



## **1. Background**

### **Illinois Sales Tax**

The Illinois Retailers' Occupation Tax Act (35 ILCS 120/1, *et seq.*)(ROT) imposes a tax upon persons engaged in this State in the business of selling tangible personal property to purchasers for use or consumption. 86 Ill. Adm. Code 130.101. The Use Tax Act (35 ILCS 105/1, *et seq.*) imposes a tax upon the privilege of using in this State tangible personal property purchased at retail from a retailer. 86 Ill. Adm. Code 150.101. Taken together, those taxes comprise "sales tax" in Illinois.

### **Sales Tax Manufacturing Exemption**

Under the ROT statute, subsection 35 ILCS 120/2-5(14) provides, in part:

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

(14) Machinery and equipment that will be used by the purchaser, or a lessee of the purchaser, primarily in the process of manufacturing or assembling tangible personal property for wholesale or retail sale or lease, whether the sale or lease is made directly by the manufacturer or by some other person, whether the materials used in the process are owned by the manufacturer or some other person, or whether the sale or lease is made apart from or as an incident to the seller's engaging in the service occupation of producing machines, tools, dies, jigs, patterns, gauges, or other similar items of no commercial value on special order for a particular purchaser...35 ILCS 120/2-5(14).

Under the Use Tax statute, subsection 35 ILCS 105/3-5(18) contains virtually identical language:

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, whether that sale or lease is made directly by the manufacturer or by some other person, whether the materials used in the process are owned by the manufacturer or some other person, or whether that sale or lease is made apart from or as an incident to the seller's engaging in the service occupation of

producing machines, tools, dies, jigs, patterns, gauges, or other similar items of no commercial value on special order for a particular purchaser.... 35 ILCS 105/3-5(18).

Under the Use Tax Statute, subsection 35 ILCS 105/3-50(4)<sup>1</sup> provides:

§ 3-50. Manufacturing and assembly exemption. ...For the purposes of this exemption, terms have the following meanings: ...

(4) "Equipment" includes an independent device or tool separate from machinery but essential to an integrated manufacturing or assembly process; including computers used primarily in a manufacturer's computer assisted design, computer assisted manufacturing (CAD/CAM) system; 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. **Equipment includes chemicals or chemicals acting as catalysts but only if the chemicals or chemicals acting as catalysts effect a direct and immediate change upon a product being manufactured or assembled for wholesale or retail sale or lease.** (emphasis added). 35 ILCS 105/3-50(4).

### **The Department's Manufacturing Exemption Regulation**

The Department's Regulation on manufacturing machinery and equipment, 86 Ill. Adm. Code 130.330, limits what chemicals can be considered as chemicals and chemicals acting as catalysts which qualifies them for the manufacturing exemption in subsection (c)(6):

6) The exemption includes chemicals or chemicals acting as catalysts but only if the chemicals or chemicals acting as catalysts effect a direct and immediate change upon a product being manufactured or assembled for sale or lease. (Section 2-45 of the Act) The following examples are illustrative:

A) Example 1. A chemical acid is used to etch copper off the surface of a printed circuit board during the manufacturing

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<sup>1</sup> The ROT statute contains the identical language at 35 ILCS 120/2-45(4).

process. The acid causes a direct and immediate change upon the product. The acid qualifies for the exemption.

B) Example 2. An aluminum oxide catalyst is used in a catalytic cracking process to refine heavy gas oil into gasoline. In this process, large molecules of gas oil or feed are broken up into smaller molecules. After the catalyst is injected into the feed and used in the cracking process, it is drawn off and reused in subsequent manufacturing processes. The catalyst qualifies for the exemption. 86 Ill. Adm. Code 130.330(c)(6).

### **Horsehead Corporation**

The Petitioner, Horsehead Corporation,<sup>2</sup> is a Delaware corporation with its headquarters in Pennsylvania. Horsehead produces zinc, zinc oxide and zinc powder from recycled sources through multiple facilities, including a processing plant in Calumet City, Illinois. Once Horsehead extracts and produces zinc in its various forms, those products are sold to third parties or for resale.

### **Horsehead's Zinc Extraction Process**

The zinc extraction process at Horsehead's Calumet City facility begins with Horsehead obtaining electric arc furnace dust (EAF Dust) from steel mill producers. EAF Dust contains zinc oxide, iron oxide and various impurities which may include chlorides, lead and cadmium. Horsehead heats the EAF Dust with coke in Waelz kilns to a point where impurities are stripped away from the zinc oxide, pure zinc is extracted and zinc is collected in powder form. The remaining EAF Dust is heated to a higher temperature in order for the iron (ferrous) oxide, which has a higher melting point than zinc oxide, to be separated from impurities. The resulting zinc powder, also known as zinc dust, and the iron-rich material is sold to third parties for use in their own manufacturing processes.

### **The Waelzing Process**

Three witnesses were called to explain the "Waelzing process" at the final hearing by the Petitioner: John Schlesinger, Ph.D. and professor of metallurgical engineering at Missouri University of Science and Technology; John Pusateri, the Director of Technology at AZR; and Reges Zagrocki, an employee of AZR who

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<sup>2</sup> Horsehead Corporation changed its name to American Zinc Recycling, Corp. (AZR) in May 2017 according to the AZR website.

provides technical support to AZR's recycling groups. Dr. Schlesinger testified as an expert witness.

Horsehead utilizes two rotary Waelz kilns to process EAF Dust and to extract zinc at its Calumet City plant. Joint Final Pretrial Order Stip.1. One kiln is approximately 180 feet long and 10 and a half feet in diameter and the other kiln is 160 feet long and 12 feet in diameter. The kilns are slightly inclined and rotate slowly on their axes. EAF Dust and coke are heated in the kilns. *Id.*

Horsehead purchases finished coke, which is more expensive than coal, for use in its Waelz kilns. John Pusateri testified that "Metallurgical coke is produced during the destructive distillation of coal." Tr. 47-48.<sup>3</sup> During that process, coal is heated to give off compounds and volatile materials, such as methane, which results in a material higher in carbon than ordinary coal. The carbon material is screened, and the fine particles, or "breeze," is collected and sold as finished coke. *Id.*

The first step in processing the coke and EAF Dust for use in a Waelz kiln is to pelletize those materials by mixing the EAF Dust, which is a fine brown powder, with the metallurgical or finished coke compound, at about a twenty-five percent ratio to the EAF Dust. Water is also added to the mixture so that the powders cling together. The mixture produces pellets that are a quarter of an inch or less in diameter. Tr. 51-53. The purpose of pelletizing the powdered coke and EAF Dust is twofold: first, it makes the physical handling of the powders into the feed tube of a kiln easier, and, second, it places the right amount of carbon in the vicinity of the EAF Dust so that the twenty-five percent ratio for further processing can be achieved. Tr. 53.

When pellets enter a Waelz kiln, the pellets are fed on one side of the kiln and oxygen from the air outside the kiln is drawn in on the opposite side of the kiln. Tr. 55-56; Petr. Ex. 2A.<sup>4</sup> An external energy source, a natural-gas burner, is used to begin heating the kiln. The heated air within the kiln begins to dry out the pellets and heats the pellets to 600-700 degrees centigrade at which point chemical reactions begin to occur.

This initial process is described as the drying zone, the first of four "zones" that encompass the overall processing steps that occur in a Waelz kiln. Petr. Ex.1. The overall processing steps within the four zones take approximately two to two

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<sup>3</sup> "Tr." followed by a number refers to the transcript of proceedings for the final hearing in this matter.

<sup>4</sup> For one of Horsehead kilns, just the EAF Dust is pelletized and coke is added with the pellets as those two items are fed into that kiln. Tr. 88; 90.

and a half hours from start to finish. Tr. 82. At the conclusion of the overall processing steps, virtually all the coke is consumed. Tr. 79; 82-83.

The second zone in the kiln is described as the “reduction zone.” *Id.* Several chemical reactions occur in this stage. As the coke burns, carbon from the coke reacts with carbon dioxide to create carbon monoxide.<sup>5 6</sup> Tr. 24. That conversion is an endothermic process, or one which consumes energy. Tr.27-28.

The carbon monoxide acts as a reducing agent.<sup>7</sup> Tr. 38; 61. The carbon monoxide seeps into the bed of the Waelz kiln and reduces the zinc oxide in the bed to zinc vapor. Tr. 24.<sup>8</sup> The carbon monoxide also reduces the iron oxide in the bed of the kiln to metallic iron. Tr. 61-63.<sup>9</sup> Both the zinc oxide and the iron oxide reductions produce carbon dioxide along with zinc and iron. That carbon dioxide reacts with the burning carbon to create additional carbon monoxide, and those cycles continue through the zone two processes. Tr. 61-62.

In the third zone of the Waelzing process, the metallic iron reacts with the oxygen in the air to reform iron oxide. Tr. 26.<sup>10</sup> That reaction is exothermic, which generates heat. Tr. 26. By the time the entire Waelzing process is completed, the kiln reaches temperatures between 1,000 and 1,100 degrees centigrade due to the exothermic processes occurring within the kiln. Tr. 60. The exothermic reactions occurring in the kiln that create heat make the Waelz process self-sustaining. Tr. 57-59.

In the fourth, or final zone, of the Waelz process, the zinc vapor rises from the kiln and reacts with the oxygen dioxide in the air to form zinc oxide. Tr. 28-29.<sup>11</sup> This reaction is also exothermic which adds to overall heating of the kiln. Tr.29. The zinc oxide is small particulate matter which is drawn off from the top of the kiln. Tr. 29-30. The zinc oxide particulate is what is called Waelz oxide, or crude zinc oxide. That material is sent to another Horsehead plant in Pennsylvania,

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<sup>5</sup> “Under normal circumstances, when coke is burned in an oxygen rich atmosphere (such as outside the kiln), the carbon (C) in the coke burns to produce carbon dioxide (CO<sub>2</sub>). However, when it is burned in an oxygen-poor atmosphere (such as in the kiln), some of the carbon forms carbon monoxide (CO).” Parties Joint Stipulation #2.

<sup>6</sup> Stated as a chemical formula,  $C+CO_2=2CO$

<sup>7</sup> “Reduction reactions are the ones that convert iron oxide into metallic iron and zinc oxide into zinc vapor.” Tr. 32.

<sup>8</sup>  $ZnO (solid)+CO= Zn(a gas)+CO_2$

<sup>9</sup>  $FeO (solid) +CO= Fe(a solid)+CO_2$

<sup>10</sup>  $Fe+ \frac{1}{2}O_2= FeO$

<sup>11</sup>  $Zn+\frac{1}{2}O_2= ZnO$

where it is further refined in a kiln to boil off certain impurities such as chlorides, compounds and oxides before the zinc oxide is sold to customers. Tr. 66-67.

The metallic iron which was formed during the Waelzing process is also collected and sold to Horsehead customers, primarily cement plants, which use that iron in making a certain type of Portland cement. Tr. 68.

## **2. Analysis**

### **A. Burden of Proof**

The two Notices of Liability offered in evidence by the Department at the final hearing provide *prima facie* proof that the Department's assessments in those notices are correct. 35 ILCS 120/4; 35 ILCS 105/12.

The parties have presented the sole substantive issue in this case to be whether the coke used by Horsehead in its Waelz kilns to reclaim zinc and metallic oxides from EAF dust meets the definition of a chemical or a chemical acting as a catalyst for purposes of qualifying for the manufacturing machinery and equipment exemption from Illinois use tax. 35 ILCS 105/3-50(4). As a general proposition, a taxpayer claiming an exemption from tax bears the burden of proving it is entitled to the exemption. "Under Illinois law, taxation is the rule. Tax exemption is the exception." *Provena Covenant Medical Center v. Dep't of Revenue*, 236 Ill. 2d 368, 388 (2010). "A person claiming an exemption from taxation has the burden of proving clearly that he comes within the statutory exemption. Such exemptions are to be strictly construed, and doubts concerning the applicability of the exemptions will be resolved in favor of taxation." *Zenith Electronics Corp. v. Dep't of Revenue*, 293 Ill. App. 3d 651, 655 (1<sup>st</sup> Dist. 1997) (citing *Van's Material v. Dep't of Revenue*, 131 Ill. 2d 196, 216 (1989)).

### **B. The Chemical Exemption**

The pertinent portion of the manufacturing and machinery equipment exemption statute for this case is: "Equipment includes chemicals or chemicals acting as catalysts but only if the chemicals or chemicals acting as catalysts effect a direct and immediate change upon a product being manufactured or assembled for wholesale or retail sale or lease." 35 ILCS 105/3-50(4).

To determine whether Horsehead's purchases of coke qualify for the exemption from use tax, the plain language of the that statutory subsection must be reviewed and interpreted. "The fundamental rule of statutory interpretation is to determine and give effect to the intent of the legislature, and the statutory language is the best indicator of the legislature's intent." *Quality Saw & Seal, Inc. v. Ill. Commerce Comm'n*, 374 Ill. App. 3d 776, 781, (2<sup>nd</sup> District 2007). "The best indication of legislative intent is the statutory language, given its plain and ordinary meaning." *Andrews v. Kowa Printing Corp.*, 217 Ill. 2d 101, 106 (2005). "Where the language is clear and unambiguous, we must apply the statute without resort to further aids of statutory construction." *Id.*

To qualify for the exemption, the chemicals or chemicals acting as a catalyst must effect "a direct and immediate" change upon a product being manufactured. The plain and ordinary meaning of "direct" includes "1) Extending or moving from one place to another without changing direction or stopping....2) Without intervening factors or intermediaries."  
(<https://en.oxforddictionaries.com/definition/direct>).

Immediate is defined includes "Occurring or done at once: instant."  
(<https://en.oxforddictionaries.com/definition/immediate>).

The terms "direct" and "immediate" are clear and unambiguous, so there is no need to resort to further aids of statutory construction. The Department regulations<sup>12</sup> provides two examples of reactions that are direct and immediate:

A) Example 1. A chemical acid is used to etch copper off the surface of a printed circuit board during the manufacturing process. The acid causes a direct and immediate change upon the product. The acid qualifies for the exemption.

B) Example 2. An aluminum oxide catalyst is used in a catalytic cracking process to refine heavy gas oil into gasoline. In this process, large molecules of gas oil or feed are broken up into smaller molecules. After the catalyst is injected into the feed and used in the cracking process, it is drawn off and reused in subsequent manufacturing processes. The catalyst qualifies for the exemption. 86 Ill. Adm. Code 130.330(c)(6).

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<sup>12</sup> Administrative regulations have the force and effect of law and are interpreted with the same canons as statutes. See *Hartney Fuel Oil Co. v Hamer*, 2013 IL 115130, ¶37 (citing *People ex rel. Madigan v. Ill. Commerce Comm'n*, 231 Ill. 2d 370, 380 (2008)).

Does Horsehead's coke directly and immediately cause a change the product, zinc, being sold by Horsehead? The direct and immediate answer is "No."

Coke does not react with zinc oxide or zinc directly and immediately. Simply placing coke next to zinc oxide or zinc does not create any chemical reaction whatsoever, a point conceded by Horsehead's own witnesses. Tr. 24; Tr. 77. "Q. Okay. So, in other words, --so all these steps have to take place? In other words, the coke or carbon do not react directly with either the zinc oxide or the iron oxide to reduce them to zinc and iron? That's correct; is it not? A. That's right." Tr. 37-38. The lack of a direct and immediate reaction dooms the Petitioner's argument to the contrary.

One of the first in the series of chemical reactions that take place during the entire Waelz process, which occurs over several hours, is the formation of carbon when the solid coke is heated, burned and consumed. One chemical reaction that occurs afterwards is the combination of carbon with oxygen to form carbon monoxide. Following that reaction, carbon monoxide reduces both zinc oxide and iron oxide to zinc and iron while carbon dioxide is also formed. The final material reactions in the kiln are for the zinc and iron to combine with oxygen dioxide in the air in the kiln to form zinc oxide and iron oxide. Nowhere within those chemical processes and reactions, does coke have a direct and immediate effect on zinc oxide and iron oxide.

Horsehead's argument that coke has a direct and immediate effect on the final zinc and iron products relies on collapsing and conflating all steps within the Waelz process into one continuous and singular chemical reaction. That simplistic view turns the chemical exemption statute on its head as it would logically follow that any chemical which is used for any reason at any time during a manufacturing process would qualify for the exemption despite not causing a direct or immediate change on the final product. The limiting language used by the Illinois legislature in the exemption statute clearly indicate their intent to include only chemicals or chemicals that act as catalysts that effect a direct and immediate change as the only types of chemicals that qualify for the exemption.

Horsehead's argument renders the language "direct and immediate" void. "In giving meaning to the words and clauses of a statute, no part should be rendered superfluous" and "[s]tatutory provisions should be read in concert and harmonized." *Hartney Fuel Oil Co. v Hamer*, 2013 IL 115130, ¶ 25 (citing *Standard Mutual Insurance Co. v. Lay*, 2013 IL 114617, ¶ 26 and *People v. Rinehart*, 2012 IL 111719, ¶ 26).

In its presentation at the final hearing of this case, all three of Horsehead's witnesses were asked to explain the Waelz process. They were all shown demonstrative exhibits consisting of four charts, each representing the four zones of the Waelz process. (Pet'r Ex. 2A-2D). In a case where each step of the process had to be reviewed and analyzed to determine whether coke qualifies for the manufacturing exemption, the chemical reactions displayed on Chart 2B were inaccurate and misleading as the formulas stated on that chart that carbon reacts with iron oxide and zinc oxide when it is carbon monoxide, not carbon, that reacts with those two compounds. That chart "compresses" the overall reactions which puts the coke closer to the final product reactionwise. The inaccuracies of the various chemical reactions were cleared up somewhat during the expert witness's testimony:

Q. And the only reason I say that is because you said that there were a couple, you know, this is kind of short-handing a couple steps. I think that's what's being short-handed.

A. Well, what's being short-handed is the overall reduction reaction. The reduction reaction that you see reacts iron oxide to carbon to produce iron and CO<sub>2</sub>; but, in fact, if I were to take a hunk of solid iron oxide and place it next to a hunk of solid carbon, nothing would happen because that then would be a solid state reaction. So what actually happens in this process is that as this reaction generates CO<sub>2</sub>, it reacts with the carbon to produce two carbon monoxides. The carbon monoxide is a gas and can diffuse into the solid feed pellets; and when that happens, the carbon monoxide actually reduces the iron oxide to metallic iron and reduce the zinc oxide to zinc vapor. Once that happens, in the process of reducing it, the carbon monoxide becomes carbon dioxide; and then that frees up the carbon dioxide to react with more carbon and produce more carbon monoxide to keep the reduction process moving

Q. Just to drill down on that, you said if you started with the two solid components of this reaction and you just put a solid next to a solid, nothing would happen.

A. Yeah. Tr. 23-24.

The other two witnesses also acknowledged that the charts were inaccurate. "Well, the carbon is actually—these reduction reactions are a little bit simplified as what actually occurs is the carbon-as the bed heats up, the carbon in the bed

begins to partially oxidize to carbon monoxide: and that is the main reducing agent for iron oxide and zinc oxide..." Tr. 78. "Q. Okay. Just to make this clear, where the equation shows, for example, FeO plus C reacts and forms Fe iron plus CO<sub>2</sub>, this really should be FeO, meaning iron oxide, this really should be CO, carbon monoxide, correct? A. Yes." Tr. 100. <sup>13</sup>

### Catalysts

The plain language of 35 ILCS 105/3-50(4) includes the term "catalyst." A chemical catalyst is defined as "A substance that enables a chemical reaction to proceed at a faster rate or under different conditions (as at a lower temperature) than possible." Merriam Webster Online Dictionary.

In his opening statement and closing argument, both of which are not evidence, counsel for Horsehead used the term "catalyst," but did not use it to describe the chemical compound at issue, coke, but for one of its byproducts, carbon. "You will also hear how the carbon acts as a catalyst...Under the applicable tax rules, the carbon-if carbon is a catalyst, it will be exempt from use tax." Tr. 8-9. (opening statement). "The carbon in the coke is being converted to a gaseous form because that's how the reaction occurs. Just like any kind of catalyst particulate -catalyst process, you need the presence of the carbon just like you need--as you need the presence of any other catalyst for the reaction to occur." Tr. 107. (closing argument). That claim was also repeated in the Petitioner's Post-Trial Brief. "In order to refine the zinc and iron from the EAF Dust, Petitioner has to use a chemical catalyst." Pet'r Post-Trial Brief at 1,3.

Neither coke, or even carbon, is a catalyst under the definition for catalyst, above, but are simply chemical compounds and chemicals necessary to be integrated in the overall chemical processes used to extract zinc and iron oxide from the EAF Dust in Horsehead's Waelz kilns. Most telling, despite calling an expert witness and two experienced and knowledgeable employees of Horsehead, none of the witnesses were asked to define the term "catalyst," and none of the questions posed or the answers given by any of the witnesses included the term "catalyst."<sup>14</sup>

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<sup>13</sup> Charts 2C and 2D contain the same inaccuracies as they both repeat the reactions occurring in Zone 2 of the Waelz process. Tr. 101.

<sup>14</sup> Petitioner makes the additional arguments that 1) coke should not be considered to be coal, and therefore disqualified for the exemption as a fuel under 86 Ill. Adm. Code 130.330(c)(3), and 2) even though the coke is consumed, as opposed to being reused, it still would qualify for the exemption. Pet'r Post-Trial Brief at 10-13. Because the coke does not effect a direct and immediate change on the zinc as an initial matter, these issues are moot and do not need to be decided at this time.

## Direct and Immediate Changes

To support its position that coke effects a direct and immediate change on the zinc product it sells, Horsehead refers to *PPG Industries, Inc. v. Department of Revenue*, (No. 13 L 050140, September 9, 2014). However, that case is a circuit court case with no precedential value.<sup>15</sup> Petitioner properly identified *PPG* as a circuit court case and proceeded to argue that its use of coke effects a direct and immediate change on zinc based on a review of that case. In addition to being non-precedential, the analysis in *PPG* is not persuasive.

In *PPG*, the taxpayer manufactured glass through a float process in which raw material was fed into a 200-foot-long furnace which was heated and which produced 1500 ton batches of molten glass.<sup>16</sup> The molten glass was poured onto molten tin and formed a continuous glass ribbon. The glass ribbon moved from the furnace through a 60-foot cooling chamber known as a float bath and, finally, to an oven where stresses in the glass were removed. After those processes, the glass was cut and sold.

The float bath was used to size glass, create a uniform thickness in the glass and to cool the glass. The taxpayer used nitrogen and hydrogen to cool the heating elements and other machinery located in the upper plenum of the bath chamber and to pressurize the lower plenum to reduce the amount of oxygen in the bath's atmosphere.

The administrative law judge found that the nitrogen and hydrogen did not effect a direct and immediate change on the glass being manufactured for sale. He determined those chemicals were used to cool the machinery in the bath chamber, and that the hydrogen reacted with oxygen in the bath chamber as opposed to reacting to the final product, glass. Accordingly, the administrative law judge decided against the taxpayer and held that hydrogen and nitrogen purchases by the taxpayer did not qualify for the exemption under 35 ILCS 105/3-50(4).

The circuit court judge overruled that finding. He did agree that the nitrogen and hydrogen did not react chemically with the glass, but decided that the two chemicals still qualified for the exemption. The court held that a

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<sup>15</sup> There is no Illinois Appellate Court case, which would be precedential, that defines "direct and immediate" for purposes of the chemical exemption statute.

<sup>16</sup> The following factual underpinnings of *PPG* are taken from the underlying Department's administrative law decision, UT 13-07 (11/29/2012). The circuit court adopted the findings of fact made by the administrative law judge and reversed the administrative law judge's decision.

“proximate” cause of an event was the equivalent of being a “direct” cause of an event.

The circuit court judge was wrong in determining that the term “direct” for purposes of 35 ILCS 105/3-50(4) should be defined to encompass any chemical reaction that was in a proximate causal relationship with the ultimate item being manufactured. As stated above, the term “direct” is easily defined as “(1) Extending or moving from one place to another without changing direction or stopping....2) Without intervening factors or intermediaries.” The simple definition of “direct” does not encompass the legal theory of proximate cause, a term used for negligence and criminal actions.

For example, “To recover in negligence actions, a plaintiff must establish that defendant owed a duty to plaintiff and that the breach of this duty proximately caused the injuries of which plaintiff complains.” *Bogovich v. Nalco Chemical Co.*, 213 Ill. App 3d 439, 441 (1<sup>st</sup> Dist. 1991). “Proximate cause has been defined as that cause which, in natural or probable sequence, produces the complained of injury.” *Id.* (citing cases).

To adopt Horsehead’s unwieldy argument that any chemical reaction which “proximately caused” a final product would, once again, turn the chemical exemption statute on its head. That broad application would mean that any chemical used in a chemical process would be encompassed in the universe of exempt chemicals under that statute as opposed to the finite group of chemicals that were clearly intended by the state legislature to be included as exempt chemicals—only those that effected a direct and immediate change on a final manufactured product.

Even assuming, *arguendo*, that the term or legal theory of proximate cause could be included in a tax statute, the state legislature chose not to do so. In *People v. Wilson*, 343 Ill. App 3d 244 (3<sup>rd</sup> Dist. 2010), the court noted that the term “probable cause” appeared in 19 Illinois statutes. *Id.* at 248. Had the Illinois legislature wanted to use the term “proximate cause” in enacting or amending the chemical exemption statute and use that term in lieu of “direct,” it clearly could have done so. In choosing not to do so, the legislature clearly signaled that the term “direct” means just that, and nothing more.

Moreover, Horsehead’s argument also fails to address the term “immediate” used in conjunction with the term “direct” in the chemical exemption statute. In *Wilson*, the court quoted the 2009 Illinois Pattern Jury Instruction, Civil, No. 15.01, “When I use the expression ‘proximate cause,’ I mean a cause which, in the

natural and ordinary course of events, produced the plaintiff's injury. It need not be the only cause, nor the last or nearest cause. It is sufficient if it combines with another cause resulting injury."

Accordingly, a proximate cause is not required to have the temporal limitation of immediacy to an injury. It can occur any time prior to a final injury so long as it produces the injury. That is the opposite of the required temporal limitation that describes chemical reactions that must occur for a chemical to qualify for the exemption under 35 ILCS 105/3-50(4). Only those chemicals which effect a direct and immediate change upon a product being manufactured are exempt.

### **C. Imposition of Penalties**

Late payment and late filing penalties were imposed on Horsehead in the relevant Notices of Liability in this matter pursuant to the Uniform Penalty and Interest Act, incorporated in the Use Tax Act at 35 ILCS 105/12. Horsehead believes those penalties should not have been imposed as it had reasonable cause to take the position it did on the singular substantive issue of whether the purchases of coke used in its Calumet City, Illinois Waelz kilns qualified for an exemption under 35 ILCS 105/3-50(4).

The Department's Regulation on what should be considered as reasonable cause to avoid penalties, reads, in part:

b) The determination of whether a taxpayer acted with reasonable cause shall be made on a case by case basis taking into account all pertinent facts and circumstances. The most important factor to be considered in making a determination to abate a penalty will be the extent to which the taxpayer made a good faith effort to determine his proper tax liability and to file and pay his proper liability in a timely fashion.

c) A taxpayer will be considered to have made a good faith effort to determine and file and pay his proper tax liability if he exercised ordinary business care and prudence in doing so. A determination of whether a taxpayer exercised ordinary business care and prudence is dependent upon the clarity of the law or its interpretation and the taxpayer's experience, knowledge, and education. Accordingly, reliance on the advice of a professional does not necessarily establish that a taxpayer exercised ordinary business care and prudence, nor does reliance on incorrect facts

such as an erroneous information return. 86 Ill. Adm. Code 700.400(b) and (c).

Horsehead argues that in compliance with subsection (c) above, the lack of a specific definition of the term “direct and immediate change” in the chemical exemption statute, rendered that law unclear. Pet’r Post-Trial Brief at 14-15. As support for its position, it points to the fact that the Circuit Court judge in the non-precedential case, *PPG Industries, Inc. v. Dep’t of Revenue*, (No. 13 L 050140, September 9, 2014), noted as much. Horsehead also claims that its filing history with the Department, which was noted in the audit file, reflected compliance in all regards to its state taxes otherwise. *Id.* at 15.

As to its latter argument, taxpayers are expected to be compliant with tax laws and be up to speed in filing and paying taxes. Horsehead has shown good conduct in that regard. That conduct carries some, but not a great deal of, weight in supporting its claim of good faith when it failed to pay use tax on its purchases of coke.

During the final hearing in this matter, Horsehead did not present any witness or evidence to support its claim of good faith in taking the position it did on the chemical exemption issue, although it had the opportunity to do so.<sup>17</sup> The record in this case is silent as to what or who the taxpayer relied upon in choosing to claim its coke purchases as catalysts when it chose not to pay the use tax in question other than the Petitioner’s claim that the term “direct and immediate” is undefined, leaving the chemical exemption statute unclear.

In its Supplemental Post-Trial Brief, the Petitioner alleges that it had been audited by the Department previously, and that no adjustment was proposed as to its coke purchases. That may be true, but there was no evidence at the final hearing as to any previous audits, and, more importantly, there was no evidence at the final hearing that the coke exemption issue was ever raised in any other audit and if being raised, the action of the Department in acquiescing to that issue gave comfort to the taxpayer that its position rested on sound footing.

In its Post-Trial Brief and again in its Supplemental Post-Trial Brief, the Petitioner cites to the non-precedential circuit court opinion in *PPG* as further support for its claim of good faith as that court noted there was no statutory or regulatory definition of “direct and immediate change.” Pet’r Post-Trial Brief at 4-

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<sup>17</sup> The Department’s audit file which was admitted into evidence, but not referred to during the hearing, referenced Horsehead’s history of tax compliance.

15: Pet'r Supplemental Post-Trial Brief at 2. "As recently as the Circuit Court's 2014 decision in *PPG Industries*, *infra*, the Court concluded that there was no statutory or regulatory definition of those terms (*PPG Industries*, *infra*). Accordingly, if the Circuit Court took judicial notice of the fact that the sole applicable statute and regulation were missing definitions of the key operative words, it would be fair to say the law was unclear." Pet'r Post-Trial Brief at 14-15.

It is clear, without reading that circuit court case, that there was no statutory or regulatory definition of the term "direct and immediate change" for purposes of the chemical exemption, but that begs the question as to whether that allows the Petitioner to claim good faith in this case. As stated previously, the terms "direct" and "immediate" have their simple every day meaning as used in the statute, and those meanings provide clarity to the statute, as opposed to a lack of clarity as argued by the Petitioner.<sup>18</sup>

The Notices of Liability in this case are for tax periods between January 2007 and June 2011. The unpublished circuit court opinion in *PPG* wasn't issued until 2014, well after the use tax on Horsehead's coke purchases should have been paid. While it is proper to adopt any reasoning in that decision in making an argument about the substantive issue in this case, it is another matter to cite to that court case as support for a claim of good faith when the decisions to not pay the use tax predates that court case by years.

Petitioner's argument that it was in good faith when it failed to pay use tax on its purchases of coke is rejected.

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<sup>18</sup> To be sure, a statute or regulation which lacks clarity may, standing alone, provide a taxpayer a basis to claim good faith as to that taxpayer's position on an issue in dispute.

#### **D. Conclusion**

The two Notices of Liability in the matter are affirmed in their entirety. The assessments of use tax, interest, late filing and late payment penalties are affirmed.

This is a final order subject to review under section 3-113 of the Administrative Review Law, and service by email is service under section 3-113(a). The Illinois Independent Tax Tribunal is a necessary party to any appeal.

*s/ James Conway*  
JAMES M. CONWAY  
Chief Administrative  
Law Judge

Date: October 13, 2017