UT 19-01
TAX TYPE: USE TAX
ISSUE: AGRICULTURAL MACHINERY/FEED/PRODUCTS/EXEMPTIONS

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

THE DEPARTMENT OF REVENUE OF THE STATE OF ILLINOIS v. **ABC CO., INC.** **Taxpayer**	**Docket # [ ]** **Acct ID: [ ]**

DIRECTOR'S DECISION

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 CO., INC.

I have carefully reviewed the Administrative Law Judge's (ALJ's) Recommendation for Disposition on Remand from the appellate court, and I reject the ALJ's Recommendation for Disposition on Remand and issue the following decision. In support of this decision, the following findings of fact and conclusions of law were made.

SYNOPSIS:

Between November 2010 and September 2012, ABC CO., INC. ("taxpayer") made several purchases of silage bags to be used on its farm in Chenoa, 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, *inter alia*, that the purchases of the silage bags are exempt from the 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.*). On July 26, 2016, the Director of the Department issued a final decision in which she adopted the ALJ's recommendation that the bags do not qualify for the exemption because they do not meet the definition of "equipment" under the Department's regulations. See 86 Ill. Admin. Code §130.305(k). In August 2016, the taxpayer filed an appeal of the Director's decision. The circuit court upheld the Director's decision, but the Fourth District Appellate Court reversed, finding that the bags are "equipment" under the exemption. The appellate court remanded the case back to the Department for a determination of whether the bags are essential to production agriculture in order to qualify for the exemption. Both parties have agreed that the issue should be resolved based on the record presented at the initial hearing. After reviewing the record regarding the issue remanded to the Department, I have determined that this matter should be resolved in favor of the Taxpayer.

ADOPTED FINDINGS OF FACT AS SET FORTH IN THE ADMINISTRAIVE LAW JUDGE'S RECOMMENDATION:

1. The taxpayer primarily operates a dairy farm. The taxpayer also grows crops including corn, soybeans, and alfalfa. All of the corn and alfalfa 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 silage: Phase 1 is chopping the crop and putting it into a silo, a pile, or a plastic bag. At this point it goes through a fermentation process caused by the elimination of 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 depending on the type of crop being used. Corn usually goes through these phases the fastest, which usually takes 4 to 6 days. Phase 3 is a stable phase when the feed starts to cool down. The pH is low enough that it stops bacteria from growing. The silage is ready to feed at this point, but certain crops, such as corn, will continue to improve under anaerobic conditions. Phase 4 is a stable phase, and the feed is preserved. Phase 5 is when the container 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, 28-31, 35, 42)
4. For corn silage to be at its optimum quality, it needs to be in the air-tight container two to four months because the fermentation process continues and it makes the nutrients more digestible for the cow. (Tr. p. 24)

5. Silage can also be made with small grains or legumes. Basically any green plant that is growing that has some amount of sugar or starch in it that will allow the feed to ferment can be used. (Evid. dep. pp. 12, 41)
6. To make corn silage, the entire plant material is harvested (*i.e.*, the stalk including the leaf and stem). (Evid. dep. p. 12)
7. The corn must be harvested in a timely manner. It must be harvested quickly and immediately put into an oxygen-free environment. (Tr. p. 36)
8. When the corn is chopped, it is chopped into a particle size that is conducive for animal intake. It is usually chopped to either an inch or ½ inch in length. (Evid. dep. pp. 12, 17)
9. 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)
10. 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)
11. The taxpayer has approximately 1,000 heads of cattle. The taxpayer uses 300-foot long bags, and it uses approximately 5 feet of the bag each day. (Tr. pp. 9, 17)
12. 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)

13. The chopper cuts the whole plant off at the ground, brings it in, and puts the plant through a set of knives. Ideally it will be cut to ¾ inch. The plant then goes through a crop processor, which has two rollers, to ground up everything including the corn kernels. The processor must grind the corn kernels for greater nutritional value. (Tr. p. 14)
14. The bagger is a piece of equipment on which the bag is put to fill the bag. (Tr. pp. 25-26)
15. 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)
16. 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)
17. Once the silage is made and is in a stable state, the bag becomes a storage bag. (Tr. p. 44)
18. Once silage is made, some farmers will transfer the feed to another storage structure such as a silo. Sometimes it is sold. (Evid. dep. pp. 14, 26, 32-33)
19. The length of time that the silage is kept in the bag depends in part on the type of silage. Generally, corn silage that is bagged in August or September will provide enough feed to get through the year. Other crops such as legumes can be harvested from May to October, so there may be only 6 months of storage. If it is a wet by-product feed, it is stored just a week. (Evid. dep. p. 34)
20. On the taxpayer's farm, none of the silage is more than a year old. (Tr. p. 24)
21. The taxpayer periodically checks the status of the fermentation process by sending samples of the silage to labs to be analyzed for nutrient value. The

taxpayer will use different varieties of corn, put them in different bags, and test them for nutrient value. The purpose of the testing is to allow the taxpayer to use the silage when it is at its peak quality. (Tr. pp. 30-31)

22. There is usually less spoilage with bags than with silos or piles. (Tr. pp. 16-19, 51, 63-66)

23. The bag serves the purpose of protecting the silage to keep the oxygen out. (Tr. p. 62)

24. 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)

25. People and animals such as pigs and chickens cannot eat silage. Primarily ruminant animals that have the ability to breakdown the fiber can eat the silage. (Evid. dep. pp. 41, 45)

26. Because the silage is chopped into small pieces, it can be mixed with other food, such as long hay particles, to feed the cows. (Evid. dep. p. 17)

27. Using bags allows the farmer to segregate different qualities of silage. If, for example, some crops are damaged, they may be put in separate bags and used for a different class of animal. (Evid. dep. p. 20)

28. The primary purpose of the bag is to create a more stable, oxygen-free environment in order for the fermentation process to create a premium product that will maintain the cow's health. (Evid. dep. p. 35; Tr. pp. 15-19, 37-39, 49-50, 66)

29. The fermentation is a form of processing of crops so that the crops become food for the animal. (Tr. pp. 27-28)

30. The silage bags produce the best quality feed because the bags do the best job of eliminating oxygen. The bags produce a feed quality that will enhance profitability. The bags are an integral part of producing and maintaining high quality feed for the cows. (Tr. p. 37; Evid. dep. pp. 19-20)
31. The bags change the corn plant from something that is "pretty much inedible to . . . something that the cows eat like candy." (Tr. p. 38)
32. The Department conducted an audit of the taxpayer's purchases of the silage bags between November 2010 and September 2012. (Dept. Ex. #1, 2)
33. 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:

The appellate court remanded this case for a determination of whether the silage bags are essential to production agriculture under subsection (k) of Section 130.305 of the Department's administrative rules. 86 Ill. Adm. Code §130.305(k). Section 3-35 of the Use Tax Act defines "production agriculture" 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 (emphasis added).

The question in this case is whether the silage bags that are used by the Taxpayer are essential to the raising or propagation of livestock or crops for livestock consumption.

The corn plants that are harvested on the Taxpayer's farm are not considered very good feed for the cattle unless those plants are chopped up and fermented. (Tr. P. 29-30) The fermentation process is considered an integral part of producing and maintaining a high qualify feed for cattle. (Evid. dep. pp. 19-20) The silage bags are best way to keep oxygen out and stabilize the fermentation process. (Tr p. 37)

Based on the evidence presented at hearing, I believe that the integral use of the silage bags in the Taxpayers livestock operations is essential to the raising or propagation of livestock or crops for livestock consumption on the Taxpayer's farm.

RECOMMENDATION:

For the foregoing reasons, the Notices of Tax Liability at issue in this case shall be rescinded.

Dated 5/29/19

David Harris, Director
Illinois Department of Revenue