie Blue*'s spreadsheet] supports the amended returns. In fact, it doesn't.").

The evidence shows that *Bonnie Blue* began to prepare her spreadsheet in 2008, in anticipation of the Department's audit of *ABC Business*'s Illinois returns. Tr. pp. 206-07 (*Bonnie Blue*). The most recent version of the spreadsheet was finalized after *ABC Business* protested the NODs and Denials the Department issued to *ABC Business*. *See* Stip. Exs. A-C; *ABC Business* Ex. FFF, App. 2 (identifying *ABC Business*'s protest in this matter, dated June 17, 2010, as one of the documents Square considered prior to rendering his opinions); Tr. pp. 206-07, 210-13, 226 (*Bonnie Blue*). A document is prepared in anticipation of litigation if it is prepared with an eye toward pending or anticipated litigation of any kind. *See e.g.*, In re N.W., 293 Ill. App. 3d 794, 688 N.E.2d 855 (1997). "Records made with a view toward possible litigation do not qualify as 'made in the ordinary course of business' …." Earle M. Jorgenson Co., 358 Ill. App. 3d at 400, 415, 830 N.E.2d at 828. Certainly, the final version of *Bonnie Blue*'s spreadsheet, which *Bonnie Blue* completed in 2011, after *ABC Business* protested the NODs and Denials issued in this matter, was prepared in anticipation of the litigation pending as a result of *ABC Business*'s protests.

Since *Bonnie Blue* was the person who prepared the spreadsheet reflecting *ABC Business*'s AHP calculation, *ABC Business* was allowed to question her at length regarding the entries she included within it. *See* Tr. pp. 225-26. *ABC Business* was also able to question its expert, Square, about *Bonnie Blue*'s spreadsheet, because his opinions were, in large part, based on that document. When both *Bonnie Blue* and Square testified regarding the amounts *Bonnie Blue* added and subtracted from the amounts *ABC Business* reported on line 5 of its federal return, before arriving at the amounts included in the row titled, Total, each said that such amounts could be corroborated by comparing them to certain amounts *ABC Business* reported on

ABC Business's federal returns. Tr. pp. 211, 223, 227-28, 268-69, 311 (*Bonnie Blue*), 562-64 (Square).

But a taxpayer's books and records are the documents a taxpayer must take into account when preparing its tax returns, and which tax collectors require taxpayers to keep, to support the entries reported on a tax return. 35 ILCS 5/913; 35 ILCS 120/7. This is why proof that a particular entry has been made on a return does not constitute probative evidence that the entry is correct. Bohannon v. Commissioner, T.C. Memo. 1997-153 (March 26, 1997) ("A tax return does not establish the correctness of the facts stated in it.") (*citing* Seaboard Commercial Corp. v. Commissioner, 28 T.C. 1034, 1051 (1957)). Both taxpayers and tax collectors regularly propose to correct entries that previously have been reported on tax returns. In this case, for example, for all but one of the years at issue, *ABC Business* is seeking to correct its original Illinois returns, on which it reported that it had no nonbusiness income deductions. Stip. Exs. PP-RR, TT-VV (p. 2 of each return). The evidence necessary to show that the entries on the top part of *Bonnie Blue*'s spreadsheet accurately identify the amounts of interest income realized by the *SAs* is the same type of evidence that is required to show that the entries on *ABC Business*'s returns are correct — that is, *ABC Business*'s regularly kept books and records. PPG Industries, Inc., 328 Ill. App. 3d at 33, 765 N.E.2d at 48; In re Marriage of Westcott, 163 Ill. App. 3d 168, 176, 516 N.E.2d 566 (1987). This hearing record makes clear that *ABC Business* lacks books and records that would support, back up, or corroborate many of the entries *Bonnie Blue* included on her spreadsheet, when estimating the total interest income realized by the *SAs* during the years at issue. *ABC Business* Ex. FFF, p. 25 & App. 3; Tr. pp. 278-80 (*Bonnie Blue*).

At the end of the hearing, *Bonnie Blue*'s spreadsheet was again offered into evidence, as: "a compilation of information that is already [in] the record …." Tr. p. 571. In In re Marriage of Westcott, 163 Ill. App. 3d 168, 516 N.E.2d 566 (1st Dist. 1987), the court noted that:

> When original documents are voluminous and cannot conveniently be examined to extract the fact to be proved, … then any competent witness who has seen the originals, … may testify to the fact, provided it is capable of being determined by calculation. In addition, the documents summarized must be available in court, as they were in the case at bar, or made available to the opponent.

Id., at 176, 516 N.E.2d at 571.

Here, however, *Bonnie Blue* never saw any regularly kept books and records which supported many of the entries she included in the top part of her spreadsheet, because she could not find any such documents. Tr. pp. 262-63, 278-80 (*Bonnie Blue*). The inference I draw from *Bonnie Blue*'s testimony is that *ABC Business* did not have any such records when *Bonnie Blue* began to prepare her spreadsheet in 2008. Square noted in his report that records were not available when Square was reviewing the completed version of *Bonnie Blue*'s spreadsheet, years later. *ABC Business* Ex. FFF, pp. 18 (& n.39), 25. Finally, since *ABC Business* did not have books and records which supported many of the entries *Bonnie Blue* included in the top part of her spreadsheet, *ABC Business* could not make such records available to the Department, prior to hearing, or to offer as evidence at hearing.

The evidence admitted at hearing makes clear that many of the entries *Bonnie Blue* included within the top part of her spreadsheet were not, and cannot be, backed up, supported, or corroborated by any books and records that were, themselves, admitted as evidence at hearing. As a result, that spreadsheet does not constitute credible, documentary evidence showing the total interest income actually realized by the *SAs* during the years at issue.

C. *ABC Business*'s Lack Of Books And Records Which Identify The Amounts Of Interest Income Each Individual *SA* Actually Realized During Each of the Years at Issue Is Fatal To Its Claims Of Entitlement To Nonbusiness Income Deductions

ABC Business asserts that the nonbusiness income deductions claimed for each such year is a portion of the sum of the amounts of the interest income that was realized by all of the *SAs* that were in existence during each particular year, yet it lacks any documentary evidence, closely identified with its regularly kept books and records, which identify the amounts of interest income any of the *SAs* actually realized during any of the years at issue. The absolute best evidence *ABC Business* was able to provide was *Bonnie Blue*'s rough estimate of such amounts. *ABC Business* Ex. FFF, App. 3; Tr. pp. 548-49 (Square). That rough estimate, moreover, fails to take into account the fact that *ABC Business* was only one of the partners in the separate *SA* partnerships. Since *ABC Business* did not keep the partnership agreements regarding each *SA*, no one at hearing was capable of knowing, or demonstrating, how much of the interest income actually realized by each *SA* partnership account was *ABC Business*'s and its unitary affiliates. The same is true for anyone who reviews this record. *Bonnie Blue*'s rough estimate of the amount of interest income realized by the *SAs* is simply a conclusion that is unsupported by any books and records.

When considering whether the evidence admitted at hearing is sufficient to support *ABC Business*'s claims of entitlement to deductions for nonbusiness income, it is helpful to compare the facts and the nature of the evidence offered in this case, with the facts and evidence offered by the taxpayer in <u>Balla</u>. <u>Balla</u>, 96 Ill. App. 3d 293, 421 N.E.2d 236. Diane Balla (Balla) was a divorced mother and custodial parent of three children, who protested the Department's denial of her claim for a personal exemption deduction for each of her children on her individual income tax return. *Id*., at 294, 421 N.E.2d at 237. Following administrative review, the court noted that personal exemptions are deducted from adjusted gross income or base income when calculating taxable income, and that the burden of proving entitlement to the statutory deduction is on the taxpayer. *Id*., at 295-96, 421 N.E.2d at 238. After determining that taxpayer had the burden, the court next presented the following discussion about whether Balla had borne it:

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> *** Since the burden was properly placed on the petitioner, it was her responsibility to introduce evidence at the hearing to prove the legitimacy of her claim. Whether she has introduced a sufficient amount of evidence forms the basis of the petitioner's next claim.
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> The petitioner's contention is that her uncontroverted testimony that she was the sole source of her children's support was sufficient to establish her entitlement to the claimed exemptions. The Department denied the exemptions on the ground that the petitioner "did not prove that she furnished more than one-half of the support of her three children." The circuit court confirmed this finding, stating that "(t)he testimony of the (petitioner) consisted of statements, in the main, which could at best be regarded as conclusory ***. There were no records to corroborate the conclusion." We may reverse the Department's finding concerning the sufficiency of the petitioner's testimony only if it is against the manifest weight of the evidence. [all citations omitted] A finding is against the manifest weight of the evidence only where an opposite conclusion is clearly evident.
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> In finding the petitioner's testimony insufficient to sustain her burden of proof, the trial court relied on cases involving the Retailers' Occupation Tax Act. The petitioner argues that while it is appropriate to require businessmen to produce books and records in support of their claims, it is unreasonable to expect the same level of proof from a working mother raising three children.
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> While we do not hold that the type of proof required to establish the petitioner's claim must rise to the level of that expected under the Retailers' Occupation Tax Act, we do not believe it is unreasonable to expect her to do more than simply state that she supported the children. At the Department hearing, the hearing officer requested her to produce a copy of her 1975 federal tax return and the federal audit report. The hearing officer considered these documents to be very important in establishing the petitioner's claim, and continued the hearing for two months to allow her to obtain them. We do not believe that the Department imposed an unreasonable burden on the petitioner by expecting her to comply with this request. It was certainly no greater than the burden imposed by the IRS. The petitioner admitted that the IRS would reexamine its disallowance of the exemptions only if she could present certain evidence in support of her claim. The petitioner's attorney interpreted this as meaning that the IRS "would not accept merely words that she did not owe the money; they requested supporting documents." Under these circumstances, we do not believe that the Department's finding that the

> petitioner's uncontroverted testimony was insufficient to establish her claim was obviously or clearly wrong.
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> ***

Balla, 96 Ill. App. 3d at 296-97, 421 N.E.2d at 238-39.

The Balla court would not hold that, for purposes of the IITA, an individual taxpayer has the same burden of production that the Retailers' Occupation Tax Act (ROTA) imposes upon a retailer who seeks to take advantage of a statutory credit, deduction or exemption authorized by that tax act. *Id.*; *see also* 35 ILCS 120/7. But it did recognize that, for purposes of the credits, deductions or exemptions that are authorized by the IITA, even individual taxpayers are required to present documentary evidence in order to rebut the Department's presumptively correct determination that the taxpayer was not entitled to the credit, deduction or exemption claimed. Balla, 96 Ill. App. 3d at 297, 421 N.E.2d at 239.

In her case, Balla was asking for three personal exemption deductions, each of which, in 1974 and today, is valued at $1,000. 35 ILCS 5/204(a)-(b) (formerly Ill.Rev.Stat. ch. 120, ¶ 2-204(a)-(b) (1974)). In this case, on its returns and in *Bonnie Blue*'s spreadsheet, *ABC Business* has claimed nonbusiness income deductions in the following amounts for the following years:

TYE	Amount of nonbusiness income deductions reported on *ABC Business*'s original Illinois return	Amount of nonbusiness income deductions reported on *ABC Business*'s amended Illinois return	Amount of nonbusiness income deductions estimated on *Bonnie Blue*'s spreadsheet
1994	0	X	X
1995	0	X	X
1996	0	X	X
1997	X	no change	X
1998	0	X	X
1999	0	X	X
2000	0	X	X

Stip. Exs. PP-VV (p. 2, Part III, line 2a of each return); *ABC Business* Ex. FFF, App. 3.

Again, the first part of *ABC Business*'s litigation position in this matter is its factual assertion that it realized a certain amount of interest income from all of the *SAs* during each of the years at issue. *ABC Business* Ex. FFF, p. 17 & App. 3. As to this first part, *ABC Business*'s litigation position is not so different than Balla's. Balla offered her own, uncontroverted, testimony that she was the primary source of her children's support. Balla, 96 Ill. App. 3d at 296, 421 N.E.2d at 238. The Balla court noted that the circuit court considered her testimony to be at best conclusory, and without corroboration by any records, and did not consider such evidence to be sufficient to show that Balla was entitled to the deductions claimed. *Id*.

Here, *Bonnie Blue*'s rough estimate of the interest income realized by the *SAs* is also, at best, *ABC Business*'s conclusion about the amount of interest income realized by all of the *SAs* in existence during each of the years at issue. For example, the stipulated exhibits show that there were three *SAs* in existence in 1999 (Stip. Ex. CC), but since *ABC Business* has no books and records which identify the interest income realized by each *SA*, there is no way for me, the Director, or any other downstream reviewer of this record, to perform even the simplest test of *ABC Business*'s claim that the sum of the amounts of interest income realized by *SAs* 151, 141, and 181 equaled $XXX in 1999. Stip. Ex. UU, p. 2 (Part III, line 2a); *ABC Business* Ex. FFF, App. 3; Tr. pp. 553-54 (Square). *ABC Business*'s conclusory estimate of the amounts of interest income actually realized by the *SAs* is very much like Balla's conclusory testimony that she provided all of the support for her three children ─ both are uncorroborated by any documentary evidence.

In stark contrast with Balla, moreover, *ABC Business* is a multinational, unitary business engaged in manufacturing, wholesaling, and financing the products it sells within the waters' edge. Stip. Exs. T-Z. *ABC Business* is precisely the type of sophisticated corporate taxpayer which, if it were engaged in retailing in Illinois, would be required to keep the kind of detailed books and records described in ROTA § 7, and to offer such records into evidence if called upon to support its claim to a statutory deduction reported on a return. 35 ILCS 120/7; Balla, 96 Ill. App. 3d at 296-97, 421 N.E.2d at 238-39. When comparing the facts and issues here with the facts and issues in Balla, moreover, it is instructive to consider the type of evidence that a taxpayer is required to keep and produce to support a deduction, credit or exemption claimed on a return filed pursuant to the ROTA. Section 7 of the ROTA provides, in pertinent part:

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> **To support deductions made on the tax return form,** or authorized under this Act, on account … of receipts from any other kind of transaction that is not taxable under this Act, **entries in any books, records or other pertinent papers or documents of the taxpayer in relation thereto shall be in detail sufficient to show … the amount of receipts realized from every such transaction and such other information as may be nece*SA*ry to establish the non-taxable character of such transaction under this Act**.

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35 ILCS 120/7 (emphasis added); *see also* Novicki v. Department of Finance, 373 Ill. 342, 345, 26 N.E.2d 130, 131 (1940) ("The amount of [a taxpayer's] receipts is purely a question of fact which is susceptible of accurate computation ….").

For each year at issue in this matter, each *SA* had a stream of interest income, a portion of which *ABC Business* claims Illinois may not constitutionally apportion. But before even considering *ABC Business*'s constitutional argument, I respectfully submit that Illinois law requires *ABC Business* to produce documentary evidence ─ in the form of books and records ─ which clearly identifies the amount of each interest income stream upon which its claim of deduction is based. PPG Industries, Inc., 328 Ill. App. 3d at 33, 765 N.E.2d at 48; Balla, 96 Ill. App. 3d at 296-97, 421 N.E.2d at 238-39. Since, for purposes of the IITA, individual taxpayers like Balla must produce documentary evidence to obtain a $1,000 deduction, a sophisticated corporate taxpayer like *ABC Business* cannot be held to a *lesser* standard of proof, when claiming deductions which, for all of the years at issue, exceed a billion dollars. Stip. Exs. PP-VV (p. 2, Part III, line 2a of each return); *ABC Business* Ex. FFF, App. 3; PPG Industries, Inc., 328 Ill. App. 3d at 33, 765 N.E.2d at 48. As a simple matter of fact, *ABC Business* lacks any books and records which identify the amounts of interest income that it claims to have realized from transactions it asserts were not entirely subject to Illinois apportionment.

After reviewing the hearing record, I conclude that *ABC Business* has not borne its initial burdens of production and persuasion to identify the amounts of interest income each of the *SAs* actually realized during the years at issue. *ABC Business*'s witnesses, *Bonnie Blue* and Square, concede that *ABC Business* has no regularly kept books and records which identify such amounts. The evidence further strongly suggests that *ABC Business* no longer has the partnership agreements that are essential to document the actual percentages of the interest income that was realized by each partnership which would accrue to the respective partners in each partnership.

Moreover, the document *ABC Business* prepared to estimate the amount of the interest income realized by the *SAs* ─ that is, the top part of *Bonnie Blue*'s spreadsheet ─ was prepared: (1) years after *ABC Business* filed returns reporting any nonbusiness income deductions; (2) in anticipation of the Department's audit of *ABC Business*'s Illinois returns, and in anticipation of the hearing *ABC Business* requested when it protested the Department's Denials and NODS; and (3) using data which cannot be supported, backed-up or corroborated by any regularly kept books and records. *ABC Business* Ex. FFF, pp. 18-19 (& nn.39, 43-46); Tr. pp. 233-34, 278-80, 301 (*Bonnie Blue*), 449 (Square). Since *ABC Business* cannot provide any books and records which identify the actual amounts of interest income each of the *SAs* realized, or which identify the actual amounts of interest income it and its Illinois unitary affiliates realized, as partners in each of the *SAs*, *ABC Business* is unable to provide the clear and cogent evidence required to show that only a certain portion of such unknown amounts of interest income was deductible nonbusiness income, which Illinois may not apportion. Container Corp. of America, 453 U.S. at

175, 103 S.Ct. at 2946, 77 L.Ed.2d 545; Texaco-Cities Service Pipeline Co., 182 Ill. 2d at 268, 695 N.E.2d at 484; PPG Industries, Inc., 328 Ill. App. 3d at 33, 765 N.E.2d at 48.

Finally, in its brief, *ABC Business* argues that "[t]he Department has no legal justification for apportioning and taxing all of *ABC Business*'s interest income from its *Service* Accounts." *ABC Business*'s Brief, p. 30. This argument is not well founded. For six of the seven years at issue, it was *ABC Business*, itself, and not the Department, that apportioned whatever amounts of interest income were realized by the *SAs*. *See* Stip. Exs. PP-RR, TT-VV (p. 2 of each return). *ABC Business*'s original Illinois returns for those years, moreover, were made at times that were much more contemporaneous with *ABC Business*'s senior management's meeting minutes, which reflect *ABC Business*'s strategic plan to increase the amount of capital held in the form of cash to use in *ABC Business*'s automotive operations. Stip. Exs. E-G. *ABC Business*'s original returns for TYE 1994-1996, and TYE 1998-2000 are written statements, by *ABC Business*, in which it reported that it had no nonbusiness income deductions for those years. *See* Stip. Exs. PP-RR, TT-VV (p. 2 of each return). To the extent that *ABC Business*'s original returns for those years reflect its factual determination that the *SAs*' interest income was part of its apportionable business income, *ABC Business*'s original returns may be treated as *ABC Business*'s written admissions that they were. *See* Dayan v. McDonald's Corp., 125 Ill. App. 3d 972, 984, 466 N.E.2d 958, 967 (1st Dist. 1984).

On the other hand, if *ABC Business*'s original reports of having no nonbusiness income deductions for TYE 1994-1996 and 1998-2000 are better understood and treated as errors of law, during the years at issue, the IITA provided *ABC Business* with a way to correct its prior errors of reporting income as business income. 35 ILCS 5/909; 35 ILCS 5/1501(a)(1) (2004). But even then, the IITA has always required a taxpayer, if the Department initially denies the refunds, credits, or deductions claimed, to establish the correctness of its amended return by producing documentary evidence, closely identified with its regularly kept books and records, to show that its reported revisions are correct. 35 ILCS 5/909; Bodine Electric Co., 81 Ill. 2d at 512-13, 410 N.E.2d at 833.

Regarding *ABC Business*'s original return for TYE 1997 (*see* Stip. Ex. SS, p. 2), the Department was fully, and legally, justified in denying the nonbusiness income deduction reported on that return, because *ABC Business* could not even produce books and records which documented how much interest income any of the *SAs* realized during that year, let alone how much *ABC Business* and its unitary affiliates realized, as partners in each of the *SAs*. The same legal basis applies equally to the Department's denials of the nonbusiness income deductions reported on *ABC Business*'s amended returns for TYE 1994-1996 and 1998-2000. A taxpayer's inability to produce books and records which support a claim of deduction constitutes a perfectly legal basis for denying the claim. *E.g.*, Bodine Electric Co., 81 Ill. 2d at 512-13, 410 N.E.2d at 833; Balla, 96 Ill. App. 3d at 296-97, 421 N.E.2d at 239.

Conclusion:

After considering all of the evidence admitted at hearing, I conclude that *ABC Business* has not satisfied its burden of clearly proving that it was entitled to the nonbusiness income deductions reported on its original and amended returns, or in the amounts stated on *Bonnie Blue*'s spreadsheet. Texaco-Cities Service Pipeline Co., 182 Ill. 2d at 268, 695 N.E.2d at 484; Bodine Electric Co., 81 Ill. 2d at 512-13, 410 N.E.2d at 833. For the same reason, I conclude that *ABC Business* has not satisfied its burden of producing clear and cogent evidence that the NODs and Denial result in extraterritorial values being taxed in the amounts reflected within that exhibit. Container Corp. of America, 453 U.S. 159, 175, 103 S.Ct. at 2946, 77 L.Ed.2d 545. I respectfully recommend that the Director finalize the NODs and Denial as issued, pursuant to statute.

November 2, 2015

John E. White
Administrative Law Judge