IT 97-10
Tax Type: INCOME TAX
Issue: Discretionary Relief Under Section 304(f)(Distortion)
Reversionary Sales
Reasonable Cause Asserted On Application of Penalties
Throwback Sales (General)

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

THE DEPARTMENT OF REVENUE OF THE STATE OF ILLINOIS	)	Docket Nos.
v.	)	Tax Years Ending12/87 - 12/90
TAXPAYER , et al, TAXPAYER .	)	John E. White, Administrative Law Judge

---

RECOMMENDATION FOR DISPOSITION

Appearances: Paul Frenz, McBride Baker & Coles, for TAXPAYER , Inc. ("TAXPAYER"). Deborah Mayer, Special Assistant Attorney General, for the Illinois Department of Revenue ("Department").

Synopsis: This matter involves two Department audits of TAXPAYER; one for tax years 1987 and 1988, and one for tax years 1989 and 1990. After its audits, the Department revised Illinois tax returns filed by TAXPAYER and by a subsidiary. Thereafter, the Department issued two Notices of Tax Deficiency ("NOD") to TAXPAYER, and one to TAXPAYER Biomedical, Inc. TAXPAYER protested the NOD's, and requested a hearing.

A hearing was held at the Department's Office of Administrative Hearings in March, 1996. The issues presented for determination are set forth below.

Statement Of Issues:

I. Whether TAXPAYER'S subsidiary, TAXPAYER Oil & Gas Co. ("POG"), was properly included as a member of TAXPAYER'S unitary business group for 1987.

II. Whether the Department's calculation of TAXPAYER'S throwback sales was proper.

III. Whether the gain from TAXPAYER'S sale of POG's assets was business income.

IV. Whether royalty income TAXPAYER received from licensing patents and other proprietary assets to foreign entities was business income.

V. Whether the certain foreign dividends TAXPAYER received were business income.

VI. Whether the Department properly issued a Notice of Deficiency to TAXPAYER Biomedical for tax year ending 9/30/89.

VII. Whether the assessment of a § 1005 penalty was appropriate for the audit years 1987 through 1990.

Findings of Fact:

Facts Regarding TAXPAYER'S Businesses:

1. TAXPAYER is a diversified global manufacturing company, founded in 1883, and based in Pittsburgh, Pennsylvania. Stip. Ex. No. 22, TAXPAYER'S 1987 Annual Report, p. 1.

2. TAXPAYER manufactures glass, chemicals, and coatings and resins. It is a major producer of flat and fabricated glass products, automotive and aircraft glass, continuous-strand fiber glass, original and refinish coatings, and industrial and specialty chemicals. TAXPAYER'S products serve a wide variety of world industries, including manufacturing, building, processing and services. Stip. ¶ 8; *see also* Stip. Ex. No. 14, p. 42 (pp. 39-56 of Stip. Ex. No. 14 consists of TAXPAYER'S 1987

10-K Report); Stip. Ex. No. 22, TAXPAYER'S 1987 Annual Report, p. 1.

3. TAXPAYER conducted operations in each of its three major lines of business at the following Illinois locations:

Location	Business Activity
Chicago	Specialty Chemicals (closed 1988)
Chicago	Coatings & Resins printing inks (closed 1989)
Chicago	Insulating and tempered glass sales (closed 1987)
Gurnee	Chemicals Surfactant
Lincoln	Insulating glass manufacture (closed 1989)
Mt. Zion	Float and tempered glass manufacture
Belvidere	Coatings & Resins automotive coatings satellite (for a specific customer in this case Chrysler)
Normal	Coatings & Resins automotive coatings satellite (opened in 1988)
Palatine	Coatings & Resins pretreatment chemicals (opened 1988)
Batavia	Coatings & Resins Lucite & Olympic - Trade paint (opened in 1989)

Stip. ¶ 11.

4. As part of its business of manufacturing chemicals, TAXPAYER and at least one other subsidiary explored for, mined, processed and sold potash. Stip. ¶ 26; Hearing Transcript ("Tr."), pp. 63-64, 107, 114-15 (WITNESS A ("WITNESS A")); TAXPAYER Ex. No. 165, TAXPAYER'S 1986 Annual Report, p. 18.

5. Prior to 1986, TAXPAYER'S potash operations were supervised by TAXPAYER'S Agricultural and Performance Chemicals Division ("APCD"). Stip. ¶ 26; Stip. Ex. No. 26,[1] p. 9 (Minutes of Regular Meeting of Board of Directors of TAXPAYER, January 15, 1981 ("1/15/81 minutes")).

[1]. The parties agreed to keep Stip. Ex. No. 26 under seal. For convenience, I have numbered the pages in stipulation exhibit no. 26 on the bottom right corner of each page. The cites to stipulation exhibit number 26 will refer to those hand-written page numbers.

6. WITNESS A was, *inter alia*, the manager of administration for TAXPAYER’S U.S. potash project from 1981 to 1987. Tr. p. 107 (WITNESS A). TAXPAYER’S U.S. potash project included all the operations TAXPAYER undertook to explore and/or drill for, process and sell potash within the United States. Tr. pp. 114-16 (WITNESS A).

7. TAXPAYER geologists believed that the potash being mined in Canada was part of a mineral bed that could be accessed in the northern United States. Tr. p. 115 (WITNESS A).

8. By late 1980, TAXPAYER had been exploring for potash in the United States for twelve to fourteen years. Stip. Ex. No. 26, p. 8-9 (1/15/81 minutes).

9. TAXPAYER secured mineral leases in Michigan as part of its potash project. *See* Stip. Ex. No. 26, p. 2 (11/2/80 minutes).

10. Late in 1980, while drilling for potash in Michigan, TAXPAYER discovered oil and gas reserves. Stip. ¶ 26; Stip. Ex. No. 26, p. 2 (11/2/80 minutes); Tr. pp. 64-67 (WITNESS A), 119-20 (WITNESS A, describing TAXPAYER’S discovery as "the biggest gas well in the history of Michigan at an elevation where gas had never been produced before").

11. After discovering oil and gas in Michigan, TAXPAYER’S chemical division personnel submitted an Authorization for Capital Transaction ("ACT") to TAXPAYER’S board of directors to obtain authorization to spend $5,269,000.00 on oil and gas exploration, as an outgrowth of TAXPAYER’S U.S. potash project. Stip. Ex. No. 26, p. 2 (11/2/80 minutes); *see also*, Stip. Ex. No. 27 (sample of an ACT). The money sought by TAXPAYER’S chemical division

was to acquire additional mineral leases in the immediate vicinity of TAXPAYER’S high pressure gas discovery, to perform further work in the exploration hole, and to conduct further tests there. Stip. Ex. No. 26, p. 2 (11/2/80 minutes). The major segments of the project for which the ACT was sought included contracting for use of a deep drilling rig, maintaining a mineral leasing program and performing further tests. *Id.* The ACT was approved by TAXPAYER’S board. Stip. Ex. No. 26, p. 3 (11/2/80 minutes).

12. On December 18, 1980, TAXPAYER’S APCD submitted another ACT to the board of directors for $14,250,00.00 for gas exploration, as an outgrowth of TAXPAYER’S U.S. potash project. Stip. Ex. No. 26, p. 5 (12/18/80 minutes). The funds were requested "to obtain promptly more drilling rigs to be used to earn an interest in the prospects obtained from Dart Industries, and to acquire additional leases in the potash exploration hole which had indicated the presence of high pressure gas." *Id.*, pp. 5-6. TAXPAYER’S board authorized those funds. *Id.*, p. 6.

13. TAXPAYER’S chemical division personnel concluded that JEM Petroleum Corporation ("JEM") would be TAXPAYER’S best choice to act as the operator, and TAXPAYER’S partner, regarding the exploration activities in the area of TAXPAYER’S oil and gas discovery in Michigan. Stip. Ex. No. 26, pp. 8-9 (1/15/81 minutes). TAXPAYER’S management committee agreed that the TAXPAYER/JEM participation agreement served TAXPAYER’S interests better than any other partnership being considered (*id.*, p. 10), and TAXPAYER’S board subsequently approved the decision to enter

into a partnership agreement with JEM. Stip. Ex. No. 26, pp. 13-14 (1/21/81 minutes).

14. The participation plan between TAXPAYER and JEM allowed TAXPAYER to maintain exclusive control over all matters associated with the potash deposits in Michigan. Stip. Ex. No. 26, p. 9 (1/15/81 minutes). That participation agreement also allowed TAXPAYER to retain all rights in the Falmouth Prospect (the first hole at which TAXPAYER discovered oil and gas), and provided that JEM would manage the exploration of that prospect for TAXPAYER on a cost reimbursement basis. *Id.*

15. On April 16, 1981, officers of TAXPAYER’S APCD asked TAXPAYER’S board to approve two more requests for funds to be used on TAXPAYER’S oil and gas operations in Michigan. Stip. Ex. No. 26, p. 15 (4/16/81 minutes). They sought over 2 million dollars for oil and gas exploration, and over 16 million dollars for oil and gas development activities. Stip. Ex. No. 26, p. 16 (4/16/81 minutes). TAXPAYER’S board granted the funds requested. *Id.*

16. In February 1981, two officers of TAXPAYER’S APCD sought and received authorization from TAXPAYER’S board to spend 15.5 million dollars for TAXPAYER’S 1982 oil and gas exploration and development program. Stip. Ex. No. 26, p. 28 (2/18/82 minutes). While requesting those funds, one of TAXPAYER’S officers advised that TAXPAYER was negotiating the sale of the gas produced in Michigan. *Id.*

17. In 1986, TAXPAYER reorganized its chemicals business into three profit centers: chlor-alkali and derivatives; performance chemicals; and potash. TAXPAYER Ex. No. 165, 1986 Annual Report,

p. 16. TAXPAYER’S potash center oversaw TAXPAYER’S oil and gas operations. *Id.*; Stip. Ex. No. 52, p. 3 (identifying as one section of TAXPAYER’S chemicals division the "Potash/Oil & Gas" section); Tr. pp. 68-69 (WITNESS A).

18. TAXPAYER’S board of directors continued to authorize funding for, and other transactions involving, TAXPAYER’S oil and gas operations in Michigan, up to and including TAXPAYER’S sale of assets used in those oil and gas operations to Marathon. *See, e.g.* Stip. Ex. No. 26, pp. 38-39 (12/15/83 minutes, J.H. WITNESS B, TAXPAYER’S general manager of oil and gas operations, presented TAXPAYER’S APCD's request for 13 million dollars for its 1984 oil and gas exploration and development program, which request was approved by TAXPAYER’S board), p. 41 (12/10/84 minutes, board approved WITNESS B's request for 10 million dollars for APCD's 1985 oil and gas exploration and development program), pp. 64-66 (10/30/87 minutes, board approved sale of assets to Marathon); Stip. Ex. No. 27 (ACT requesting funds to construct the Stoney Point gas processing plant); Stip. Ex. No. 50, Purchase and Sale Agreement (contract for sale of assets from TAXPAYER to Marathon).

Facts Regarding Issue I: Whether POG Was Unitary With TAXPAYER?

19. In December 1981, TAXPAYER formed a wholly owned subsidiary, TAXPAYER Oil & Gas Company, Inc. ("POG"), which it incorporated in Delaware. Stip. ¶ 27; Stip. Ex. No. 14, p. 24.

20. TAXPAYER assigned to POG oil and gas joint venture or partnership interests in various wells in exploration fields and other assets held by TAXPAYER in Michigan. Stip. ¶ 28.

21. The first two exploration fields in Michigan yielded gas only. The last exploration field yielded both oil and gas. The gas from that field required special processing. At the time, the only processor was Marathon Oil, whose processing charges TAXPAYER deemed prohibitive. Stip. ¶ 32.

22. On May 8, 1984, TAXPAYER, believing it could process gas cheaper at its own plant, approved a design and construction plan for the Stoney Point Gas Processing Plant ("Stoney Point"). Stip. ¶ 33. The plan was submitted by WITNESS B, and reviewed by J.L. VICE PRESIDENT, vice-president of TAXPAYER'S APCD, and by J.C. CONTROLLER, the controller of TAXPAYER'S APCD. Stip. ¶ 33; Stip. Ex. No. 27 (ACT requesting funds to build the Stoney Point plant); Stip. Ex. No. 28 (economic analysis, dated April 30, 1984); Stip. Ex. Nos. 29-30 (supplemental ACTs requesting and authorizing total expenditures of $3.9 million).

23. From 1983 to 1985, TAXPAYER, in conjunction with JEM, began construction of the Stoney Point plant. Stip. ¶ 34; *see also* Stip. Ex. Nos. 31-40.

24. On October 1, 1985, TAXPAYER entered into a Participation Agreement with certain owners of working interests in oil and gas leases for the Stoney Point plant. Stip. ¶ 35; Stip. Ex. No. 41, Stoney Point Participation Agreement.

25. In 1985, POG became the operator of oil and gas interests in Michigan. Stip. ¶ 36; *but see* Stip. Ex. No. 41, Participation Agreement, p. 3, art. I, ¶ 1.7 ("Operator" of the Stony Point Processing Plant was TAXPAYER , Inc.). Before TAXPAYER named POG operator in 1985, JEM was the operator of TAXPAYER'S oil and

gas interests in Michigan, under TAXPAYER’S supervision. Stip. ¶ 36.

26. TAXPAYER employees worked on and/or supervised POG's oil and gas operations. *See* Stip. ¶ 40.

27. M.W. GEN. MANAGER, a general manager of oil and gas operations for TAXPAYER’S chemical division, worked on POG's behalf, and supervised the activities of others working on POG's behalf. *See, e.g.*, Stip. Ex. No. 64 (1/12/87 letter from GEN. MANAGER to Marathon regarding meeting between the two companies to "exchange certain technical and operations data for exploring alternatives to gas processing in the Southern Michigan area."); Stip. Ex. No. 65 (1/26/87 letter from GEN. MANAGER to Stoney Point field and gas plant operators to inform them of meeting with Marathon).

28. As the general manager of oil and gas operations for TAXPAYER’S APCD (*see* Stip. Ex. No. 134), WITNESS B made the day-to day operating decisions for POG. Tr. pp. 78-79 (WITNESS A). WITNESS B was a contract employee for TAXPAYER, and was not an employee of POG. *Id.*, p. 72.

29. WITNESS A, a TAXPAYER employee and manager of administration for TAXPAYER’S U.S. potash project from 1981 to 1987, worked on oil and gas operations for TAXPAYER. Stip. Ex. No. 63 (12/16/86 memo from WITNESS A to GEN. MANAGER, regarding a study comparing the operations of TAXPAYER’S Stoney Point gas plant with one owned/operated by Marathon); Tr. pp. 63-69, 107 (WITNESS A).

30. SP PLANT MANAGER, the Stoney Point gas plant manager, was a TAXPAYER employee. Stip. Ex. No. 64 (SP PLANT MANAGER

represented POG at meeting with Marathon); Tr. p. 275 (WITNESS A).

31. TP EMPLOYEE, a TAXPAYER employee, was TAXPAYER'S operations manager in charge of oil and gas production in Michigan. Stip. Ex. No. 64 (TP EMPLOYEE represented POG at Marathon meeting); Tr. pp. 274-75 (WITNESS A). TP EMPLOYEE reported to WITNESS B or to GEN. MANAGER. Tr. p. 275 (WITNESS A).

32. ACCOUNTANT, a TAXPAYER accountant, performed accounting services for TAXPAYER and for POG. Tr. pp. 84, 280 (WITNESS A); *see also*, Stip. Ex. No. 64 (ACCOUNTANT identified by GEN. MANAGER as chief accountant representing POG at Marathon meeting).

33. In conjunction with TAXPAYER'S U.S. potash project, TAXPAYER and POG conducted joint exploration for potash and oil and gas in the Hersey-Evart Field. Stip. ¶ 41; Stip. Ex. Nos. 45-46; Tr. pp. 91-93 (WITNESS A).

34. POG and TAXPAYER split the costs associated with the Hersey-Evart Field. Stip. ¶ 42; Stip. Ex. Nos. 47-49. Generally, the percentage split of costs between TAXPAYER and POG resulted from agreements made during TAXPAYER'S annual budget time, which agreements and splits were then carried through the year with monthly billings sent to the affected divisions or subsidiaries to account for the charges or credits TAXPAYER allocated to each. Tr. pp. 281-88 (WITNESS A).

35. TAXPAYER provided all of POG's operating funds. Stip. ¶ 31; Stip. Ex. No. 14, pp. 19-20; Tr. pp. 287-88 (WITNESS A).

36. When TAXPAYER paid for something on behalf of POG, it was billed to POG through an inter-unit transfer system set up by TAXPAYER

to account for and/or allocate to its operating divisions and/or subsidiaries costs associated with the various aspects of TAXPAYER’S businesses. Tr. pp. 87-88 (WITNESS A); TAXPAYER’S Brief, p. 9.

37. POG's expenses for salaries, automobile leases, United Way contributions, services charges, etc. were paid by TAXPAYER and transferred and charged to a POG account. Stip. ¶ 39; Stip. Ex. No. 43, Inter-Unit Transfer System, Advice of Debit Forms.

38. The receipts earned from selling gas processed at the Stony Point plant were deposited into a lock box controlled by TAXPAYER’S treasury department. Tr. p. 280 (WITNESS A).

39. POG had offices in Colorado and Michigan. Stip. ¶ 29. POG's office in Colorado was also the headquarters for TAXPAYER’S potash project. Tr. pp. 68-69 (WITNESS A).

40. The officers of POG were also either officers or employees of TAXPAYER. Stip. ¶ 30; Stip. Ex. No. 14, pp. 22-24 (list of common officers/directors); Tr. p. 78 (WITNESS A).

41. TAXPAYER approved the contracts for the sale of oil and gas in Michigan. *See* Tr. p. 279 (WITNESS A). TAXPAYER also wrote and/or approved the contract for the sale of POG's assets. Stip. Ex. No. 50, Purchase and Sale Agreement.

42. While "[s]ales from oil and gas operations [were] a minor portion of [TAXPAYER’S] chemical business" TAXPAYER’S oil and gas operations were part of its chemicals business. TAXPAYER Ex. No. 165, 1986 Annual Report, p. 18.

43. TAXPAYER’S 1981 Annual Report states:

> The diversity of TAXPAYER'S market helped to soften the effects of the economic downturn in 1981. In broad categories, the Company's major markets are transportation and construction, which are served in varying degrees by the glass, coatings and resins, and fiber glass segments; *chemical processing and petroleum refining, which account for the bulk of the chemicals business*; and other industrial and agricultural markets served by the various business lines.

Stip. Ex. No. 161, TAXPAYER'S 1981 Annual Report, p. 6 (emphasis added).

44. TAXPAYER'S 1984 Annual Report states:

> TAXPAYER has four primary chemicals business lines. Accounting for 65 percent of sales are its core chemicals -- chlorine, caustic soda, chlorine derivatives, ethylene glycols and other ethylene products. TAXPAYER is the largest merchant seller of chlor-alkalies and the second largest producer. Performance and specialty chemicals and biochemicals tally about 18 percent of sales, and potash represents about 10 percent. *The remainder involves the final primary line -- oil and gas operations -- and miscellaneous businesses.*

Stip. Ex. No. 163, TAXPAYER'S 1984 Annual Report, p. 16 (emphasis added).

45. After TAXPAYER discovered oil and gas in Michigan, it considered oil and gas exploration and production one of the business or product lines within its chemicals division. Stip. Ex. No. 161, 1981 Annual Report, p. 6; Stip Ex. No. 163, 1984 Annual Report, p. 16; TAXPAYER Ex. No. 165, 1986 Annual Report, p. 18.

Facts Regarding Issue II, Whether The Department Improperly Calculated TAXPAYER'S Throwback Sales

46. TAXPAYER maintained inventory at each Illinois location at which it conducted business. Stip. ¶ 11.

47. During both audit cycles, TAXPAYER’S contact with the Department's auditors was TP EMPLOYEE ("TP EMPLOYEE"). Tr. p. 39-43 (TP EMPLOYEE).

48. Each time the Department conducted an audit of TAXPAYER, the Department's auditor asked TP EMPLOYEE if she could review documents identifying TAXPAYER’S "origin sales", i.e., all sales made from TAXPAYER’S Illinois locations. Tr. pp. 39, 43 (TP EMPLOYEE).

49. TP EMPLOYEE told both auditors that TAXPAYER did not keep records on which sales were identified by location of origin. Tr. pp. 40, 43 (TP EMPLOYEE).

50. Although TP EMPLOYEE personally reviewed sales data prepared by personnel from at least one Illinois location, and thereafter personally created sales records after reviewing sales data accumulated by TAXPAYER’S sales force (*see* Tr. pp. 46-47 (TP EMPLOYEE)), TP EMPLOYEE informed each auditor that the only way TAXPAYER could provide information regarding its sales of products from Illinois was to have the auditor review all of TAXPAYER’S original sales invoices. Tr. pp. 40, 43 (TP EMPLOYEE).

51. TP EMPLOYEE told each auditor that TAXPAYER’S sales invoices were kept in Pittsburgh, Pennsylvania. Tr. pp. 40-41 (TP EMPLOYEE). Neither TP EMPLOYEE nor any other person on TAXPAYER’S behalf ever tendered any sales invoices to either auditor for review. Tr. p. 55 (TP EMPLOYEE).

52. TP EMPLOYEE was also asked to provide the Department auditor with TAXPAYER’S records regarding destination sales (i.e., all

sales shipped to a certain destination) to Alaska, Hawaii and to foreign countries. Stip. Ex. No. 14, p. 62. In response, TAXPAYER provided records regarding TAXPAYER’S destination sales to Illinois only. *See* Tr. p. 360 (TP TAX COUNSEL).

53. During the audit period, TAXPAYER distributed to its chemicals division managers standardized monthly financial statements which included net sales figures, domestic sales figures, tolled sales figures, export sales figures, and captive sales figures. *See* Stip. Ex. No. 52 (definition of each term included in the exhibit). In a memo to TAXPAYER’S chemicals division managers, TAXPAYER informed its managers that "[d]etail sales information by SKU number, customer, account, etc. is available in the OP&I system." *Id.*, p. 3 (Chemicals Management Statement Terms and Descriptions, § I.1).

54. Although TAXPAYER prepared and maintained in the regular course of its business destination sales records applicable to the states identified in written requests by a Department auditor (*see* Stip. Ex. No. 14, p. 62; Tr. pp. 350-51 (TP TAX COUNSEL)), it did not provide such records to the auditor who sought to review them. Tr. p. 357 (TP TAX COUNSEL).

55. The Department's auditors calculated TAXPAYER’S throwback sales to Alaska, Hawaii and to foreign countries by using a formula, the ratio of which was based on average Illinois inventory to average "everywhere" inventory, and that formula was applied against TAXPAYER’S total sales everywhere. Stip. ¶ 23.

56. TAXPAYER did not file income tax returns in, or pay any income tax to, the States of Alaska or Hawaii. Stip. ¶ 25.

57. TAXPAYER did not file returns in the foreign countries identified on its federal form 1118. Tr. pp. 383-87 (TP TAX COUNSEL); *see also, e.g.*, Stip. Ex. No. 5, pp. 74-75 (schedule from TAXPAYER'S 1987 federal form 1118 identifying countries in which it paid tax on income from performance of services).

58. TAXPAYER'S federal form 1118's do not identify whether any tax TAXPAYER paid to foreign countries identified on those forms was imposed on income from sales of tangible personal property TAXPAYER might have made from Illinois to those locations. *See, e.g.*, Stip. Ex. No. 5, pp. 74-75 (schedule from TAXPAYER'S 1987 federal form 1118); Tr. pp. 410-11 (TP TAX COUNSEL).

59. Prior to testifying at hearing, TP EMPLOYEE had not personally reviewed TAXPAYER'S sales invoices, nor had he directed that any others conduct such a review. Tr. p. 60 (TP EMPLOYEE).

60. TAXPAYER'S state tax counsel, TP TAX COUNSEL ("TP TAX COUNSEL"), testified at hearing that he personally reviewed a printout of TAXPAYER'S destination sales records relating to TAXPAYER'S sales to Alaska. Tr. p. 315 (TP TAX COUNSEL). TP TAX COUNSEL described the records as a computer printout of data prepared and maintained by TAXPAYER'S tax department and by accountants within various TAXPAYER divisions. Tr. pp. 350-51 (TP TAX COUNSEL). When each audit was being conducted, such records existed in the same form as those purportedly reviewed by TP TAX COUNSEL, and would have been available to TP EMPLOYEE, the Department's audit contact with TAXPAYER. Tr. pp. 351, 355-57 (TP TAX COUNSEL).

61. At hearing, TP TAX COUNSEL concluded the records he reviewed established that no sales were made from Illinois to Alaska. Tr. pp. 311-26, 351, 355 (TP TAX COUNSEL). The records TP TAX COUNSEL purportedly reviewed, and upon which he based his conclusion, were never tendered to the Department for independent review, and were not offered as evidence at hearing.

62. TP TAX COUNSEL's testimony that TAXPAYER had no record that would provide "information . . . regarding sales originating from Illinois and going to any other state" (*see* Tr. p. 361) is inconsistent with TP TAX COUNSEL's own testimony regarding the computer printout he purportedly reviewed regarding TAXPAYER'S sales to Alaska (*see* Tr. pp. 315, 350-51), with TAXPAYER'S internal memorandum outlining the nature of its computerized recordkeeping and data analysis capabilities (Stip. Ex. No. 52), and with TP EMPLOYEE's testimony regarding his review of sales data prepared by TAXPAYER'S Illinois sales and other employees, and his own preparation of records from such data. Tr. pp. 46-47 (TP EMPLOYEE).

63. TAXPAYER made sales to Hawaii from one of its Illinois locations (Tr. pp. 317-19 (TP TAX COUNSEL)), yet it offered no records to document the total amount of gross receipts TAXPAYER received from those throwback sales.

64. Throughout both audit periods, section 913 of the Illinois Income Tax Act ("IITA") provided that "[all books and records and all other papers and documents which are required to be kept sTP EMPLOYEE, at all times during business hours of the day, be subject to inspection by the Department or its duly authorized

agents . . . ." Ill. Rev. Stat. ch. 120, ¶ 9-913 (1987)-(1991) (*now* 35 **ILCS** 5/913).

65. TAXPAYER failed or refused to tender books and records it had in its possession that would have allowed the Department to calculate the correct amount of TAXPAYER'S sales from Illinois to Alaska, Hawaii and to foreign countries. ***See, e.g.***, Stip. Ex. No. 52; Tr. pp. 41, 46-47 (TP EMPLOYEE), 315, 351, 356-57 (TP TAX COUNSEL) (on pp. 356-57, TP TAX COUNSEL, in response to a question regarding an auditor's request for a schedule of destination sales for Alaska, Hawaii and foreign countries, TP TAX COUNSEL testified "[w]e provided them with destination sales for Illinois.", on p. 357, regarding TAXPAYER records TP TAX COUNSEL purportedly reviewed before testifying that no sales were made from Illinois to Alaska (destination sales), TP TAX COUNSEL testified, "It's applicable to the State of Alaska. We *would not* tender it to the State of Illinois. ... [I]t *would not* have been [tendered].") (emphasis added).

66. At hearing, TAXPAYER offered no books and records to correctly identify the total amount of gross receipts it received during the audit period from sales of tangible personal property from Illinois to Alaska, Hawaii and to foreign countries.

Facts Regarding Issue III, Whether The Gain From TAXPAYER'S Sale Of POG's Assets Was Business Income

67. In 1987, TAXPAYER entered into an asset sale agreement with Marathon Oil. Stip. ¶ 43; Stip. Ex. No. 50, Purchase and Sale Agreement dated 10/21/87. The sale resulted in a gain as reported on TAXPAYER'S federal tax returns. Stip. ¶ 43.

68. TAXPAYER sold POG's assets pursuant to a program undertaken to divest or realign certain businesses that no longer met strategic and performance objectives of TAXPAYER. Stip. Ex. No. 22, TAXPAYER'S 1987 Annual Report, p. 21 (notes to financial statements, note 2 titled, "Acquisitions divestitures and business realignments"). The program included closing, relocating, downsizing or selling certain businesses or facilities. *Id.* As part of the program, TAXPAYER sold its ethylene glycols and potash businesses and its oil and gas operations. *Id.*; *see also, id.*, p. 14 (Statement Of Earnings For TAXPAYER and Consolidated Subsidiaries).

69. TAXPAYER excluded POG from its unitary business group on its 1987 IL-1120, thereby excluding the income from the gain on the sale to Marathon as part of TAXPAYER'S unitary business income. Stip. ¶ 44; Stip. Ex. No. 9.

70. The Department revised the composition of TAXPAYER'S unitary group to include POG as a member. Stip. ¶ 45.

71. TAXPAYER reported a gain of $33,952,165 on part I of its 1987 federal tax form 4797, and an ordinary gain of $20,563,954 on part II thereof. Stip. Ex. No. 5; Stip Ex. No. 14, p. 25 (copy of TAXPAYER'S federal form 4797).

72. When calculating the taxable income of TAXPAYER'S unitary business group, the Department included $58,147,150 (the sum of the gains identified, *supra*, plus $3,631,831) as POG's federal taxable income. Revised Stip. ¶ 48.[2]

---

[2]. After hearing, the parties agreed to correct errors in the written stipulation of facts admitted at hearing. The Department's

73. The Department included $80,139,245 (the gross proceeds from the sale to Marathon) in the sales factor denominator. Revised Stip. ¶ 49; Stip. Ex. No. 13, pp. 25, 27 (Schedules CA-4C and Schedule IX).

74. The assets TAXPAYER sold to Marathon were assets POG used in its oil and gas operations, which operations, along with TAXPAYER’S potash operations, had been managed by the same section (Potash/Oil & Gas) of TAXPAYER’S chemicals division. Stip. Ex. No. 52, p. 2.

75. TAXPAYER regularly sought to acquire (or to sell) interests in companies it believed were (or were no longer) in the best interests of the company. Stip. Ex. No. 22, TAXPAYER’S 1987 Annual Report, p. 21; Stip. Ex. No. 26, p. 45-46 (12/18/86 minutes); Stip Ex. Nos. 161-164 (respectively, TAXPAYER’S Annual Report for 1981, 1982, 1984 and 1985); TAXPAYER Ex. No. 165 (TAXPAYER’S 1986 Annual Report); Department's Brief, pp. 54-56 (identifying TAXPAYER’S acquisitions and sales of interests in companies during 1981 - 1987).

Facts Regarding Issue IV, Whether TAXPAYER’S Foreign Royalty Income Was Business Income

76. TAXPAYER operates four research and development ("R&D") facilities in the United States to advance its leadership in technology. One R&D facility is dedicated to glass, one to fiberglass, one to coatings and resins, and one to chemicals. Stip. ¶ 9.

---

identification of those errors to TAXPAYER, and TAXPAYER’S agreement to correct those errors, is appended to the stipulation.

77. Each of TAXPAYER’S research facilities conducts research and development involving new and improved products and processes, and additional process and product development work is undertaken at many of TAXPAYER’S manufacturing plants. Stip. ¶ 10; Stip. Ex. No. 14, p. 43 (TAXPAYER’S 1987 form 10-K).

78. TAXPAYER earned the royalty income at issue from licensing patents, trademarks, processes and technical data owned by TAXPAYER. Stip. ¶ 13. The patents, trademarks, processes and technical data TAXPAYER licensed to others were researched and developed by TAXPAYER in the ordinary course of its glass, coatings and resins and chemical business. Stip. ¶ 13; Stip. Ex. No. 23, Trademark License Agreement.

79. TAXPAYER’S employees negotiated, drafted and executed the license agreements at TAXPAYER’S corporate headquarters in Pittsburgh, Pennsylvania. Stip. ¶ 14.

80. During the audit period, TAXPAYER increased the number of license agreements either by amending or adding to the number of licenses in force and effect. *See* Stip. ¶ 15.

81. When TAXPAYER invested in, created or owned a company located in a foreign country, regardless of its ownership percentage, TAXPAYER granted non-exclusive licenses for any of its trademarks, patents or technical processes, where requested to do so by the foreign company to manufacture, produce or market the product. Stip. ¶¶ 16, 17.

82. When a company in a country in which TAXPAYER has no subsidiaries, other operations, or other licensees requests a license, TAXPAYER may grant a non-exclusive license for any of

its patents, trademarks or technical processes the foreign company requests to produce, manufacture or market the product in that country if TAXPAYER would financially benefit from the license agreement. Stip. ¶ 18.

83. During the first audit period, tax years 1987 and 1988, TAXPAYER reported over 61 million and 70 million dollars in foreign royalty income. Stip. ¶ 19. During the second audit period, tax years 1989 and 1990, TAXPAYER reported over 89 million and 83 million dollars in foreign royalty income. Stip. ¶ 59.

84. As a result of its audits, the Department included in TAXPAYER'S unitary business income the amounts of foreign royalties TAXPAYER previously reported as nonbusiness income. Stip. ¶¶ 13, 61. The Department also included the same amount of royalty income in TAXPAYER'S sales factor denominator. Stip. ¶¶ 13, 61.

85. TAXPAYER used the patents, trademarks and other property it licensed to foreign companies in the regular course of its business. Stip. Ex. No. 16, p. 23 (exhibit C, royalties questionnaire).

86. TAXPAYER regularly licensed patents, trademarks and other intellectual property it developed in the ordinary course of its business to foreign companies. *See id.*; *see also*, Stip. ¶¶ 15-19, 59.

Facts Regarding Issue V, Whether TAXPAYER'S Foreign Dividend Income Was Unitary Business Income

87. During the tax years at issue, TAXPAYER claimed a 100% deduction for dividends it received from foreign corporations. Tr. pp. 457-58 (Department auditor Michele Morgan ("Morgan")).

88. During the audit, the auditor determined some of the dividends to which TAXPAYER claimed a 100% deduction were received from foreign companies in which TAXPAYER held less than an 80% ownership interest. Tr. pp. 457-59 (Morgan). The auditor adjusted TAXPAYER'S Illinois subtraction modification to include only an 85% deduction for such dividends. *Id.*; 35 **ILCS** 5/203(b)(2)(*O*).

89. TAXPAYER introduced no evidence that 15% of the dividends it received from foreign companies in which it held less than an 80% ownership interest should have been excluded from its apportionable unitary business income.

Facts Regarding Issue VI, Whether The Department Properly Issued A Notice Of Deficiency To TAXPAYER Biomedical For Tax Year 1989

90. TAXPAYER Biomedical, Inc. ("TAXPAYER-Bio") filed a separate 1989 IL-1120 for the partial year beginning 1/1/89 and ending 9/30/89. Stip. Ex. No. 51.

91. TAXPAYER filed a 1989 combined IL-1120 in which TAXPAYER-Bio was excluded from TAXPAYER'S unitary business group. Stip. ¶ 71.

92. During prior tax years, TAXPAYER included TAXPAYER-Bio as a member of its unitary business group. Stip. Ex. No. 9, TAXPAYER'S 1987 Illinois income tax returns, pp. 5, 8 (counting certification as first page of unnumbered exhibit); Stip. Ex. No. 10, TAXPAYER'S 1988 Illinois income tax returns, pp. 5, 9; Tr. p. 449 (Morgan).

93. TAXPAYER introduced no evidence that TAXPAYER-Bio should not have been included as a member of TAXPAYER'S unitary business group for tax year 1989 or part thereof, nor did it introduce

any evidence that the NOD issued to TAXPAYER-Bio was in any way improper.

Facts Regarding Issue VII, Whether the Assessment of A § 1005 Penalty Was Appropriate

94. Following both audits, the Department proposed to assess section 1005 penalties for failure to pay the tax due on the return as determined by the audit. Stip. ¶¶ 50, 74.

95. TAXPAYER introduced no evidence to establish that it had reasonable cause to claim that POG was not unitary with TAXPAYER and that the various types of income it received were nonbusiness income.

96. TAXPAYER introduced no documentary evidence showing reasonable cause to claim the Department's calculation of Illinois throwback sales was incorrect.

<u>Conclusions of Law:</u>

Issue I: Whether POG Was Unitary With TAXPAYER

Section 1501(a)(27) of the IITA defines a unitary business group as:

> a group of persons related through common ownership whose business activities are integrated with, dependent upon and contribute to each other. The group will not include those members whose business activity outside the United States is 80% or more of any such member's total business activity . . . . Common ownership in the case of corporations is the direct or indirect control or ownership of more than 50% of the outstanding voting stock of the persons carrying on unitary business activity. Unitary business can ordinarily be illustrated where the activities of the members are: (1) in the same general line (such as manufacturing, wholesaling, retailing of tangible personal property, insurance, transportation or finance); or (2) are steps in a vertically structured

> enterprise or process (such as the steps involved in the production of natural resources, which might include exploration, mining, refining, and marketing); and, in either case, the members are functionally integrated through the exercise of strong centralized management (where, for example, authority over such matters as purchasing, financing, tax compliance, product line, personnel, marketing and capital investment is not left to each member).

35 **ILCS** 1501(a)(27) (1996).

The Department's regulations also address certain characteristics commonly exhibited by members of a unitary business group. For example, subsection (h) of 86 Ill. Admin. Code § 100.9700, provides, in part:

> h) General line of business and vertically structured enterprises
>
> 1) Section 1501(a)(27) of the Act establishes that persons meeting all of the other tests for inclusion in a unitary business group, including common ownership, strong centralized management and comparability of apportionment method, will ordinarily be in one of the following relationships to one another:
>
> A) in the same general line of business, or
>
> B) steps in a vertically structured enterprise or process.
>
> 2) Section 1501(a)(27) of the Act recites that two persons will ordinarily be considered to be in the same general line of business if they are both involved in one of the following activities:
>
> A) manufacturing
>
> B) wholesaling
>
> C) retailing
>
> D) insurance
>
> E) transportation
>
> F) finance
>
> 3) IITA Section 1501(a)(27) does not contemplate that the above list be exclusive. For example, two persons who ordinarily that are both involved in rendering services to the public would ordinarily be considered to be in the same general line of business. In this regard, a retailer that renders services that are

incidental to its retail business will not be in the same general line of business as a person that is primarily a service dispenser.

4) *It is not a requirement of IITA section 1501(a)(27) that the activities of the two persons in whichever category is applicable relate to the same or product line in order for the two persons to be in the same general line of business.*

86 Ill. Admin. Code § 100.9700(h) (emphasis added).

Whether certain companies are engaged in a unitary business is a question of fact, to be determined on a case-by-case basis. Citizens Utility Co. v. Department of Revenue, 111 Ill. 2d 32, 47, 488 N.E.2d 984, 990 (1986). The Department established the ***prima facie*** correctness of its determination that TAXPAYER and POG were engaged in a unitary business by introducing the NOD it issued against TAXPAYER into evidence at hearing. 35 **ILCS** 5/904(a). Thereafter, the burden shifted to TAXPAYER to show that POG was not unitary with its parent. ***See*** Balla v. Department of Revenue, 96 Ill. App. 3d 293 (1st Dist. 1981).

TAXPAYER argues it was not unitary with its subsidiary because the companies were not engaged in the same general line of business. TAXPAYER’S Post-Hearing Brief ("TAXPAYER’S Brief") p. 11. It also denies the operations of TAXPAYER and POG were steps in a vertically-structured enterprise, and it disputes that the two companies were tied together through strong centralized management. ***Id.***, pp. 11-12.

One of the general lines of business in which TAXPAYER engaged was manufacturing and/or processing and selling chemicals. Stip. ¶ 8. That business was conducted through TAXPAYER’S APCD. For over a decade prior to its discovery of oil and gas in Michigan, TAXPAYER had been mining, processing and selling potash, a chemical used principally as fertilizer by the farming industry. *See* TAXPAYER Ex. No. 165, 1986 Annual Report, p. 18. After TAXPAYER discovered oil and gas in Michigan as a direct result of the operations of its potash project, TAXPAYER immediately set out to include oil and gas as another natural resource to be explored and exploited under the supervision of its chemicals division. *See* Stip. Ex. No. 26, *passim*. As its initial oil and gas exploration efforts proved fruitful, TAXPAYER made it its business to begin extracting, processing and selling the hydrocarbons it discovered. *Id.*; Stip. Ex. No. 161, pp. 1, 6; Stip. Ex. No. 163, p. 16. TAXPAYER had a gas processing plant built after it concluded that processing the gas it discovered would be cheaper than having another company process it. Stip. ¶ 33; Stip. Ex. No. 27. TAXPAYER undertook all of those activities as an outgrowth of the potash operations of its chemicals manufacturing business. *See* Stip. Ex. No. 26, pp. 2-28.

While TAXPAYER did not appear to be engaged in the oil and gas exploration and production business before it discovered those natural resources in Michigan, once it made that discovery, it made such operations part of its chemical manufacturing business. *See* Stip. Ex. No. 161, pp. 1, 6; Stip. Ex. No. 163, p. 16. When a parent forms a wholly-owned subsidiary to conduct operations already begun by the parent, such action indicates the companies were engaged in the same general line of business. A.B. Dick Co. v. McGaw, No. 4-96-0057, slip op., p. 19 (1st Dist. April 4, 1997). Although I believe TAXPAYER saw its oil and gas operations as being in a product line different than the other chemicals TAXPAYER had long been manufacturing, the operations of POG were in the same general line as those of TAXPAYER'S chemical division, that is, the business of manufacturing and selling chemicals. *See* 86 Ill. Admin. Code § 100.9700(h)(4).

The operations of TAXPAYER and POG were also functionally integrated through TAXPAYER'S exercise of strong centralized control over the operations of POG, once it formed that subsidiary. Citizens Utilities Co. v. Department of Revenue, 111 Ill. 2d 32, 51, 488 N.E.2d 984, 992 (1986). All directors of POG were officers or employees of TAXPAYER. Stip. ¶ 30. The day-to-day operational decisions for POG were made by WITNESS B, a TAXPAYER manager and contract employee. Tr. pp. 78-79 (WITNESS A). All of TAXPAYER'S major purchases and capital expenditures were approved by TAXPAYER'S board (*see* Stip. Ex. No. 26), paid for by TAXPAYER, and those amounts then charged to POG through TAXPAYER'S inter-unit transfer-system. *See* Stip. Ex. Nos. 42, 47-49; Tr. pp. 280-81 (WITNESS A). TAXPAYER paid the salaries of persons who worked for POG. Stip. ¶ 31. TAXPAYER'S accounting personnel performed accounting services for POG. Tr. p. 280 (WITNESS A). In its annual reports, TAXPAYER described its oil and gas operations as the operations of TAXPAYER'S chemicals division. *See* Stip. Ex. Nos. 161-164; TAXPAYER Ex. No. 165. TAXPAYER approved and signed the contracts to sell the oil and gas produced in Michigan. Stip. Ex. No. 26. TAXPAYER employees and its board approved the construction of the Stoney Point gas plant. *Id.* When TAXPAYER determined the time had come to get out of the oil and gas business, TAXPAYER entered into the agreement to sell the assets of POG. Stip. Ex. No. 50.

I conclude POG was properly included as member of TAXPAYER’S unitary business group.

Issue II: Throwback Sales

TAXPAYER makes the following argument on this issue:

> ... [T]his is not a case where the TAXPAYER either did not have records or refused to make records available to the Department and its auditors. Indeed, the Department has never taken the position that TAXPAYER failed to maintain proper books and records relating to sales. Here, TAXPAYER advised the auditors that there were documents from which purported reversionary sales, if any, could be calculated. The auditors did not look at those documents. Instead, the first auditor developed her own formula based on inventory in order to make a reversionary sales calculation. This same formula was used by the second auditor. In this context, this formula is not based upon the Department's best judgment and information and, such a formula is improper and cannot support a prima facie finding for the Department. Consequently, the formula does not meet the test that it be based on some minimum standard of reasonableness.

TAXPAYER’S Post-Hearing Brief ("TAXPAYER’S Brief"), pp. 3-4. TAXPAYER’S argument continues,

> In its Brief (pp. 12-13), the Department states that the TAXPAYER never produced, during either audit cycle, origin or destination sales records that were requested.
>
> ... Both Mr. TP TAX COUNSEL and Mr. TP EMPLOYEE testified that the only records which would indicate sales made out of Illinois and into other states or countries would be TAXPAYER’S original sales invoices. These documents were maintained in the Pittsburgh headquarters building and, also, in various state locations and were on microfiche. (tr. 40-41).
>
> ... The Department apparently gives great significance to the fact that TAXPAYER never physically gathered up these sales invoices and dropped them in the auditor's laps. Certainly this is not the requirement of a TAXPAYER . A TAXPAYER can identify those documents that are

> available and that will assist the auditor in conducting the audit. *It is the auditor's obligation to review those records where they can be found.* In this case, both auditors were aware that the destinations sales information they sought was contained in the original sales invoices, yet, they chose, for whatever reason, not to review these documents. Instead, they chose to create and then use a formula based upon inventory and not on actual sales.

TAXPAYER’S Reply Brief ("TAXPAYER’S Reply"), pp. 4-5 (emphasis added).

Here, the Department was auditing TAXPAYER at one of TAXPAYER’S Illinois business locations, and the Department's auditors were asking to see records identifying those sales TAXPAYER made in Illinois. Illinois apportions business income of non-residents using a three-factor formula. 35 **ILCS** 5/304(a). One of the factors, the sales factor, measures sales made in Illinois versus sales made everywhere else. 35 **ILCS** 5/304(a)(3)(A). Under Illinois' apportionment formula, a sale of tangible personal property is considered to have been made in Illinois if it was delivered or shipped to a purchaser in Illinois (35 **ILCS** 5/304(a)(3)(B)(i)), or, the sale can be "thrown back" to Illinois if it was shipped from an office, store, warehouse, factory or other place of storage in Illinois and the seller was not taxable in the state of the purchaser. 35 **ILCS** 5/304(a)(3)(B)(ii); <u>Dover v. Department of Revenue</u>, 271 Ill. App. 3d 700, 707-08, 648 N.E.2d 1089, 1094-95 (1st Dist. 1995) (the Department's regulation is valid when determining whether the seller is "taxable in the state of the purchaser").

Like any TAXPAYER being audited, TAXPAYER is entitled to an accurate count of its income and to an accurate count of its income producing activities in Illinois. Here, TAXPAYER admits it had books and records from which an accurate count of its Illinois sales could be made. TAXPAYER’S Brief, pp. 3-4; TAXPAYER’S Reply, pp. 4-5. Instead of tendering those records for Department review, however, TAXPAYER’S employee told the auditors the only records TAXPAYER had which would document its sales of property shipped from Illinois to Alaska, Hawaii and to foreign countries were original sales invoices stored in Pittsburgh. In its brief, TAXPAYER argues the Department's auditors were obliged to review TAXPAYER’S original sales invoices where they were found. TAXPAYER’S Brief, pp. 3-4; TAXPAYER’S Reply, pp. 4-5 (*quoted supra*, pp. 22-23). I disagree. When TP EMPLOYEE told the auditors the information they sought (TAXPAYER’S original sales invoices) could be found in Pittsburgh, TAXPAYER was not making its records "subject to inspection by the Department or its duly authorized agents and employees." 35 **ILCS** 5/913; *see also*, 35 **ILCS** 5/501.

TAXPAYER, a TAXPAYER who takes full advantage of the opportunities available and services rendered to persons who conduct business in Illinois, argues that when a Department auditor asks to review corporate records detailing its Illinois sales, it may demand that the auditor travel outside Illinois to inspect them. That argument does not comport with the recordkeeping procedures in place under the Retailers' Occupation Tax Act ("ROTA"),[3] and TAXPAYER has

[3]. Section 130.801 of the Department's ROT regulations on books and records provides, in part:

> (b) Retailers must maintain complete books and records covering receipts from all sales and distinguishing taxable from nontaxable receipts.
>
> * * *
>
> (e) Such books and records must be kept within Illinois except in instances where a business has several branches, with the head office being

not articulated any legal support for its argument that under the IITA, the Department's auditors may be compelled to travel outside Illinois to inspect records regarding the TAXPAYER’S Illinois activities. ***See*** [Illinois] State Tax Rep., (CCH) ¶ 14-029, p. 1919 (1987) (Official Commentary on the Illinois Income Tax Act) (section 913 of the IITA was "adopted from the Retailers' Occupation Tax [Act]").

The Department's power to inspect records means the power to audit. People v. Floom, 52 Ill. App. 3d 971, 975, 368 N.E.2d 410 (1st Dist. 1977). The power to inspect records includes the power to make copies of the records being inspected, on TAXPAYER’S premises, if the Department so elects. ***Id.***, 52 Ill. App. 3d at 976. The Department simply cannot audit, review or copy records never made available for inspection. So, when TAXPAYER argues that, "for whatever reason, the auditors chose not to review these [original sales invoice] records" (TAXPAYER’S Brief, p. 3), it is not being forthright. Unlike the cases cited by TAXPAYER in its Reply (TAXPAYER’S Reply, pp. 8-9), the reason the Department auditors never reviewed TAXPAYER’S sales invoices is because TAXPAYER never made those documents available to be reviewed.

> located outside Illinois, and where all books and records have been regularly kept outside the State at such head office. Under such circumstances, upon written permission from the Department, books and records may be kept outside Illinois, *but the TAXPAYER must, within a reasonable time after notification by the Department, make all pertinent books, records, papers and documents available at some point within Illinois for the purpose of such investigation and audit as the Department may deem necessary.*

86 Ill. Admin Code § 130.801 (emphasis added).

I am also reluctant to accept either TAXPAYER’S argument, or its witnesses' testimony, that the only records TAXPAYER had that would document its sales of property shipped from Illinois to Alaska, Hawaii and to foreign countries were TAXPAYER’S original sales invoices. TAXPAYER’S witness, TP TAX COUNSEL, testified directly that he reviewed records, other than TAXPAYER’S original sales invoices, which he alleged could be used to establish that TAXPAYER shipped no products from locations in Illinois to Alaska. Tr. pp. 350-51.

Further, other evidence introduced at hearing showed that TAXPAYER used a computerized recordkeeping and data analysis system which would have contained information TAXPAYER included in its original sales invoices. For example, stipulation exhibit number 52 is a memo informing TAXPAYER’S chemicals division section managers about TAXPAYER’S computerized financial and management recordkeeping and data analysis capabilities. That memo provides a description of 36 different data entries on the monthly reports TAXPAYER furnished to its managers. The memo also informs TAXPAYER managers that "[d]etail sales information by SKU number, customer, account, etc. is available in the OP&I system." Stip. Ex. No. 52, p. 3 (Chemicals Management Statement Terms and Descriptions, § I.1).

TAXPAYER’S computerized recordkeeping and data analysis system likely produced the records TP TAX COUNSEL said he reviewed prior to testifying at hearing. TP TAX COUNSEL described those records as a printout of all of TAXPAYER’S sales, sorted by product group, shipped into Alaska. *Compare* Tr. pp. 350-56, 406 (TP TAX COUNSEL) *with* Stip. Ex. No. 52, p. 3 (sales data by SKU number available from TAXPAYER’S computer records). Assuming TP TAX COUNSEL's testimony about the computer printout is true (and assume I must, because that printout was never offered as evidence at hearing), TAXPAYER’S ability to prepare such a printout strongly suggests TAXPAYER’S computerized recordkeeping system could be searched using a "shipped to" field query. Now, it could be that TAXPAYER created and maintained an electronic database that could be searched using a "shipped to" request, but could not be searched using a "shipped from" request. Such a system, however, would not provide TAXPAYER’S managers the ability to identify, measure, and analyze current sales data, or predict future sales, from each sales or production location.[4]

Considering TP EMPLOYEE's testimony that he reviewed sales data prepared by Illinois sales personnel, and that he created sales records from such data (Tr. pp. 45-47), and considering also the detailed data processing capabilities TAXPAYER made available to its managers, it is reasonable to conclude TAXPAYER’S computerized recordkeeping and data analysis system could be used to create a schedule of sales TAXPAYER shipped from locations in Illinois to other specific locations. What certainly seems clear from all the evidence is that data normally included on one of TAXPAYER’S original sales invoices was also entered onto TAXPAYER’S computerized recordkeeping and data analysis system which TAXPAYER, in fact, used

---

[4]. If TP TAX COUNSEL was able to obtain a printout of all of TAXPAYER’S sales into Alaska (a search in which the "shipped from" field query would be "all" (or some variant thereof), and the "shipped to" field query would be "Alaska", it seems unreasonable to believe that the same system could not produce a printout of sales data using a search in which the "shipped from" field query would be "Illinois" and the "shipped to" field query would be "Alaska", then "Hawaii", etc.

to monitor and analyze the sales activity of its operations. *See* Stip. Ex. No. 52. Therefore, I give little if any weight to TP EMPLOYEE's and TP TAX COUNSEL's testimony that the only records from which TAXPAYER’S Illinois origination sales could be gleaned were TAXPAYER’S original sales invoices.

And if it is wrong to infer TAXPAYER has more records than its original sales invoices, that error does not affect the type of evidence TAXPAYER was required to offer at hearing on this particular issue. Where the Department has established its *prima facie* case, a TAXPAYER does not rebut it merely by offering testimony denying the accuracy of the proposed assessment. A.R. Barnes v. Department of Revenue, 173 Ill. App. 3d 826, 833-34 (1st Dist. 1988). To rebut the *prima facie* case of the Department, even unsophisticated individual TAXPAYER s must support a claim that tax is not due with documentary evidence. Balla v. Department of Revenue, 96 Ill. App. 3d 293, 297 (1st Dist. 1981).

While the court in Balla was understandably hesitant to impose on an unsophisticated individual the same burden of proof required of retailers under the ROTA (*see* Balla, 96 Ill. App. 3d at 296), there is no reason for such hesitancy here. This issue involves a fact question most peculiarly similar to investigations conducted under the ROTA: What was the total amount of gross receipts TAXPAYER realized from making sales of tangible personal property in Illinois? 35 **ILCS** 5/304(a)(3)(A); 86 Ill. Admin. Code §§ 100.3370(a)(1), (c)(1). Under the ROTA, TAXPAYER would have been required to introduce at hearing its original sales invoices (or other documentary evidence closely identified therewith) to support its argument that the Department's calculation of tax due was incorrect. *E.g.*, Masini v. Department of Revenue, 60 Ill. App. 3d 11, 15 (1st Dist. 1978) (although a TAXPAYER argued that "the Department ha[d] all the records that it requested," the court found TAXPAYER had not rebutted the Department's *prima facie* case because "those records were not in evidence at the hearing.").

Like most persons who conduct business, TAXPAYER is the master of its own records. The documentary evidence introduced at hearing shows TAXPAYER appreciates the value of well-kept business records, and that documentary evidence also shows TAXPAYER uses automated recordkeeping systems. *See, e.g.*, Stip. Ex. No. 22, 1987 Annual Report, p. 3 (lauding a TAXPAYER employee for working "30 or more hours straight to get a new billing system in place for better and faster service, and a TAXPAYER competitive advantage."); Stip. Ex. No. 52 (detailing TAXPAYER’S computerized recordkeeping and data analysis capabilities). TAXPAYER obviously works to make such records and recordkeeping systems available to its managers so that TAXPAYER’S operations might function more efficiently.

TAXPAYER’S business records, and not the testimony of its employees who may or may not have reviewed them,[5] provide the best proof of facts probative of the particular issue in dispute. Even though testimony alone is insufficient to rebut the presumption of correctness granted the Department's calculation of tax proposed to

[5]. Neither TP EMPLOYEE nor TP TAX COUNSEL personally reviewed the records each testified were the only records from which the Department's auditors could count the receipts from TAXPAYER’S sales of tangible personal property from Illinois to Alaska, Hawaii and to foreign countries. Tr. p. 60 (TP EMPLOYEE); Tr. pp. 308-10, 315, 350 (TP TAX COUNSEL).

due based on TAXPAYER'S Illinois throwback sales (*see* 35 **ILCS** 5/904(a); Balla v. Department of Revenue, 96 Ill. App. 3d at 297; A.R. Barnes v. Department of Revenue, 173 Ill. App. 3d at 833-34), TAXPAYER offered only its witnesses' testimony to prove the contents of its records at hearing, instead of the records themselves.

TAXPAYER has clearly set itself up as the gatekeeper of its records. TAXPAYER, in effect, asks the fact finder to trust and accept its witnesses' conclusions regarding the contents of its business records, while refusing to offer the records themselves for Department inspection or audit. That I will not do. Not only is such a request contrary to Illinois precedent regarding the quanta of proof necessary to rebut the Department's *prima facie* case, it is also contrary to public policy as reflected in the IITA.[6] *See* Balla v. Department of Revenue, 96 Ill. App. 3d at 297; A.R. Barnes v. Department of Revenue, 173 Ill. App. 3d at 833-34; 35 **ILCS** 5/913. Finally, TAXPAYER'S offer of testimony instead of documents is unworkable in practice in this case. Without any records, for example, what number should be included in TAXPAYER'S sales factor numerator to identify the amount of receipts TAXPAYER earned from the "minimal" amount of chemicals sales TP TAX COUNSEL admitted TAXPAYER

[6]. Tolerating a TAXPAYER'S purposeful non-production of books and records has never been a policy articulated by the Illinois General Assembly or upheld by Illinois courts. *See* 35 **ILCS** 5/913; People v. Floom, 52 Ill. App. 3d 971, 368 N.E.2d 410. And TAXPAYER'S non-production of records certainly appears purposeful in this case. For example, TP TAX COUNSEL testified that TAXPAYER would not make certain records available to the Department. Tr. p. 357 (destination sales records were "applicable to the State of Alaska. We *would not* tender it to the State of Illinois."), p. 364 ("We *wouldn't* provide the auditor with a copy of any other state's return.") (emphasis added).

would have made from Illinois to Hawaii? Tr. pp. 318-19 (TP TAX COUNSEL).

In the final analysis, TAXPAYER can hardly be heard to complain about the Department's use of a formula to calculate the amount of sales to be thrown back to Illinois while simultaneously refusing to tender the records from which an accurate count of such sales could be made. Because TAXPAYER presented no records to corroborate its claim that the Department improperly identified the amount of sales to be thrown back to Illinois, I conclude it has not rebutted the *prima facie* correctness of the Department's determination of tax proposed to be due.

TAXPAYER'S final argument on this issue, that if one member of TAXPAYER'S unitary business group had nexus in Alaska, Hawaii or in foreign countries where TAXPAYER made sales which the Department proposed to throwback to Illinois, the whole unitary group must be deemed to have nexus in that location, was specifically rejected by the Illinois appellate court in Dover v. Department of Revenue. Dover, 271 Ill. App. 3d at 710, 648 N.E.2d at 1096. TAXPAYER ignored the Dover decision in its briefs, and instead argued the applicability of case law from California. TAXPAYER'S Brief, pp. 4-7. I see no reason to do so in this recommended decision.

Issues III-IV: Business Income Issues

I will address these issues together in this section because they both involve a determination whether a particular type of income received by TAXPAYER during the applicable tax years was business income, as that term is defined in the IITA. Section 1501(a)(1) of the IITA defines business income, in pertinent part, as follows:

> The term 'business income' means income arising from transactions and activities 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). Nonbusiness income is defined as "all income other than business income or compensation." 35 **ILCS** 5/1501(a)(13). All income is presumed business income unless clearly classifiable as nonbusiness income. 86 Ill. Admin. Code § 100.3010(a). A TAXPAYER has the burden of establishing that a particular item of income is nonbusiness income. Dover Corp. v. Department of Revenue, 271 Ill. App. 3d at 712, 648 N.E.2d at 1097.

In 1986, the First District Illinois Appellate Court ruled the IITA's definition of business income embraced two separate and distinct tests by which income could be classified as business income: the transactional test and the functional test. National Realty & Investment Co. v. Department of Revenue, 144 Ill. App. 3d 541, 543-44, 494 N.E.2d 924 (2d Dist. 1986). If either test is met, the income is properly classified as business income. Dover Corp. v. Department of Revenue, 271 Ill. App. 3d at 711-12, 648 N.E.2d at 1097.

Recent Illinois appellate court cases reject outright TAXPAYER’S argument that the transactional test is the only appropriate means of determining whether income is business income under the IITA. Kroger Co. v. Department of Revenue, 284 Ill. App. 3d 473, 479-82, 673 N.E.2d 710, 714 (1st Dist. 1996) ("The plain meaning of section 1501(a)(27) embraces two definitions of business income"); Texaco-

Cities Service Pipeline Co. v. McGaw, 286 Ill. App. 3d 529, 532, 675 N.E.2d 1004, 1006 (1st Dist. 1997) ("Finding the *Kroger* analysis to be both thorough and persuasive, we affirm the trial court's determination that Illinois law embraces two alternative tests for classifying business income"). What the first district acknowledged in National Realty more than a decade ago is still the law in Illinois.

The transactional test is derived from the first clause of section 1501(a)(1) (transactions and activity in the regular course of the TAXPAYER’S trade or business). Under the transactional test, income is business income if derived from a type of business transaction in which the TAXPAYER regularly engages. The functional test is derived from the second clause of section 1501(a)(1) (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). Under the functional test, the relevant inquiry is whether the property was used in the TAXPAYER’S regular trade or business operations. Kroger, 284 Ill. App. 3d at 482; Dover, 271 Ill. App. 3d at 711-12.

TAXPAYER argues that since it was not engaged in the business of selling gas processing plants, the gain from TAXPAYER’S sale of POG's assets was not business income. In two recent cases, the Illinois appellate court found the gain from sales of property used in the company's business to be business income under the functional test, and ruled such gain was subject to apportionment by Illinois. In Kroger Co. v. Department of Revenue, the court held that the gain from Kroger's sale of leaseholds used in its business was business income. Kroger, 284 Ill. App. 3d at 483, 673 N.E.2d at 716. In Texaco-Cities Service Pipeline Company v. McGaw, the court held that income earned from a company's sale of pipeline was business income where the pipeline was property used in the company's regular business operations. Texaco-Cities, 286 Ill. App. 3d at 532-33, 675 N.E.2d at 1006-07.

Here, TAXPAYER approved the acquisition of, and paid for, the assets it sold in 1987 as an outgrowth of its chemical division's operations. *See* Stip. Ex. No. 26. TAXPAYER manufactured and sold chemicals in Illinois. Stip. ¶ 11. Prior to its protest of NOD's issued in this matter, TAXPAYER had identified its oil and gas operations as one of the different product lines within its general business line of manufacturing and selling chemicals. Stip. Ex. No. 161, 1981 Annual Report, p. 6; Stip Ex. No. 163, 1984 Annual Report, p. 16. TAXPAYER, the parent, was unitary with POG, the subsidiary whom TAXPAYER named operator of the assets TAXPAYER sold in 1987 (*see, e.g.*, Stip. Ex. No. 26), and TAXPAYER sold those assets pursuant to a program undertaken to divest or realign certain businesses that no longer met TAXPAYER'S strategic and performance objectives. Stip. Ex. No. 22, 1987 Annual Report, p. 21. Clearly, POG's assets were property TAXPAYER used in its regular business operations. The gain from TAXPAYER'S sale of those assets was business income under the functional test.

Additionally, documentary evidence introduced at hearing supports a conclusion that TAXPAYER regularly acquired and/or sold different businesses, or interests therein, when it decided that such acquisitions, dispositions and/or sales would be in TAXPAYER'S best interests. Stip. Ex. No. 22, TAXPAYER’S 1987 Annual Report, p. 21; Stip Ex. Nos. 161-164 (respectively, TAXPAYER’S Annual Report for 1981, 1982, 1984 and 1985). During the period 1981 through 1987, TAXPAYER acquired 24 companies, businesses, or interests in such companies, and it sold or otherwise divested itself of five different companies, businesses or interests therein. *See* Department's Brief, pp. 54-56 (listing the acquisitions and dispositions identified in TAXPAYER’S 1981-1987 Annual Reports, Stip. Ex. Nos. 161-164 and TAXPAYER Ex. No. 165). The gain from TAXPAYER’S sale of assets used in its oil and gas operations was, therefore, income received from a type of transaction regularly undertaken in the course of TAXPAYER’S business. The gain is also business income under the transactional test.

TAXPAYER earned royalty income from licensing patents, trademarks, processes and technical data owned by TAXPAYER. Stip. ¶ 13. The royalty income TAXPAYER earned from licensing its patents and other intellectual property was also business income under either the transactional or functional test. The income was earned from transactions in the regular course of TAXPAYER’S trade or business, and those transactions involved dispositions (actually, licenses) of properties which were an integral part of its own business. The patents, trademarks, processes and technical data TAXPAYER licensed to others were researched and developed by TAXPAYER in the ordinary course of its glass, coatings and resins and chemical business. Stip. ¶ 13. TAXPAYER’S employees negotiated, drafted and executed the license agreements at TAXPAYER’S corporate headquarters in Pittsburgh, Pennsylvania. Stip. ¶ 14; Stip. Ex. No. 23, Trademark

License Agreement. During the first audit period, tax years 1987 and 1988, TAXPAYER reported over 61 million and 70 million dollars in foreign royalty income. Stip. ¶ 19. During the second audit period, tax years 1989 and 1990, TAXPAYER reported over 89 million and 83 million dollars in foreign royalty income. Stip. ¶ 59.

I cannot accept TAXPAYER'S argument that its licenses of intellectual property should not be considered transactions in the regular course of its business because it only licensed such technology after being asked to do so. In the first place, TAXPAYER may not have always waited to be asked before it licensed technology to a foreign company it purchased. For example, in his 1982 letter to TAXPAYER shareholders, TP CHAIRMAN, TAXPAYER'S chairman of the board, wrote:

> Part of our long-term strategy is to continue to build upon our areas of technological and marketing strength. In 1982, we acquired the majority interest in Boussois, S.A., a French flat glass company, to reinforce our strong position business worldwide. In addition, we purchased a domestic printing ink company, an adhesives manufacturer, and a coatings operation in Spain, *with a plan to infuse these businesses with advanced proprietary technology to nurture their growth.*

Stip. Ex. No. 162, TAXPAYER'S 1982 Annual Report, p. 1 (emphasis added). TAXPAYER'S publicly stated plans to "infuse" acquired foreign businesses with advanced proprietary technology seems wholly inconsistent with its current description of itself as a coy corporate suitor who would share its technical attributes only if asked to do so by the successfully courted business.

The inference to be drawn from Mr. TP CHAIRMAN' letter, moreover, is that TAXPAYER'S acquisition and licensing policies were intertwined, at least to some degree. During the period following a corporate acquisition, one should reasonably expect the acquiring company to be making most of the decisions regarding the activities of the acquired company. In that respect, any request to license TAXPAYER’S technology, made by a company just acquired by TAXPAYER, simply cannot be divorced from the intentions of TAXPAYER itself.

But even if TAXPAYER never once licensed its technology to a company without first being asked by the potential licensee, that does not mean the royalty income TAXPAYER earned from such transactions was nonbusiness income. If a person is regularly approached and asked to engage in a particular business transaction, and it regularly accepts such offers, the income it receives from concluding such transactions is income received in the regular course of the person's business. Taken to its logical conclusion, if receipts from sales to offerors were to be considered nonbusiness income, retailers and service providers would have no business income. TAXPAYER has not identified any case law supporting its claim that since its licensees were always (it argues) the offerors, the receipts TAXPAYER earned from regularly licensing its intellectual property cannot be considered business income.

In Dover Corp. v. Department of Revenue, the Illinois appellate court recently upheld a determination that royalty income received from licensing patents to foreign companies was business income. Dover, 271 Ill. App. 3d 700, 648 N.E.2d 1089. There, the court found Dover had not shown that its royalty income was nonbusiness income because it "failed to establish that the patents generating the income were not held or created in the regular course of business operations or that the purpose of developing and acquiring the patents was not integral to its business operations." *Id.*, 271 Ill. App. 3d at 712, 648 N.E.2d at 1097. Here, the documentary evidence shows both that the technology TAXPAYER licensed *was* created in the regular course of TAXPAYER’S business, and that TAXPAYER’S patents, trademarks and other proprietary information *were* integral to TAXPAYER’S operations. Contrary to TAXPAYER’S argument, the evidence establishes that TAXPAYER’S foreign royalty income was business income.

V. Whether The Department Properly Reduced The Foreign Dividend Deduction From 100% To 85% For Tax Years 1989 and 1990

Section 203 of the IITA defines a corporation's base income as its [federal] taxable income as modified by certain additions and subtractions thereto. 35 **ILCS** 5/203(a). One of the deductions to be taken from a corporation's taxable income is:

> An amount equal to: (i) 85% for taxable years ending on or before December 31, 1992, or, a percentage equal to the percentage allowable under Section 243(a)(1) of the Internal Revenue Code of 1986 for taxable years ending after December 31, 1992 of the amount by which dividends included in taxable income and received from a corporation that is not created or organized under the laws of the United States or any state or political subdivision thereof, including, for taxable years ending on or after December 31, 1988, dividends received or deemed received or paid or deemed paid under Sections 951 through 964 of the Internal Revenue Code, exceed the amount of the modification provided under subparagraph (G) of paragraph (2) of this subsection (b) which is related to dividends; plus (ii) 100% of the amount by which dividends, included in taxable income and received, including, for taxable years ending on or after December 31, 1988, dividends received or deemed received or paid or deemed paid under Sections 951 through 964 of the Internal Revenue Code, from any corporation specified in clause (i)

> that would but for the provisions of Section 1504(b)(3) of the Internal Revenue Code be treated as a member of the affiliated group which includes the dividend recipient, exceed the amount of the modification provided under subparagraph (G) of subsection (b) which is related to such dividends;

35 **ILCS** 5/203(b)(2)(*O*). Section 203(b)(2)(*O*) provides for a 100% deduction from taxable income for dividends a corporation receives from a foreign subsidiary in which the corporation owns more than an 80% interest, and it provides for an 85% deduction for dividends a corporation receives from a foreign subsidiary in which the corporation owns less than an 80% interest. *See* Department's Brief, p. 40.

In its brief, TAXPAYER argues the 15% of foreign dividends it received from foreign subsidiaries in which it owned less than an 80% interest cannot be included in TAXPAYER'S unitary business income because the Department never determined TAXPAYER was engaged in a unitary business with the foreign subsidiaries who paid the dividends at issue. TAXPAYER'S Brief, p. 19.

TAXPAYER'S argument is flawed, for two reasons. The first reason is that Illinois law clearly provides that all income is presumed business income unless clearly classifiable as nonbusiness income. Dover Corp. v. Department of Revenue, 271 Ill. App. 3d at 712, 648 N.E.2d at 1097; 86 Ill. Admin. Code § 100.3010(a). A TAXPAYER has the burden of establishing that a particular item of income is nonbusiness income. Dover, *supra*. The second reason TAXPAYER'S argument is unpersuasive is because the United States Supreme Court has held that a payor of income need not be unitary with the payee for the income to be considered apportionable business income. Allied Signal v. Director, Division of Taxation, 504 U.S. 768, 787, 112 S.Ct. 2251, 2263, 119 L.Ed. 2d 533, 552 (1992) ("What is required instead is that the capital transaction serve an operational rather than an investment function.").

The Illinois General Assembly made a policy decision to include within a corporation's Illinois base income subject to apportionment a fractional amount of the foreign dividends at issue. 35 **ILCS** 5/203(b)(2)(*O*). TAXPAYER introduced no evidence at hearing to show the percentage of dividends at issue served only an investment function (*see* Allied Signal, 504 U.S. at 787, 112 S.Ct. at 2263, 119 L.Ed. 2d at 552), or were derived from unrelated business activities which constituted discrete business enterprises. F.W. Woolworth Co. v. New Mexico, 458 U.S. 354, 362, 102 S.Ct. 3128, 3134 (1982). TAXPAYER’S books and records, instead, show TAXPAYER acquired interests in foreign businesses intending to expand, globally, the operations of its diversified manufacturing businesses. *See, e.g.*, Stip. Ex. No. 22, TAXPAYER’S 1987 Annual Report, p. 21; Stip. Ex. No. 162, TAXPAYER’S 1982 Annual Report, p. 1. I conclude TAXPAYER has not rebutted the *prima facie* correctness of tax proposed based on the Department's adjustment of the dividend deductions.

VI. Whether The Department Properly Issued A Notice Of Deficiency To TAXPAYER Biomedical For Tax Year Ending 9/30/89

TAXPAYER introduced no facts to support its claim that the NOD issued to TAXPAYER-Bio was improper, and it abandoned the issue in its briefs. I conclude TAXPAYER has not rebutted the *prima facie* correctness of the NOD issued against TAXPAYER-Bio.

VII. Whether The Assessment Of A § 1005 Penalty Was Appropriate For The Audit Years 1987 Through 1990

TAXPAYER introduced no evidence to show it had reasonable cause to believe POG was not unitary with TAXPAYER, or that the various types of income at issue were nonbusiness income. For years prior to the audits, TAXPAYER had stated that oil and gas operations were part of TAXPAYER'S business of manufacturing chemicals. *See, e.g.*, Stip. Ex. No. 161, TAXPAYER'S 1981 Annual Report, p. 6; Stip. Ex. No. 163, TAXPAYER'S 1984 Annual Report, p. 16. The evidence also establishes POG's operations were functionally integrated with those of TAXPAYER, under TAXPAYER'S centralized management of its diversified chemical manufacturing business. *See, e.g.*, Stip. Ex. No. 26, *passim*. The record contains no evidence showing TAXPAYER had reasonable cause to claim the operations of POG were separate and discrete from those of TAXPAYER.

TAXPAYER may have had reasonable cause to claim that the Department's calculation of Illinois throwback sales was incorrect, but it failed to introduce any evidence of such cause at hearing.

Regarding the business income issues, the Illinois appellate court recently found that a TAXPAYER showed no evidence of reasonable cause when it ignored the National Realty court's decade-old ruling that income earned from the disposition of property which was an integral part of a TAXPAYER’S business was business income. Kroger Co. v. Department of Revenue, 284 Ill. App. 3d at 479-82, 673 N.E.2d at 714. Here, TAXPAYER regularly licensed intellectual property it researched, developed and used in its own businesses. TAXPAYER acquired and used the assets it sold to Marathon in its oil and gas operations, and TAXPAYER also regularly sought to purchase and sell businesses, and/or interests therein. No ordinary business care or prudence is shown when TAXPAYER ignores the nature, scope and regularity of its own business transactions. TAXPAYER introduced no evidence, and only argument, of reasonable cause in these matters. I conclude the penalties proposed should be assessed for both audit periods.

I recommend the Director finalize the NOD's as issued.

___________	______________________
Date	Administrative Law Judge