ILLINOIS INDEPENDENT TAX

TRIBUNAL

HORSEHEAD CORPORATION, Petitioner,	)	
v.	)	14 TT 227
ILLINOIS DEPARTMENT OF REVENUE Respondent.	)	Chief Judge James M. Conway

PETITIONER'S BRIEF IN SUPPORT OF PETITION

NOW COMES PETITIONER, HORSEHEAD CORPORATION, by its attorneys, Joseph E. Bender and Difede Ramsdell Bender PLLC, and herewith submits this Brief in Support of its Petition before the Illinois Tax Tribunal to determine that it does not owe the Use Tax assessed by the Department of Revenue.

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INTRODUCTION

This case involves the purchase by Horsehead Corporation ("Petitioner") of high carbon "coke" as part of its refining process to separate electrical arc furnace dust (or "EAF Dust") into its two primary component parts, namely zinc and iron. EAF Dust is a by-product of steel manufacturing and the Petitioner purchases the EAF Dust from various steel mills. Petitioner uses the coke to split the EAF Dust into zinc and iron, and the issue is whether the coke qualifies for an exemption from Illinois' Use Tax as a chemical that effects a "direct and immediate change" on the EAF Dust.

This Brief is divided into eight parts. Part I is an overall statement of the case. Part II is the background of the refining process by which Petitioner refines the EAF Dust into its component parts. Part III outlines the audit by the Illinois Department of Revenue (the "Department"), and Part IV confirms the Tribunal's jurisdiction over the case. Part V of the Brief discusses the burden of proof, with the legal arguments contained in Part VI. Part VII outlines the penalties imposed by the Department, followed by the conclusion in Part VIII.

I. Statement of the Case. This is a case involving the Illinois Use Tax Act, 35 ILCS 105/1 et seq. The Petitioner, Horsehead Corporation (now known as American Zinc Recycling) operates a zinc refining business in several states, including a refinery located in Calumet City, Illinois. Petitioner refines the zinc from EAF Dust and does so through the "waelzing" process. The waelzing process also produces iron oxide that Petitioner sells.

EAF Dust is a by-product of steel mills that contains iron, zinc and a number of other trace elements. The entire objective of the waelzing process is to separate and purify the zinc and iron from the EAF Dust.

In order to refine the zinc and iron from the EAF Dust, Petitioner has to use a chemical catalyst. The chemical that accomplishes the waelzing process is carbon, which Petitioner purchases in the form of coke. As will be detailed below, the coke is heated and becomes gaseous, and that gas reacts with the

zinc oxide released in the processing of the EAF Dust to result in pure zinc.

The question before the Tribunal is whether the coke used as a chemical to separate the zinc and iron from the EAF Dust qualifies as exempt from the Illinois Use Tax.

II. Background.

1. Petitioner is based in Pittsburgh, Pennsylvania with refining locations in Calumet City Illinois, as well as in Barnwell South Carolina, Rockwood Tennessee and Palmerton Pennsylvania (Final Pretrial Order, Stipulation of Facts, paragraph 1).

2. In each of the refining locations, Petitioner has one or more waelz "kilns." The waelzing process occurs in each of these kilns. Each kiln is a large, rotating cylindrical oven approximately eleven feet in diameter and approximately 170 feet long. Each kiln is angled so that as it rotates, the pelletized EAF Dust slowly works its way from the mouth of the kiln to the end of the kiln (Hearing Transcript [hereinafter, "HR Tr."] page 40, lines 17-24 and page 51, lines1-4).

3. Before the waelzing process begins, Petitioner "pelletizes" the EAF Dust. The EAF Dust is very fine, and in order to facilitate handling, the EAF Dust is mixed with water to produce pellets a little bit smaller than a quarter of an inch. That avoids the problem of having the fine EAF Dust blow around during the refining process (HR Tr. page 51, lines 20-24 and page 52, lines 1-14).

4. In order to start the waelzing process, Petitioner heats the waelzing kiln by using natural gas heaters located outside of the kiln (additionally, the process produces heat as described below) (HR Tr. page 56, lines 1-7). Next, the pelletized EAF Dust is fed into the waelz kiln and the waelzing process begins (HR Tr. page 55, lines 4-20).

5. There are a number of steps that occur during the waelzing process (HR Tr. page 61, lines 1-24; page 62, lines 1-9). As the coke and EAF Dust pellets are heated in the bed of the kiln, the coke (and specifically, the carbon in the coke) is immediately engaged in the process. The coke starts to become gaseous, and as outlined in the hearing, gaseous carbon is carbon monoxide (HR Tr. page 36,

lines 9-15). The gaseous coke then reacts with the zinc and iron compounds in the EAF Dust by stripping oxygen molecules from those zinc and iron compounds to produce solid iron particles and zinc vapor. At that point, the zinc vapor fumes up out of the bed (HR Tr. page 57, lines 21-24, page 58, lines 1-10).

6. Now in the process, Petitioner has to crack the oxygen molecule off from the zinc oxide. The coke comes into play again. In order to crack off that oxygen molecule, Petitioner needs to use the carbon in a gas form as a catalyst or a chemical to split the bond of the zinc with the oxygen. As the coke is heated in the waelz kiln, it releases the carbon in the form of carbon monoxide (represented by the symbol CO). The carbon monoxide cracks off the oxygen molecule from the zinc oxide, so that you are left with pure zinc, which is a vapor at the process operating temperatures.

From a formula standpoint, the overall chemical equation is:

Zinc oxide in the heated EAF Dust *and* carbon monoxide from the heated coke

produces

carbon dioxide *and* pure zinc

or

$$\mathbf{ZnO + CO = CO_2 + Zn}$$

7. As the zinc fumes off in the process and turns into zinc vapor, that zinc vapor combines with the oxygen from the air above the bed of the kiln, resulting in zinc plus oxygen, or zinc oxide, (represented by the chemical symbol ZnO (the Zn is zinc, which combines with a single molecule of oxygen, or O)) (HR Tr. page 57, lines 21-24, page 58, lines 1-10). That reoxidation of the zinc (i.e., bonding together of the gaseous zinc with an oxygen molecule) produces a substantial amount of heat which allows the waelz process to be self-sustaining (HR Tr. page 58, lines 11-18).

8. The zinc oxide that is produced is in a fine particle form, and a fan at the end of the process draws the zinc oxide particles into a fabric filter baghouse where they are collected (HR Tr. page

66, lines 9-16). The zinc particles are then sent to another facility owned by Petitioner for a second stage of refinement consisting of direct heating to drive off any further impurities (HR Tr. page 66, lines 19-24; page 67, lines 1-17). Note that the second stage of heating is done by way of gas fired furnace, since no additional carbon is needed (Id).

9. Petitioner also derives a second source of revenue from the process; as mentioned above, the EAF Dust consists primarily of iron and zinc. In the waelzing process, the zinc and the iron are separated. The zinc undergoes a second stage of refinement and is sold, but the iron that remains in the kiln is cooled, collected and sold as additive to construction material (an aggregate) or in the making of Portland type 2 cement (HR Tr. page 68, lines6-23).

III. Department of Revenue Audit.

The Department audited Petitioner on the basis that the high carbon coke that Petitioner purchases and uses as a chemical in the process does not qualify for the exemption under the Illinois Use Tax Act for Manufacturing Machinery and Equipment. The period under audit was January 1, 2007 through June 30, 2009 and July 1, 2009 through June 30, 2011. At trial, the Department alternatingly claimed that the coke was used as a heat source for the waelz kiln, or that the coke did not qualify for the exemption. The Department issued two Notices of Tax Liability (the "NTLs") dated October 3, 2014 assessing tax on that basis.

IV. Jurisdiction.

Petitioner filed a Petition with the Illinois Tax Tribunal dated December 1, 2014, which was within the statutory period for filing a petition with the Tribunal. Accordingly, the Tribunal has jurisdiction of this case pursuant to 35 ILCS 1010/1-45 and 35 ILCS 1010/1-50.

V. Burden of Proof.

The Department introduced the NTLs for the tax period in controversy under the Final Pretrial Order. Petitioner agrees that the NTLs, without more, constitutes prima facie proof that the Petitioner

owes tax in the amount determined by Department. 35 ILCS 120/4.

However, the Department's prima facie case is overcome, and the burden shifts to the Department to prove its case, after the Petitioner presents evidence that is consistent, probable and closely identified with books and records, to show that the Department's determination was not correct. *Copilevitz v. Department of Revenue*, 41 Ill. 2d 154 (1968); *A.R. Barnes and Company v. Department of Revenue*, 173 Ill. App. 3d 826 (1st Dist. 1988); *DuPage Liquor Store, Inc. v. McKibbin*, 383 Ill. 276 (1943).

At the hearing, Petitioner introduced three witnesses (including an independent expert witness), all of whom testified consistently as to the waelzing process and the impact of the coke on the process. The witnesses also testified as to how the coke became gaseous due to the heat of the kiln, and that gaseous coke/carbon monoxide interacted directly with the EAF Dust to produce the desired outputs. That testimony corresponds with the Petitioner's records and tax treatment of the coke. Accordingly, the burden has now shifted to the Department to prove that the tax assessed in the NTLs is correct.

VI. Argument.

A. *Petitioner uses the Coke in the Waelzing Process, and the form of the Coke that is used is simply the Gaseous Form of that Coke*.

When you strip the Department's position to its core, the Department is arguing that Petitioner's purchase of the coke is not exempt since the coke has to be heated to interact as part of the waelzing process. Thus, the Department's argument goes, since the coke in its solid form does not interact directly with the EAF Dust, the coke is not an exempt chemical. However, the Department's argument misses the mark. In the process, Petitioner needs to use carbon. As was outlined in the hearing, coke is carbon in solid form. Then the Petitioner simply heats up the coke to use that carbon in its gaseous form. Petitioner agrees completely that the entire waelzing process involves a number of steps and reactions. However, that is not the focus of this case. Since the narrow question is whether the coke

acts as a chemical that affects a direct and immediate change on the EAF Dust, the focus and application of the exemption needs to be on the particular part of the waelzing process where the coke is used, and not on the multiple other reactions occurring in the overall process.

In his testimony, Dr. Schlesinger, Profession of Metallurgy at the University of Missouri, outlined the waelzing process undertaken by Petitioner at its Calumet City, Illinois location. Dr. Schlesinger discussed how the waelzing process starts with the input of EAF Dust. As he testified, EAF Dust is comprised of two main ingredients, namely zinc and iron oxide (plus a few other impurities in the EAF Dust). John Pusateri and Rege Zagrocki (the scientists at Petitioner who orchestrate the process) noted that the carbon, in the form of coke, would be added to the EAF Dust per the pelletizing process. The pelletized EAF Dust would then be loaded into the kiln, which would then be heated by use of an external natural gas burner.

In the kiln, the heat from the external natural gas heaters (along with the heat created by the oxidation of the zinc vapor) causes a couple of reactions to occur. After drying the pelletized EAF Dust and coke, the heat releases carbon monoxide from the coke and the carbon monoxide reacts with the zinc in the EAF Dust to form zinc vapor. As that zinc vapor is released from the kiln bed, the zinc vapor combines with oxygen in the freeboard, resulting in zinc oxide, or ZnO.

> Therefore, what the waelz process requires is the carbon, in gaseous carbon monoxide form. In this regard, Petitioner notes that, as explained in the hearing, the carbon molecules do not exist in a gaseous form in pure carbon ["Releasing carbon is sort of a difficult term to describe because its not like I have carbon atoms floating off by themselves in the atmosphere."] (TR page 36 lines 12-15).

The applicable provisions of the Use Tax Act provide that:

> Equipment" includes an independent device or tool separate from machinery but essential to an integrated manufacturing or assembly process; ...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.

120/2-45(4).

The Department's position is that since the coke in its solid form does not interact directly with the EAF Dust, Petitioner does not qualify for the exemption. However, that position misses the mark. Petitioner does cause the coke (comprised of virtually all carbon) to interact with the zinc oxide-it just does so in gaseous form. The coke is heated in the kiln and that same coke, in gaseous form, is the chemical that causes the required direct and immediate change upon the EAF Dust.

By way of example, Petitioner's process is identical to the concept of cooking a vegetable by either boiling that vegetable in water or steaming that same vegetable. Water is H_2O in liquid form, and steam is H_2O in gaseous form. There is no fundamental change in liquid water and gaseous water other than the application of heat. The carbon that Petitioner uses is exactly the same; coke is the chemical in the solid form, but in order to cause the reaction to occur, the coke needs to be converted into its gaseous form (in order to react with the zinc in EAF Dust). As the testimony in the hearing made clear, there is absolutely no step that has to occur to the coke *other than heating it up*. Accordingly, the coke makes a direct and immediate change on the zinc, *subject only to the requirement of heating it*. What Petitioner is doing is nothing more than releasing the active compound directly from the form in which it is purchased.

Further, as the Department argued in the hearing, its focus was on whether the coke in its purchased, solid form interacted directly with the zinc in the EAF Dust (*see, e.g.,* Tr. page 37, lines 13-18, which was the Department's cross-examination ["In other words, the coke or the carbon do not react directly with either the zinc oxide or the iron oxide to reduce them to zinc and iron?"]; TR page 78 and 79, lines 19-24 and 1 ["And what's happening in zone 2 is that as that coke is heated, it throws off carbon monoxide, correct...And it is that carbon monoxide that is effecting a change on the zinc and the

iron, correct?"]. That, in conjunction with the arguments made by the Department, make it clear that the Department would agree that if the coke interacted directly with the zinc oxide, then the Department would not challenge the exemption. However, Petitioner wants to stress that the coke is interacting directly and immediately with the zinc, just in gaseous form. Again, all that has to happen is that the coke is heated, and that step alone is how the coke interacts directly with the EAF Dust to cause the waelzing process to occur. Since heating it up is the only requirement for the coke to in fact interact directly with the zinc is heating it up, the exemption should be allowed.

B. *Assuming, Arguendo, that the test is measured on the Coke Purchased versus the Gaseous form of the Coke that is in the Kiln, the Petitioner is still Eligible for the Exemption.*

Even if you assume, *arguendo*, that the Department's interpretation of the requirements of the exemption is correct, the Petitioner is still entitled to the exemption.

As stated above, the Department is taking the position that the Petitioner's purchase of coke is not exempt because the coke has to be heated before it makes that direct and immediate change on the zinc. That requires an examination of what a "direct and immediate change" is.

The most recent judicial interpretation of a direct and immediate change was in the Circuit Court of Cook County in *PPG Industries, Inc. v. Illinois Dep't of Revenue,* (No. 13 L 050140, September 9, 2014). The Circuit Court was reviewing an administrative decision that PPG Industries was not entitled to a refund of use tax that it had paid on its purchase of nitrogen and hydrogen gas used in its manufacturing process. Specifically, PPG Industries manufactures flat glass using a process that involves heating the glass in a melting furnace, and then flowing the molten glass over a bed of tin to sizes specified by customers. During the process to cool the molten glass to its solid form, PPG Industries uses nitrogen gas to cool the glass and machinery, and hydrogen as a reducing agent to remove oxygen from the process (as was outlined in the hearing, a reducing agent removes the oxygen from the manufacturing process [HR Tr. page 62 lines 10-23]). PPG Industries filed for a refund of use

tax it had paid on the hydrogen and nitrogen, and the Administrative Law Judge denied the refund claim.

PPG Industries appealed the administrative denial to the Circuit Court, which reversed the denial of the refund claim and concluded that PPG Industries was entitled to the exemption and refund. The Circuit Court specifically examined the requirements of a "direct and immediate change" and concluded that PPG Industries' use of the nitrogen and hydrogen met the requirement. Specifically, the Court confirmed that there was no definition of "direct" in the Regulations, and thus the Court looked to the "plain, everyday meaning" of those terms (citing *Hennings v. Chandler*, 229 Ill 2d. 18, 224, 890 N.E.2d 920, 923 (2008)). The Court concluded that "direct" was the same as "proximate," and meant "a cause that directly produces an effect; that which is natural and continuous sequence, unbroken by any new independent cause, produces an event, and without which the [event] would not occur (citing *Bryan A. Garner*, Dictionary of Modern Legal Usage 104 (1987). The Court concluded that the nitrogen and hydrogen met both the direct and immediate causes in the Use Tax statute.

Thus, a chemical would be exempt if it proximately "produced an effect that was a natural and continuous sequence." Petitioner's use of the coke is falls squarely within that concept. Petitioner introduces coke (in pelletized form) with the EAF Dust in the kiln. Once heated, the coke becomes gaseous which reacts to strip off the oxygen molecule from the zinc oxide, resulting in pure zinc. The entire waelzing process is the continuous flow of one reaction after another. First, the coke is heated and becomes gaseous. Then, the gaseous coke interacts with the zinc to strip off the oxygen molecule from the zinc oxide, resulting in pure zinc. This falls squarely within the cited concept that the coke in the kiln causes the "natural, continuous, unbroken" event. At no point does Petitioner do anything to change the chemical processes that start with the introduction of EAF Dust, coke and heat to the waelz kiln-the entire process is an unbroken chain; all Petitioner does is put EAF Dust and the coke in the kiln and does not undertake any other steps.

As a further point, Petitioner notes that PPG Industries uses the hydrogen and nitrogen in its

process to likewise affect the oxygen in the process of manufacturing glass, in a manner identical to that used by Petitioner in the waelzing process.

As noted above, the Department's position is that the coke does not qualify merely because the coke has to be heated to its gaseous state during the process. By taking that position, the Department has concluded that in order to qualify for the exemption, a taxpayer cannot do anything with a chemical in the manufacturing process. If a taxpayer does do anything with a chemical, the Department's position goes, it would not qualify for the exemption. This can lead to some absurd related arguments. If the Department argues that coke is not exempt since you had to heat it up, what will it argue next? For example, if a circuit board manufacturer (within the meaning of Il. Amin. Code Sec. 130.330(c)(3)) purchased a 55-gallon drum of acid to etch a circuit boards, would the Department argue the drum of acid is not exempt since you had to open the drum up to release the acid that is inside? Would the Department argue that in order for the exemption to apply, you would have to place the drum of acid next to the circuit board and the *drum* of acid would have to cause a direct and immediate change to the circuit board? While this is obviously an outlandish example, it simply illustrates the flaw of the Department's logic.

C. *The Coke that Petitioner Purchases is **not** Coal, and thus the exclusion in Illinois Administrative Code Section 130.330(c)(3) does not apply.*

One issue that arose during the course of this matter was whether the Petitioner's use of the coke would fall outside of the exemption due to Section 2-45 of the Use Tax Act and corresponding Section 130.330(c)(3) of the Illinois Administrative Code. That Section of the Illinois Administrative Code provides that:

> Equipment includes any independent device or tool separate from any machinery but essential to an integrated manufacturing or assembling process: including ... 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 which require periodic replacement in the course of normal operation. ***The exemption does not include*** hand tools, supplies (such as rags, sweeping or cleaning compounds), coolants, lubricants, adhesives, or solvents, items of personal apparel (such as gloves, shoes, glasses, goggles, coveralls, aprons, masks, mask air filters, belts, harnesses, or holsters), ***coal***, fuel oil, electricity, natural gas, artificial gas, steam, refrigerants or water.
>
> (emphasis added)

Thus, the question is whether Petitioner's purchase of the coke was the same as "coal" as used in the Regulations such that the exemption for chemicals that cause a direct and immediate change would not be available.

There are two very straightforward reasons why the carveout in Code Section 130.330(c)(3) does not apply. First, as John Pusateri testified, the coke that Petitioner acquires for use in the process is metallurgical coke. (Tr. 47, lines 14). Metallurgical coke is a high carbon, highly purified input in the process. Effectively, coke is solid carbon. It is a different chemical structure than coal, and is different in appearance. Further, it is significantly more expensive than coal. Additionally, in the process of creating coke, you actually remove the features that make coal attractive as a heat source for the generation of power (HR Tr. page 48 lines 21-24 and page 49, lines 1-7). While Petitioner agrees that there is a relationship between coal and coke, there is that same relationship between a tree and a wooden canoe or ladder (or, for that matter, a diamond). No one would mistake a wooden ladder or diamond for a tree, and no one would mistake coke for coal (HR Tr. page 81, lines 2-24 and page 82 lines 1-8).

The second reason why Code Section 130.330(c)(3) does not apply is that the list of excluded items all have one thing in common-they are all sources of power. The list of excluded items is coal, fuel oil, electricity, natural gas, artificial gas, and steam. Those are all items that are used to produce mechanical energy--to power an engine, produce heat, etc. As Mr. Pusateri testified, Petitioner is not

purchasing the coke for energy generation. Rather, the coke is being purchased as a source of the carbon necessary for the waelzing process (Id.).

D. *Petitioner Does Not Purchase the Coke for Use as a Fuel or Heat Source.*

In the hearing and in the audit file introduced by the Department, the Department alleged that the Petitioner purchases the coke as a heat source, and not as an exempt chemical (*see, e.g.,* HR Tr. page 11, line 4). Petitioner simply wants to address this allegation. As all three witnesses testified consistently, the waelzing process begins with natural gas fired burners to heat the kiln. The process itself generates a substantial amount of heat, primarily through the oxidation of the zinc vapor (*see, e.g.*, HR Tr. page 27, line 22 ("the reoxidation (of zinc) is exothermic, which means that it generates energy"); HR Tr. page 65, lines 5-24 and page 66, lines 1-5 ("you have heat from the natural gas burners...you have heat from the reoxidation of the zinc vapor"). The sole purpose of the coke is for the carbon to crack off the oxygen from the zinc oxide and the oxygen from the iron oxide.

E. *There is no requirement that the Coke be Reused in order to qualify as Exempt.*

During the hearing, the Department raised the issue that the coke is not reused, and in fact, is partially consumed in the process. Petitioner wishes to emphasize that the reusability of an item is not a requirement to be exempt.

Specifically, the exemption provides that:

> 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.

120/2-45(4) (emphasis added).

The exemption anticipates that there are two exemptions; both chemicals **and** chemicals that are classified as catalysts, will qualify for the exemption **provided that** the chemicals, **or** chemicals acting as catalysts, effect a direct and immediate change. There certainly is precedent for an exempt chemical

that is a catalyst to be exempt, and in some cases, the chemical catalyst can be reused in multiple rounds of chemical reactions (*see, e.g.,* Example 2 of 86 Ill. Adm. Code 130.330(c)(6), which provides that an aluminum oxide catalyst is use to refine heavy gas oil into gasoline, and the aluminum oxide is drawn off and reused). However, the plain language of the statute does not require that a chemical be reusable time and time again, and in fact, argues against that position by providing that **either** a chemical **or** a chemical used as a catalyst will be exempt; the chemical or chemical catalyst must simply effect a direct and immediate change on the product being manufactured.

This interpretation that both (i) chemicals, and (ii) chemicals acting as catalysts, are exempt is borne out by the two examples in 86 Illinois Administrative Code Section 130.330(c)(6). The second example, cited above, notes that the aluminum oxide catalyst is "drawn off and reused in subsequent manufacturing processes." However, the first example in that Section discusses the use of acid to etch copper off a printed circuit board; there is no mention that the acid is reused (and typically, acids cannot be reused due to their nature). The first example, relating to acid used in etching applies to the first category of exempt chemicals, while the second example, relating to aluminum oxide, applies to the second category of exempt catalysts. This interpretation of the Administrative Code supports the conclusion that the coke can still qualify for the exemption regardless of whether it is reused, just as in the first example in the Administrative Code.

VII. Imposition of Penalties.

The NTLs imposed the Illinois Late Payment and Late Filing penalties on Petitioner. Those penalties are set forth in the Uniform Penalty and Interest Act (the "UPIA") and incorporated by reference in the Use Tax Act (35 ILCS Chapter 35 Section 105/12).

However, under Section 3-8 of the UPIA, those penalties are not imposed if the taxpayer had reasonable cause for its position:

> No penalties if reasonable cause exists. The penalties imposed under the provisions of section 3-3, 3-4, 3-5 and 3-7.5 of this Act shall not apply if the taxpayer shows that [its] failure to file a return or pay tax at the required time was due to reasonable cause. Reasonable cause shall be determined in each situation in accordance with the rules and regulations promulgated by the Department.

The Department's regulations emphasize that, in evaluating whether reasonable cause for abatement exists, the primary focus is to be on the question whether the taxpayer made a good faith effort to comply evidenced by its exercise of ordinary business care and prudence in the process of filing returns and paying taxes. *See* 86 Ill. Admin. Code, ch. I, section 700.400(b), (c):

> (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...*

(emphasis added)

Regardless of whether the underlying tax applies, the Petitioner should fall within the exemption from penalties pursuant to the Regulations. The above Regulations state that the most important factor in determining whether to abate a penalty is whether the taxpayer made a "good faith effort to determine [its] proper tax liability and file and pay [its] property liability in a timely fashion." The determination in turn examines whether the law is clear (subsection (c)). In this case, the relevant statute is Section 3-50 of the Use Tax Act and Section 130.330(c) of the Administrative Code, which exempts chemicals that make a "direct and immediate change" on an item being manufactured. 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 terms, it would be fair to say that the law was unclear. And, given the lack of legal clarity, it would be unfair to impose late filing and late payment penalties upon Petitioner. Petitioner further notes that in the audit, the Department's auditor concluded that Petitioner's internal controls did not require improvement, and that Petitioner was compliant with all other corporate and withholding taxes, thereby evidencing that Petitioner had shown a history of the required "good faith" effort to comply with its tax obligations (*see*, Auditor Comments introduced by the Department as Respondent's Exhibit 2). The sole item under audit was the proper treatment of the coke, which treatment is, by all accounts, unclear.

VIII. Conclusion.

Petitioner uses the waelzing process to refine EAF Dust into its component parts, namely zinc and iron, and sells those component parts. The waelzing process requires the use of carbon, which Petitioner buys in the form of coke. As was made clear during the hearing, since carbon molecules don't go "floating off by themselves into the atmosphere," heating the coke turns the coke into carbon monoxide which acts as a chemical that effects a direct and immediate change on the EAF Dust to break it into those component parts. Petitioner purchases specialized, high carbon coke, which is heated in the waelz kiln to turn into the required gaseous carbon/carbon monoxide.

The Illinois Use Tax Act provides that the carbon will be exempt if the carbon effects a "direct and immediate change" upon the EAF Dust. Unrefuted testimony at the trial has proven that to be true. The coke is simply heated and turns into gaseous carbon (in the form of carbon monoxide), which causes that direct and immediate change.

In a nutshell, the Department's whole case is based on the premise that the exemption is not available since the coke is heated during the process to become gaseous for the process to occur. There is no change in the coke, other than the application of heat to cause it to become gaseous, that occurs, and the Department has not established any other change in the coke in order to support its case. Basically, the Department is saying that water, boiling water and steam are completely different things. That is clearly not a reasonable interpretation of the exemption in the Use Tax Act.

Further, the Petitioner has established that (i) it does not purchase the coke as a heat source; (ii) the coke is not "coal" within the meaning of Illinois Administrative Code Section 130.330(c)(3), and (iii) the applicable exclusion does not require the coke be reused in order to qualify for the exemption.

Based on the uncontroverted facts at hand, Petitioner seeks a ruling that its purchase of coke qualifies for the exemption for chemicals that produce a direct and immediate effect on the item being manufactured.

Dated: September 21, 2017.

Respectfully Submitted:

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NOTICE OF FILING

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PLEASE TAKE NOTICE, that on September 21, 2017, Joseph E. Bender filed by e-mail and via UPS overnight delivery with the Illinois Independent Tax Tribunal, located at 160 N. LaSalle Room N506, Chicago, Illinois, 60601, the foregoing instrument entitled **PETITIONER'S BRIEF IN SUPPORT OF PETITION** in the above captioned matter.

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Dated: September 21, 2017

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CERTIFICATE OF SERVICE

Joseph E. Bender certifies that, on September 21, 2017, he served a true and exact copy of the foregoing instrument entitled **PETITIONER'S BRIEF IN SUPPORT OF PETITION** on the Illinois Department of Revenue by sending the same as an attachment to an electronic mail message and via UPS overnight delivery addressed to the individual below:

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