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Illinois Supreme Court Affirms 'Clearly Erroneous' Standard of Review for Illinois Independent Tax Tribunal Matters

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On November 21, 2019, the Illinois Supreme Court issued an opinion affirming in part and reversing in part the Illinois appellate court's judgment in *Horsehead Corp. v. Department of Revenue, et al.*, 2019 IL Sup. Ct. No. 124155. Specifically, the Illinois Supreme Court: 1) affirmed that Horsehead Corporation's (hereafter "Horsehead" or "Taxpayer") purchase of metallurgical coke did not qualify for the Illinois Use Tax Chemical exemption; 2) affirmed the appellate court's use of the "clearly erroneous" standard of review; but 3) reversed the appellate court's penalty abatement denial.

By way of background, Horsehead is a Delaware corporation with its primary place of business in Pennsylvania as well as a zinc refining manufacturing facility located in Calumet City, Illinois. The Illinois Department of Revenue (hereafter "Department") issued Horsehead two notices of tax liability for the tax periods of January 1, 2007, through June 30, 2011, in an amount of \$1,521,041 for Illinois Use Tax, late payment and filing penalties, and interest.

At issue in this case was Horsehead's purchases of metallurgical coke, a solid material consisting almost entirely carbon, for which Horsehead had not paid any Illinois Use Tax. Horsehead averred that it was exempt from paying use tax on the coke under Section 3-5(18) of the Use Tax Act (35 ILCS 105/3), as it was for machinery and equipment used primarily in the manufacturing of tangible personal property. Specifically, Horsehead relied upon the "chemical exemption" found in Section 3-5(4) of the Use Tax Act. Horsehead appealed the notices to the Illinois Independent Tax Tribunal (hereafter "Tax Tribunal").

In issuing a decision affirming the two notices at issue, the Tax Tribunal concluded that the coke did not qualify for the claimed exemption as it did not affect a direct and immediate change upon the product being

manufactured. The Tax Tribunal also upheld the late payment and late filing penalties the Department imposed under section 12 of the Use Tax Act which incorporates portions of the Uniform Penalty and Interest Act (35 ILCS 735/3-1). The Tax Tribunal declined to abate the penalties at issue because Horsehead did not present any witnesses or evidence to support its claim of good faith in taking the position that it qualified for the chemical exemption. Horsehead filed a petition for review of the Tax Tribunal's decision with the Illinois appellate court.

The Illinois appellate court affirmed the Tax Tribunal's decision using the "clearly erroneous" standard of review and finding that the Tax Tribunal's conclusion, that the coke did not affect a direct and immediate change on the zinc and iron in the EAF dust, was supported by the evidence presented to the Tax Tribunal. The appellate court also held that the Tax Tribunal's finding that Horsehead was not entitled to an abatement of penalties was not against the manifest weight of the evidence. The Illinois Supreme Court granted Horsehead's petition for leave to appeal and accepted an *amicus curie* brief in support of Horsehead's position that the Taxpayers' Federation of Illinois filed with the court.

The first issue the Illinois Supreme Court addressed was the appellate court's use of the "clearly erroneous" standard of review. Horsehead argued that the proper standard of review should be *de novo* because the Tax Tribunal had neither rulemaking nor enforcement power with respect to any tax law and it does not qualify for deference to its decision. The Illinois Supreme Court explained that the Tax Tribunal Act specifically defines the tribunal as an independent administrative body "with tax expertise" that acts as a "tax-expert forum" in resolving disputes between the department and taxpayers for specified tax liabilities exceeding \$15,000. The supreme court added that the Tax Tribunal thus has tax expertise by way of its statutory mandate which requires that administrative law judges who serve on the tribunal have "substantial knowledge of state tax laws and the making of a record in a tax case."

Accordingly, the supreme Court rejected Horsehead's argument that no deference should be paid to a decision by the Tax Tribunal and stated that the degree of deference afforded to a Tax Tribunal decision turns on whether the issue presented is a question of fact, law or mixed question of both fact and law. Moreover, the Supreme Court held that the "clearly erroneous" standard of review was the proper standard in this case as the decision presents a mixed question of law and fact as the tax tribunal found that Horsehead was not entitled to the statutory use tax exemption because the coke did not affect a direct and immediate change on the manufacturer product.

The Illinois Supreme Court next reviewed Horsehead's claim that the Tax Tribunal erred by holding that its purchase of metallurgical coke did not qualify for the use tax chemical exemption provided in Section 3-50(4) of the Use Tax Act. The supreme court explained that in order to be eligible for the use tax chemical exemption, the coke Horsehead used in the manufacturing process must effect a change on the zinc and iron in the EAF dust at once and without intermediate steps. The supreme court added that the evidence presented indicated that at no time in the described chemical process and reactions does the coke have a direct and immediate effect on the zinc or iron being manufactured. The supreme court also stated that based on the plain language of section 3-50(4) of the Use Tax Act, the legislature chose to limit the exemption to only those chemicals that effect a "direct and immediate change" in the final manufacturer product. Accordingly, the supreme court held that the Tax Tribunal did not commit clear error in determining that Horsehead's coke purchases did not qualify for the use tax chemical exemption as Horsehead did not meet the requirement of a "direct and immediate change."

Finally, the Illinois Supreme Court reversed the lower courts penalty determination by abating the penalties at issue and recognizing the unique factual circumstances surrounding the manufacturing process at issue and stating that upholding such penalties was against the manifest weight of the evidence. In doing so, the supreme court held that Horsehead was not required to produce evidence of its decision-making process to prove reasonable cause for an abatement of the penalty. Rather, the supreme court noted the lack of case law or

statutory definitions on the underlying tax exemption issue, and that the evidence reflected that Horsehead had shown good conduct in complying with its tax obligations historically. The supreme court also noted the severity of the penalties at issue, which constitute almost 25 percent of the overall tax liability, as a factor in its decision to abate the penalties.

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