UT 18-05
Tax Type: Use Tax
Tax Issue: Aircraft Use Tax

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
SPRINGFIELD, ILLINOIS

DEPARTMENT OF REVENUE OF THE STATE OF ILLINOIS v. **ABC, LLC** **Taxpayer**	Docket # [redacted] Acct ID: XXXXX-XXXXX Letter ID: XXXXXXXXXXXXXX

RECOMMENDATION FOR DISPOSITION

Appearances: Matthew Crain, Special Assistant Attorney General, for the Department of Revenue of the State of Illinois; R. Stephen Scott of Scott & Scott, P.C. for ABC, LLC

Synopsis:

After conducting an audit, the Department of Revenue ("Department") issued a Notice of Tax Liability ("NTL") to ABC, LLC ("taxpayer") that assessed tax, interest, and penalties on the purchase of an aircraft pursuant to the Aircraft Use Tax Law (35 ILCS 157/10-1 *et seq.*). The taxpayer filed a timely protest to the NTL. An evidentiary hearing was held during which the taxpayer argued that it does not owe the aircraft use tax for the following reasons: (1) the purchase is exempt from the tax under the multi-

state exemption of the Use Tax Act (35 ILCS 105/3-55); (2) the taxpayer is a retailer that purchased the aircraft for resale; (3) the taxpayer did not "use" the aircraft for purposes of the tax; (4) the taxpayer's activities do not have substantial nexus with Illinois; and (5) the purchase is exempt from the tax under the Safe Harbor Rule of the Interim Use Exemption. The Department argued that none of these exemptions applies. After reviewing the record, it is recommended that the Notice of Tax Liability be upheld.

FINDINGS OF FACT:

1. The taxpayer is a limited liability company organized under the laws of the State of Nevada. (Taxpayer Ex. #11; Tr. p. 54)
2. The taxpayer has two members who are brothers, and both reside in Taylorville, Illinois. (Taxpayer Ex. #11; Tr. pp. 54, 56, 84)
3. On August 19, 2008, the taxpayer purchased a xxxx Beech F33A aircraft for $XX,XXX.XX. The aircraft was located in California at the time of the purchase. (Dept. Ex. #1, p. 9; Taxpayer Ex. #1, #3, #4)
4. The Aircraft Bill of Sale shows that the taxpayer purchased the aircraft from Z Plane, LLC. (Taxpayer Ex. #4)
5. At the time of the purchase, the aircraft was not in "airworthy" condition. (Taxpayer Ex. #1; Tr. p. 57)
6. The taxpayer purchased the aircraft with the intent to repair it and sell it for a profit. The taxpayer considered it an "investment asset." (Tr. pp. 56, 73)
7. The taxpayer's members own a separate company called XYZ Aircraft, which repairs airplanes and is located in Taylorville, Illinois. (Tr. pp. 59-60, 82)

8. The taxpayer brought the aircraft to Taylorville, Illinois to begin repairing it. (Tr. p. 59)
9. XYZ Aircraft, as well as other vendors, performed some repair work on the aircraft. One vendor repaired the wings; another one repaired the fuselage, and another one repaired the engine. Not all of these vendors were located in Illinois. (Tr. pp. 60-61)
10. On June 30, 2010, the aircraft became completely airworthy. (Tr. p. 74)
11. After the aircraft became airworthy, the taxpayer used independent sales people to try to sell the aircraft. (Tr. p. 81)
12. The taxpayer provided a list of flights that the aircraft took between August 4, 2011 and May 11, 2013. The list includes the following:

Date	Origin City	Destination City
8/4/11	Taylorville, IL	Chicago/Waukegan, IL
8/6/11	Chicago/W., IL	
8/6/11	Chicago/W., IL	Fort Wayne, IN
8/14/11	Fort Wayne, IN	Taylorville, IL
12/31/11	Taylorville, IL	Brooksville, FL
3/7/12	Brooksville, FL	Fort Lauderdale, FL
3/7/12	Fort Lauder., FL	Brooksville, FL
4/6/12	Brooksville, FL	Chattanooga, TN
4/6/12	Chattanooga, TN	Taylorville, IL
8/13/12	Bloomington/N., IL	Oshkosh, WI
8/13/12	Oshkosh, WI	Bloomington/Normal, IL
9/27/12	Bloomington/N., IL	Perryville, MO
9/27/12	Perryville, MO	Bloomington/Normal, IL
10/5/12	Bloomington/N., IL	Perryville, MO
10/5/12	Cape Girardeau, MO	Bloomington/Normal, IL
10/9/12	Bloomington/N., IL	Cape Girardeau, MO
3/31/13	Taylorville, IL	Nashville, TN
5/11/13	Nashville, TN	Taylorville, IL

(Taxpayer Ex. #8; Tr. pp. 87-94)

13. The taxpayer indicated that the list is not complete because it does not include flights that did not go into the air traffic control system. (Taxpayer Ex. #8; Tr. pp. 87-94)
14. According to the taxpayer's list, the aircraft took 18 flights between August 4, 2011 and May 11. 2013. Of these 18 flights, 15 of them either originated or ended in Illinois. (Taxpayer Ex. #8)
15. The aircraft was kept in Taylorville, Illinois (rather than Nevada) because of its central location between the two coasts. (Tr. p. 75)
16. On December 19, 2013, the taxpayer sold the aircraft to a person who lives in Texas. (Taxpayer Ex. #10; Tr. pp. 74, 66-67, 93)
17. On March 27, 2015, the Department issued a Notice of Tax Liability to the taxpayer for Aircraft Use Tax that assessed tax in the amount of $5,114, plus penalties and interest, on the purchase of the aircraft. The NTL was admitted into evidence under the certificate of the Director of the Department. (Dept. Ex. #1)

CONCLUSIONS OF LAW:

Section 10-15 of the Aircraft Use Tax Law ("AUTL") imposes a tax upon the privilege of using in Illinois any aircraft acquired by gift, transfer, or purchase after June 30, 2003. 35 ILCS 157/10-15. When the aircraft is acquired by purchase, the tax rate is 6.25% of the selling price (as long as it is not less than the fair market value on the date of the purchase). *Id*. Section 10-35 of the AUTL incorporates by reference the Use Tax Act ("UTA") (35 ILCS 105/1 *et seq.*), except for the provisions of section 3-70[1]. Section 12 of the UTA incorporates by reference section 5 of the Retailers' Occupation Tax Act

[1] Section 3-70 of the Use Tax Act allows an exemption for property acquired by a nonresident. 35 ILCS 105/3-70.

(35 ILCS 120/1 *et seq.*), which provides that a certified copy of the Department's determination of the amount of tax due shall be *prima facie* correct and shall be *prima facie* evidence of the correctness of the amount of tax due as shown therein. 35 ILCS 157/10-35; 105/12; 120/5.

Once the Department has established its *prima facie* case by submitting the certified copy of the Department's determination into evidence, the burden shifts to the taxpayer to overcome this presumption of validity. Clark Oil & Refining Corp. v. Johnson, 154 Ill. App. 3d 773, 783 (1st Dist. 1987). To prove its case, a taxpayer must present more than testimony denying the Department's assessment. Sprague v. Johnson, 195 Ill. App. 3d 798, 804 (4th Dist. 1990). The taxpayer must present sufficient documentary evidence to support its claim. *Id.*; Balla v. Department of Revenue, 96 Ill. App. 3d 293, 295 (1st Dist. 1981).

It is well-established under Illinois law that tax exemption provisions are strictly construed in favor of taxation. Heller v. Fergus Ford, Inc., 59 Ill. 2d 576, 579 (1975). The party claiming the exemption has the burden of proving by clear and convincing evidence that it is entitled to the exemption. *Id.*; JB4 Air, LLC v. Department of Revenue, 388 Ill. App. 3d 970, 974 (2nd Dist. 2009). Whenever doubt arises, it must be resolved in favor of requiring the tax to be paid. *Id.*; Quad Cities Open, Inc. v. City of Silvis, 208 Ill. 2d 498, 508 (2004).

Whether the Multi-State Exemption in Section 3-55(e) of the UTA Applies

The taxpayer first argues that the purchase of the aircraft is exempt from the use tax pursuant to section 3-55(e) of the UTA. Section 10-15 of the AUTL provides, in relevant part, as follows:

> This tax does not apply … (iii) if the use of the aircraft is not subject to the Use Tax Act by reason of subsection (a), (b), (c), (d), or (e) of Section 3-55 of that Act dealing with the prevention of actual or likely multistate taxation; … 35 ILCS 157/10-15.

Section 3-55(e) of the Use Tax Act provides, in relevant part, as follows:

> Sec. 3-55. Multistate exemption. To prevent actual or likely multistate taxation, the tax imposed by this Act does not apply to the use of tangible personal property in this State under the following circumstances:
>
> . . .
>
> (e) The temporary storage, in this State, of tangible personal property that is acquired outside this State and that, after being brought into this State and stored here temporarily, is used solely outside this State or is physically attached to or incorporated into other tangible personal property that is used solely outside this State, or is altered by converting, fabricating, manufacturing, printing, processing, or shaping, and, as altered, is used solely outside this State. … 35 ILCS 105/3-55(e).

The taxpayer contends that the purchase is exempt under this subsection because the taxpayer brought the aircraft into Illinois for temporary storage while it was being repaired and refurbished "through converting, fabricating and shaping the aircraft." (Taxpayer's brief, p. 6) The taxpayer paid XYZ Aircraft to repair the plane, and several facilities participated in the repair. After the repairs, the taxpayer did not lease or use the aircraft for any private purpose; the aircraft was only used by independent parties (not agents of the taxpayer) for demonstration purposes. The taxpayer claims that most of the sale activities were outside of Illinois. The taxpayer occasionally returned the aircraft to the XYZ Aircraft repair facility because of its central location between the two coasts.

These facts do not support a finding that the purchase is exempt under this subsection. First, the aircraft was not stored in this State temporarily. The taxpayer purchased the aircraft on August 19, 2008 and brought it to XYZ Aircraft in Taylorville, Illinois to begin repairing it. Although some out-of-state vendors assisted XYZ by

repairing some of the components, the taxpayer did not present documentary evidence indicating that the aircraft itself was taken out of Taylorville. Once it became airworthy on June 30, 2010, the aircraft remained primarily based in Illinois until it was sold on December 19, 2013. Over 5 years passed between the time the aircraft was initially brought into Illinois and the time that it was finally removed; 5 years is not a "temporary" time period.

Even if the time period for repairs is considered to be "temporary storage," after the repairs were completed, the aircraft was not used solely outside this State. Between June 30, 2010 and December 19, 2013, the aircraft was used for at least 18 flights, and 15 of these flights either originated or ended in Illinois. This exemption clearly does not apply.

Whether the Taxpayer is a Retailer that Purchased the Aircraft for Resale

The taxpayer argues that the purchase is exempt from use tax because the taxpayer is a retailer that purchased the aircraft for resale. The taxpayer states that the definition of the word "retailer" includes "every person engaged in the business of selling tangible personal property for use, and not for resale in any form." 86 Ill. Admin. Code §150.201. Although the taxpayer claims to be a retailer, it also claims that it is not a "retailer maintaining a place of business in this State" as that term is defined in the UTA (see 35 ILCS 105/2). The taxpayer contends that this is the reason why the taxpayer did not register with the Department as a retailer.[2] The taxpayer maintains that it purchased the aircraft for repair and then for sale to a user who would be responsible for paying tax on the purchase transaction. The taxpayer, therefore, argues that the purchase is exempt from use tax.

This argument is without merit because the taxpayer is not a "retailer" as that word is defined in the UTA. The definition of "retailer" includes the following: "The isolated or occasional sale of tangible personal property at retail by a person who does not hold himself out as being engaged (or who does not habitually engage) in selling such tangible personal property at retail . . . does not make such person a retailer hereunder."[3] 35 ILCS 105/2; see also 86 Ill. Admin. Code §150.101(d). Nothing in the record indicates that the taxpayer habitually engages in selling aircraft. The taxpayer indicated that it sold other airplanes (Tr. p. 81), but it did not provide any documentary evidence to show how many or how often the other sales were made. According to the record, this was an occasional sale. One of the taxpayer's members testified that he and his brother "are always looking for a project to possibly make a few dollars." (Tr. p. 56) He said that he saw photos of the aircraft and thought there was a possibility of making a profit after it was repaired. *Id*. The taxpayer did not present any documentary evidence that the taxpayer is in the business of selling aircraft. Because the taxpayer is not a retailer, the purchase does not qualify as a purchase for resale.

Whether the Taxpayer "Used" the Aircraft for Purposes of the Tax

The taxpayer also argues that it did not "use" the aircraft as that term is defined in the Department's regulations. The taxpayer refers to the following definition of "use":

> "Use" means the exercise by any person of any right or power over tangible personal property incident to the ownership of that property, except that it does not include the sale of the property in any form as tangible personal property in the regular course of business to the extent

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[2] The taxpayer did not present evidence that it was registered as a retailer in any state, such as Nevada.

[3] Even though an isolated or occasional sale transaction may not result in a use tax liability under the UTA, a purchaser may still incur an Illinois use tax liability if he or she purchases a specific type of tangible personal property, such as an aircraft, watercraft, or vehicle, in an isolated or occasional sale transaction. See Aircraft Use Tax Law, *supra*; Watercraft Use Tax Law (35 ILCS 158/15-1 *et seq.*); Vehicle Code (625 ILCS 5/3-1001 *et seq.*).

> that the property is not first subjected to a use for which it was purchased, and does not include the use of that property by its owner for demonstration purposes; provided that the property purchased is deemed to be purchased for the purpose of resale, despite first being used, to the extent to which it is resold as an ingredient of an intentionally produced product or by-product of manufacturing. 86 Ill. Admin. Code §150.201.

The taxpayer claims that according to the evidence, the taxpayer intended to resell the aircraft following its repair and refurbishment. The taxpayer, therefore, claims that it did not "use" the aircraft as that word is defined for purposes of the imposition of the use tax. The taxpayer also claims that it did not "use" the aircraft because under the Retailers' Occupation Tax Act a "sale at retail" refers to the transfer of ownership of tangible personal property for "use or consumption" from a retailer who is in the business of selling that product. See 35 ILCS 120/1 *et seq*. The taxpayer argues that the aircraft was not available for use and consumption when it was purchased because it was damaged and required substantial repair.

These arguments are without merit. "Use" means "the exercise by any person of any right or power over tangible personal property incident to the ownership of that property." 35 ILCS 105/2; 86 Ill. Admin. Code §150.201. The court in Time, Inc. v. Department of Revenue, 11 Ill. App. 3d 282 (1st Dist. 1973) stated as follows:

> The use tax is not a tax which arises out of the use or operation of tangible personal property, but rather it is a tax placed upon the exercise of powers or rights incident to ownership. [citations omitted] Therefore, mere use without rights of ownership cannot be taxed, but the exercise of power over personal property incident to ownership thereof which converts the product into another form or prepares it for conversion . . . is a taxable use in Illinois. *Id*. at 288-289.

The taxpayer in the present case engaged in the exercise of power over the aircraft incident to ownership by bringing the aircraft into Illinois for repairs. The taxpayer, therefore, is subject to the use tax.

The definition of "use" includes exceptions, one of which is when the property is sold "in the regular course of business to the extent that the property is not first subjected to a use for which it was purchased." This is the resale exception that was discussed in the previous section, and the taxpayer does not qualify for this exception because it is not a retailer.

Additional exceptions include when the property is used by its owner (*i.e.*, retailer) for demonstration purposes or when the owner (*i.e.*, retailer) sells the property "as an ingredient of an intentionally produced product or by-product of manufacturing." Again, the taxpayer does not qualify for these exceptions because the taxpayer is not a retailer. Even if it is assumed that the taxpayer is a retailer, the taxpayer did not "manufacture" the aircraft, and for reasons discussed subsequently, the taxpayer does not qualify for the demonstration exception.

The full definition of "use" under section 2 of the UTA provides as follows:

> "Use" means the exercise by any person of any right or power over tangible personal property incident to the ownership of that property, except that it does not include the sale of such property in any form as tangible personal property in the regular course of business to the extent that such property is not first subjected to a use for which it was purchased, and does not include the use of such property by its owner for demonstration purposes: Provided that the property purchased is deemed to be purchased for the purpose of resale, despite first being used, to the extent to which it is resold as an ingredient of an intentionally produced product or by-product of manufacturing. "Use" does not mean the demonstration use or interim use of tangible personal property by a retailer before he sells that tangible personal property. *For watercraft or aircraft, if the period of demonstration use or interim use by the retailer exceeds 18 months, the retailer shall pay on the retailers' original cost price the tax imposed by this Act, and no credit for that tax is permitted if the watercraft or aircraft is subsequently sold by the retailer.* "Use" does not mean the physical incorporation of tangible personal property, to the extent not first subjected to a use for which it was purchased, as an ingredient or constituent, into other tangible personal property (a) which is sold in the regular course of business or (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: Provided that the property purchased is deemed to be purchased for the purpose of resale, despite first being used, to the extent to which it is resold as an ingredient of an intentionally produced product or by-product of manufacturing. (Emphasis added; 35 ILCS 105/2)

Under this definition, the time period allowed for the demonstration or interim use of an aircraft is 18 months. In the present case, even if it is assumed that the taxpayer is a retailer, the period of time that the taxpayer used the aircraft exceeded 18 months. The taxpayer purchased the aircraft on August 19, 2008 and sold it on December 19, 2013. This 64 month time period is well beyond the time period allowed in the exemption.

The taxpayer also states that in the case of DuPage Aviation Corp. v. Department of Revenue, 37 Ill. App. 3d 587 (2nd Dist. 1976), the purchaser of airplanes was not taxed on the purchases because the airplanes were purchased for resale and only used for demonstration purposes. The DuPage Aviation case is distinguishable because the purchaser of the airplanes was a retailer, and when the planes were eventually sold, the retailer paid the retailers' occupation tax on the sales. *Id*. at 589.

Whether the Taxpayer's Activities have a Substantial Nexus with Illinois

The taxpayer correctly states that in order for a company to have a use tax responsibility, a substantial nexus must exist between the company's taxable activities and the State. The tax must meet this nexus requirement in order to be constitutional. See Irwin Industrial Tool Co. v. Department of Revenue, 394 Ill. App. 3d 1002, 1013 (1st Dist. 2009), *aff'd*, 238 Ill. 2d 332 (2010). The commerce clause requires a "definite link" between a state and the person or property that it seeks to tax. Irwin Industrial, 238 Ill. 2d at 342. Physical presence within the taxing state is necessary; the physical presence

need not be "substantial" but must be more than a "slightest presence." *Id.*, citing Brown's Furniture, 171 Ill. 2d at 424; see also Quill Corp. v. North Dakota, 504 U.S. 298, 315 n. 8 (1992). Whether there is sufficient physical presence depends upon the facts of each case. Irwin Industrial, 394 Ill. App. 3d at 1013.

The taxpayer meets this nexus requirement. The taxpayer's physical presence in Illinois is more than slight because immediately after the aircraft was purchased, the taxpayer brought it into Illinois where it remained at least until it became airworthy on June 30, 2010. After that, Illinois was where the aircraft was primarily kept until it was sold on December 19, 2013, and during this time period, 15 of the 18 recorded flights either originated or ended in Illinois. In addition, both of the taxpayer's only members reside in Illinois. These connections with Illinois are more than sufficient to meet the nexus requirement.

Whether the Purchase is Exempt Pursuant to the Safe Harbor Rule of the Interim Use Exemption

The taxpayer's final argument concerns the Safe Harbor Rule of the Interim Use Exemption found in subsection (a)(1)(B) of section 150.306 of the Department's Use Tax regulations. The regulation provides, in relevant part, as follows:

> a) Interim Use Exemption
>
> > 1) *Except as otherwise provided in this subsection (a) and in subsection (c) of this Section*, tangible personal property purchased by a retailer for resale, and used by the retailer or his or her agents prior to its ultimate sale at retail, is exempt from Use Tax, provided that the tangible personal property is of the same general type of property sold by that retailer and is carried as inventory on the books of the retailer or is otherwise available for sale during the interim use period. Beginning July 1, 2008, the following provisions apply to persons claiming the interim use exemption:
> >
> > > A) The interim use exemption may not be claimed for any item if any of the following circumstances exist:

i) title to the item is held by any party other than the retailer, except that title may be held by the retailer, the manufacturer of the item, or a captive finance company;

ii) the retailer elects to claim an Internal Revenue Code section 179 deduction on the item as a depreciable business asset; or

iii) if the item is leased by the retailer, the aggregate gross receipts received from all leasing of the item by the retailer exceeds the retailer's selling price of the item.

B) Safe Harbor Rule. For items that are not excluded from the exemption under subsection (a)(1)(A), interim use will be deemed to occur if the retailer satisfies all of requirements of subsections (a)(1)(B)(i) through (vi):

i) The item is one of the following:

- listed in the retailer's records as part of inventory;
- not depreciated by the retailer under Internal Revenue Code section 167; or
- otherwise shown by the retailer's records, documents, or operations as available for sale during the interim use period.

ii) The period of use or lease of the item by the retailer is less than 24 months.

iii) The item is of the same general type of property sold by the retailer.

iv) The item is ultimately sold by the retailer.

v) If the retailer receives revenues from the lease of the same general type of property as the item for which interim use is claimed, then the annual total of such lease revenues must be less than the annual total of the sales revenues received from the property.

vi) If the item is leased under a lease agreement for more than 30 days, the lease agreement must contain a provision that, if the retailer locates a buyer for the item, the lease may be terminated within 7 days or the lessee may receive comparable property substituted by the retailer for the item within 7 days.

. . .

3) In determining whether a taxpayer is "primarily" a retailer, the Department will examine only the activities of his Illinois operations. In addition, the Department will examine the activities of divisions of a corporate entity that are not separately registered with the Department. If divisions of a corporate entity are separately registered, however, their activities will not be examined in making this determination.

. . .

b) Demonstration Use Exemption

1) *Except as provided in subsection (c)*, tangible personal property purchased for resale and used by its owner for demonstration purposes is not subject to Use Tax.

. . .

c) *Aircraft and Watercraft*

For watercraft or aircraft, if the period of demonstration use or interim use by the retailer exceeds 18 months, the retailer shall pay Use Tax on the original cost price of the aircraft or watercraft, and no credit for that tax is permitted if the aircraft or watercraft is subsequently sold by the retailer. For purposes of this Section, the term "watercraft" means a Class 2, Class 3 or Class 4 watercraft as defined in Section 3-2 of the Boat Registration and Safety Act [625 ILCS 45/3-2], a personal watercraft, or any boat equipped with an inboard motor.

. . .

(Emphasis added; 86 Ill. Admin. Code §150.306.)

The taxpayer claims that it meets all the requirements of the Safe Harbor Rule in subsection (a)(1)(B), and the Department's auditor "blindly" applied subsection (c) of section 150.306. According to the taxpayer, the period of interim use by the taxpayer from the XYZ Aircraft repair facility was less than 24 months. The taxpayer calculated this time period by subtracting the amount of time that the aircraft was taken and flown

away from Taylorville, Illinois (7½ months according to the taxpayer) and the amount of time the aircraft was held at locations outside of Illinois by third parties (9 months according to the taxpayer). The taxpayer, therefore, believes that the period of interim use was less than 24 months as allowed by the Safe Harbor Rule.[4]

The taxpayer's argument is again without merit. The Safe Harbor Rule of the Interim Use Exemption applies only to retailers, and as stated previously, the taxpayer is not a retailer. Even if the taxpayer were a retailer, the period of interim use begins on August 19, 2008, which is when the taxpayer began using the aircraft. Contrary to the taxpayer's assertions, subsection (c) applies to aircrafts, and the period of time allowed for interim use under subsection (c) is 18 months. The taxpayer purchased the aircraft on August 19, 2008 and sold it on December 19, 2013, which is a time period of 64 months. The taxpayer clearly does not qualify for this exemption.

Recommendation:

For the foregoing reasons, it is recommended that the Notice of Tax Liability be upheld.

Linda Olivero
Administrative Law Judge

Enter: October 15, 2017

[4] It is unclear exactly how the taxpayer calculated this time period of interim use, but apparently it began on August 4, 2011, which is the day of the first recorded flight of the aircraft.