

ST 00-7

Tax Type: Sales Tax

Issue: Machinery & Equipment Exemption – Manufacturing

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

**DEPARTMENT OF REVENUE
STATE OF ILLINOIS**

v.

“ABC FILM COATING COMPANY”

Taxpayer

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0000-0000

NTL #SF-9700000000000

Mimi Brin

Administrative Law Judge

RECOMMENDATION FOR DISPOSITION

Appearances: Thomas F. Joyce, of Bell, Boyd & Lloyd, for “ABC Film Coating Company”; James Dickett and Richard Rohner, Special Assistant Attorneys General, for the Illinois Department of Revenue

Synopsis:

This matter comes on for hearing pursuant to a timely protest and request for hearing by “ABC Film Coating Company” (“ABC” or taxpayer) regarding Notices of Tax Liability SF-9700000000000 (the “NTL”) issued by the Illinois Department of Revenue (the “Department”) for Use Tax on tangible personal property purchased by the taxpayer between January 1, 1992 through December 31, 1997 (the “Tax Period”). Pursuant to a pretrial order, the parties identified the following as the issues in this matter: whether the tangible personal property listed as exceptions on the audit for the tax years 1/1/92-12/31/95 and 1/1/96-12/31/97 are exempt from Use Tax pursuant to 35 ILCS 105 3/5(18) and 105 3/50. As a sub-issue thereunder, taxpayer questions whether in interpreting such statute and any regulation issued thereunder, the Department is

complying with the Illinois Administrative Procedure Act and the Department of Revenue Sunshine Act. Order, 3/10/99; Order, 3/23/99; 6/14 pp. 7-8¹ Following the submission of all evidence and a review of the record, it is recommended that this matter be resolved in favor of the Department on all issues. In support of this recommendation, I make the following findings of fact and conclusions of law:

Findings of Fact:

1. The Department's *prima facie* case, inclusive of all jurisdictional elements, was established by the admission into evidence of the Audit Correction and/or Determination of Tax Due, for the tax period of 1/1/92-11/30/93 (Department Gr. Ex. No. 1, p. 2), for the tax period of 12/1/93-12/31/95 (Department Gr. Ex. No. 1, p. 3) and for tax period 1/1/96-12/31/97 (Department Gr. Ex. No. 1, p. 4). However, the parties entered into a Joint Stipulation of Facts, made part of Department Ex. No. 2, that set forth the tax assessment remaining. Department Ex. No. 2, par. 1
2. "ABC" manufactures, in (suburb), highly complex multi-layer coatings on carriers (rolls of plastic film) from which the coatings are transferred onto substrates (such as onto intravenous solution bags, furniture, plastic credit cards) by its customers. Department Ex. No. 2, par. 3; Department Ex. No. 3, p. 1; 6/15 pp. 12, 17, 18, 29-30 (testimony of "Joe Doakes",)"Doakes")² Examples of the products manufactured by "ABC" include

¹ The hearing in this cause was conducted on June 14, 15 and 16, 1999. The transcript for the June 14 hearing date is cited herein as "6/14 p.", that for June 15, is cited as "6/15 p." and for June 16, I cite the transcript as 6/16 p."

² Taxpayer complains (Taxpayer Brief, pp.6-8) that Doakes' testimony should be considered in spite of the Department's objection to his testimony at hearing. 6/15 pp. 31, 36-7 The Department objected to the witness' competency to testify about specific chemicals at issue used by "ABC" prior to his employment there. 6/15 pp. 31-2 I allowed the testimony following proper foundation (6/15 pp. 38-9), saying that I

the magnetic stripe on the back of a credit card, the white signature panel on the credit card and the wood veneer covering fiber board, wood or a wood-like product. Taxpayer Exs. No. 36, 37, 38; Department Ex. No. 3; 6/15 pp. 15-16

3. The layers of product are applied to a continuous web of material, known as the “carrier”, which is discarded by the customer after it applies the multi-layer coatings it carries to another surface. Taxpayer Ex. No. 39; 6/15 pp.18-9, 87-8, 161, 163-5 Taxpayer generally uses a polyester carrier layer because of its strength characteristics. 6/15 pp. 163, 192-3
4. Leslie Carlson, a Department auditor (hereinafter referred to as “Carlson”), conducted the audit for the period 1/1/92-12/31/95 (hereinafter referred to as “Audit 1”). 6/14 pp.14-15
5. Carlson examined taxpayer’s purchases of consumable supplies and fixed assets, and listed certain chemicals as taxable exceptions. 6/14 pp. 15-17, 29-31

would consider its value when examining the record. “Doakes”’s testimony was consistent with that of other “ABC” witnesses, and, therefore, his testimony, as well as theirs, is relied upon for my findings of facts. Thus, “ABC’s” complaint is not an issue.

Taxpayer also states in its brief that the Department failed to call a single witness, as compared to the nine witnesses it called, and thereby failed to present a rebuttal case. Taxpayer Brief, pp. 4, 34 This is not an accurate reflection of the proceedings. There was a concern expressed about recalling taxpayer’s witness, “Richard Roe”, following his examination in taxpayer’s case. Department’s counsel stated that he would exceed the scope of direct examination during his cross-examination so that “Roe” would not have to be recalled by him in rebuttal. Taxpayer agreed. 6/15 pp. 177-8 Also, taxpayer called as its witness “James Dandy”, who was on the Department’s witness list, not taxpayer’s list. The Department had no objection to the taxpayer calling this witness in its case, rather than calling him in rebuttal, and cross-examined him following direct examination by the taxpayer. 6/15 pp. 219-20 Taxpayer also called, in its case, the Department auditors and supervisor pertinent to this matter, as well as the chemist used by the Department to assist it in this cause. The Department conducted its examination of these witnesses following taxpayer’s direct examination, and introduced its documentary evidence admitted of record, during these cross-examinations, without objection.

6. Carlson sought direction from her supervisor and the Department's technical support office regarding whether these chemicals were taxable (6/14 pp. 17, 18-21), which, in turn, sought advice from Dr. "Benjamin Casey", the Department's consultant on chemicals (hereinafter referred to as "Casey"). 6/14 pp. 35-40, 49, 50, 51, 52 (testimony of Ray Stout, Department of Revenue, Public Service Administrator)
7. Collins spoke, at length and in detail, to a "ABC" employee, "Alan Bundy", regarding taxpayer's use of certain chemicals before he responded to the Department concerning what these chemicals did for "ABC". 6/14 pp. 86, 90
8. Subsequent to his discussions with "Bundy" at the Department's request, "Casey", in January 1996, did an experiment using a chemical (methylethylketone) on which the Department ultimately assessed use tax. 6/14 pp. 96-102, 112
9. Carlson, Ray Stout and "Casey" toured taxpayer's facility prior to the conclusion of the audit. 6/14 pp. 32, 51, 113
10. Department auditor Patricia Hoyt (hereinafter referred to as "Hoyt") conducted the audit for the period 1/1/96-12/31/97 (hereinafter referred to as "Audit 2"). 6/14 pp. 56-7
11. Hoyt examined taxpayer's purchases of consumable supplies and fixed assets and listed certain chemicals as taxable exceptions. 6/14 pp. 57-9 She followed Audit 1's list of taxable exceptions regarding the chemicals. 6/14 pp. 57, 66 (testimony of Iris Edwards, Hoyt's supervisor)

12. Taxpayer's business is centered upon very specialized, highly proprietary technology, with the technology based upon the proper combination of chemicals. 6/15 pp. 19-20, 193-4
13. Taxpayer identified the liquid chemicals at issue as "solvents" on its computer generated purchase orders. Taxpayer Gr. Ex. 28, pp.3, 4, 5; Department Ex. No. 7; 6/14 pp. 29, 61; 6/15 pp. 22-29; 6/16 pp. 6-7
14. The following liquid chemicals are at issue in this matter:
 - Methylethylketone (MEK)
 - Isopropyl acetate
 - Methyl isobutyl ketone (MIK)
 - N propyl acetate
 - Toluene
 - Ethanol (et. al.)
 - Diacetone alcohol
 - Glycol ether
 - Acetone
 - Ee/ethyl acetate
 - VMP
 - Nipar
 - N butyl acetate
 - Cleaner
 - Blend 2330
 - Methanol
 - Isopropyl alcohol
 - Trichlor
 - Cyclohexanone
 - M pyrolDepartment Ex. No. 2 (Joint Stipulation of Facts); 6/15 pp. 67-8
15. Taxpayer used MEK, isopropyl acetate, MIK, N propyl acetate, toluene, ethanol and diacetone alcohol (hereinafter referred to as the "primary chemicals") primarily in the manufacturing process and to achieve a direct and immediate effect on the property to which it is applied during that process. 6/15 pp. 41-2, 123-4, 175, 176, 198, 217 The primary use is

- basically, to deliver the pigment, inks and resins to the film layers for the production of the product. 6/15 pp. 211-12 These chemicals may not change the property to which they are applied, but they do effect them. 6/15 pp. 196, 217 (testimony of “Gomez Addams”)
16. Chemicals in the same family, i.e. acetate, ketone and alcohol, behave in similar fashion. 6/15 pp. 174-5, 199-201
 17. There was no competent testimony as to how nipar and cyclohexanone were used by the taxpayer. 6/15 p. 134
 18. Trichlor, Blend 2330 and cleaner were used for cleaning purposes and not in product manufacture. 6/15 pp.101, 134
 19. A solvent is any substance that will make a uniform solution of another substance, usually referred to as a solute. 6/14 p. 91 Although any chemical may sometimes act as a solvent in a particular situation, it may not act as a solvent in another use. 6/14 p. 92-3 Liquid chemicals, in the broadest generic terms, are sometimes referred to as “solvents”, and taxpayer does refer to the chemicals at issue as solvents. 6/14 pp. 91-92; 6/15 pp. 54, 84, 103, 149, 207, 213-14, 215, 216
 20. “ABC’s” coating chemists make technically complex decisions as to which chemicals to use on the various layers used to manufacture a product. These decisions are based upon which chemicals will effect the particular material used in the particular layer to achieve the results needed for an acceptable finished product. Taxpayer Exs. No.26, 40; 6/15 pp. 193-4, 199-207 They also include an evaluation of the proper

combination of chemicals to assure, *inter alia*, the proper appearance, performance and viscosity of the product and product flow. 6/15 p. 194, 213-15

21. Certain of the primary chemicals are necessary to prevent “mud-cracking”, a condition whereby small cracks are created on the surface of the layers of film during the drying process between applications of layers, and it is a condition which is unacceptable to the manufacture of “ABC’s” products. Taxpayer Ex. No. 26; 6/15 pp. 56-7, 62-6, 167-171
22. Certain of the primary chemicals are necessary to prevent “attacking” in the manufacturing process, whereby a proper balance must be maintained to allow the proper adherence of multiple layers of film to one another, without dissolving or otherwise effecting the underlying layers of film. This condition is unacceptable to “ABC’s” production of the tangible personal property it produces. Taxpayer Ex. No. 26; 6/15 pp. 57-8, 62-6, 171-3
23. Certain of the primary chemicals are used by “ABC” to control “cross linking”, which concerns and is essential to the proper chemical bonding between the layers of film necessary to the manufacture of its products. 6/15 pp. 59-60, 62-6, 158-161; Taxpayer Ex. No. 26
24. Certain of the primary chemicals are used to control “intercoat adhesion” which concerns and is necessary to the adherence of the layers of film coatings to each other and is critical to the manufacture of taxpayer’s products. Different chemicals are used in various combinations with

different resins, i.e. vinyl or acrylic, to achieve the required result.

Taxpayer Ex. No. 26; 6/15 pp. 60-1, 62-6, 142-57

25. The most common application of the primary chemicals was to combine them with resins or pigments to make a mixture that was used by the taxpayer to produce its products. 6/15 pp. 68, 181, 208-10 Generally, the mixtures are stored between 24 and 48 hours after mixing prior to first use, and, depending on the mixture, may be stored for later use. 6/15 pp. 68-9
26. “ABC” uses three printing presses to manufacture its products, with 38 coating stations which include twelve coating lines, with each coating line consisting of one or two coating stations and one or two drying ovens, which operate to put down a single layer of film and dry or cure it, before the product goes on to the next step in the process on a different “piece of equipment”. Department Ex. No. 3; 6/15 pp. 77, 78-80, 105
27. None of the chemicals at issue are acids. 6/15 pp. 95, 210
28. Some of the chemicals at issue can corrode surfaces, although they are not, generally, thought of as being corrosive. 6/15 pp. 95, 211
29. None of the liquid chemicals at issue were purchased with any pigment, resin, lacquer, dye or additive contained in them, rather, they are added to these to create mixtures. 6/15 pp. 107, 179, 180-1
30. “ABC” may use the chemicals at issue to either dissolve resins or provide assistance in keeping certain resins dispersed. 6/15 pp. 169-70, 208

31. None of the chemicals at issue became part of the final product sold to customers except in negligible, trace amounts. Instead, they evaporate during the manufacturing process. 6/15 pp. 109, 218
32. Taxpayer distinguishes between “equipment”, which it depreciated using the straight-line method of accounting, and the chemicals at issue, which are considered “raw materials” and are characterized as “inventory”. Department Ex. No. 3, pp. 11, 27, 29; Department Ex. No. 10 (“ABC” record entitled ““ABC” International-Fixed Assets U.S. Operations 12/31/96”,-excludes the chemicals at issue either as fixed assets or accumulated depreciation); Department Ex. No. 11 (“ABC” International-Fixed Assets U.S. Operations, 12/31/97-excludes the chemicals at issue either as fixed assets or accumulated depreciation) 6/15 p. 115; 6/16 pp. 9-11, 17
33. Taxpayer did not include the chemicals at issue on its 1997 Illinois Department of Revenue ST-16 Annual Report of Manufacturer’s Purchase Credit Earned. Department Ex. No. 9; 6/16 pp. 9-10, 16-19
34. Some, but not all of the chemicals at issue may be recovered at the end of the manufacturing process in their mixed states, and, as such, may then be used for cleaning purposes. 6/15 pp. 122-3 A less expensive cleaning solvent could be purchased from a third party, who extracted a mixture following other processes, and who sells these extracted mixtures at a discount. 6/15 p. 123

35. If the primary chemicals are not recaptured and recycled at the end of the manufacturing process, they are discarded. 6/15 p. 124

Conclusions of Law:

The Use Tax Act (35 ILCS 105/1 *et seq.*) (the “UT” or “UTA”) imposes a tax upon the privilege of using, in Illinois, tangible personal property purchased at retail from a retailer. The UTA also provides for exemptions from the imposition of the tax, with the exemption pertinent hereto being the manufacturing and assembly exemption (“MM&E”) Id. at 105/3-50

The MM&E exemption addresses, *inter alia*, machinery and equipment used primarily in the manufacturing of tangible personal property for wholesale, retail sale or for lease. Id.; 35 ILCS 105/3-5(18) The UTA defines certain terms as follows:

- (1) ‘Manufacturing process’ means the production of an article of tangible personal property, whether the article is a finished product or an article for use in the process of manufacturing or assembling a different article of tangible personal property, by a procedure commonly regarded as manufacturing, processing, fabricating, or refining that changes some existing material into a material with a different form, use, or name.

XXXXXXXXXXXXXX

- (3) ‘Machinery’ means major mechanical machines or major components of those machines contributing to a manufacturing or assembling process.
- (4) ‘Equipment’ includes an independent device or tool separate from machinery but essential to an integrated manufacturing or assembly process...; any subunit or assembly comprising a component of any machinery or auxiliary, adjunct, or attachment parts of machinery, such as tools, dies, jigs, fixtures, patterns, and molds, and any parts that require periodic replacement in the course of normal operation; but does not include hand tools.

35 ILCS 105/3-50

The Department has promulgated regulations in furtherance of these statutory provisions. 86 Ill. Admin. Code, ch. I, section 130.330 represents the Department's regulatory enactment of the statutory provisions cited above. The regulation essentially reiterates the statute's definition of machinery. As for equipment, the regulation parrots the statute and adds that equipment does not include "supplies (such as rags, sweeping or cleaning compounds), coolants, lubricants, adhesives, or solvents, items of personal apparel (such as gloves, shoes, glasses, goggles, coveralls, aprons, masks, mask air filters, belts, harnesses, or holsters), coal, fuel oil, electricity, natural gas, artificial gas, steam, refrigerants or water." Id. at 130.330 (c)(3)

The parties agree that "ABC's" process of creating the coated film products is manufacturing. They also agree that the primary chemicals assessed are used primarily in that process. The Department contends that the chemicals are neither machinery nor qualifying equipment. Conversely, taxpayer advises that the Department's position appears to be that chemicals, as a class, are excluded from consideration under this exemption. It proffers that this position is legally incorrect as the Department should consider this exemption by conducting on a case by case analysis of how particular chemicals are used by a taxpayer. In addition, "ABC" argues that the chemicals at issue are devices or component subunits or assemblies defined by statute as exempt equipment.

I need not make a decision as to whether the Department correctly classifies these chemicals as solvents or otherwise precludes chemicals as a class from the MM&E exemption. As I discuss in this recommendation,³ the present liability follows a multi-layered analysis by Department agents of the MM&E statute, regulation, ruling letters as

³ See discussion beginning at p. 30.

well as a consideration of this taxpayer's actual use of these chemicals in its operations. These actions alone act to belie these assertions. Thus, what is at issue in this matter is whether the specific chemicals at issue are exempt from the imposition of the use tax under the MM&E exemption.

I. INTERPRETATION OF STATUTORY LANGUAGE

I begin my analysis in this cause by determining whether the words of the statute, and the Department's interpretation of them, highlighted by its regulations, allow for the exclusion of the chemicals at issue from exemption as MM&E. As noted by the language of the statute, cited above, although the words "device" and "component subunit" or "assembly" define "equipment", these words, themselves, are not defined. In order to decide this matter, it is necessary to determine if the legislature intended this language to include, as exempt from the imposition of the UT under this specific statute, chemicals which, *inter alia*, have a direct and immediate effect upon tangible personal property during the manufacturing process but are not incorporated into the products produced.

In Illinois, it is fundamental that "[a]dministrative regulations have the force and effect of law and must be construed under the standards governing the construction of statutes." Medcat Leasing Co. v. Whitley, 253 Ill. App.3d 801, 803 (4th Dist. 1993) (citing Union Electric Co. v. Department of Revenue, 136 Ill.2d 385, 391 (1990); Craftsmasters v. Department of Revenue, 269 Ill. App.3d 934 (4th Dist. 1994) As with statutes, these regulations enjoy a presumption of validity. Medcat Leasing Co. at *id.* Courts afford "substantial deference to an administrative agency's interpretation of a statute which the agency administers and enforces" (National School Bus Service, Inc. v.

Department of Revenue, 302 Ill. App.3d 820, 825 (1st Dist. 1998)) as decisions regarding regulations are based upon the agency's experience and expertise. Id. (citations omitted) Further, an agency's interpretation of a statute is a source for ascertaining legislative intent, although not binding on courts. Medcat Leasing Co., supra Rules and regulations promulgated pursuant to legislative authority should be set aside only when they are clearly arbitrary, capricious or unreasonable. Acker v. Illinois Department of Revenue, 116 Ill. App.3d 1080 (1st Dist. 1983)

In Illinois, it is fundamental that in interpreting a statute, it is necessary to ascertain the intent of the legislature and give it effect. Illinois Department of Revenue v. Country Gardens, Inc., 145 Ill. App.3d 49 (5th Dist. 1986) This legislative intent is determined, primarily, through a consideration of the statutory language. Id. The words of a statute are given their plain, ordinary, and accepted meaning, "grounded on the nature, object, and consequences that would result from construing it one way or another." Pedigo v. Johnson, 130 Ill. App.3d 392, 396 (4th Dist. 1985) When the language is clear and unambiguous, there is no need for further analysis. If, however, this is not the case, as in this matter, an analysis begins with an examination of the entire statute, with every part construed in connection with every other part, so as to create a harmonious whole. Department of Revenue v. Country Gardens, Inc., supra A review of the statute also must be made to determine the objective the legislature sought to accomplish. Id.

Since there is no quarrel that the primary chemicals are used in the manufacturing process, it is left to determine if they must be considered as "machinery" or "equipment" exempt from UT. The statute expressly defines machinery as being "major mechanical

machines”. 35 ILCS 105/3-50 “ABC”, in advancing its argument that words are to be given their common meaning, provides a definition (Taxpayer Brief, p. 12) of “machine” found in Webster’s Third International Dictionary (1971), that being:

‘[A]n assemblage of parts that are usu.[sic] solid bodies but include in some cases fluid bodies or electricity in conductors and that transmit forces, motion, and energy one to another in some predetermined manner and to some desired end.’ (emphasis provided by taxpayer)

Following a discussion of Webster’s meanings of “equipment”, “device” and “mechanism” taxpayer concludes that the language of the statute strongly suggests that chemicals were not meant to be excluded, as a class, from this exemption.

“ABC’s” presentation of the definitions, its argument based upon those definitions and, thus, its conclusion regarding the interpretation of the statutory language, are flawed. In 1998, the Arizona Court of Appeals in Arizona Department of Revenue v. Capitol Castings, Inc., 193 Ariz. 89 (Ariz. Tax 1998), review den. Jan. 12, 1999, addressed whether chemicals used directly in a manufacturing process were exempt from the use tax as “machinery” or “equipment”.⁴ In affirming the Arizona Department of Revenue’s taxation of the chemicals, the court reversed a prior decision regarding the same issue in the case of Cyprus Sierrita, 177 Ariz. 301 (Ariz. Tax 1994). In reversing Cyprus, the Capitol Castings court was particularly critical of Cyprus for the way it

⁴ The Arizona exemption statute provided, in pertinent part:

- B. In addition to the exemption allowed by subsection A of this section, the following categories of tangible personal property are also exempt:
 - 1. Machinery or equipment, used directly in manufacturing, processing, fabricating, job printing, refining or metallurgical operation. The terms “manufacturing”, “processing”, “fabricating”, “job printing”, “refining” and “metallurgical” as used in this paragraph refer to and include those operations commonly understood within their ordinary meaning. A.R.S. §42-1409(B)(1) (1997) (currently found at §42-5159)

analyzed the words “manufacturing” and “equipment” used in the exemption statute.

Specifically, the Capitol Castings court said that:

In equating ‘chemicals’ with ‘machinery’, the Cyprus court reasoned as follows:

‘Machinery’ is defined as ‘machines as a functioning unit.’

‘Machine’ in turn is defined as:

[a]n assemblage of parts that are usually solid bodies but include in some cases fluid bodies or electricity in conductors and that transmit forces, motion and energy one to another in some predetermined manner and to some desired end.

Capitol Castings, supra at 93

The Capitol Castings court noted that the Cyprus court neglected to cite Webster’s definition in full, and that it excluded from its citation the parenthetical examples provided in the definition, itself. In fact, as the Capitol Castings court noted, the full definition of “machine” in Webster’s dictionary, reads as follows:

an assemblage of parts that are usu. solid bodies but include in some cases fluid bodies or electricity in conductors and that transmit forces, motion, and energy one to another in some predetermined manner and to some desired end (as for sewing a seam, printing a newspaper, hoisting a load, or maintaining an electrical current) Webster’s Third New International Dictionary 1353 (1971) (emphasis added)

Capitol Castings, supra at 93-4

In ignoring the crucial examples of machine provided in the definition, the Capitol Castings court determined that the Cyprus decision took an overly broad reading of the statutory language, thus, violating the basic premise [in Arizona law] that tax exemptions must be strictly construed. Id. at 94 I note that it is, likewise, well-settled in Illinois that tax exemption provisions are strictly construed against the taxpayer and in favor of the taxing body (Telco Leasing, Inc. v. Allphin, 63 Ill.2d 305 (1976), Medcat Leasing Co., v. Whitley, supra) with the exemption claimant having to clearly prove entitlement to the exemption (United Air Lines, Inc. v. Johnson, 84 Ill.2d 446 (1981))

with all doubts being resolved in favor of taxation. Follett's Illinois Book & Supply Store, Inc. v. Isaacs, 27 Ill.2d 600 (1963)

“ABC”, herein, did exactly what the overturned Cyprus court did, in that it failed to include in its Webster’s definition of “machine” the crucial examples provided in the definition. The chemicals at issue are not solid like a sewing machine or printing press; are not used or act in a hydraulic fashion; nor do they carry electrical current. Reading the entire definition, I concur with the Capitol Castings court in that it is appropriate to conclude that the chemicals at issue do not fall within a plain and ordinary meaning of machine, so as to find exemption as machinery.

“ABC” further proffers that the word “equipment” is “so generally defined in Webster’s Third International Dictionary as to encompass chemicals.” Taxpayer Brief, p. 12 Again, the Capitol Castings court took the Cyprus court to task for its flawed interpretation of the word “equipment” by stating:

The Cyprus court took an equally broad approach in deciding that chemicals were ‘equipment.’ It began with a portion of the appropriate definition of ‘equipment’ which reads:

2a: the physical resources serving to equip a person or thing
<funds for buildings and <the vocal of a singer <a new jail
became part of the municipal—Amer. Guide Series: Va.: as
(1): the implements (as machinery or tools used in an
operation or activity: APPARATUS <where a tractor is
standard <sports (2): all the fixed assets other than land and
buildings of a business enterprise <the plant, and supplies
of the factory

Webster’s at 768 However, the court omitted the portion of the definition that is most relevant in a business setting—the ‘fixed assets’ of a business enterprise other than land and buildings. (citation omitted) The court also relied on a broad statement that ‘equipment’ and other related terms ‘can signify, in common, all the things used in a given work or useful in effecting a given end. Equipment usually covers everything except personnel needed for efficient operation of service... .’ Id. From this, the court

concluded that '[t]he chemicals fall within these common definitions of 'equipment'...' (citation omitted)

A court does not construe an exemption statute "reasonably and strictly" by interpreting its words broadly, expansively, or figuratively, or by blending selected portions of abstract definitions to achieve a desired result. Because we conclude that Cyprus applied an overbroad rule of construction and reached a clearly erroneous result, we overrule it.

Capitol Castings, *supra* at 94

Because this exemption exists for the benefit of manufacturing business enterprises in Illinois, I again agree with the Capitol Castings court in that the definition of equipment that is most appropriate in this circumstance is the one which plainly addresses the business environment, that is fixed assets, other than land and buildings. Therefore, the plain and ordinary meaning of 'equipment' used in this particular statute would not include the chemicals at issue.

"ABC" correctly advises that Webster's defines "device" as "a piece of equipment or a mechanism designed to serve a special purpose or perform a special function." Taxpayer Brief, p. 12 However, taxpayer again neglects to include the examples following this definition, those being "<a ~ for measuring heat release> <an improved steering ~>" Webster's at 618 Just as the appropriate and complete definitions of machine and equipment did not, plainly and ordinarily, include these chemicals, nor do the examples provided for the word "device" suggest an understanding to include them.

In its attempt to advance its position that a plain reading of the words machinery and equipment includes chemicals, or at least, does not preclude them, taxpayer proffers a Webster's definition of "mechanism", since that word is used as part of the dictionary definition of "device". Taxpayer is correct when it states that "mechanism", according to Webster's, speaks of "physical or chemical processes" and "a sequence of events in a

chemical reaction...” among its many definitions of this word. Taxpayer Brief, p. 12

However, the very first definition offered by Webster’s for the word “mechanism” is “a piece of machinery: a structure of working parts functioning together to produce an effect <the valve ~ to operate the valve when it is in the engine block – Joseph Heitner> <~ of a watch>” Webster’s at 1401 This definition clearly fits into a plain, ordinary and assuredly harmonious, business related understanding of the words machinery and equipment, provided by Webster’s dictionary and discussed above. In addition, I note that the word “mechanism” is not found in the pertinent Illinois statute or regulation. Thus, basing any argument regarding the analysis of statutory terms and giving them their plain and ordinary meanings does not apply to this word, and is inappropriate to this instant analysis.

After analyzing the plain and ordinary meanings of the words machinery, equipment and device, I determine that the accepted, ordinary meaning of these words within the context of this exemption statute does not include the chemicals at issue. I find further support for this position in a case determining whether a “process” was patentable under 35 U.S.C. §101.⁵ In distinguishing machines and devices from the processes of chemical actions, the United States Supreme Court in the matter of Diamond v. Diehr, 450 U.S. 175, 182, 101 S.Ct. 1048, 1954 (1981) cited the case of Corning v. Burden, 15 How. 252, 267-268 (1854), in pertinent part, for the following:

⁵ Title 35. Patents

§ 100. Definitions

(b) The term “process” means process, art or method, and includes a new use of a known process, machine, manufacture, composition of matter, or material.

§ 101. Invention patentable

Whoever invents or discovers any new and useful process, machine, manufacture, or composition of matter, or any new and useful improvement thereof, may obtain a patent therefor, subject to the conditions and requirements of this title.

“A process, eo nomine, is not made the subject of a patent in our act of congress. It is included under the general term ‘useful art.’ An art may require one or more processes or machines in order to produce a certain result or manufacture. The term machine includes every mechanical device or combination of mechanical powers and devices to perform some function and produce a certain effect or result. But where the result or effect is produced by chemical action, by the operation or application of some element or power of nature, or of one substance to another, such modes, methods, or operations are called processes. A new process is usually the result of discovery; a machine of invention. The arts of tanning, dyeing, making water-proof cloth, vulcanizing India rubber, smelting ores, and numerous others, are usually carried on by processes as distinguished from machines. One may discover a new and useful improvement in the process of tanning, dyeing, &c., irrespective of any particular form of machinery or mechanical device. And another may invent a labor-saving machine by which this operation or process may be performed, and each may be entitled to his patent. As, for instance, A has discovered that by exposing India rubber to a certain degree of heat, in mixture or connection with certain metallic salts, he can produce a valuable product, or manufacture; he is entitled to a patent for his discovery, as a process or improvement in the art, irrespective of any machine or mechanical device. B, on the contrary, may invent a new furnace or stove, or steam apparatus, by which this process may be carried on with much saving of labor, and expense of fuel; and he will be entitled to a patent for his machine, as an improvement in the art. (emphasis added)

Taxpayer used chemicals at issue in a manner that fits squarely into a “process” as explained by the Supreme Court, above. The testimony was extensive and consistent illustrating that the result or effect produced by “ABC’s” use of the primary chemicals is caused by chemical action, by the operation or application of some element or power of nature, or of one substance to another. Therefore, as concluded by the Corning court, such modes, methods, or operations constitute the art of processing, much the same as making water-proof cloth or producing a viable product by exposing India rubber to “a certain degree of heat, in mixture or connection with metallic salts.” See 6/15 p. 214

Thus, just as discussed in Corning, “ABC’s” technical processes involving the chemicals at issue are distinct from the ovens and presses into which the coated layers are placed to create the final product.

On this point, “Doakes”, taxpayer’s senior vice president of operations, and in charge of all technological and manufacturing operations (6/15 p. 11) testified at length regarding “ABC’s” use of the primary chemicals in unique and complex formulas (6/15 p. 20), with the goal being that unique selection of particular liquid chemicals that will have a positive effect and produce a viable product. 6/15 p. 51 He explained that different chemicals have different effects on the film to which they are applied (6/15 pp. 51-2) and that the experiments demonstrated by Taxpayer Ex. No. 26 are intended to illustrate how the “proper or improper selection of certain liquid chemicals can produce a product that is acceptable and a product that is unacceptable both from our [“ABC’s”] own manufacturing operations as well as for our customers and the final product use once converted by our customers.” 6/15 pp. 49-50; 127-8

“Doakes” further testified that “ABC” keeps detailed records of all chemicals it uses for “traceability back to all materials that produced final product.” 6/15 p. 44 When discussing the designation of the chemicals as solvents on taxpayer’s books and suppliers’ invoices, he referred to the formulas created by the chemicals as “the recipe”, that is, the component parts of a particular product. 6/15 p. 24 “Doakes” refers to the chemicals at issue as specialized “ingredients”, mixed with resins and pigments used to make taxpayer’s products. 6/15 pp. 68-9, 106-7 In fact, to explain the experiments articulated in Taxpayer Ex. No. 26, “Doakes” agreed that the methodology demonstrated by the experiments was similar to illustrating what happens when you use yeast in the

bread manufacturing process or use sand in its place. 6/15 p. 53 (supporting “Roe’s” use of that analogy in the narrative portion of Taxpayer Ex. No. 26) “Doakes’s” testimony makes clear that these chemicals are used by “ABC” as product ingredients in the manufacturing process. As discussed, infra,⁶ product ingredients such as those at issue herein, are exempt from use tax under another, distinct, UTA provision.

Other testimony offered by taxpayer was consistent with this. “Richard Roe” is “ABC’s” senior chemist, who manufactures formulae and quality control inks and supervises production runs and quality control products before they leave the facility. 6/15 p. 133 In his narrative describing his experiments in Taxpayer Ex. No. 26, “Roe” discusses using vinyl, acrylic or adhesive resin layers upon which various chemical mixtures were applied. In one experiment, the mixtures of toluene/ethyl methacrylate and alcohol/ethyl methacrylate exhibited poor intercoat adhesion when applied to a vinyl chloride/vinyl acetate layer, whereas the methyl ethyl ketone and isopropyl acetate ethyl methacrylate combinations had good intercoat adhesion when applied to that same layer. 6/15 p. 140-9 “Roe” also made it clear that the type of vinyl resin used is also imperative to the correct formulation of the manufactured product. For example, one type of vinyl resin correctly reacts with ethanol formula while another type reacts unacceptably with alcohol. 6/15 pp. 148-55, 166-7, 208-9, 210

To illustrate cross-linking, “Roe” explained in his narrative that resins combined with methyl ethyl ketone, toluene, ethanol and isopropyl alcohol creates a successful formula, whereas when ethanol and isopropyl alcohol are removed from as ingredients, the formula created is uncoatable because it becomes solid. 6/15 pp. 158-60

⁶ See discussion of 35 ILCS 105/2 beginning at p. 26.

“Roe’s” testimony regarding other conditions affecting “ABC’s” products, such as mud-cracking (diacetone alcohol necessary for a homogenous appearance) and attack, continued along the exact same lines, that is, the correct mixture of chemicals is necessary to prevent the condition and produce an acceptable product. 6/15 pp. 168-73

Contrary to taxpayer’s assertion (Taxpayer Brief, p. 27) that the chemicals at issue act as tools in the manufacturing process, the conclusion drawn from the extensive technical evidence presented is that the chemicals are the raw materials, or the ingredients, necessary to the successful production of the products manufactured by “ABC”, much the same as the polyester film used as the products’ carrier layer is selected because of its strength quality. The ingredients of the chemical mixtures depends upon a variety of variables and takes into consideration the ills sought to be avoided or the properties to be enhanced. As described by “Roe”, surely for purposes of the layman, the selection of chemical ingredient is similar to choosing yeast rather than sand as an ingredient in the bread manufacturing process.

Taxpayer, itself, also acknowledges that the Illinois legislature distinguishes between chemicals and machinery and equipment, as the UTA exempts farm machinery and equipment (35 **ILCS** 105/3-5(11) (enacted August 12, 1980)) and farm chemicals (35 **ILCS** 105/3-5(7) (enacted October 1, 1975)) Although taxpayer states that “if the legislature had removed the farm chemical exemption when it enacted the [broader] farm machinery and equipment exemption, it might have created an unwarranted inference with respect to farm chemicals” (Taxpayer Brief p. 14), it is more reasonable to conclude that there is a definite distinction, recognized by the legislature, between chemicals and machinery and equipment.

I also do not conclude, as taxpayer suggests, that the statutory language defining equipment must be read broadly to include the chemicals at issue in this matter. Taxpayer Brief, p. 9 Equipment is defined by the statute as including “an independent device or tool separate from machinery”; “any subunit or assembly comprising a component of any machinery or auxiliary, adjunct, or attachment parts of machinery...” “and any parts that require periodic replacement in the course of normal operation.” 35 **ILCS 105/3-50(3)**

Initially, although the statute speaks to “any” subunit or assembly and “any” parts, these terms must be read in context with the word “equipment” that they describe. As discussed, supra, Webster’s definition of equipment and device, when read in a business context as well as in conjunction with the machinery section of the exemption provision, does not lend itself to such an expansive interpretation as to include the chemicals at issue, even though they are used in the manufacturing process.

This is in contrast to the pollution control facilities exemption statute (35 **ILCS 105/2a**)⁷ addressed by the court in Beelman Truck Co. v. Cosentino, 253 Ill. App.3d 420 (5th Dist. 1993), and offered by “ABC” in its argument for an expansive reading of the MM&E provision. The Beelman court interpreted particular language in the pollution control facilities exemption, that being “any system, method, device or appliance” used

⁷ The statute reads as follows:

§2a “Pollution control facilities’ means any system, method, construction, device or appliance appurtenant thereto sold or used or intended for the primary purpose of eliminating, preventing, or reducing air and water pollution as the term ‘air pollution’ or ‘water pollution’ is defined in the ‘Environmental Protection Act’, enacted by the 76th General Assembly, or for the primary purpose of treating, pretreating, modifying or disposing of any potential solid, liquid or gaseous pollutant which if released without such treatment, pretreatment, modification or disposal might be harmful, detrimental or offensive to human, plant or animal life, or to property.

The purchase, employment and transfer of such tangible personal property as pollution control facilities is not a purchase, use or sale of tangible personal property.

or intended to eliminate, prevent, or reduce pollution. Relying on another pollution facilities exemption case, Wesko Plating, Inc., v. Department of Revenue, 222 Ill. App.3d 422 (1st Dist. 1991), the Beelman court applied a broad reading to the words “system” and “method” stating that the language of the statute, itself, was broad. Beelman at 423. The Wesko court interpreted the words “system” and “method” in light of the ordinary meaning of those terms as provided by Webster’s Third New International Dictionary (1968). It found that the two words were synonymous, and that the terms incorporated “the concept of an integrated process, a whole created by the interrelationship of component parts” (id. at 426) concluding, based upon the definitions, that these were broad terms. The court did not analyze any of the other terms within the statute, nor were any terms defined by statute.

This is simply not the case here. First, taxpayer directs the focus of its reading of the statutory language on the words “any” subunit or assembly, and “any” parts that require periodic replacement. Taxpayer’s focus is incorrect in light of the Wesko court’s analysis of statutory language. In Wesko, the court concentrated on the words “system” and “method”, not on the word “any” which precedes the two, and determined that system and method were the operative broad terms.

Likewise, we must discern the scope of the words “subunit” or “assembly” and “parts” when read in concert with the remainder of the exemption provision. As discussed above, these words describe equipment. As previously analyzed, equipment, as used in this exemption, does not include the chemicals at issue, therefore, “subunits”, “assembly” and “parts” would also not include them.

The legislature used very broad terms in construing the parameters of the pollution control facilities exemption, thus enabling an expansive interpretation of that statute, the same result, however, is not achieved through the plain, ordinary and reasonable interpretation of the pertinent words in the MM&E exemption. Use of Webster's Third International Dictionary does not mandate or even warrant a broad reading of those terms as the words themselves, read within the context of the statute and the definitional refinement placed upon by the legislature, are clearly more restrictive. This is especially true as the Department's exclusion of these chemicals is in step with acceptable understandings of the distinction between chemicals used in a manufacturing process and the machinery and equipment used in that process.

Taxpayer further argues that the Department's MM&E regulation anticipates chemicals as exempt from the imposition of use tax, if those chemicals have an immediate and direct physical change upon the tangible personal property to be sold. There was a great deal of testimony at hearing relating to the proposition that the primary chemicals have such an effect as coatings on the layers which make up the product taxpayer sells. I do not take issue with this testimony. However, the regulation does not say that anything which effects a direct and immediate physical change upon the property to be sold is exempt. Rather, the regulation provides:

- 3) By way of illustration and not limitation, the following activities will generally be considered to constitute an exempt use:
 - A) the use of machinery or equipment to effect a direct and immediate physical change upon the tangible personal property to be sold.

86 Ill. Admin. Code, ch. 130.330 (d)(3)(A) (emphasis added)

The operative words, of course, are "the use of machinery or equipment". Only machinery or equipment that has the necessary effect qualifies. Therefore, the ovens and

presses used by “ABC” may well qualify under this regulation section. But, since the chemicals are neither machinery nor equipment, they do not qualify no matter what their effect.⁸

In further analysis, I agree with the taxpayer that not only must the words of a statute be given their plain, ordinary and accepted meaning, but they must be read within the context of the entire statute, so that each part will be harmonious with all others. In this part of the analysis, taxpayer’s argument also fails.

II. UTA EXEMPTION FOR CHEMICALS

The UTA already provides for the exclusion of the chemicals, such as the ones at issue, under circumstances acknowledged by Illinois courts. Under the statute, the word “use” is defined as:

the exercise by any person of any right or power over tangible personal property incident to the ownership of that property, except that it does not include the sale of such property in any form as tangible personal property in the regular course of business to the extent that such property is not first subjected to a use for which it was purchased, and does not include the use of such property by its owner for demonstration purposes: Provided that the property purchased is deemed to be purchased for the purpose of resale, despite first being used, to the extent to which it is resold as an ingredient of an intentionally produced product or by-product of manufacturing... . “Use” does not mean the physical incorporation of tangible personal property, to the extent not first subjected to a use for which it was purchased, as an ingredient or constituent, into other tangible personal property (a) which is sold in the regular course of business or (b) which the person incorporating such ingredient or constituent therein has undertaken at the time of such purchase to cause to be transported in interstate commerce to destinations outside the State of Illinois; Provided that the property purchased is deemed to be purchased for the purpose of resale, despite first being used, to

⁸ This is not to be interpreted to mean that all tangible personal property qualifies for this exemption simply by clearly being machinery or equipment. For example, although mobile, motorized carts used in manufacturing plants to move people from place to place within a facility are machinery or equipment, they do not qualify for the exemption as they are not involved in the manufacturing process.

the extent to which it is resold as an ingredient of an intentionally produced product or by-product of manufacturing.

35 ILCS 105/2

The very language of this section of the UTA permits the exemption of chemicals used in the manufacturing process. The legislature chose, however, not to totally exempt these chemicals, regardless of their import to the process, although it surely could have done so. Rather, chemicals used in the manufacturing process are exempt from use tax to the extent that they are incorporated into the product produced.

This limitation on exemption has always been recognized and approved by the courts. For example, in Container Corporation of America v. Wagner, 293 Ill. App.3d 1089, 1094 (1st Dist. 1997), the court held that solvents, which the Department conceded were chemicals (id. at 1095), used to dilute concentrated inks and lacquers used in the manufacturing process but which remained in the printed boxes after production only in de minimus amounts, were not exempt from the UT. That court stated “[a]lthough it cannot be disputed that the solvents are personal property and are a necessary part of the box manufacturing process, they are consumed and are not, therefore, passed along in the chain of production.”

The Container Corp. court found support for this limitation on the exemption of solvents or chemicals used in the manufacturing process in several cases, including Granite City Steel Company v. Department of Revenue, 30 Ill.2d 552 (1964). In Granite City, the taxpayer manufactured pig iron. In its manufacturing process, it heated iron ore, coke and limestone in furnaces. The coke was used to produce heat required to melt the iron and induce desired chemical reactions. In addition, during the burning process, carbon from the coke was infused into the iron, with carbon being an essential ingredient

in the finished pig iron. Some of taxpayer's coke was derived from metallurgical coal it purchased to convert in its own coke ovens. In the conversion process, some byproducts were created that were sold. The vast majority of the coke produced or purchased by the taxpayer was used in the manufacture of pig iron.

The Department assessed use tax only on the coal and coke consumed in the production process that was not resold as a by-product or that did not appear in the finished product. The Supreme Court approved this limitation. See also Brennan Cattle Co. v. Jones, 41 Ill.2d 260 (1968) (medication administered to cattle not exempt from UT because no showing that medications physically present in cattle when they were resold); Columbia Quarry Co. v. Department of Revenue, 40 Ill.2d 47 (1968) (concerns limestone necessary as a fluxing agent to remove impurities from molten metal while it is in the molten stage in the production of pig iron-in the process; lime separates into carbon dioxide which dissipates into the atmosphere, and lime which becomes part of slag, a product sold by taxpayer-only limestone present in slag exempt from tax)

I recognize that the cases, except for Container Corp., were decided before the MM&E exemption provision of the UTA was enacted (P.A. 80-1292, eff. Jan. 1, 1979). However, all of the cases are necessary to this discussion as they evidence the long standing interpretation of the UTA whereby chemicals used in and essential to the manufacturing process are given exemption from the imposition of the tax, but only to the extent that they are incorporated into a product, and not dissipated during production.⁹ The legislature is deemed to be aware of statutes and the legal interpretations of them

⁹ Taxpayer appears to imply, in a somewhat brief reference (Taxpayer Brief, p. 14) that to exclude these liquid chemicals from the MM&E exemption would, in some manner violate the Equal Protection and Uniformity Clauses of the State Constitution. Although it is difficult for me to address such a cursory

when it enacts subsequent legislation. Burrell v. Southern Trust, et al., 176 Ill.2d 171 (1997); Spina v. Toyota Motor Credit Corporation, 301 Ill. App.3d 364 (1st Dist. 1998) If the legislature intended that chemicals, necessary to the manufacturing process be totally exempt from UT even if they are not made part of the product produced, it could have amended the UTA to provide for this, or, could have included, clearly, all chemicals in the MM&E exemption. It did neither.

To accept taxpayer's interpretation of the exemption would be to accept the proposition that the legislature intended to contravene its own statutorily imposed limitations on exemptions for chemicals used in the manufacturing process, but, only chose to do so in an extremely vague and assuredly indirect manner. I cannot accept this conclusion, especially since exemptions are to be strictly construed against the taxpayer and in favor of the taxing body (Telco Leasing, Inc. v. Allphin, supra; Medcat Leasing Co., v. Whitley, supra), with the exemption claimant having to clearly prove entitlement to the exemption (United Air Line, Inc. v. Johnson, supra) with all doubts resolved in favor of taxation. Follett's Illinois Book & Supply Store, Inc. v. Isaacs, supra

As ingredients of the manufactured product, the chemicals at issue fall four-square within that part of the statute that addresses such use, that is, 35 ILCS 105/2. Based upon the above, I conclude that the Department correctly disallowed exempt status to these chemicals as failing to qualify as machinery or equipment under the pertinent statute.

statement, I find that because chemicals such as those at issue can be exempt from use tax pursuant to another statutory provision, there is no constitutional violation as alluded to by taxpayer.

III. DEPARTMENT'S INTERPRETATION OF EXEMPTION

Taxpayer suggests that the Department's assessment results from its rejection of all chemicals as qualifying under the MM&E exemption because they are solvents, in the broadest sense and, by regulation, the Department excludes solvents from exemption. Such a conclusion, however, is not substantiated by the record. Rather, the Department dealt with the chemicals at issue and has, historically dealt with chemicals used in the manufacturing process, on a case by case analysis.

At hearing, auditor Carlson, discussed her understanding of how the chemicals at issue functioned in the manufacturing process. She did testify that she placed import on the taxpayer's referral to the chemicals as solvents, and the fact that they were identified by taxpayer as raw material in its inventory account. 6/14 pp. 16, 17, 29-31 However, she also testified that she thought that a solvent was a particular type of chemical, that is, "a paint thinner or something used to maintain consistency of a paint while it's being stored until it's ready to be used on the product." 6/14 pp. 31, 32¹⁰ Carlson also understood that these chemicals were not part of the final product, that is, they evaporated during the manufacturing process. 6/14 p. 16 She came to that determination even following her tour of taxpayer's facility. 6/14 p. 32 Finally, Carlson testified that it was the Department's technical support arm, whose assistance she and her supervisor requested, that made the final determination of taxability, and not herself. 6/14 p. 33

Ray Stout, from technical support, actually made the determination of taxability in this matter. 6/14 p. 35 He, however, did not rely on the regulatory exclusion from

¹⁰ Carlson's understanding of "solvent" is consistent with the definition provided by Webster's Third International Dictionary (1968) which provides:
1: a substance capable of or used in dissolving or dispersing one or more other substances; esp: a liquid component of a solution present in greater amount than the solute: MENSTRUM <water is a good ~ for

exemption of “solvents”. Rather, he forwarded to “Casey” the information supplied by taxpayer’s representative regarding how the chemicals at issue were used by “ABC”. 6/14 p. 36 Stout understood “Casey” to have concluded, after his own research, that the primary purpose of the chemicals was to spread the pigments and dyes on the film. 6/14 pp. 36, 38, 39, 40, 41, 49, 50 He also understood that a solvent was “something that dissolves, in this case, pigments and dyes, to transfer it onto the film in an even coating manner, so a solvent is something that dissolves those pigments and dyes so it could be applied to the film.” 6/14 p. 51; see n. 10, supra Stout’s determination concerning the taxability of these chemical purchases also involved his study of all pertinent and statutory provisions as well as Department ruling letters. 6/14 pp. 43, 44, 52

Additionally, as noted by the taxpayer, the Department has considered various chemicals used in the manufacturing process, and issued private letter rulings (hereinafter referred to as “PLR”) exempting them as MM&E. In each case, the Department viewed a number of factors as being crucial to its determination. PLRs 82-0408 and 85-0155 concern resins that become part of separation columns used in the manufacture of fructose. The useful life of the resins was from one to four years before replacement. In neither situation does the resin act as an ingredient for the product manufactured, nor was it consumed during the manufacturing process. Additionally, the resins discussed do not appear to be substantively similar to the chemicals at issue herein, that is, from the face of the PLRs, the resins may not be liquids, and, their use appears to be as solid columns necessary in the production of fructose. This analysis corresponds favorably with

many salts, alcohol for many resins, and either for fats> <the best ~ for a material is usu. related to it in chemical structure – P.O. Powers> - compare PLASTICIZER, THINNER

Webster's Third New International Dictionary's (1968) definition of resin that provides as its lead definition:

1 a any of various hard brittle solid to soft semisolid amorphous fusible flammable substances (as amber, copals, dammars, mastic, guaiacum) that are usu. transparent or translucent and yellowish to brown in color with a characteristic luster, that are formed esp. in plant secretions and are obtained as exudates of recent or fossil origin (as from tropical trees or pine or fir trees) or as extracts of plants, that contain usu. resin acids and their esters and are soluble in ether and other organic solvents but not in water, that are electrical nonconductors, and that are used chiefly in varnishes, printing inks, plastics, and sizes, in medicine and as incense <the spirit soluble ~s are in general of the soft variety, while the oil soluble are usually hard

Webster's at 1932

PLRs 85-0315 concerns acid used in the manufacturing of MM&E exempt molds, that remove metal from the molds during processing, that are periodically replaced and that act as abrasives doing the same job as that of a milling machine. Likewise, the abrasive media discussed in PLR 94-0172 acts as an acid to etch copper off of the surface of printed circuit boards. In neither case is the chemical an ingredient of the product produced. Further, it is clear that in both situations, the chemical acts more economically or more efficiently than a corresponding machine that could be used for the same effect. Consistent with this analysis, is ruling letter 94-0013, cited by taxpayer, wherein the Department states that chemical abrasives can qualify for the MM&E exemption, but not hand held abrasive materials that are not in electric, hydraulic or pneumatic form. Again, this suggests that abrasive chemicals that take the place of an actual machine are considered for the exemption, and not so those chemicals that do not. In contrast, the primary chemicals at issue herein are the ingredients or the raw material of the product

produced, none are acids or are used as corrosives. Their purpose cannot be assumed by a machine.

Finally, in PLR 95-0207, the Department agreed that fluid, cracking catalysts used to refine heavy gas oil into gasoline qualified as exempt from the imposition of the use tax as MM&E. First, that taxpayer states that the catalysts, which do not become part of the final product, are treated as assets and are amortized over their useful lives in accordance with generally accepted accounting principles. That taxpayer affirmatively states that the useful life of a catalyst was measured in years. That taxpayer distinguished the catalysts from solvents without discussion. In comparison, the testimony at hearing establishes that, pursuant to general accounting principles as understood by “ABC”, the chemicals at issue are not recorded as or considered to be assets of the business. Neither are they amortized, since they are consumed in the manufacturing process and therefore have a useful life of less than one year.

At hearing, the Department elicited testimony establishing, *inter alia*, that these chemicals constitute some of the raw materials or ingredients used to manufacture the products, that “ABC” characterizes them as raw materials and inventory and does not treat these chemicals as assets for accounting or financial reporting purposes and, that these chemicals do not stay with the product, but rather, except for trace amounts, they evaporate during the process. There was no testimony offered that these chemicals are used in lieu of machines, such as etchers or millers, nor that they behave in any electrical, hydraulic or pneumatic manner. Therefore, not only are these chemicals consumables, as argued by the Department, but they have numerous other characteristics, considered prior to the issuance of these assessments, that preclude them from this exemption.

Since it is evident that the Department does not treat, as taxable, all chemicals used in the manufacturing process simply because they are solvents in the broadest sense of the word, or because they are consumables, it is unnecessary to entertain taxpayer's argument that the Department has violated the Illinois Department of Revenue Sunshine Act, 20 ILCS 2515/4¹¹, the MM&E exemption statute, 35 ILCS 105/3-50, or the Illinois Administrative Procedure Act, 5 ILCS 100/1-1 *et seq.*¹² Taxpayer Brief, p. 17 However, I note a number of points. First, I agree with taxpayer that private letter rulings have no precedential effect (Taxpayer Brief, p. 5, n. 3) but, where these clearly contain any policy of general applicability, compliance with the Illinois Administrative Procedure Act is required. The court in National School Bus Service, Inc. v. Department of Revenue, 302 Ill. App.3d 820, 825 (1st Dist. 1998) (affirming the Illinois Department of Revenue's interpretation, in ruling letters, of the rolling stock exemption of the UTA) approvingly cites Sparks & Wiewel Construction Co. v. Martin, 250 Ill. App.3d 955 (4th Dist. 1993) (Illinois Department of Labor interpreted the Prevailing Wage Act as it applied to specific employees of a particular contractor) for the point that "[N]ot all statements of agency policy must be announced by means of published rules. When an administrative agency interprets statutory language as it applies to a particular set of facts, adjudicated cases are a proper alternative method of announcing agency policies."

¹¹ Taxpayer cites paragraph 2515/4 of this statute. However, I believe it intended to cite to paragraph 2515/3, which states, in pertinent part:

Any written informal ruling, opinion or letter issued by the Department in response to any inquiry or request for any opinion from any person regarding the interpretation of, liability incurred under, coverage of or applicability of any revenue laws administered by the Department shall be maintained as a public record in the Department's principal office, and made available for public inspection and copying...Whenever such informal ruling, opinion or letter contains any policy of general applicability, the Department shall formulate and adopt such policy as a rule in accordance with the provisions of the Illinois Administrative Procedure Act.

As in National School Bus and Sparks & Wiewel, the Department has, at the audit level, or when addressing requests for letter rulings, as well as during these administrative hearings process, interpreted the application of the MM&E provisions on chemicals and considered that issue in light of a variety of factors as discussed above. The Department, therefore, has not violated the Sunshine Act or the other provisions regarding policies of general applicability, since its evaluations are made on a case by case review with consideration of facts specific to each case.

IV. ABATEMENT OF PENALTIES FOR REASONABLE CAUSE

Taxpayer concludes its brief with an argument that should the chemicals be found to be taxable, reasonable cause exists to abate any penalties assessed. First, the issue of waiver of penalties was not raised as an issue at the pretrial conference, and it does not appear as an issue in the orders of March 10 and March 23, 1999, that reflect the agreement of the parties as to the issues in this cause.

Department hearing regulations (86 Ill. Admin. Code, ch. I, sections 200. 101 *et seq.*) address this circumstance. In sections 200.140 (b) and (c), the pre-trial conference is conducted for the purpose, *inter alia*, of simplifying the issues, with the agreements or determinations on the simplification of issues being entered on the record by a written order. In addition, section 200.155 (b) states that “[o]nly evidential and related matters having or possibly having a bearing on the adjustments or issues involved in the case shall be heard and considered.”

Notwithstanding taxpayer’s failure to raise this issue prior to its post hearing brief, the evidence of record does not allow for an abatement of penalties for reasonable

¹² The pertinent provision in the MM&E exemption statute is an almost verbatim reiteration of that in the Sunshine Act, cited supra.

cause. “ABC” called as its witness, “James Dandy”, its controller. 6/16 pp.5-24 His direct examination concerned the representations in “ABC” books that the chemicals at issue are solvents. 6/16 pp. 5-8 The Department’s cross examination elicited testimony that “ABC” did not include these chemicals in its 1997 ST-16 Annual Report of Manufacturer’s Purchase Credit Earned report to the State. Department Ex. No. 9; 6/16 pp. 9-10 Also elicited was the fact that “ABC” did not depreciate these chemicals, nor did it document these chemicals on its own books and records as machinery or as fixed assets. Department Exs. No. 10, 11; 6/16 p. 11 Rather, it identified them as raw materials and inventory. 6/16 p. 11

During redirect examination, “Dandy” explained why, pursuant to his understanding of accounting principles, the chemicals were not included in the ST-16 Report or carried as machinery or depreciated on the taxpayer’s books. There was no testimony from “Dandy” regarding why the taxpayer did not pay to its vendors the sales tax on these purchases.

Further, Carlson testified that initially, “ABC” explained that the chemicals it showed as solvents on its records were used in the manufacturing process and, it was not until sometime “later” in her audit process, after her supervisor was already involved, that taxpayer raised the MM&E exemption. 6/14 pp. 17-19 Stout testified that while he was doing his research into the issue, taxpayer did supply him with some ruling letters concerning chemicals and the MM&E exemption. 6/14 p. 38

What is conspicuously missing from the record is any evidence as to why the taxpayer did not pay the use tax to its vendors on these chemical purchases. Nor is there evidence as to who advised “ABC” about this exemption and exactly when the taxpayer

identified these chemicals as a possible MM&E exemption from use tax. This is critical to the waiver of penalty for reasonable cause issue.

The Uniform Penalty and Interest Act, 35 **ILCS** 735/3-1 *et seq.*, provides, at §3-8, for the waiver of penalties if “the taxpayer shows that his failure to file a return or pay tax at the required time was due to reasonable cause”, with reasonable cause “determined in each situation in accordance with the rules and regulations promulgated by the Department.” (emphasis added) See also, Rohrbaugh v. United States, 611 F.2d 211, 215 (7th Cir. 1979) The Department’s reasonable cause regulation is found at 86 Ill. Admin. Code ch. I, sec. 700.400. That provision (700.440 (b)) indicates that the most important factor is the extent to which the taxpayer made a good faith effort to determine the correct tax liability and subsection (c) provides that a taxpayer is considered to have made a good faith effort if he used ordinary business care and prudence in determining his tax liability.

In this matter, taxpayer’s arguments for abatement of penalties for reasonable cause are that 1) “this is a case of first impression and no case law directly adverse to “ABC’s” tax return treatment had been decided as of the taxable periods at issue in this case”; and, 2) the Department’s principal objection to the MM&E tax exemption in this matter appears to be based upon faulty information from “Casey”. Taxpayer Brief, p. 36 Each of these arguments is flawed, and therefore, taxpayer’s conclusion allowing for the abatement of penalties is without basis.

Taxpayer is correct in that there does not appear to be any case law in Illinois that addresses the issue in this case, that is, whether chemicals used primarily as necessary ingredients in the manufacturing of tangible personal property qualify for the MM&E

exemption. However, there is well established case law that speaks to chemicals necessary to the manufacturing process, supporting clear statutory language (35 ILCS 105/2 (definition of “use”)) exempting such chemicals only if they are incorporated into the manufactured product or result in a by-product that is then sold. Granite City Steel Co. v. Department of Revenue, 30 Ill.2d 552 (1964); Columbia Quarry Co. v. Department of Revenue, 40 Ill.2d 47 (1968); Brennan Cattle Co. v. Jones, 41 Ill.2d 260 (1968); Container Corporation of America v. Wagner, 293 Ill. App.3d 1089 (1st Dist. 1997) Based upon the facts of record that these chemicals do not remain with the product manufactured nor do resold by-products result from their use, this prevailing case law dictates that it was prudent and ordinary business care for “ABC” to pay the use tax on these purchases. Kroger Company v. Department of Revenue, 284 Ill. App.3d 473 (1st Dist. 1996), rehearing den. Oct. 31, 1996, appeal den. 171 Ill.2d 567, Jan. 29, 1997 (court’s rejection of taxpayer’s argument for abatement of penalties for reasonable cause under income tax provision, based in part on the existence of Illinois case law concerning issue involved in case) This is especially true because there is nothing of record to support even a reasonable inference that the taxpayer considered the MM&E exemption for its chemicals at the time the use tax was due, that is, prior to the audits.

Because of these points, Du Mont Ventilation Co, v. Department of Revenue, 99 Ill. App.3d 263 (3rd Dist. 1981), cited by taxpayer (Taxpayer Brief, p. 36) does not apply. In the Du Mont matter, the court allowed the abatement of penalties in a withholding tax case based upon taxpayer’s accountant’s failure to advise taxpayer during an its own routine audit preceding Department’s audit, that taxpayer’s filing requirements changed from monthly to quarterly. Thus, in Du Mont, the taxpayer paid the correct amount of

tax to the Department, but, did not do so timely. In the instance case, “ABC” chose not to pay the tax at all. In addition, Du Mont did not rely solely on its own staff to assure proper tax compliance. It used a certified public accounting firm for audit and consultation, and that firm did not alert taxpayer to the changed filing requirements in spite of auditing taxpayer months prior to the Department’s audit.

These are not the facts herein. Illinois law consistently mandated payment of use tax on chemicals used just as taxpayer uses the chemicals at issue. Further, there is no evidence of record that taxpayer sought guidance from outside authority, for, at least, clarification purposes, including seeking a letter ruling from the Department as provided for by statute.

Taxpayer’s second basis for abatement rests on its contention that “Casey’s” evaluation of the chemicals and how they are used, was mistaken. While there is no argument that “Casey’s” analysis was flawed, this argument bears no correlation to the issue of whether taxpayer’s failure to pay the tax, at the time it was due, was reasonable. Again, there is no evidence of record that taxpayer even considered the MM&E exemption at the time the taxes were due. In fact, the evidence is that taxpayer did not initially offer the MM&E exemption as its defense during Audit 1. Instead, the MM&E exemption came “later”, appearing to be an afterthought. This is not an acceptable basis for the abatement of penalties based upon reasonable cause. Therefore, I find that there are no grounds to abate penalties.

V. CONCLUSION

In conclusion, I make the following recommendation:

1. Under any circumstance, that part of the assessment for nipar and cyclohexanone is finalized, as there was no competent testimony regarding “ABC’s” use of these chemicals during the tax period. However, at the very least, the assessment for these chemicals finalized pursuant to paragraph 3, below;
2. Under any circumstance, that part of the assessment for trichlor, blend 2330 and cleaner is finalized, as these were used by “ABC” during the tax period as cleaners, and not part of the manufacturing process. However, at the very least, the assessment for these chemicals is finalized pursuant to paragraph 3, below;
3. The assessment for the primary chemicals as well as all other chemicals is finalized, as these chemicals are not machinery or equipment pursuant to the MM&E exemption, and, the Department’s interpretation of that exemption resulting in the assessment of use tax on “ABC’s” purchase of the chemicals at issue, is not arbitrary, capricious or unreasonable.
4. Although it is not an issue in this matter, but raised by the taxpayer only in its post hearing brief, I recommend that penalties not be abated in this cause.

3/20/2000

Mimi Brin
Administrative Law Judge