

**ST 16-06**

**Tax Type: Sales Tax**

**Tax Issue: Agricultural Machinery/Feed/Products/Exemptions**

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

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**THE DEPARTMENT OF REVENUE  
OF THE STATE OF ILLINOIS**

v.

**ABC BUSINESS, INC.**

**Taxpayer**

**Docket # XXXX  
Acct ID: XXXX**

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**RECOMMENDATION FOR DISPOSITION**

Appearances: Matthew Crain, Special Assistant Attorney General, for the Department of Revenue of the State of Illinois; David R. Reid of Reid Law Office, LLC for ABC Business, Inc.

Synopsis:

Between November 2010 and September 2012, ABC Business, Inc. (“taxpayer”) made several purchases of silage bags to be used on its farm in Illinois. The taxpayer did not pay use tax on the bags when they were purchased. On February 20, 2014, the Department of Revenue (“Department”) notified the taxpayer that it was initiating an audit of the purchases. At the conclusion of the audit, the Department issued six Notices of Tax Liability (“NTLs”) to the taxpayer alleging that it owes use tax, plus interest and penalties, on the bags. The taxpayer timely protested the NTLs, and an evidentiary hearing was held during which the taxpayer argued that the purchases of the silage bags are exempt from the use tax. The primary issues presented are the following: (1) whether the purchases of the silage bags are exempt from use tax because the bags qualify as farm machinery and equipment pursuant to section 3-5(11) of the

Use Tax Act (“Act”) (35 ILCS 105/1 *et seq.*), and (2) whether, in the alternative, the purchases are exempt because the bags qualify as manufacturing and assembling machinery and equipment pursuant to section 3-5(18) of the Act. The record includes an evidence deposition of the taxpayer’s expert witness and briefs filed by the parties. After reviewing the record, it is recommended that this matter be resolved in favor of the Department.

FINDINGS OF FACT:

1. The taxpayer primarily operates a dairy farm. The taxpayer also grows crops including corn, soybeans, and alfalfa. All of the corn that the taxpayer grows is used to feed its cows. (Tr. pp. 9-10, 22)
2. The taxpayer uses the corn to make corn silage, which is one of the better feeds for improving the health of the cows and increasing milk production. (Tr. p. 10)
3. The following are the five phases in the process of making corn silage: Phase 1 is chopping the crop and putting it into a silo, a pile, or a plastic bag. At this point it goes under fermentation to eliminate oxygen, and the feed gets hot. Once the pH starts to drop, Phase 2 begins during which the feed is producing lactic acid that will preserve the feed and pickle the feed. It reduces yeast growth and mold growth. The total time period for phase 1 and phase 2 together is typically anywhere from four days to two weeks. Phase 3 is a stable phase when the feed starts to cool down. The pH is low enough that it stops bacteria from growing. Phase 4 is a stable phase, and the feed is preserved. Phase 5 is when it is opened and exposed to oxygen, and then it goes through a secondary fermentation. Different types of toxins can occur in the silage after it has been exposed to oxygen. (Tr. pp. 10-15; Evid. dep. pp. 12-15, 30, 35)

4. To make high quality silage, it is best to immediately put the corn crop into an airtight, oxygen-free environment. The lack of oxygen causes the fermentation process and creates the best environment to preserve the silage. (Tr. p. 11-12, 42)
5. During the 1940's and 1950's, most farmers made silage using silos. Plastic bags are now the most economical method to ferment and preserve the feed. (Evid. dep. p. 16)
6. To make its silage, the taxpayer uses plastic bags that are tubular and come in various sizes. With a smaller herd size, smaller bags are used. The corn crop is stuffed into the bags like a sausage, with approximately 15 or 16 pounds per cubic foot. The diameter of the bag could be as small as 8 feet or as large as 14 feet. (Taxpayer Ex. B; Tr. pp. 12-13, 64; Evid. dep. pp. 18, 20)
7. The taxpayer uses a chopper to chop the crop, a bagger to put it into a bag, and a wagon to carry the bag. (Tr. pp. 15, 25-26)
8. The plastic bags can be used only one time. As the silage is removed, the empty portion of the bag is cut off and thrown away. (Taxpayer Ex. B; Tr. pp. 13, 67)
9. The bag may need to be repaired if an animal, such as a raccoon, makes a hole in it. (Tr. p. 24; Evid. dep. p. 39)
10. Once the silage is made and is in a stable state, the bag becomes a storage bag. (Tr. p. 44)
11. The silage bags produce the best quality feed because the bags do the best job of eliminating oxygen. The bags create a more stable, oxygen-free environment than any other method to produce silage; there is usually less spoilage with bags than with silos or piles. (Tr. pp. 17-19, 23, 37-39, 66)

12. The silage that the taxpayer makes is used to feed the cows on its farm. The taxpayer does not sell its silage. (Tr. pp. 22)
13. The Department conducted an audit of the taxpayer's purchases of the silage bags between November 2010 and September 2012. (Dept. Ex. #1, 2)
14. On June 23, 2014, the Department issued six Notices of Tax Liability ("NTLs") to the taxpayer that show use tax due on the purchases of silage bags that the taxpayer used on its farm to make silage. Copies of the NTLs were admitted into evidence under the certificate of the Director of the Department. (Dept. Ex. #1)

#### CONCLUSIONS OF LAW:

Under the Use Tax Act, Illinois imposes a tax upon the privilege of using in Illinois tangible personal property purchased at retail from a retailer. 35 ILCS 105/3. The use tax is a corollary to the retailers' occupation tax ("ROT"), which is a tax on persons engaged in the business of selling at retail tangible personal property. 35 ILCS 120/2. The use tax is imposed at the same rate as the ROT. 35 ILCS 105/3-10; 120/2-10. The purpose of the use tax is to prevent avoidance of the ROT by people who make purchases in states that do not impose the ROT and to protect Illinois merchants from the diversion of business to retailers outside Illinois. Brown's Furniture, Inc. v. Wagner, 171 Ill. 2d 410, 418 (1996). If the person who uses the property does not pay the use tax to the retailer, it must be paid directly to the Department. 35 ILCS 105/3-45.

Section 12 of the Act incorporates by reference section 5 of the Retailers' Occupation Tax Act ("ROTA") (35 ILCS 120/1 *et seq.*), which provides that the Department shall determine the amount of tax due "according to its best judgment and information." 35 ILCS 105/12; 120/5. A certified copy of the Department's determination of the amount of tax due "shall, without further proof, be admitted into evidence... and shall be prima facie proof of the correctness of the

amount of tax due, as shown therein.” *Id.* Once the Department has established its *prima facie* case by submitting the certified copy of the Department’s determination into evidence, the burden shifts to the taxpayer to overcome this presumption of validity. Clark Oil & Refining Corp. v. Johnson, 154 Ill. App. 3d 773, 783 (1<sup>st</sup> Dist. 1987). To prove his case, a taxpayer must present more than testimony denying the Department's assessment. Sprague v. Johnson, 195 Ill. App. 3d 798, 804 (4<sup>th</sup> Dist. 1990). The taxpayer must present sufficient documentary evidence to support its claim. *Id.*; Balla v. Department of Revenue, 96 Ill. App. 3d 293, 295 (1<sup>st</sup> Dist. 1981).

It is well-settled that tax exemption provisions are strictly construed in favor of taxation. Heller v. Fergus Ford, Inc., 59 Ill. 2d 576, 579 (1975). The party claiming the exemption has the burden of clearly proving that he or she is entitled to the exemption, and all doubts are resolved in favor of taxation. *Id.*

### **Farm Machinery and Equipment Exemption**

Section 3-5 of the Act includes a list of items that are exempt from the use tax and provides, in relevant part, as follows:

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

...

(11) Farm machinery and equipment, both new and used, including that manufactured on special order, certified by the purchaser to be used primarily for production agriculture ... 35 ILCS 105/3-5(11).

Section 3-35 of the Act defines “production agriculture” and provides as follows:

Sec. 3-35. Production agriculture. For purposes of this Act, ‘production agriculture’ means the raising of or the propagation of livestock; crops for sale for human consumption; crops for livestock consumption; and production seed stock grown for the propagation of feed grains and the husbandry of animals or for the purpose of providing a food product, including the husbandry of blood stock as a main source of providing a food product. ‘Production agriculture’ also means

animal husbandry, floriculture, aquaculture, horticulture, and viticulture. 35 ILCS 105/3-35.

The Department's Use Tax Regulations incorporate by reference the Department's Retailers' Occupation Tax Regulations. 86 Ill. Admin. Code §150.1201. Section 130.305 of the ROT Regulations concerns Farm Machinery and Equipment, and subsection (b) of that section provides the same definition of "production agriculture" that is included in section 3-35 of the Act. Subsection (f) provides as follows:

f) Production Agriculture, with respect to crops, is limited to activities necessary in tilling the soil, planting, irrigating, cultivating, applying herbicide, insecticide or fertilizer, harvesting and drying of crops. ... Activities such as the clearing of land, mowing of fence rows, creation of ponds or drainage facilities are not included, nor are the operations involved in the storing or transporting of crops and produce. The processing of crops into food or other products is not production agriculture. ... 86 Ill. Admin. Code §130.305(f).

The taxpayer argues that it has met its burden of proof and has shown that the primary purpose of the silage bags is for "production agriculture" because they are used in harvesting the crops. The taxpayer states that "harvest" is defined in part as "the gathering in of a crop." Webster's New World Dictionary, Second College Ed. p. 659. The taxpayer contends that "gathering in" includes the placement of the harvested plant in a silage bag, and the corn silage process is part of "harvesting and drying of crops" under subsection (f) of the regulation.

In response, the Department argues that the bags are used for two purposes: the first purpose is to process the harvested crop into food for the cattle, and the second purpose is to store the silage until it is needed for feeding. Under the regulation, neither purpose qualifies as production agriculture. In addition, the Department claims that even if production agriculture included the processing of crops into cattle feed, the evidence indicated that the majority of the time the bags are being used for storage. After the harvested crops are put into the bag, the silage becomes stable after approximately two weeks. A bag that is 170 feet long and 8 feet in

diameter may take 70 days to deplete. (Evid. dep. p. 33) Under the regulation, operations involved in the storing of crops are not included in the exemption.

In reply, the taxpayer argues that any storage purpose is clearly secondary to the production agriculture purpose. The witnesses testified that the primary purpose of the bags is to produce the best quality feed and create a more stable, oxygen-free environment than any other method of producing silage. The taxpayer claims that the storage time may be minimal and dependent on the circumstances of each farm (the size of the bags, the herd size, etc.). Property that is used primarily in an exempt process and partially in a nonexempt manner still qualifies for the exemption. See 86 Ill. Admin. Code §130.305(h), 130.330(d)(1). The taxpayer contends that even if it is assumed that the bags are used for subsequent storage, an exemption would still be allowed because more than one-half of a bag's useful life is used for production agriculture. See 86 Ill. Admin. Code §130.305(m). The taxpayer asserts that the bag is used primarily in production agriculture its entire useful life.

The taxpayer notes that the bags are plastic and come in different sizes. The taxpayer claims that a farmer would not want to use a large bag and unnecessarily expose a large mass of silage to oxygen and risk spoilation. In this regard, the bag can be compared to a vacuum-packed container that cannot be restored to its original state after it has been opened. (Tr. pp. 13, 25) The taxpayer contends that this is why the silage must be used to feed the herd in a short time frame in order to preserve the quality of the silage. Therefore, according to the taxpayer, storage is not the desired result, and production agriculture is the primary use of the bags.

I believe the silage bags do not qualify for the farm machinery and equipment exemption because the bags are neither machinery nor equipment as those terms are defined by the Department. The Department's regulation provides, in relevant part, the following definitions:

i) Machinery means major mechanical machines or major components thereof contributing to the production agriculture process or used primarily in State or Federal agricultural programs. Farm machinery would include tractors, combines, balers, irrigation equipment, cattle and poultry feeders, but not improvements to real estate such as fences, barns, roads, grain bins, silos, and confinement buildings. ...

...

k) Equipment means any independent device or apparatus separate from any machinery, but essential to production agriculture. ... The exemption does include hand-operated equipment such as wheelbarrows, hoes, rakes, pitchforks and shovels so long as they are used in production agriculture as that term is defined in subsection (b) of this Section. Hand tools used in maintenance activities, such as wrenches, pliers, wire stretchers, grease guns, hammers and screwdrivers, are not used in production and do not qualify for the exemption. Supplies, such as baling wire, baling twine, work gloves, boots, overshoes and chemicals for effluent systems are not exempt.

l) New or used repair or replacement parts, necessary for the operation of the machine used in production agriculture or in State or Federal agricultural programs, qualify for the exemption. ... Included in the repair or replacement parts category are: batteries, tires, fan belts, mufflers, spark plugs, plow points, standard type motors and cutting parts. Consumable supplies such as fuel, grease, oil and anti-freeze are not repair or replacement parts. 86 Ill. Admin. Code §130.305(i), (k), (l).

The silage bags clearly do not meet the definition of machinery, and I believe the bags fall under the category of consumable supplies rather than equipment. The plastic bags can be used only one time. As the silage is removed, the empty portion of the bag is cut off and discarded. The plastic is thin enough that animals can make holes in it. As the taxpayer has indicated, the bags are intended to be used only on a temporary basis. Because the bags are thrown away after each use, the taxpayer must repeatedly purchase new ones. The bags are not the type of durable product that the term “equipment” commonly describes.<sup>1</sup>

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<sup>1</sup> It is worth noting that the legislature defined “consumable supplies” for purposes of the exemption relating to aircraft maintenance to include “protective films,” the material of which would be similar to that of the bags. 35 ICLS 120/2-5(40).

Exemption provisions are strictly construed in favor of taxation. Heller, supra. In Mid-American Growers, Inc. v. Department of Revenue, 143 Ill. App. 3d 600 (3<sup>rd</sup> Dist. 1986), the court stated as follows:

The general rule that exemptions are to be strictly construed against the claimant calls for no strained construction adverse to the real intention of the legislature and requires a normal and reasonable construction. Construction statutes provide that words and phrases shall be taken in their plain or ordinary sense. Such is also the judicially established rule. *Id.* at 603.

The ordinary meaning of the word “equipment” does not include consumable products. I believe the farm machinery and equipment exemption was not intended to apply to disposable plastic bags.

### **Manufacturing Machinery and Equipment Exemption**

The taxpayer has also argued, in the alternative, that the silage bags qualify for the manufacturing machinery and equipment exemption. That exemption is included in section 3-5 of the Act, which provides, in relevant part, as follows:

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

...

(18) Manufacturing and assembling machinery and equipment used primarily in the process of manufacturing or assembling tangible personal property **for wholesale or retail sale or lease**, ... (Emphasis added); 35 ILCS 105/3-5(18).

The Department argues that this exemption does not apply because the taxpayer does not sell the silage. The taxpayer did not provide arguments in response.

As the previous analysis indicated, the bags are neither machinery nor equipment; the bags are consumable supplies, and supplies do not qualify for the manufacturing machinery and equipment exemption. See 86 Ill. Admin. Code §130.330(c)(3). In addition, the taxpayer uses the silage to feed the cows on its farm; the bags are not used to produce a product for wholesale

or retail sale or lease. The taxpayer's use of the bags, therefore, does not qualify for the manufacturing machinery and equipment exemption.

Recommendation:

For the foregoing reasons, it is recommended that the silage bags are not exempt from the use tax, and the Notices of Tax Liability be finalized.

Linda Olivero  
Administrative Law Judge

Enter: June 15, 2016