ILLINOIS INDEPENDENT

TAX TRIBUNAL

INNOPHOS HOLDINGS INC., Petitioner,	)	
v.	)	14 TT 214
	)	Chief Judge James M. Conway
ILLINOIS DEPARTMENT OF REVENUE, Respondent.	)	

ORDER ON PARTIAL SUMMARY JUDGMENT MOTIONS ON COUNTS I, II, and IV of the PETITION

Innophos Holdings, Inc. is challenging income tax notices of deficiencies issued by the Department for tax years 2009 and 2010. According to the Department, it issued the notices following an audit because it determined that Innophos failed to include in its Illinois sales factor formula certain sales made to purchasers in states where the purchasers were not taxable, otherwise known as "throwback sales," pursuant to 35 ILCS 5/304(a)(3)(B)(ii).

In Count I of its Petition, Innophos contends that a 2013 amendment to Illinois' alternative allocation and apportionment statute, 35 ILCS 5/304(f), precluded the Department from making an automatic adjustment of including throwback sales in Innophos' sales factor formula.

In Count II of the Petition, Innophos argues that before the Department can add throwback sales into a taxpayer's sales factor formula, it bears the burden of proving that adding such sales reflects the Illinois market for the taxpayer's goods, based on its reading of the § 304(f) amendment.

In Count IV of the Petition, Innophos additionally argues that, in the alternative, if throwback sales are to be included in its sales factor formula, it was

deprived of due process as the 2013 amendment to § 304(f) was made retroactive to tax years ending after December 31, 2008. Because the amendment was made several years after the tax returns for 2009 and 2010 were filed, Innophos claims it was impossible to petition for alternative apportionment relief at the time the returns were filed.

The Department, in turn, argues the addition of throwback sales is automatic and nothing in the 2013 amendment to the alternative apportionment statute changed that requirement; the burden of proof does not shift to the Department when it adds throwback sales into a taxpayer's sales formula; and Innophos had the opportunity to apply for alternative apportionment if it so chose.

As explained below, Innophos' partial summary judgment motion is denied and the Department's partial summary judgment motion is granted.

1. Background

Illinois Income Apportionment

Non-residents of Illinois must calculate business income allocable to Illinois by multiplying overall business income by a fraction, the numerator of which is the total sales of the person in this State and the denominator of which is the total sales of the person everywhere during the taxable year. 35 ILCS 5/304(a) and (h).[1] Different rules apply to determine whether certain sales are "in this State" or otherwise includable in the sales numerator depending on the type of property which is being sold. Innophos' sales at issue in this matter are sales of tangible personal property.

> Sales of tangible personal property are "in this State" if:
>
> (i) The property is delivered or shipped to a purchaser…within this State regardless of the f.o.b. point or other condition of the sale; or
>
> (ii) The property is shipped from an office, store, warehouse, factory or other place of storage in this State

[1] Prior to 2000, Illinois included property and payroll factors, along with sales factors, to apportion business income to Illinois.

> and …the purchaser is not taxable in the state of the purchaser.

35 ILCS 5/304(a)(3)(B)(i) and (ii).

The type of sales referred to in § 304(a)(3)(B)(ii) is commonly referred to as "throwback sales." The intent of throwing sales back into the Illinois sales factor numerator is to have 100% of a taxpayer's income taxable by states having the jurisdiction to do so.[2] The inclusion of throwback sales has been a settled point of law in Illinois for decades. The Illinois Appellate Court has upheld the application of the throwback sales statute, including sales occurring as far back as the 1980s, as sales "in this State" in a series of cases dating from 1995 through 1999.[3]

Alternative Apportionment

35 ILCS 5/304(f) provides relief to taxpayers who believe the operative allocation and apportionment provisions of § 304 are unfair when particularly applied to that taxpayer's business:

> **(f) Alternative Allocation.** If the allocation and apportionment provisions of subsections (a) through (e) and of subsection (h) **do not, for taxable years ending before December 31, 2008, fairly represent the extent of the business activity in this State, or, for taxable years ending on or after December 31, 2008, fairly represent the market for the person's goods, services, or other sources of business income**, the person may petition for, or the Director may, without a petition, permit or require, in respect of all or any of the person's business activity, if reasonable:
>
> (1) Separate accounting;
>
> (2) The exclusion of any one or more factors;
>
> (3) The inclusion of one or more additional factors which will fairly represent the person's business activities or market in this State; or
>
> (4) The employment of any other method to effectuate an equitable allocation and apportionment of the person's business income. (emphasis added).

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[2] Having 100% of a taxpayer's income, and no more or no less, taxed by states having jurisdiction to tax it is an oft-cited goal of state apportionment formulas. *See, e.g.*, *GTE Automatic Electric, Inc. v. Allphin*, 68 Ill. 2d 326, 335 (1977).

[3] *Dover Corp. v. Dept. of Revenue*, 271 Ill. App. 3d (1st Dist. 1995); *Beatrice Cos, Inc. v Whitley*, 292 Ill. App. 3d 532 (1st Dist. 1997); and *Hartmarx Corp. and Subsidiaries v. Bower*, 309 Ill. App. 3d 959 (1st Dist. 1999).

Innopohos

Innophos, Inc. is an international manufacturer of specialty phosphates which are used in food, pharmaceutical and industrial markets. Its headquarters are in Cranberry, New Jersey and it has manufacturing facilities in several states and other countries. In addition to several manufacturing plants in Illinois, it has a distribution center in Chicago Heights, Illinois. Innophos ships product from that distribution center to 41 other states and to other countries.

The Illinois Department of Revenue audited Innophos for tax years 2009 and 2010. The Department determined that Innophos failed to include throwback sales in its sales factor numerator for each of the years under audit. Its findings resulted in notices of deficiencies being issued to Innophos for tax years 2009 and 2010 assessing a total of $2,532,130 in tax, interest, and penalties. The findings contained in those notices are deemed to be *prima facie* correct and are *prima facie* evidence that the amount of tax and penalties due is correct. 35 ILCS 5/904(a). At this juncture in the proceedings, it is Innophos' burden to come forward with clear and convincing evidence as to why the throwback sales should be excluded from its sales factor numerator in each year. *See Copilevitz v. Dep't of Revenue*, 41 Ill. 2d. 154, 156-157 (1968).

2. Analysis

Summary judgment is proper when "the pleadings, depositions and admissions on file, together with affidavits, if any, show there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." *Performance Marketing Association, Inc. v Hamer*, 2013 IL 11496, ¶12 (2013) (quoting 735 ILCS 5/2-1005(c)(2010)). In the present case, the parties have filed cross-motions for partial summary judgment on Counts I, II and IV of the Petition. When both parties file cross-motions for summary judgment, they agree that no material facts are in dispute and invite a decision as a matter of law. *Irwin Indus. Tool Co. v. Ill. Dep't. of Revenue*, 238 Ill. 2d 332, 340 (2010).

A. The Department was entitled to add throwback sales to Innophos' sales factor numerator.

In 2013, the Illinois legislature amended its alternative apportionment statute, 35 ILCS 5/304(f), through the passage of Public Act 098-0478, to be effective retroactively to tax years ending on or after December 31, 2008. Prior to that law,

alternative apportionment was available to calculate Illinois business income only if applying the statutory formula of apportionment under 35 ILCS 5/304 did not fairly represent "the extent of business activity in this State." Following Public Act 098-0478, the focus was changed from being the taxpayer's business activity in this State to being "…the market for the person's goods, services, or other sources of business income."

Innophos' argument is that the amendment to § 304(f) cannot be reconciled to the automatic inclusion of throwback sales under § 304(a)(3)(B)(ii) under a "harmonious reconciliation" of those statutes and that adding throwback sales results in "inflating the Illinois market by the addition of non-Illinois sales to the sales factor numerator." Pet. Motion at 11.

The Department counters that the amendment to § 304(f) does not preclude the automatic inclusion of throwback sales, the amendment was made to conform the alternative apportionment statute to more closely align with Illinois' move to market-based apportionment for sales of intangible property and services, and that the Petitioner's reading of § 304(a)(3)(B)(ii) and § 304(f) violates basic statutory interpretation.

Statutory Interpretation

"The fundamental rule of statutory interpretation is to determine and give effect to the intent of the legislature, and the statutory language is the best indicator of the legislature's intent." *Quality Saw & Seal, Inc. v. Illinois Commerce Comm'n,* 374 Ill. App. 3d 776, 781, (2nd District 2007). "The best indication of legislative intent is the statutory language, given its plain and ordinary meaning." *Andrews v. Kowa Printing Corp.*, 217 Ill. 2d 101,106 (2005). "Where the language is clear and unambiguous, we must apply the statute without resort to further aids of statutory construction." *Id.*

The present language of § 304(a)(3)(B)(ii) is clear and unambiguous:

> (B) **Sales of tangible personal property are in this State if:**
>
> (i) The property is delivered or shipped to a purchaser…within this State regardless of the f.o.b. point or other condition of the sale; or
>
> **(ii) The property is shipped from an office, store, warehouse, factory or other place of storage in this State and …the purchaser is not taxable in the state of the purchaser.** (emphasis added).

There can be no question that the Illinois legislature intended to include throwback sales under subsection (B)(ii) as Illinois sales based on the plain language of that subsection. The inclusion of throwback sales as Illinois sales is automatic. The plain language of § 304(a)(3)(B)(ii) remained unchanged following the 2013 amendment to 35 ILCS 5/304(f). That evinces the legislature's intent to keep § 304(a)(3)(B)(ii) as existing law.

Another tenet of statutory construction is that "Statutory provisions should be read in concert and harmonized." *Hartney Fuel Oil Co. v Hamer*, 2013 IL 115130, ¶ 25 (citing *People v. Rinehart*, 2012 IL 111719, ¶ 26). But Innophos argues that the language in the amendment to § 304(f) cannot be reconciled with the automatic inclusion of throwback sales under § 304(a)(3)(B)(ii) as throwback sales cannot automatically be considered part of the Illinois "market" for Innophos' sales. Pet. Motion at 11. Its conclusion is based on an unsupported interpretation of the meaning of the language in the amendment to § 304(f) and the term "market."

Prior to the enactment of Public Act 098-0478 in 2013, alternative apportionment was allowed when the regular allocation and apportionment provisions of § 304 did not fairly represent the taxpayer's business activities in Illinois. Public Act 098-0478 shifted the focus under § 304(f) to when the regular allocation and apportionment provisions did not fairly represent the market for the taxpayer's goods, services, or other sources of business income.[4] As the Department points out, Public Act 098-0478 was enacted following a shift in Illinois to assigning sales relating to intangible property and the sales of services to market-based sourcing rules from a costs of performance methodology. Dept. Motion at 16, 25-33. For example, in 2008, Public Act 095-0233 added a market-based approach of sourcing for sales of certain intangible property and services.

Under a costs of performance analysis, sales are assigned to the state in which the income-producing activity is performed.[5] The analysis is for sales "other than sales of tangible personal property." UDIPTA Section 17. In other words, costs of performance sourcing rules apply to the sales of intangible property, goods

[4] In attempting to use § 304(f), a taxpayer must first determine sales under the normal apportionment rules of § 304, including subsection (B)(ii) for sales of tangible personal property, before trying to determine and calculate an alternative method.

[5] Costs of performance analysis to determine the sourcing of sales has its genesis under the Multistate Tax Commission's Uniform Division of Income for Tax Purposes (UDIPTA) Section 17. Illinois is not a member of the Multistate Tax Compact and is not a state which currently follows UDIPTA in lockstep.

and service, but not to sales of tangible property. As difficulties arose in attempting to quantify and assign costs associated with sales of intangible property, goods, and services, along with other perceived problem in using a costs of performance analysis, many states moved to apply market-based sourcing rules to the sales of intangible property, goods, and services. Market-based sourcing rules generally assign sales for intangible property, goods, and services to the state where the benefit is received, which is generally where the customer is located. [6]

The language of Public Act 098-0478 which amended § 304(f) changed the focus of alternative apportionment from a taxpayer's business activities in Illinois to the Illinois market for a taxpayer's goods, services, or other business income. The use of the term "market," while added to § 304(f) to account for market-based sales of intangible property and services, applies to Illinois sales of tangible property as well.

Prior to Public Act 098-0478, Illinois defined sales of tangible personal property to be "in this State" to be property "(i) delivered or shipped to a purchaser…within this State…" and throwback sales. § 304(a)(3)(B)(i) and (ii). Those two types of sales define the scope of the Illinois market for a taxpayer's sales of tangible personal property as well as defining the scope of a taxpayer's business activity within Illinois as those two types of sales were specifically defined as "sales within this State" by the Illinois Legislature.

The language of § 304(a)(3)(B) was not changed after Public Act 098-0478 became law which reflects the Legislature's intent to continue to include throwback sales as sales within this State and to include throwback sales as part of a taxpayer's Illinois market. Contrary to Innophos' assertion that adding throwback sales results in "inflating the Illinois market by the addition of non-Illinois sales to the sales factor numerator," adding throwback sales of tangible personal property results in defining the Illinois market for the sales of tangible personal property by the addition of throwback sales, defined to be Illinois in-state sales, to sales where the customers are located in Illinois to arrive at the overall Illinois sales factor numerator.

There is nothing inconsistent between the statutory language of § 304(a)(3)(B)(ii) which includes throwback sales as sales within this State and the 2013 amendment to the alternative apportionment statute subsection of § 304(f)

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[6] For an overview of moving from a Costs of Performance to a Market-Based Sourcing Analysis see Battin, Eberle, and LaCava, *Demystifying the Sales Factor: Costs of Performance* and *Demystifying the Sales Factor: Market-Based Sourcing*, Tax Analysts State Tax Notes, pp. 153-159 (Jan. 2014) and pp. 403-408 (May 2014), respectively.

which looks to the Illinois market for a fair representation of a taxpayer's business. Accordingly, the clear and unambiguous language of both subsections of § 304 can be read in harmony. *Hartney*, at ¶ 249. [7] Innophos' strained reading of § 304(f), which would result in the automatic exclusion of throwback sales from being defined as sales within this State and render § 304(a)(3)(B)(ii) superfluous and void, is rejected.

B. The burden of proof remains with Innophos to prove it is entitled to alternative apportionment

Innophos also takes aim at the burden of proof standard when either the taxpayer or the Department proposes alternative apportionment. That standard is set out at 86 Ill. Admin. Code § 100.3390. That regulation states, in part:

> c) Burden of Proof. A departure from the required apportionment method is allowed only where such methods do not accurately and fairly reflect business activity in Illinois. An alternative apportionment method may not be invoked, either by the Director or by a taxpayer, merely because it reaches a different apportionment percentage than the required statutory formula. However, if the application of the statutory formula will lead to a grossly distorted result in a particular case, a fair and accurate alternative method is appropriate. The party (the Director or the taxpayer) seeking to utilize an alternative apportionment method has the burden or going forward with the evidence and proving by clear and cogent evidence that the statutory formula results in the taxation of extraterritorial values

[7] Because the statutory language is clear, there is no need to resort to other aids of construction such as examining the legislative history of the statute. *People ex rel. Baker v. Cowlin*, 154 Ill. App. 2d 193, 196 (1992). Both Innophos and the Department provide a history of the Illinois' sales factor apportionment and the alternative apportionment statute sub-sections in their motions as support for their respective positions. In its recounting of steps leading up to the enactment of Public Act 98-0478, Innophos refers to a "2013 Spring Legislative Agenda" publication put out by the Department as support for its position that its tax returns are correct as filed and that throwback sales should be excluded from its sales factor formula, Pet. Motion at 5, and the Department addressed that argument. Dept. Motion at 15-18. Even if the language of Public Act 98-0478 was ambiguous which would allow this Tribunal to resort to examining the legislative history of the statute, an argument premised on a Department's informal summary statement, such as the "2013 Spring Legislative Agenda," would be rejected as being irrelevant as that document is not part of the legislative record for Public Act 98-0478.

> and operates unreasonably and arbitrarily in attributing to Illinois a percentage of income which is out of all proportion to the business transacted in this State. In addition, the party seeking to use an alternative apportionment formula must go forward with the evidence and prove that the proposed alternative apportionment method fairly and accurately apportions income to Illinois based upon business activity in this State.

Innophos argues that if throwback sales are to be included in its sales factor numerator, the burden of proof should be shifted from itself to the Department to prove that the inclusion of throwback sales will "fairly represent the market for the person's goods in Illinois." Pet. Motion at 12-14. The argument, however, fails to recognize that the inclusion of throwback sales as sales within this State is automatic under the normal apportionment rules of § 304(a)(3)(B)(ii). It is not the Department who needs to make an alternative apportionment argument to include those sales. The inclusion of throwback sales through the Department's audit was by applying the normal apportionment rules, not the alternative apportionment rule under § 304(f). It is incumbent upon a taxpayer, once the normal allocation and apportionment provisions are made to its income, to petition the Department in order to seek approval to use an alternative methodology if it so chooses.

C. Innophos is not entitled to alternative apportionment relief

In Count IV of the Petition, Innophos argues, in the alternative, that it should be entitled to alternative apportionment relief because the retroactive effect of Public Act 98-0478, passed in 2013 and effective for tax years ending on or after December 31, 2008, made it impossible for Innophos to have requested alternative apportionment at the time it filed its original returns for tax years 2009 and 2010, which, effectively denies Innophos "Due Process." Pet. Motion at 14-16.

The procedures to apply for alternative apportionment are laid out in the Illinois income tax regulations at 86 Ill. Admin. Code § 100.3390.[8] That regulation includes, among other things, when a petition must be filed. § 100.3390(e) states:

[8] The language of § 100.3390 has remained unchanged from prior to the enactment of Public Act 98-0478.

e) Timely Filed Petitions. A taxpayer petition for use of a separate accounting method or any other alternative apportionment method will not be considered by the Director unless such petition has been timely filed. A taxpayer who petitions the Director for an alternative apportionment formula does so subject to the Department's right to verify, by audit of the taxpayer's return and supporting books and records within the applicable statute of limitations, the facts submitted as the basis of the petition. A petition for alternative allocation or apportionment is timely filed if the petition is filed:

1) 120 days prior to the due date of the tax return (including extensions) for which permission to use such alternative method is sought. A taxpayer who does not petition more than 120 days prior to the due date of the original return must file the return and pay tax according to the statutorily approved allocation or apportionment method.

2) as an attachment to a return amending an original return which was filed using the statutory allocation and apportionment rules. A taxpayer who has not filed a petition for alternative apportionment under subsection (e)(1) above, or whose subsection (e)(1) petition has been rejected, may thereafter file such petition with an amended return and the Department will consider the petition along with any other issues raised in the claim for refund pursuant to the procedures set forth at Section 100.9110 of this Part.

3) as part of a protest to a notice of deficiency issued as a result of the audit of the taxpayer's return and supporting books and records; provided that the audit adjustments being protested result in the need for the petition for alternative apportionment. Alternative apportionment may not be raised in a protest to a notice of deficiency if such petition could have been submitted under subsection (e)(1) or (e)(2) above (i.e., the petition for an alternative apportionment formula is not necessitated by the proposed adjustments made to the taxpayer's return during the course of the audit).

At the time it filed its 2009 and 2010 Illinois income tax returns, Innophos did not include throwback sales in its sales factor numerator despite being required to do so under § 304(a)(3)(B)(ii). Had it done so, it could have petitioned the Department for alternative apportionment treatment under § 304(f) if it determined the statutory formula required under § 304(a) through (e) led to a "grossly distortive" result of its business activity in this State. § 100.3390(c). Throwback sales of tangible personal property were properly includable as a reflection of

Innophos' business activity in Illinois, both before and after the 2013 amendment of § 304(f), as part of Innophos' calculation under § 304(a)(3)(B). The § 304(f) amendment did not prevent Innophos from including throwback sales in its sales formula at the time it filed its tax returns and then requesting alternative apportionment prior to the § 304(f) amendment being enacted. Similarly, Innophos could have filed amended returns after the filing of its original returns requesting alternative apportionment.[9] Innophos was eligible to file for alternative apportionment either under subsection § 100.3390 (e)(1) or (e)(2), but failed to do so within the proscribed time limits.

Under § 100.3390(e)(3), taxpayers may petition for use of an alternative apportionment method as part of a protest to a notice of deficiency "provided that the audit adjustments being protested result in the need for the petition for alternative apportionment." The Department argues that the Petitioner's claim for a need for alternative apportionment is based on Innophos' reading of Public Act 98-0478, and not based on the underlying audit of Innophos. Dept.'s Motion at 46. However, as explained above, Public Act 98-0478 had nothing to do with the inclusion of throwback sales as part of Innophos' audit, something the Department readily admits throughout the rest of its arguments. However, that does not mean that Innophos is automatically entitled to alternative apportionment. The burden remains on Innophos to explain why the regular apportionment methodology "grossly distorts" as opposed to being a fair representation of its Illinois market for sales before it can resort to requesting alternative apportionment.

Innophos' flawed conclusion is that including throwback sales in the sales numerator is inherently distortive "….in every instance…" by inflating the Illinois market by the addition of non-Illinois sales. Pet. Motion at 11. That is a non-sequitur. As discussed above, throwback sales are sales within this State by operation of § 304(a)(3)(B)(ii) and are not excludable non-Illinois sales. It is axiomatic that the addition of any throwback sales will quantifiably increase a taxpayer's in-state sales. That fact, alone, does not automatically result, as Innophos argues in its summary judgment motion, in "a grossly distortive" result in calculating a taxpayer's Illinois sales factor and the Illinois market for sales that would allow for alternative apportionment under § 100.3390(a). Moreover, Innophos has failed to advance any proposed methodology or made any offer of proof of facts to suggest that an alternative apportionment is reasonable and appropriate in recognizing Innophos' Illinois in-state sales after its throwback sales are properly

[9] According to the Department, an amended return could have been filed six months after the issuance of the Notice of Deficiency in this case. Dept's. Motion at 45, fn.11.

included in its sales factor. Innophos' request for alternative apportionment, in the absence of such proof, is rejected.[10]

Conclusion

Innophos was required to include throwback sales into its sales factor numerator for tax years 2009 and 2010. It failed to do so in a timely manner and its current request for alternative apportionment is unsupported. Innophos' Motion for Partial Summary Judgment on Counts I, II, and IV of the Petition is DENIED and the Department's Motion for Summary Judgment on those Counts is GRANTED.

s/ *James Conway*
JAMES M.CONWAY
Chief Administrative
Law Judge

Date: November 17, 2015

[10] The Department also claims that the Tax Tribunal does not have jurisdiction to entertain and review any petition for alternative apportionment because the Tax Tribunal statute, 35 ILCS 1010/1 *et seq*. (2014), does not specifically grant the Tribunal authority to review such petitions and that petitions are exclusively reviewable by the Director of the Illinois Department of Revenue pursuant to § 100.3390. The Petitioner points out that if it had paid the tax in dispute and filed a Protest Monies Act case, the Circuit Court would have the ability to address such an issue as a refund case. Pet. Motion at 16. That issue does not need to resolved today as Innophos has not made a case for alternative apportionment.