

ILLINOIS INDEPENDENT
TAX TRIBUNAL

Safety-Kleen Systems, Inc.)
)
 Petitioner,)
)
 v.)
)
 Illinois Department of Revenue,)
)
 Respondent.)

Case No.

RECEIVED
AUG 22 2016
BY: _____

1677167

PETITION
(Use Tax)

The Petitioner, Safety-Kleen Systems, Inc., hereby petitions the Illinois Independent Tax Tribunal to review and modify or reverse the Notice of Tax Liability ("Notice") issued by the Department of Revenue ("Department"), for the reasons stated below:

INTRODUCTION

1. Petitioner's address is 42 Longwater Drive, Norwell, Massachusetts 02061. Its phone number is (781) 792-5209 and its taxpayer identification number is 0290-7488.
2. Petitioner seeks relief from the Notice dated June 17, 2016 and concerns the period January 1, 2010 through December 31, 2012. A copy of the Notice is attached to this Petition.
3. The amount claimed due on the Notice is in excess of \$15,000, exclusive of penalties and interest.

BACKGROUND FACTS

4. Petitioner provides solvent parts washers and recycled solvent to commercial customers throughout North America. Petitioner also sells industrial chemicals such as oil, antifreeze, and aqueous solutions.
5. Petitioner provides a regular, scheduled service to drain used solvent from its customers' parts washers and replenish the washers with recycled solvent. Petitioner also collects used items such as oil, oil filters, antifreeze, and brake fluid.
6. Petitioner transports used industrial chemicals, primarily solvent, to its Recycling Center in Dolton, Illinois. Used solvent is subjected to a series of processes that remove spent materials and transform the solvent into usable, recycled solvent that is used to replenish customers' parts washers.
7. During the period at issue, Petitioner purchased chemical catalysts, chemical recycling equipment and machinery, repair parts for chemical recycling equipment and machinery, services from construction contractors, virgin solvent from retailers, and other tangible personal property.
8. Petitioner utilizes virgin solvent purchased from retailers to blend with recycled solvent to ensure an adequate supply of solvent is available for replenishment of customers' solvent parts washers.
9. Petitioner maintains a distribution center in Dolton, Illinois that conducts purchases for regional branches, including Canadian branches.
10. During the audit period, Petitioner remitted Illinois use tax on purchases of virgin solvent and empty, steel drums.

11. The Department completed a reconciliation of use tax and gave Petitioner credit for use tax accrued on virgin solvent purchases and steel drums during the audit period.
12. A portion of the items purchased by Petitioner and received in Illinois are distributed to locations outside Illinois.
13. The Department audited Petitioner and determined that Petitioner owed Illinois use tax on chemical catalysts, chemical recycling equipment and machinery, repair parts for chemical recycling equipment and machinery, services from construction contractors, virgin solvent purchased from retailers, and other purchases of tangible personal property.
14. The Department performed a block sample by testing October 2010, February 2011, and May 2012. Results from these test months were extrapolated across the 36-month audit period to determine the final tax liability.
15. Petitioner's purchases of virgin solvent made within the test months were treated by the Department as if no tax had been paid or accrued, due to the use tax credit granted by the Department.
16. Petitioner filed Form ICB-1, Request for Informal Conference Board Review, on July 10, 2015 requesting relief from the Department's assessment of use tax. On January 19, 2016, the Informal Conference Board denied the requested audit adjustment, stating "the recycling of solvents is considered a taxable use in Illinois."

ERRORS ALLEGED

COUNT I – The Department Erred In Proposing To Assess Use Tax On Machinery And Equipment Used To Recycle Used Solvent

17. The Department proposes assessing Petitioner with use tax on purchases of machinery, equipment, and related repair and replacement parts, used within the solvent recycling process.

18. In Sec. 3-50, the Use Tax Act provides that:

"Manufacturing process" means the production of an article of tangible personal property, whether the article is a finished product or an article for use in the process of manufacturing or assembling a different article of tangible personal property, by a procedure commonly regarded as manufacturing, processing, fabricating, or refining that changes some existing material into a material with a different form, use, or name...

35 ILCS 105/3-50.

19. The solvent being recycled is tangible personal property. Petitioner's process of recycling old, fouled solvent into a new, usable form through a series of physical and chemical processes qualifies as a "refining" process under the Use Tax Act.

20. In Sec. 3-5, the Use Tax Act provides that:

Use of the following tangible personal property is exempt from the tax imposed by [the Use Tax] Act... 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...

35 ILCS 105/3-5(18).

21. In Sec. 3-50, the Use Tax Act provides that:

...the machinery and equipment exemption also includes machinery and equipment used in the general maintenance or repair of exempt machinery and equipment or for in-house manufacture of exempt machinery and equipment...

35 ILCS 105/3-50.

22. The use tax does not apply to Petitioner's "use" of machinery, equipment, and associated components that are used to perform and support the solvent recycling process.

WHEREFORE, Petitioner respectfully requests that this Tribunal enter an order:

- (a) Finding that Petitioner is not subject to use tax on machinery, equipment, and associated components that are used to perform and support the solvent recycling process; and
- (b) Directing that the Notice be modified or withdrawn accordingly.

COUNT II – The Department Erred In Proposing To Assess Use Tax On Chemicals Acting As Catalysts Effecting a Direct Change Upon Used Solvent During The Recycling Process

23. The Department proposes assessing Petitioner with use tax on purchases of chemicals acting as catalysts in the solvent recycling process.

24. In Title 86, Part 130.330, the Retailers' Occupation Tax Regulations provides that:

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.

86 ILAC 130.330(c)(6).

25. An item that is exempt from Retailers' Occupation Tax is also exempt from use tax. In Sec. 3-65, the Use Tax Act provides that:

If the seller of tangible personal property for use would not be taxable under the Retailers' Occupation Tax Act despite all elements of the sale occurring in Illinois, then the tax imposed by this Act does not apply to the use of the tangible personal property in this State.

35 ILCS 105/3-65.

26. During the solvent recycling process, many different chemicals are utilized to physically separate undesirable waste particles from reusable particles. These chemicals act as catalysts that effect a direct and immediate change upon the solvent being recycled.

27. The chemicals acting as catalysts qualify for the exemption referenced within the Retailers' Occupation Tax Regulations, and the Use Tax does not apply to Petitioner's use of such chemical catalysts.

WHEREFORE, Petitioner respectfully requests that this Tribunal enter an order:

(a) Finding that Petitioner is not subject to use tax on purchases of chemicals acting as catalysts within the solvent recycling process; and

(b) Directing that the Notice be modified or withdrawn accordingly.

COUNT III – The Department Erred In Proposing To Assess Use Tax On Services Provided by Construction Contractors

28. The Department proposes assessing Petitioner with use tax on purchases of services provided by construction contractors incidental to a construction contract.

29. In Title 86, Part 130.1940, the Retailers' Occupation Tax Regulations provides that:

A construction contractor does not incur Retailers' Occupation Tax liability as to receipts from labor furnished and tangible personal property (materials and fixtures) incorporated into a structure as an integral part thereof for an owner when furnished and installed as an incident of a construction contract. The construction contractor incurs Use Tax on the cost price of the tangible personal property that is incorporated into real estate.

86 ILAC 130.1940(c).

30. In Title 86, Part 130.1940, the Retailers' Occupation Tax Regulations provides that:

“Construction Contract” means a contract, written or oral, to “construct” ... a “structure” ... or to otherwise incorporate tangible personal property into real estate.

86 ILAC 130.1940(a)(6).

31. An item that is exempt from Retailers' Occupation Tax is also exempt from use tax. In

Sec. 3-65, the Use Tax Act provides that:

If the seller of tangible personal property for use would not be taxable under the Retailers' Occupation Tax Act despite all elements of the sale occurring in Illinois, then the tax imposed by this Act does not apply to the use of the tangible personal property in this State.

35 ILCS 105/3-65.

32. During the audit period, Petitioner entered into written and oral construction contracts with construction contractors to incorporate tangible personal property in efforts to maintain and repair the real estate of the Dolton Recycling Center.

33. Petitioner is not subject to use tax on services provided by construction contractors, as the Retailers' Occupation Tax Regulations places the burden of use tax upon the construction contractor.

WHEREFORE, Petitioner respectfully requests that this Tribunal enter an order:

(a) Finding that Petitioner is not subject to use tax on purchases of services provided by construction contractors incidental to a construction contract; and

(b) Directing that the Notice be modified or withdrawn accordingly.

COUNT IV – The Department Erred In Proposing To Assess Use Tax On The Purchase Of Tangible Personal Property Distributed and Used Outside of Illinois

34. The Department proposes assessing Petitioner with use tax on retail purchases of tangible personal property, including steel drums and virgin solvent, received and stored in Illinois and subsequently distributed and used outside of Illinois.

35. In Sec. 2, the Use Tax Act provides that:

"Use" does not mean the interim use of tangible personal property nor the physical incorporation of tangible personal property, as an ingredient or constituent, into other tangible personal property, ... (b) which the person incorporating such ingredient or constituent therein has undertaken at the time of such purchase to cause to be transported in interstate commerce to destinations outside the State of Illinois.

35 ILCS 110/2.

36. In Title 86, Part 150.310, the Use Tax Regulations provides that:

To prevent actual or likely multi-state taxation, the tax shall not apply to the use of tangible personal property in this State under the following circumstances ... The temporary storage, in this State, of tangible personal property acquired outside this State that, subsequent to being brought into this State and stored here temporarily, is used solely outside this State ...

86 ILAC 150.310(a)(4).

37. Empty steel drums purchased by Petitioner and received in Illinois are temporarily stored at Petitioner's Distribution Center, and subsequently distributed to Petitioner's branches and customers throughout the Midwest and Canada, including many locations outside of Illinois. The drums are used to store and transport waste such as used oil filters and used chemicals.

38. Virgin solvent is purchased by Petitioner and blended with recycled solvent to ensure an adequate supply of recycled solvent is available for servicing its customers' parts washers both within and outside of Illinois.

39. Virgin solvent is first subjected to its intended use when used in parts washers at Petitioner's customer's locations.

40. Used solvent collected by Petitioner at customer' locations both within and outside of Illinois is a substantially different product than the virgin solvent purchased at retail in

Illinois. Used solvent is contaminated with debris and foreign chemicals that must be removed through the recycling process before it can be used in Petitioner's leased parts washers.

WHEREFORE, Petitioner respectfully requests that this Tribunal enter an order:

- (a) Finding that Petitioner is not subject to use tax on retail purchases of tangible personal property received in Illinois, temporarily stored in Illinois, and subjected to intended use outside of Illinois; and
- (b) Directing that the Notice be modified or withdrawn accordingly.

COUNT V – The Department Erred In Extrapolating The Results Of The Block Sample Test Periods Related To Purchases Of Virgin Solvent

- 41. The Department proposes assessing Petitioner with use tax on purchases of virgin solvent delivered to Petitioner's Dolton, Illinois Recycling Center.
- 42. Petitioner accrued and remitted use tax in the amount of \$441,318.00 during the audit period on the purchases of virgin solvent proposed for assessment.
- 43. The Department acknowledged such use tax and granted Petitioner a \$441,318.00 credit in the Notice of Tax Liability. However, the Department's review resulted in a use tax liability of approximately \$691,621.31 upon Petitioner's purchases of virgin solvent, despite the fact that Petitioner had accrued and remitted use tax on all purchases of virgin solvent during this period. This occurred because the three test months selected by the Department contained an unseasonably large volume of purchases of virgin solvent. During the audit period, the monthly total of virgin solvent invoices received averaged \$195,430.10. However, during the three test months selected by the

Department, the monthly total of virgin solvent invoices received averaged \$240,110.74, a 23% increase over the actual monthly average. This artificially high average is embedded in the Department's extrapolation and generated an erroneous tax liability upon purchases of virgin solvent.

44. The Department's treatment of purchases of virgin solvent is not in accordance with sound sampling procedures.

WHEREFORE, Petitioner respectfully requests that this Tribunal enter an order:

- (a) Finding that the block sample conducted by the Department was improper as related to purchases of virgin solvent; and
- (b) Directing that the Notice be modified or withdrawn accordingly.

COUNT VI – The Department Erred In Proposing To Assess Late Payment Penalties

45. The Notice propose late payment penalties for the period at issue.
46. Based on published Illinois tax authority, Petitioner reasonably believed that there was no use tax on due on chemical catalysts, repair parts for chemical recycling equipment and machinery, services from construction contractors, and retail purchases of tangible personal property received in Illinois, temporarily stored in Illinois, and subjected to intended use outside of Illinois.
47. Petitioner exercised ordinary business care and prudence in determining its use tax liability for the period at issue.

WHEREFORE, Petitioner respectfully requests that this Tribunal enter an order:

- (a) Finding that Petitioner had reasonable cause for its nonpayment of the use tax at issue; and
- (b) Directing that the Notice be modified or withdrawn accordingly.

RELIEF REQUESTED

Petitioner respectfully requests modification or reversal of the Notice in accordance with the errors alleged.

Dated: August 15, 2016

SAFETY-KLEEN SYSTEMS, INC.

By:  JS

Brian L. Browdy
Ryan Law Firm LLP
311 S. Wacker Drive, Suite 4800
Chicago, IL 60606
(312) 980-1122 (Phone)
(847) 942-7318 (Mobile)
(312) 942-7318 (Fax)
brian.browdy@ryanlawllp.com

Petitioner's Representative

CERTIFICATE OF SERVICE

I hereby certify that on August 15, 2016, a copy of the foregoing Petition was mailed to the Independent Tax Tribunal and Department of Revenue at the addresses below:

Illinois Independent Tax Tribunal
160 N. LaSalle Street, Room N506
Chicago, Illinois 60601

-and-

Illinois Department of Revenue
Office of Legal Services
100 W. Randolph St., Level 7-900
Chicago, Illinois 60601



Garrett Blackwood

Taxpayer Statement



June 17, 2016

TDD 1 800 544-6304



Letter ID: CNXXXX3X419752X0

Account ID: 0290-7488

Total amount due: \$3,073,879.62

#BWNKMGV
#CNXX XX3X 4197 52X0#
SAFETY-KLEEN SYSTEMS INC
ATTN: TAX DEPARTMENT
42 LONGWATER DR
NORWELL MA 02061-1612



This statement lists our most recent information about your unpaid balance, available credits, or returns you have not filed. A payment voucher is included so you may pay the balance due.

Sales/Use Tax & E911 Surcharge You have available credits of \$139,936.09 **Account ID: 0290-7488**

Period	Tax	Penalty	Interest	Other	Payments/Credits	Balance
31-Dec-2012	2,355,555.00	465,762.00	279,306.62	-	(26,744.00)	3,073,879.62
• \$3,073,879.62 of this amount is subject to protest.						
28-Feb-2015	34,695.00	-	-	-	(68,157.09)	(33,462.09)
31-May-2015	33,152.00	-	-	-	(47,400.00)	(14,248.00)
31-Aug-2015	28,687.00	-	-	-	(42,860.00)	(14,173.00)
31-Oct-2015	30,924.00	-	-	-	(52,556.00)	(21,632.00)
31-Jan-2016	33,344.00	-	-	-	(69,736.00)	(36,392.00)
31-Mar-2016	35,159.00	-	-	-	(50,640.00)	(15,481.00)
30-Apr-2016	35,188.00	-	-	-	(39,736.00)	(4,548.00)

SOA

Retain this portion for your records.

P-000002

Fold and detach on perforation. Return bottom portion with your payment.

Taxpayer Statement (R-12/08) (136)



Letter ID: CNXXXX3X419752X0
SAFETY-KLEEN SYSTEMS INC

Total amount due: \$3,073,879.62

Write the amount you are paying below.

\$ _____

Write your Account ID on your check.

Mail this voucher and your payment to:
ILLINOIS DEPARTMENT OF REVENUE
PO BOX 19006
SPRINGFIELD IL 62794-9006

\$3,073,879.62 is subject to protest.

Do not pay any Income Tax liability that you intend to protest.

Notice of Tax Liability
for Form EDA-105-R, ROT Audit Report



June 17, 2016



Letter ID: CNXXXX5978663845

Account ID: 0290-7488

#BWNKMGV
#CNXX XX59 7866 3845#
SAFETY-KLEEN SYSTEMS INC
ATTN: TAX DEPARTMENT
42 LONGWATER DR
NORWELL MA 02061-1612



We have audited your account for the reporting periods January 01, 2010, through December 31, 2012. As a result we have assessed the amounts shown below.

	<u>Liability</u>	<u>Payments/Credit</u>	<u>Unpaid Balance</u>
Tax	2,328,811.00	0.00	2,328,811.00
Late Payment Penalty Increase	465,762.00	0.00	465,762.00
Interest	279,306.62	0.00	279,306.62
Assessment Total	\$3,073,879.62	\$0.00	\$3,073,879.62

If you agree, pay the assessment total as soon as possible to minimize additional penalty and interest. Mail a copy of this notice and your payment with the voucher on the enclosed Taxpayer Statement. By including a copy of this notice, your payment will be properly applied to the audit liability.

If you do not agree, you may contest this notice by following the instructions listed below.

- If the amount of this tax liability, exclusive of penalty and interest, is more than \$15,000, or if no tax liability is assessed but the total penalties and interest is more than \$15,000, file a petition with the Illinois Independent Tax Tribunal within 60 days of this notice. Your petition must be in accordance with the rules of practice and procedure provided by the Tribunal (35 ILCS 1010/1-1, *et seq.*).
- In all other cases that do not fall within the jurisdiction of the Illinois Independent Tax Tribunal, file a protest with us, the Illinois Department of Revenue, and request an administrative hearing within 60 days of the date of this notice, which is **August 16, 2016**. Submit your protest on Form AH-4, Protest and Request for Administrative Hearing with the Illinois Department of Revenue (available on our website at tax.illinois.gov). Mail form AH-4 along with a copy of this notice to the address on the form. If you do not file a protest within the time allowed, you will waive your right to a hearing, and this liability will become final. An administrative hearing is a formal legal proceeding conducted pursuant to the rules adopted by the Department and is presided over by an administrative law judge. A protest of this notice does not preserve your rights under any other notice.
- Instead of filing a petition with the Illinois Independent Tax Tribunal or a protest with us, the Illinois Department of Revenue, you may instead, under Sections 2a and 2a.1 of the State Officers and Employees Money Disposition Act (30 ILCS 230/2a, 230/2a.1), pay the total liability under protest using Form RR-374, Notice of Payment Under Protest (available on our website at tax.illinois.gov), and file a complaint with the circuit court for a review of our determination.

If you do not protest this notice or pay the assessment total in full, we may take collection action against you for the balance due, which may include levy of your wages and bank accounts, filing of a tax lien, or other action to satisfy your liability.

If you have questions, write or call us weekdays between 8:00 a.m. and 4:00 p.m. Our contact information is listed below.

BUREAU OF AUDITS
TECHNICAL REVIEW SECTION
ILLINOIS DEPARTMENT OF REVENUE
PO BOX 19012
SPRINGFIELD IL 62794-9012

217 785-6579