2018 Sales Tax Court Decisions

I. Sales Tax

A. Temporary Storage Exemption

Safety-Kleen Systems, Inc. v. Illinois Dep't of Revenue, Illinois Independent Tax Tribunal No. 16 TT 167 (September 6, 2018)

Safety-Kleen Systems, Inc. supplies washer parts and cleaning products for degreasing metal parts and tools. Part of the business involves purchasing virgin solvent which is then blended with recycled solvent to then provide to customers. The Department assessed use tax on Safety-Kleen's purchase of virgin solvent for the audit period. In Summary Judgement on Count IV in this matter, Safety-Kleen alleged that its purchases of virgin solvent from outside of Illinois should be exempt from use tax under the applicable temporary storage exemption because the solvent was returning in a different form (as used or contaminated solvent) from its out-of-state customers before being refined as blended solvent to be redistributed to out-of-state customers.

In general, section 3-55(e) of the Use Tax Act, known as the temporary storage exemption, applies to tangible personal property that: 1) is acquired outside of Illinois; 2) is stored temporarily in Illinois, and 3) is then used solely outside of Illinois. Using this standard, after tangible personal property is stored in Illinois and is sent out of state, if the tangible personal property is thereafter returned to Illinois again, it is subject to use tax. In essence, the temporary storage exemption is one of several exemptions created to prevent actual or likely multistate taxation of tangible personal property.

Safety-Kleen claimed that the used solvent is different tangible personal property than the blended solvent because it has a distinct look, smell, chemical composition, PH balance, and flashpoint. The Tribunal noted that no legal authority was cited to support Safety-Kleen's position, and also stated that it was following applicable precedent to treat the temporary storage exemption as an exemption, as opposed to an exclusion from tax. This means that a taxpayer has the burden of proof to prove its right to a tax exemption.

In sum, the Tribunal held that the solvent had not fundamentally changed because the used solvent that returned to Illinois was thereafter recycled to be used for the solvent's intended purpose. Since the solvent came back to Illinois, the temporary storage exemption was lost. Therefore, Summary Judgement was granted for the Department. Notably, this matter is still pending at the Tribunal due to other undecided issues.

B. Manufacturing and Assembling Equipment Exemption

Horsehead Corporation v. Illinois Dep't of Revenue, 2018 IL App (1st) 172802 (September 24, 2018).

Horsehead produces zinc, zinc oxide, and zinc powder from recycled sources and sells these products to third parties or for resale. The Department determined that Horsehead was liable for use tax on its purchases of coke used and consumed in its kilns in its manufacturing process.

The primary issue is whether the coke used by Horsehead in its kilns to reclaim zinc and metallic oxide from electric arc furnace dust meets the definition of a chemical or a chemical acting as a catalyst

for purposes of qualifying for the manufacturing and assembling equipment exemption (sections 3-5(18) and 3-50) of the Use Tax Act.

When originally at the Tax Tribunal, the Tribunal noted that under the plain language of the statute, the chemicals or chemicals acting as a catalyst must affect a "direct and immediate" change upon a product being manufactured. Because the evidence produced at the hearing showed that the coke did not react with zinc or zinc oxide directly, the Tribunal concluded that the coke did not qualify for the exemption. The Tribunal also upheld the imposition of penalties because Horsehead did not present any evidence to support its claim of reasonable cause based on good faith.

At the Appellate Court, Horsehead made the same two principal arguments it had made at the Tribunal: 1) that the process involved effects a direct and immediate change as to qualify for the exemption and 2) that the penalties should be abated based on reasonable cause. Of note, in discussing the Tax Tribunal's decision, the Appellate Court held that the Tax Tribunal possesses and employs tax expertise in resolving tax disputes such as these, so its decision is held to a higher level of deference. The Tribunal's decision was held to not be incorrect, particularly since Horsehead had not offered any additional argument on appeal as to what "direct and immediate" should mean. Also, the Appellate Court upheld the Tax Tribunal's decision to maintain the penalties at issue since its reasonable cause argument was based on its own erroneous reading of the exemption provisions of the Use Tax Act.

C. Aircraft Use Tax

Shakman v. Illinois Dep't of Revenue, Circuit Court of Cook County Law Division No. 2017-L-050873 (October 5, 2018)

Mr. Shakman purchased a single-seat glider airplane and paid the required taxes under the Aircraft Use Tax Act. Thereafter, Mr. Shakman created a living trust and transferred title of the airplane to the trust. To effectuate this transfer, title for the airplane was transferred with an FAA bill of sale from Mr. Shakman to the Trust. The Department found this transfer to be a taxable event. Cross motions for Summary Judgement were filed.

Mr. Shakman argued that the actual transaction lacked economic substance, so the transfer should not be taxable. The Court disagreed and held that this case did not require a close evaluation of the economic substance. The Court was concerned that if the standard for taxability in a case such as this required a subjective evaluation of the substance of each potential transaction, there could be absurd results and an undue burden on the Department. To address this concern, the Court set a bright-line standard that "[a]ny time an aircraft owner in Illinois files an FAA bill of sale with the FAA, they will incur a tax liability" under the Aircraft Use Tax Act. Summary Judgement was found for the Department.

D. Statute of Limitations

Redbox Automated Retail LLC. v. Illinois Dep't of Revenue, Illinois Independent Tax Tribunal No. 17-TT-045 (September 18, 2018)

The Department conducted a sales tax audit on Redbox (a film rental company) for tax periods 1/1/2007 through 6/30/2010 ("the first audit"). The statute of limitations for the first audit period was extended through waivers to June 30, 2013. Redbox paid the first audit liability. A second sales tax audit ("the second audit") covered tax periods of 7/1/2010 through 6/30/2014. While this second audit was being conducted, the Department agreed to provide Redbox with a refund for previously paid use taxes related to licensing agreements paid during the tax periods in the second audit. Thereafter, in February

2016, Redbox filed a claim for the periods covered in the first audit for the same type of use tax payments related to licensing agreements. The Department denied the majority of this claim and cross-motions for Summary Judgement were filed.

In sum, Redbox generally argued that: 1) the applicable statute of limitations period should have been extended to 3 years beyond when the first audit was conducted (February 2013) and 2) there was a violation of the Illinois Constitution's Uniformity Clause in creating two classes between taxpayers who discover they owe taxes on their own and those taxpayers that make that discovery through an auditing process.

The Tribunal cited the applicable statute of limitations provisions of the Use Tax Act and verified that "[t]he only authorized way to extend a statute of limitations date is for the taxpayer and Department to extend the date by written agreement." In sum, Redbox's statute of limitations argument was contrary to applicable statutes and caselaw. In regard to the Uniformity Clause argument, the Tribunal held that there was no such violation since all taxpayers have a right to file a claim for refund prior to the applicable statute of limitations period and that audit proceedings have no bearing on any statute of limitations period. The Tribunal also noted that, even if it had agreed with Redbox, the Tribunal has no authority under the Tax Tribunal Act to declare a statute or regulation unconstitutional on its face.

E. Taxable Motor Fuel

Waste Management of Illinois, Inc. v. Illinois Dep't of Revenue, 2017 IL App (1st) 162830-U (December 29, 2017)

Waste Management provides waste collection, transfer, recycling and resource recovery, and disposal services. Waste Management operates motor vehicles, including its waste hauling trucks, on Illinois' public highways. During the tax period at issue, Waste Management had some of its motor vehicles operate using compressed natural gas ("CNG"). The Department determined that Waste Management was liable for Motor Fuel Tax on its use of CNG.

Waste Management's main argument in the Tax Tribunal was that under the Motor Fuel Tax Law ("MFTL"), 35 ILCS 505/1, *et seq.*, CNG is not a taxable "Motor Fuel." Specifically, because the definition of "Motor Fuel" discusses "liquids," Waste Management argued that its use of CNG, which was only used in a gaseous state, was not taxable under the MFTL. The Tribunal ruled that CNG is a taxable "Motor Fuel" because the definition of "Motor Fuel" is unambiguous and broad in its application. The Tribunal further stated that whether the definition of "Motor Fuel" was ambiguous or not, an interpretation of taxable motor fuel to include CNG is entirely consistent with the MFTL statute. Then, the Tribunal examined the other provisions of the MFTL, including the primary legislative intent section and other definitional sections, and stated that these provided further support that CNG is taxable.

The Appellate Court issued a non-precedential Rule 23 decision which reversed the Tribunal's decision. Notably, the MFTL had been updated in June 2017 to add CNG to the tax rate section of the MFTL without adding CNG to the definition of "Motor Fuel. The Court agreed with Waste Management's arguments and held that for periods prior to July 2017, when the law was updated, CNG was not taxable under the MFTL as previously written.

F. False Claims Act

The State of Illinois *ex rel.* v. My Pillow, Inc. 2018 IL 122487 (2018)

Originally, the Law Firm Schad, Diamond, and Shedden, P.C. ("Diamond") filed a *qui tam* action against My Pillow, Inc. pursuant to the Illinois False Claims Act. Diamond alleged that My Pillow had failed to collect and remit Retailers' Occupation Tax ("ROT") and Use Tax ("UT"). The State was properly notified but decided not to proceed in the action itself. The allegations for ROT arose from My Pillow's product sales at craft shows and for UT from products sold online and by phone. The Circuit Court found against My Pillow for the UT. Under the False Claims Act, Diamond was to collect 30% of the proceeds recovered as compensation for recovering the funds on behalf of the State. In addition to this 30%, Diamond also sought other costs and fees, which specifically included its own attorney fees. My Pillow objected to this by claiming that Diamond was essentially acting as a *pro se* litigant and that the fees requested were excessive. Although the Circuit Court reduced the amount sought, the Court found that Diamond was entitled to these attorney fees.

On appeal, The Appellate Court affirmed in part, reversed in part, and remanded for further proceedings. Of note, the Appellate Court held that Diamond could only recovery any fees occurred by outside counsel and there would be no recovery for any fees related to the firm's own lawyers. Diamond petitioned the Supreme Court for leave to appeal on whether Diamond was entitled to the fees earned by the firm.

The Supreme Court held that, consistent with at least 150 years of Illinois precedent, an attorney cannot represent himself or herself in a legal proceeding and charge a fee for those services. A primary public policy concern was expressed. "[W]here a fee-shifting statute is intended to remove a burden that might otherwise deter litigants from pursuing a legitimate action and was not meant to serve as a reward to successful plaintiffs or a punishment against the government, the rationale for the law is absent when a lawyer is self-represented." Also, the Court wanted to make sure that it secured the policy of avoiding unnecessary litigation by ensuring citizens seek legal advice before filing such actions. Therefore, the Supreme Court affirmed the Appellate Court's decision that Diamond could not collect attorney fees for its own firm.

The People of the State of Illinois *ex rel.* v. Sears Brands LLC, 2018 IL App (1st) 171468 (April 17, 2018)

Relators brought this *qui tam* action on behalf of themselves and the State of Illinois under the False Claims Act against Sears Brands LLC, Home Depot USA, Lowe's Home Centers LLC, Best Buy Stores L.P., and Gregg Appliances, Inc. Relators alleged in this appeal that Best Buy had avoided payment of Retailers' Occupation Tax ("ROT") and Use Tax ("UT") by treating the sale and installation of dishwashers and over-the-range microwave ovens as a construction contract (not subject to ROT or UT). Best Buy argued, and the Trial Court found, that the relators' *qui tam* action was barred because it was the subject of an administrative civil money penalty proceeding and the State was already a party. Thus, a government action bar, as set forth in Section 4(e)(3) of the False Claims Act existed.

On appeal, the Appellate Court held that the Department's Audit Bureau and the Informal Conference Board's review of the proposed audit adjustments, while Best Buy was brought into this False Claims Act proceeding, did not constitute an administrative proceeding for which the State was a party. The Court found these to only be steps in an administrative process and that these steps were investigatory in nature. Thus, these processes did not constitute an administrative proceeding for the purposes of Best Buy's government action bar. The Appellate Court reversed and remanded.