

ST 00-9

Tax Type: Sales Tax
Issue: Graphic Arts Exemption

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

“ABC CORPORATION, INC.”,	)	<u>Docket Nos.</u>	<u>IBT Nos.</u>
“PDQ CORPORATION” and	)	97-ST-0000	0000-0000 (ABC)
“XYZ CORPORATION”,	)	96-ST-0000	0000-0000 (PDQ)
Taxpayers.	)	96-ST-0000	0000-0000 (XYZ)
v.)		
THE DEPARTMENT OF REVENUE	)	John E. White,	
OF THE STATE OF ILLINOIS	)	Administrative Law Judge	

RECOMMENDATION FOR DISPOSITION

Appearances: Thomas Donohoe, McDermott, Will & Emery, appeared for “ABC Corporation”; Mark Dyckman appeared for the Illinois Department of Revenue.

Synopsis:

Three taxpayers, “ABC Corporation” (“ABC” or “taxpayer”), “PDQ Corporation” (“PDQ”) and “XYZ Corporation” (“XYZ”) each filed an amended return to claim a credit for taxes collected and/or paid over to the Illinois Department of Revenue (“Department”). The Department denied each claim, and all taxpayers protested those denials. The claims involved sales of tangible personal property from “PDQ” and “XYZ” to “ABC” during certain months beginning in June 1991 through December 1994. Taxpayers claimed the transactions were exempt from tax pursuant to § 3-5(6) of the Use Tax Act and § 2-5(4) of the Retailers’ Occupation Tax Act, because the property purchased was equipment used primarily for graphic arts production. 35 ILCS 105/3-5(6); 35 ILCS 120/2-5(4).

A single consolidated hearing was held at the Department’s offices in Chicago. At hearing, “ABC” offered, *inter alia*, the testimony of its plant manager, demonstrative

evidence to assist in describing the process in which “ABC” used the tangible personal property at issue, as well as examples of the property substantially similar to the property “ABC” purchased during the claim period. I have reviewed the evidence adduced at hearing, and I include in this recommendation findings of fact and conclusions of law. I recommend that the issue be resolved in favor of the Department.

Findings of Fact:

Findings Regarding “ABC’s” Use of the Property at Issue

1. The property at issue consists of film and sheets of mylar. Taxpayer Exs. 6, 8-9.¹
2. “ABC” purchases the film and mylar for use in Illinois. *E.g.*, Hearing Transcript (“Tr.”) pp. 21, 24, 41 (testimony of “Charlotte Web” (“Web”), “ABC’s” “Somewhere”, Illinois plant manager).
3. “ABC” uses the film and mylar when preparing a lithographic plate for later use in graphic arts production. Taxpayer Ex. 7 (flowchart diagram identifying the steps “ABC” takes prior to, during and after its offset lithography printing operations, and how the film and mylar are used by “ABC”); Tr. p. 24.
4. Lithography is one of the common printing processes described in Major Group 27 of the United States Standard Industrial Classification Manual. Tr. pp. 25-28 (“Web”); 35 **ILCS** 120/2-30 (Major Group 27 of the U.S. Standard Industrial Classification Manual defines “printing by one or more common processes” to

¹ Taxpayer exhibit 6 is a sample (approximately 12” x 12”) of unexposed film purchased by “ABC”. Taxpayer Ex. 6. Taxpayer exhibit 8 is a sample (approx. 10” x 12”) of film after “ABC” used it take a picture of one page (8½” x 11”) of camera-ready copy received from “ABC’s” client, and then developed the film into a negative. Taxpayer Ex. 8. Taxpayer exhibit 9 is a large negative (approximately 28” x 36”, consisting of a layout of 3 pages by 2 pages) to which a slightly larger (approximately 32” x 40”) sheet of orange colored mylar is attached by tape. Taxpayer Ex. 9.

- include “letterpress; lithography (including offset), gravure, or screen”).²
5. “ABC” first uses the film in a camera that photographs the camera-ready art or printed matter that “ABC’s” customers hire it to reproduce in printed form. Taxpayer Ex. 7 (step 2); Taxpayer Ex. 6; Tr. pp. 33-34.
 6. “ABC” then develops the film into a negative. Taxpayer Ex. 7 (step 3); Taxpayer Ex. 8; Tr. p. 34. The transparent parts of the negative are the areas where ink will appear on the final printed product. *Compare* Taxpayer Ex. 3 (finished product printed by “ABC”) *with* Taxpayer Ex. 8.
 7. “ABC” then precisely attaches precut sheets of mylar to the negative in a process called “stripping” or “masking.” Taxpayer Ex. 7 (step 4); Taxpayer Ex. 9; Taxpayer Ex. 12 (the attached mylar and negative is referred to as both a “masked negative” and a “flat” in taxpayer exhibit 12); Tr. pp. 34-35, 68-69.
 8. The masked negative or flat is then put into a machine called a contact platemaker. Taxpayer Exs. 7 (step 5); Taxpayer Ex. 12; Tr. pp. 29, 35. “ABC” uses the contact platemaker when preparing a lithographic plate that, when completed, will be attached to a printing press when “ABC” produces the final product for its customers. Taxpayer Exs. 1 (diagram of a printing press), 7 (steps 5, 7-9), 12; Tr. pp. 29, 35, 52.
 9. Before a lithographic plate is completed, it begins as a sheet of metal that has been coated with a chemical emulsion. Taxpayer Exs. 7 (steps 6-7), 10 (a large completed lithographic plate, apparently made using the flat that is Taxpayer Ex. 11); Tr. pp. 29, 48-51.

² The Occupational Safety & Health Administration’s Standard Industrial Classification Manual may be searched on the internet via its web address, “<http://www.osha.gov>”.

10. The contact platemaker has two basic components. *See* Taxpayer Exs. 7 (step 5); Taxpayer Ex. 12. One component is a vacuum frame. Taxpayer Ex. 12. “ABC” inserts the masked negative on top of the plate into the frame, which creates a vacuum between the masked negative and the plate. Taxpayer Ex. 12; Tr. pp. 47-51.
11. The second component of the contact platemaker is a light source that is situated above the vacuum frame. *See* Taxpayer Ex. 12; Tr. pp. 47-51.
12. When the light shines through the masked negative onto the plate, the emulsion is chemically changed in the areas of the plate exposed to light, and the emulsion remains on the areas of the plate not exposed to light. *See* Taxpayer Exs. 7 (steps 5-6), 9, 11; Tr. pp. 29, 47-51. “ABC” then processes and develops the plate. Taxpayer Exs. 7 (step 6); Tr. pp. 51-52. Thereafter, the areas of the plate that were exposed to light attract and retain water, and the chemical treatment remaining on the plate attracts and retains oil, which is one of the components of the ink “ABC” uses. *See* Tr. pp. 29, 31-32, 50; *see also id.*, pp. 8, 28 (during taxpayer’s opening statement, counsel for “ABC” described lithography as being based on the principle that oil and water don’t mix).
13. Once the lithographic plate is completed, “ABC” attaches it to one of the cylinders on a printing press to produce the finished printed product for customers. Taxpayer Exs. 1 (diagram of a printing press), 3 (sample of a finished printed product produced by “ABC”), 7 (steps 7-9), 11; Tr. p. 52.
14. After the print job is run, “ABC” discards and recycles the plate. Tr. p. 61. “ABC” retains the masked negative for approximately 13 months, then discards it

or turns it over to its customer. Taxpayer Ex. 7 (step 10); Tr. pp. 63, 77-78.

15. “ABC” did not certify to its vendors that the mylar and film were to be used as graphic arts equipment; instead it paid use tax to the vendors from whom it purchased. *See* Stipulation of Facts (“Stip.”), ¶ 1.
16. Before “ABC” filed its amended returns, the vendors of the mylar and film filed amended returns to seek a refund of the monies it collected from “ABC” and paid to the Department with their regularly filed sales and use tax returns during the applicable period. *See* Order dated 12/9/98. Since “ABC”, as the user of that property, was in the best position to establish proof of the facts necessary to show whether the property at issue was used as graphic arts production equipment, the parties collectively agreed to consolidate the other cases for one hearing. *See* Order dated 12/9/98.

Conclusions of Law:

This consolidated matter involves claims for refund filed by the retailers as well as the claim of “ABC”, the purchaser. Stip. ¶ 1; Order dated 12/9/98. Section 7 of the Retailers’ Occupation Tax Act (“ROTA”) provides, in part:

* * * *

It shall be presumed that all sales of tangible personal property are subject to tax under this Act until the contrary is established, and the burden of proving that a transaction is not taxable hereunder shall be upon the person who would be required to remit the tax to the Department if such transaction is taxable.

* * * *

35 ILCS 120/7. Since the UTA incorporates section 7 of the ROTA (*see* 35 ILCS 105/12), “ABC” bears the burden to clearly demonstrate that the property falls within the

exemption. People ex rel. Kassabaum v. Hopkins, 106 Ill. 2d 473, 476, 478 N.E.2d 1332, 1333 (1985); Central Ill. Pub. Service Co. v. Department of Revenue, 158 Ill. App. 3d 763, 765, 511 N.E.2d 222 225 (4th Dist. 1987). Provisions granting tax exemptions are to be strictly construed against the taxpayer and in favor of the taxing party. People ex rel. Kassabaum, 106 Ill. 2d at 476, 478 N.E.2d at 1333.

Section 3-5(6) of the UTA provides:

Sec. 3-5. Exemptions. Use of the following tangible personal property is exempt from the tax imposed by this Act:

* * * *

(6) Graphic arts machinery and equipment, including repair and replacement parts, both new and used, and including that manufactured on special order, certified by the purchaser to be used primarily for graphic arts production, and including machinery and equipment purchased for lease.

35 ILCS 105/3-5. Section 2-5 of the ROTA similarly provides:

Sec. 2-5. Exemptions. Gross receipts from the proceeds from the sale of following tangible personal property are exempt from the tax imposed by this Act:

* * * *

(4) Graphic arts machinery and equipment, including repair and replacement parts, both new and used, and including that manufactured on special order or purchased for lease, certified by the purchaser to be used primarily for graphic arts production.

35 ILCS 120/2-5. The vendors charged and collected use tax from “ABC” when they sold it the film and mylar during the period at issue. Stip. ¶ 1. Thus, it is clear that “ABC” did not certify to its vendors that those goods were being purchased as “graphic arts ... equipment ... to be used primarily for graphic arts production. *See id.*; 35 ILCS 105/3-5; 35 ILCS 120/2-5.

During the years at issue, the Illinois legislature defined “graphic arts production”

as, essentially, printing by any of the different common methods as defined in Major Group 27 of the U.S. Standard Industrial Classification Manual. 35 ILCS 105/3-30; 35 ILCS 120/2-30.³ There is no dispute that printing by offset lithography is graphic arts production under that definition. Therefore, the relevant inquiry is whether the film and mylar were primarily used as equipment during printing by offset lithography.

The Department has promulgated an administrative regulation interpreting the ROTA's graphic arts production exemption. 86 Ill. Admin. Code § 130.325. "ABC" argues that the film and mylar fit the Department's definition of graphic arts production equipment in that regulation. That definition provides:

b) Graphic Arts Production

* * * *

2) Machinery means major mechanical machines or major components of such machines contributing to graphic arts production. Equipment means any independent device or tool separate from any machinery but essential to the graphic arts production process; or any sub-unit or assembly comprising a component of any machinery or auxiliary, adjunct or attachment or parts of machinery. The exemption does not include hand tools, supplies, lubricants, adhesives or solvents, ink, chemicals, dyes, acids or solutions, fuels, electricity, steam or water, items of personal apparel such as gloves, shoes, glasses, goggles, coveralls, aprons, and masks, or such items as negatives, one-time use printing

³ During the years at issue, §§ 3-30 of the UTA and § 2-30 of the ROTA provided:
Graphic arts production. For [] purposes of this Act, "graphic arts production" means printing by one or more of the common processes or graphic arts production services as those processes and services are defined in Major Group 27 of the U.S. Standard Industrial Classification Manual.

35 ILCS 105/3-30; 35 ILCS 120/2-30 (the UTA includes the word "the" where the brackets are located in the text quoted above).

Effective 1999, the Illinois General Assembly amended those sections of the ROTA and UTA to define graphic arts production as "printing, including ink jet printing, by one or more of the common processes described in Groups 323110 through 323122 of Subsector 323, Groups 511110 through 511199 of Subsector 511, and Group 512230 of Subsector 512 of the North American Industry Classification System published by the U.S. Office of Management and Budget, 1997 edition." P.A. 91-0541, § 25.

plates as opposed to multiple use cylinders or lithographic plates, dies, etc. which are expendable supplies. This exemption does not include the sale of materials to a purchaser who manufactures such materials into an otherwise exempted type of graphic arts machinery or equipment.

86 Ill. Admin. Code § 130.325(b).

“ABC” analogizes the masked negative it creates from the film and mylar to molds and dies that are exempt under the definition of equipment in the manufacturing machinery and equipment exemption of the ROTA. 35 **ILCS** 120/2-45. Specifically, “ABC” argues that the negatives “serve as a mold for the light source that burns the image onto the [lithographic] plates.” Taxpayer’s Post-Trial Brief (“ABC’s Brief”), p. 8. “ABC” also relies on a 7-year-old Department administrative decision involving the taxability of tangible personal property used in the process of manufacturing skinless hot dogs and/or sausages. “ABC’s” Brief, pp. 8-10 & Ex. 1 thereto. It argues that the film and mylar should be considered exempt graphic arts production equipment because they “serve the same function in the graphic arts production process” as did the hot dog casings at issue in that manufacturing case. “ABC’s” Brief, p. 10.

That previous administrative decision, however, does not help “ABC” here. That matter involved casings sold to meat producers and used by those producers when manufacturing skinless hot dogs for wholesale or retail sale to others. *See* Exhibit 1 to “ABC’s” Brief, pp. 3-6 (findings of fact), 21-23 (conclusions of law). First of all, the two exemptions are not interchangeable because of the fundamental differences between persons engaged in the business of manufacturing tangible personal property for wholesale or retail sale to others and persons engaged in the business of providing services, such as printers. *See Colorcraft Corp., Inc. v. Department of Revenue*, 112 Ill.

2d 473, 493 N.E.2d 1066 (1986) (persons engaged in graphic arts occupations are generally considered to be engaged in a service occupation, and not a manufacturing occupation); H.G. Adair Printing Co., v. Ames, 364 Ill. 342, 4 N.E.2d 481 (1936) (printers are engaged in a service occupation); *see also* 35 **ILCS** 120/2-30 (definition of “graphic arts production”); 35 **ILCS** 120/2-45(1) (definition of “manufacturing process”); 86 Ill. Admin. Code § 130.330(b)(5) (the Department’s manufacturing machinery and equipment exemption regulation provides, in part, “[t]he printing process is not commonly regarded as manufacturing and court decisions have found that printing is not manufacturing. ...”). The Illinois Supreme Court has historically denied the application of the manufacturing machinery and equipment exemption to the use of tangible personal property purchased for use in Illinois by persons primarily engaged in a service occupation, and granted the exemption to machinery and equipment used by persons when manufacturing goods for sale to others. *See, e.g., Colorcraft Corp.*, 112 Ill. 2d at 480-81, 493 N.E.2d at 1069; Van’s Material Co., Inc. v. Department of Revenue, 131 Ill. 2d 196, 203-04, 545 N.E.2d 695, 699 (1989). Here, while “ABC” seeks the protection of language or concepts found within the text of the manufacturing machinery and equipment exemption, it never alleges that it is a manufacturer. As a matter of Illinois law, printers are servicemen and not manufacturers. Chicago Tribune Co. v. Johnson, 106 Ill. 2d 63, 69-71, 477 N.E.2d 482, 484-85 (1985) (rejecting taxpayer’s argument that “the printing process constitutes the manufacturing of tangible personal property.”); H.G. Adair Printing Co. v. Ames, 364 Ill. 342, 4 N.E.2d 481.

Second, the property at issue in the manufacturing case “ABC” attached to its brief was actually used in the process of producing the goods the user was engaged in the

business of manufacturing and selling. Specifically, the casings were used during multiple stages in the integrated process by which skinless hot dogs were manufactured. Those manufacturing stages included, e.g., the process of holding the shapeless mixture of uncooked meat and other ingredients, and the cooking and cooling processes. The casing gave the finished skinless hot dog their distinctive shape and exterior texture. The administrative law judge who wrote the recommendation concluded, and the Director agreed, that the casings acted as molds that were used during the manufacturing process. *See* Exhibit 1 to “ABC’s” Brief, pp. 23-25.

Here, in contrast, “ABC” does not use the film and mylar when printing products for its customers. Instead, it uses them when beginning to prepare a lithographic plate for later use by “ABC”. After the lithographic plates are completed, “ABC” attaches them to a cylinder on one of its printing presses for use during graphic arts production — that is, printing by lithography. *See* 35 ILCS 105/3-30; 35 ILCS 120/2-30 (*quoted supra*, note 3). Starting to prepare a lithographic plate for eventual use in graphic arts production, however, is not “printing”, as that term is used in § 2-30 of the ROTA and § 3-30 of the UTA.

Even more fundamentally, the film and mylar do not act as a mold or die. “ABC” contends that “[t]he negatives act like a mold or a die for the light that burns the images onto the lithographic plates.” “ABC’s” Brief, p. 10. A mold allows for a material or substance to be physically changed by being bent, shaped, compressed or by some other similar process. *See* The American Heritage Dictionary 537 (3rd ed. 1994) (“mold” defined as “1. A hollow form or matrix for shaping a fluid or plastic substance. 2. A frame or model of for forming or shaping something. 3. Something made in or shaped on

a mold. 4. General shape or form. 5. Distinctive shape, character or type"); *see also* "ABC's" Brief, p. 10 (quoting Webster's similar definition of "die"). The tangible personal property in the contested case relied on by "ABC" actually shaped the raw materials into the finished product being manufactured by the user. *See* Exhibit 1 to "ABC's" Brief, pp. 23-25. Thus, the property in that matter literally acted as a mold.

Here, however, "ABC's" argument that the property at issue causes some similar physical change to the light that is emitted from the top of its contact platemaker is flawed. Taxpayer Ex. 12. "The unique property of light is ... that energy in the form of light is always moving, and its movement is only in an indirect way affected by motion of the matter through which it is moving. (*When light energy ceases to move, because it has been absorbed by matter, it is no longer light.*)" 23 Encyclopedia Britannica 1 *Light* (15th ed. 1997) (emphasis added). The evidence offered at hearing established that the light passing through the transparent part of the stripped negative onto the emulsion-coated lithographic plate causes a chemical change to the emulsion. *See* Tr. pp. 49-51. "ABC's" masked negatives, however, do not physically mold and/or incorporate rays of light "into a material with a different form, use or name." 86 Ill. Admin. Code. § 130.330(b)(2). The "dies" used by "ABC" during its printing operations are the completed lithographic plates, and not the masked negatives.

In part of its response to "ABC's" argument, the Department argues that the graphic arts exemption provides that "[t]he exemption does not include ... such items as negatives, ... etc. which are expendable supplies." Department's Post-Hearing Brief ("Department's Brief"), pp. 4-5; *see also Illinois Bell Telephone v. Allphin*, 95 Ill. App. 3d 115, 125 (1st Dist. 1981) ("Once an administrative agency establishes rules and

regulations implementing a statute, it is bound to adhere to them as long as they remain in effect.”), *aff’d*, 93 Ill. 2d 241 (1982). The Department contends that the applicable administrative regulation requires a conclusion that “ABC’s” masked negatives at issue here are not entitled to the exemption being claimed. I agree.

Significantly, “ABC” does not challenge the validity of the Department’s applicable regulation in this matter. Indeed, it bases its argument that the goods here are exempt by relying on certain parts of the applicable rule. *See, e.g.*, “ABC’s” Brief, p. 8 (“ABC” misquotes the Department’s regulatory definition of “equipment” by inserting a period where a semicolon exists in the rule). It is axiomatic, however, that administrative regulations, like statutes, should be read as a whole, and not read piecemeal, or taken out of context. *See, e.g.*, Antunes v. Sookhakitch, 146 Ill. 2d 477, 588 N.E.2d 1111, 1114 (1992); Kraft v. Edgar, 138 Ill. 2d 178, 561 N.E.2d 656, 661 (1990). The same section of the regulation that defines graphic arts production “machinery” and “equipment” also provides that the exemption:

does not include hand tools, supplies, lubricants, adhesives or solvents, ink, chemicals, dyes, acids or solutions, fuels, electricity, steam or water, items of personal apparel such as gloves, shoes, glasses, goggles, coveralls, aprons, and masks, or such items as negatives, one-time use printing plates as opposed to multiple use cylinders or lithographic plates, dies, etc. which are expendable supplies. This exemption does not include the sale of materials to a purchaser who manufactures such materials into an otherwise exempted type of graphic arts machinery or equipment.

86 Ill. Admin. Code § 130.325(b). The pertinent regulation specifies that negatives are not subject to the graphic arts exemption, and “ABC” has not challenged the validity of that rule. Thus, “ABC’s” masked negatives are not entitled to the credit claimed. *See*

Illinois Bell Telephone v. Allphin, 95 Ill. App. 3d at 125.

Conclusion:

"ABC" has not carried its burden to show that the film and mylar are exempt from use tax under Illinois' graphic arts production machinery and equipment exemption. Therefore, I recommend that the Director finalize the Department's denials of all claims for credit in these consolidated matters.

2/1/00
Date

Administrative Law Judge