UT 09-4
Tax Type: Use Tax
Issue: Nonresident Exemption
Use Tax On Aircraft Purchase
Commerce Clause (U.S. Const.) Controversy
Reasonable Cause on Application of Penalties

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

THE DEPARTMENT OF REVENUE	)	**No.: 00-ST-0000**
OF THE STATE OF ILLINOIS	)	**IBT No.: 0000-0000**
	)	**NTL Nos.: XXXXX - XXXXX**
v.	)	
	)	
ABC PROFESSIONALS	)	
CORPORATION OF USA,	)	
	)	**Julie-April Montgomery**
Taxpayer	)	**Administrative Law Judge**

RECOMMENDATION FOR DISPOSITION

Appearances: Mary Kay Martire of Foley & Lardner, LLP, on behalf of ABC Professionals Corporation of USA and ABC Professionals, Inc.; Paula M. Hunter, Special Assistant Attorney General, on behalf of the Department of Revenue of the State of Illinois.

Synopsis:

The Illinois Department of Revenue ("Department") conducted an audit of ABC Professionals Corporation of USA ("Taxpayer") for the period September 1, 2001 through June 30, 2004. At the conclusion of the audit, the Department determined that Taxpayer owed use tax on six (6) airplanes that it had purchased and which were used in Illinois but for which no sales or use tax had been paid elsewhere. On May 31, 2007, the Department issued six Notices of Tax Liability ("NTLs") to Taxpayer and ABC

Professionals, Inc. ("Parent") for the tax, interest and penalties it determined were due for the six airplanes. All six NTLs were protested and a hearing requested. The parties stated that the issues relative to a determination of Taxpayer's alleged liability are whether: 1) Taxpayer and Parent, when viewed as one, were entitled to the non-resident exemption set forth in 35 ILCS 105/3-70 so as to not be subject to the tax, penalties and interest assessed in the NTLs; and 2) reasonable cause exists for abatement of the late filing penalties. The parties further agreed that other issues determinative of the alleged liability are whether the tax, interest and penalties assessed in the NTLs: 1) impose a burden on interstate commerce in violation of the Commerce Clauses of the United States and Illinois constitutions; 2) violate the Uniformity Clause of the Illinois constitution; and 3) violate the Equal Protection Clauses of the United States and Illinois constitutions. April 8, 2008 Order. The Department introduced the NTLs and presented the testimony of John Rhodes, Department auditor, responsible for the conduct of this audit. Taxpayer presented documentary evidence as well as the testimony of John Doe, the Vice President of Operations of Parent, and James R. Kelley, a CPA with the firm of Kelley, Boshell, Toole & Ellison. Tr. pp. 11, 25. The Parties filed briefs in lieu of closing arguments subsequent to the evidentiary hearing. Following a review of the testimony and the evidence, it is recommended that the NTLs be finalized as issued with respect to Taxpayer but cancelled as to Parent. In support thereof, are the following "Findings of Fact" and "Conclusions of Law."

Findings of Fact:

1. The Department initiated a use tax audit of Parent and later changed the subject of that audit to Taxpayer. Taxpayer ("TP") Ex. Nos. 15 (December 9, 2005 Department letter), 17 (September 8, 2006 Department memo); Tr. pp. 39, 44-45, 52-53, 62.
2. The audit period is September 1, 2001 through June 30, 2004. TP Ex. No. 18 (Auditor's Narrative).
3. Taxpayer is a Delaware corporation. TP Ex. No. 1 (Certification of the Delaware Secretary of State); Tr. pp. 12-13, 39, 49.
4. Taxpayer and Parent are separate and distinct legal entities. TP Ex. No. 1; Tr. pp. 41, 64.
5. Taxpayer purchased six (6) new airplanes from a Florida dealer on the following dates:

Plane No. 259AT (MV 25311001)	purchased September 25, 2001
Plane No. 263AT (MV 25311002)	purchased November 19, 2001
Plane No. 264AT (MV 25311003)	purchased December 12, 2001
Plane No. 265AT (MV 25311004)	purchased January 11, 2002
Plane No. 266AT (MV 25311005)	purchased January 11, 2002
Plane No. 5356U (MV 25311006)	purchased December 12, 2002.

TP Ex. Nos. 3-5, 12-14 (Aircraft Bills of Sale[1] and Certifications of Purchase and Delivery), 18; Tr. pp. 15-18, 39-40.

6. All of the airplanes were delivered to Taxpayer in Delaware. TP Ex. Nos. 3-5, 12-14; Tr. pp. 16-18, 39.
7. Taxpayer is the owner of all the airplanes. TP Ex. Nos. 3-5, 12-14, 18; Tr. pp. 24, 39, 44, 62.
8. Taxpayer is in the business of buying and owning airplanes that will be used by Parent in Parent's flight training operations. Tr. p. 12.

[1] The Aircraft Bills of Sale present two dates and the date deemed the date of sale is the one for which the seller is said to "sell, grant, transfer and deliver all rights, title and interest in and to such aircraft."

9. All of the airplanes are registered in the name of the Taxpayer. TP Ex. Nos. 3-5, 12-14 (Federal Aviation Administration Certificates of Aircraft Registration); Tr. pp. 39, 44-45.

10. No state sales and use taxes were paid to any state with regard to the airplanes. TP Ex. Nos. 12 -14 ("Affidavits for Exemption of Aircrafts Sold for Removal from the State of Florida by the Purchaser"), 18; Tr. pp. 35, 40, 42, 58.

11. The airplanes were first brought into Illinois on the following dates:

No. 259AT	September 30, 2001
No. 263AT	April 30, 2002
No. 264AT	February 28, 2002
No. 265AT	April 30, 2002
No. 266AT	July 31, 2002
No. 5356U	July 31, 2003.

TP Ex. No. 8 (Department schedule of "Aircraft Dates Purchased and Arrived in Illinois"); Tr. pp. 30-31.

12. Each of Taxpayer's airplanes was used for flight instruction in Illinois from 57 to 168 days during the audit period. TP Ex. Nos. 9 (schedule of "Days in Illinois"), 10 (chart of "Days in Illinois"); Tr. pp. 31-34.

13. No employees of Taxpayer worked in Illinois. *Id.*

14. Taxpayer was not registered to do business in Illinois. *Id.*

15. Parent has its corporate offices in Florida. TP Ex. No. 18; Tr. p. 39.

16. On August 30, 2001, Parent opened a facility at the Aurora Municipal Airport which consisted of an office and two-tie downs (or parking spots) for aircraft on the tarmac. TP Ex. Nos. 6 ("Direct Aviation Operating Agreement with the City of Aurora), 7

("Lease of Business Premises"), 16 (Audit History Worksheet), 17, 18; Tr. pp. 19-24, 40, 48.

17. Parent provides flight instruction to pilots. TP Ex. Nos. 7, 17, 18; Tr. pp. 11-12, 40, 48.

18. Parent utilizes airplanes of Taxpayer in its flight instruction operations at the Aurora Municipal Airport. TP Ex. Nos. 8 (EDA-95's), 18; Tr. pp. 24, 31-34, 40.

19. On May 31, 2007, the Department issued six (6) Notices of Tax Liability as follows:

NTL No.	Airplane No.	Tax	Late Filing Penalty	Interest
XXXXX	259AT	$19,890	$1,000	$25,148
XXXXX	264AT	19,560	1,000	22,656
XXXXX	263AT	19,340	1,000	21,624
XXXXX	265AT	19,450	1,000	21,748
XXXXX	266AT	19,230	250	5,260
XXXXX	5356U	18,930	250	3,790

Copies of these Notices were admitted into evidence under the certificate of the Director of the Department. Department ("Dept.") Ex. A ("Notices of Tax Liability for Form EDA-95"); TP Ex. No. 8; Tr. p. 9.

Conclusions of Law:

In Illinois, the Use Tax Act ("UTA") (35 ILCS 105/1 *et seq*.), imposes a tax upon the privilege of using in Illinois tangible personal property purchased at retail from a retailer. 35 ILCS 105/3. Section 12 of the Act incorporates by reference section 4 of the Retailers' Occupation Tax Act ("ROTA") (35 ILCS 120/1 *et seq.*), which provides that a certified copy of the NTL issued by the Department is *prima facie* correct and is *prima facie* evidence of the correctness of the amount of tax due. 35 ILCS 105/12; 120/4. Once the Department has established its *prima facie* case by submitting the certified copy of the NTL into evidence, the burden shifts to the taxpayer to overcome the presumption of validity attached to the established *prima facie* case. Clark Oil & Refining v. Johnson, 154 Ill. App. 3d 773, 783 (1st Dist. 1987).

In order to overcome the presumption of validity attached to the NTL, the taxpayer must produce competent evidence, identified with its books and records showing that the NTL is incorrect. Copilevitz v. Department of Revenue, 41 Ill. 2d 154 (1968). Testimony alone is not enough. Mel-Park Drugs, Inc. v. Department of Revenue, 218 Ill. App. 3d 203 (1st Dist. 1991). Documentary proof is required to prevail against an assessment of tax by the Department. Sprague v. Johnson, 195 Ill. App. 3d 798 (4th Dist. 1990).

In addition, "when a taxpayer claims that he is exempt from a particular tax … the burden of proof is on the taxpayer." Balla v. Department of Revenue, 96 Ill. App. 3d 293, 296 (1st Dist. 1981) (*citing* Telco Leasing, Inc. v. Allphin, 63 Ill. 2d 305 (1976); Bodine Electric Co. v. Allphin, 81 Ill. 2d 502 (1980)). To prove its case, a taxpayer must present more than just testimony that denies the Department's determination. Sprague v. Johnson, 195 Ill. App. 3d 798, 804 (4th Dist. 1990). Rather, the taxpayer must present sufficient documentary evidence to support its claim. *Id.*

It is well established in Illinois that there is a presumption against exemption and therefore, "exemptions are to be strictly construed" with any doubts concerning the applicability of an exemption "resolved in favor of taxation." Van's Material Co. Inc. v. Department of Revenue, 131 Ill. 2d 196 (1989). The taxpayer bears the burden of proving by "clear and convincing" evidence that the exemption applies. Evangelical Hospitals Corp. v. Department of Revenue, 223 Ill. App. 3d 225 (2nd Dist. 1991).

At hearing, the Department introduced copies of six (6) NTLs under the certificate of the Director. Dept. Ex. A; Tr. p. 9. This exhibit, without more, constitutes *prima facie* proof of both the correctness of the amount of tax due and that Taxpayer is not entitled to an exemption. *See* Quincy Trading Post v. Department of Revenue, 12 Ill. App. 3d 725, 729-30 (4th Dist. 1973).

The Nonresident Exemption

Section 3-70 of the Act provides an exemption from the Use Tax ("UT") for nonresidents and states as follows:

> Property acquired by nonresident. The tax imposed by this Act does not apply to the use, in this State, of tangible personal property that is acquired outside this State by a nonresident individual who then brings the property to this State for use here and who has used the property outside this State for at least 3 months before bringing the property to this State.
>
> Where a business that is not operated in Illinois, but is operated in another State, is moved to Illinois or opens an office, plant, or other business facility in Illinois, that business shall not be taxed on its use, in Illinois, of used tangible personal property, other than items of tangible personal property that must be titled or registered with the State of Illinois or whose registration with the United States Government must be filed with the State of Illinois, that the business bought outside Illinois and used outside Illinois in the operation of the business for at least 3 months before moving the used property to Illinois for use in the State. 35 ILCS 105/3-70.

Thus, for the aircraft to be exempt from tax the UTA requires a taxpayer establish itself to be a nonresident individual who acquired the airplanes outside of Illinois and used them for at least three months, outside of Illinois, before he or she brought the planes to this state for use. 35 ILCS 105/3-70; 86 Ill. Admin. Code, sec. 150.315(a). However, if the taxpayer is not an individual but a business, like Taxpayer, it must establish that it had no operations in Illinois until September 2001, the date the first airplane at issue was purchased and brought into Illinois, when it moved to or opened an office, plant or facility in Illinois and all planes it brought into the state were used for at least three months in it's business operations outside of Illinois before being brought to this state for use. 35 ILCS 105/3-70; 86 Ill. Admin. Code, sec. 150.315(B). In addition, a business that either moves to or opens operations in Illinois, must also establish that any of its property relocated to this state that is required to be titled or registered with the state of Illinois, or whose United States government registration must be filed with Illinois is so registered or filed in order to qualify for the exemption. 35 ILCS 105/3-70; 86 Ill. Admin. Code, sec. 150.315(B). *Accord* JB4 Air LLC v. Department of Revenue, No. 07-TX-9 (Ill. App. Ct., 2nd Dist. March 10, 2009) (the nonresident exemption establishes one set of criteria for individuals in paragraph one of Section 3-70 and another set or criteria for businesses in the second paragraph of the section). Inasmuch as Taxpayer is a business, not an individual, only the second paragraph of Section 3-70 is applicable.

It is clear that because all of the aircraft were purchased in Florida and delivered to Delaware they were acquired outside of Illinois. It is also clear that Taxpayer was a nonresident at the time it acquired the planes because it was a Delaware corporation that had no presence in Illinois until its first aircraft was brought to Illinois in September 2001 to be used for flight instruction by its Parent. The record is clear that four of the six planes had been sold and delivered to Taxpayer and remained outside of Illinois for more than three months before they were brought into this state. It is, therefore, clear that two (2) of the Aircraft (259AT and 264AT) could not have qualified for the nonresident exemption because they were not used outside of Illinois for at least three months prior to the time they were first brought into Illinois.

The evidence reflects that all of the planes were used in the Parent's business operations, not Taxpayer's. Taxpayer presented no evidence that it had offices, plants or facilities in Illinois. Taxpayer presented no evidence that it had employees in Illinois. Furthermore, it is unclear whether Taxpayer was required to register its planes with the State of Illinois because only unsubstantiated contentions were made that because the planes were domiciled[2] in Florida, only Federal Aviation Administration ("FAA") registration[3] was required. TP Ex. Nos. 16, 18; TP Br. pp.10-11. Thus, Taxpayer has not shown itself to be a nonresident business that moved to Illinois. Hence, Taxpayer has not met all of the statutory requirements of the UTA to establish its entitlement to the nonresident exemption for the six aircraft.

The Illinois Supreme Court, in Philco Corporation v. Department of Revenue, makes clear that in order for the exemption to apply the property and its owner both must

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[2] Taxpayer asserts that the planes were domiciled in Florida but the Federal Aviation Administration registrations list Taxpayer's Delaware address. Also the Florida exemption affidavits (TP Ex. Nos. 12-14) identifies Taxpayer's Delaware address as the "Purchaser's Permanent Address" and it is unclear whether Taxpayer's domicile is also the domicile of the aircraft. No other evidence regarding the domicile of the planes was presented.

[3] Taxpayer alleges it is exempt from registering the planes in Illinois because one of the "Exceptions to [Illinois'] Registration Requirements [is]…[a]n aircraft owned by a non-resident person of the state of Illinois lawfully entitled to operate the aircraft in the state of his or its residence." 92 Ill. Admin. Code, Sec. 14.230(b). However, the record is unclear as to the residence of Taxpayer because the Parent's Vice President testified that Taxpayer's residence is Florida based upon the mailing address used to forward franchise tax reports (tr. p. 14; TP Ex. No. 2) while the record reflects a Delaware address for the planes' FAA certificates, EDA 95's, Delaware Franchise Tax Reports and the Florida exemption affidavits. The latter identifies Taxpayer's Delaware address as "Purchaser's Permanent Address." Thus, no clear evidence as to Taxpayer being a resident of the state of Florida appears to exist.

Taxpayer further alleges that Florida law permits it to operate the planes in Florida so long as the planes are registered with the FAA as required by F.S.A., Ch. 329, Sec. 329.01. This assertion is not entirely true because while Section 329.01 requires the owner of civil aircraft to record its title with the FAA, this same Florida statute is basically silent as to Florida's requirements for the operation of aircraft in Florida. There is no way to really know what constitutes Taxpayer's "lawful entitlement to operate aircraft in Florida" and inasmuch as there is no clear indication as to Taxpayer's state of residence, it cannot be said that the requirements for exemption from Illinois' registration requirements have been met.

come to Illinois. 40 Ill. 2d 312, 326 (1968).[4] The Court found that with respect to the nonresident exemption, the "statutory emphasis is upon the fact that the property accompanies its owner and is brought to Illinois by its owner for use here. Where the owner…remains out of the State, the exemption does not apply." *Id.* No evidence was presented to show that Taxpayer had, itself, come to Illinois in the sense articulated in the statute, that is, it did not open an office or facility in the state. The evidence did not show that Taxpayer had any offices or employees in Illinois. There was also no evidence to show the aircraft accompanied their owner, Taxpayer, to Illinois. In fact, all the evidence clearly reflects that Taxpayer was not operating any type of office, plant or facility in Illinois. Therefore, under Philco, Taxpayer is not entitled to the nonresident exemption because it has remained outside of the state of Illinois.

Taxpayer argues that all of the UTA's statutory requirements for the nonresident exemption are met when both it and its Parent's activities are considered as one. This argument is in direct contradiction with both the Taxpayer's testimony and assertion that Taxpayer and Parent are separate legal entities, "which are separately incorporated." TP Br. p. 8; Tr. p. 64. The law requires that legally separate entities remain separate and distinct entities. Lombard Public Facilities v. Department of Revenue, 378 Ill. App. 3d 921, 933 (2nd Dist. 2008).

In Lombard, the court denied a non-profit corporation, formed by a village, exemption from sales tax as a governmental body because the non-profit was created "as a separate and distinct entity." *Id.* at 934. Taxpayer cites no case law to substantiate its argument that it may combine its activities and operations with another distinct and

[4] The court's analysis concerns the previous nonresident exemption provision, Ill. Rev. Stat. 1961, Chap 120, par.439.3, which is substantially similar to the current provision.

separate legal entity to qualify for exemption. Certainly, the UTA does not provide that two distinct entities may combine forces so as to establish entitlement to the exemption. In the absence of case law and because the law requires exemptions be strictly construed, with the taxpayer bearing the burden of proving the exemption applies by clear and convincing evidence, Taxpayer cannot be deemed to have met its burden, and as such, it is not entitled to the nonresident exemption.

Penalties and Reasonable Cause

Another provision of ROTA which is incorporated into the UTA by reference is section 3 which requires the filing of monthly returns and the accompanying payment of whatever tax is due not later than the twentieth day of the following calendar month for transactions that occurred in the proceeding calendar month. 35 ILCS 105/12; 120/3. Section 5 of the ROTA (also incorporated into the UTA) permits the Department to assess penalties in accordance with Illinois' Uniform Penalty and Interest Act, 35 ILCS 735/3-1 *et seq.* ("UPIA"). 35 ILCS 105/12; 120/5. Section 3-3(a-10) of the UPIA authorizes the assessment of a late filing penalty for failure to file a tax return on or before the prescribed due date. 35 ILCS 735/3(a-10). Section 3-8 of the UPIA also provides that these penalties "shall not apply if the taxpayer shows that his failure to file a return or pay tax at the required time was due to reasonable cause." 35 ILCS 735/3-8.

The Department has adopted a regulation regarding reasonable cause which provides that "[t]he 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." 86 Ill. Admin. Code, Sec. 700.400(b).

Taxpayer's CPA, who was the company auditor when the planes were purchased, in response to a question as to why Taxpayer had "a good faith belief that it wasn't subject to use tax in Illinois," testified that "[b]ecause the aircraft were delivered from the manufacturer…legally into the state of Delaware, which does not subject personal property, such as aircraft, to a sales tax. So it was completely legal. Taxpayer had no duty to do other than what he did." Tr. pp. 34-35. Taxpayer implies that because the aircraft were delivered to Delaware where they were not subject to sales tax, tax compliance at the state level was achieved and reflected a good faith basis that it was not subject to Illinois UT. But a concluding statement of supposed compliance in one jurisdiction does not denote steps taken to assure compliance with the tax laws for any jurisdiction. To state that because an item will not be subject to tax in the jurisdiction to which it was delivered does not reflect any effort to ascertain whether tax could be due in other jurisdictions in which the Taxpayer acts. No evidence, documentary or testimonial, was presented to reflect any steps taken to investigate whether the planes could be subjected to sales/use taxes in other jurisdictions, like Illinois, because of their mobility. Moreover, Taxpayer did not detail any efforts, like investigations, research or requests for advice, made to determine the tax consequences, or lack thereof, with regard to the airplanes for any jurisdiction including Delaware, Florida or Illinois. Taxpayer did not show that it, or its designated representative, the CPA, exerted any effort, good faith or otherwise, to determine its tax liability so as to establish the existence of reasonable cause for abatement of the late filing penalties assessed.

Penalties and Interest Pursuant to Amnesty

In 2003, the Tax Delinquency Amnesty Act (35 ILCS 745/1 *et seq.*) provided a taxpayer with the opportunity to pay any outstanding taxes, free of interest and penalties, for periods that ended after June 30, 1983 but before July 1, 2002. 35 ILCS 745/10. If a taxpayer failed to pay taxes eligible for amnesty during the period of October 1, 2003 through November 15, 2003, the UPIA provides that such a taxpayer would be subject to double interest and penalties for taxes that would have qualified for amnesty. 35 ILCS 735/3-2(f), 3-3(i).

Four of the aircraft would have qualified for participation in the amnesty program –N259AT, N263AT, N264AT and N265AT. Taxpayer admits that it did not avail itself of the amnesty and pay the taxes which would have been due for these four planes that it used in Illinois before July 1, 2002. TP Br. p. 16. Taxpayer's failure to partake of the amnesty, when it had tax obligations eligible for such a program, subject Taxpayer to the double interest and penalty provisions of the UPIA.

Taxpayer asserts that imposition of the double interest and penalties on four of the aircraft subjected to UT pursuant to the Amnesty Act violates the Due Process Clauses of the United States and Illinois Constitutions for two reasons. First, interest and penalties are imposed retroactively, and as such, bear "no rational relationship to any legitimate legislative purpose." TP Br. p. 16. Second, the Amnesty Act deprives Taxpayer of a meaningful remedy because it "cannot challenge the Department's assertion of tax through the statutorily prescribed pre-deprivation administrative process without risking the imposition of 200% interest and penalties [and s]imilarly…[no] meaningful post-deprivation remedy [exists] because they are required to make a payment under amnesty and give up their right to contest the assessment in order to avoid the 200% interest and penalty sanctions." TP Reply Br. p. 10.

The Department counters that interest and penalties are not imposed retroactively but rather assessed when a taxpayer elects not to participate in the amnesty program and as such the stated and legitimate legislative purpose of revenue generation that reduces/eliminates court cases negates Taxpayer's first argument. Dept. Br. pp. 12-13. As to Taxpayer's second argument, the Department argues the Amnesty program "was designed to provide an incentive to settle…and increas[e] the risk associated with failing to participate." *Id.* at 13. The Department further asserts that "participation was voluntary and taxpayers remained free to contest their liabilities." *Id.* Moreover, the Department points out that Taxpayer has fully availed itself of its due process rights by participation in the current proceedings and, as such, Taxpayer was not deprived of its due process remedies. *Id.* at 13-14.

The Illinois legislature specifically stated that the "purpose of amnesty is to generate cash for the State" (Senator Link, Senate Transcript, Senate Bill 969, Ill. Senate, 93rd General Assembly at 40 (May 31, 2003)) while getting "taxes due off the books, eliminate court cases between the Department of Revenue and the taxpayer, and collect the tax and settle it without penalty or intent just to – to bring in more money and to settle the – the issue." *Accord* House Transcript, Senate Bill 969, Ill. House of Representatives, 93rd General assembly at 14-16 (May 29, 2003) statements of Representatives Currie and Black. So, a rational relationship to the legitimate legislative purpose of revenue generation while moving the State's business forward is the reason for the Amnesty Act. Moreover, contrary to Taxpayer's assertion, no deprivation of a meaningful remedy can be said to exist because an entity, like the Taxpayer here, is free to exercise its option to have an administrative hearing on any properly protested and disputed tax claim. Taxpayers are free to challenge disputed taxes, penalties and interest to which they may be subjected. All protested tax claims encompass a "risk" that not only will any interest and penalty proposed be upheld but so will the disputed tax amount. Taxpayer is free to evaluate the risks to decide whether payment is a better option. Taxpayer decides what remedy it seeks for which it is willing to accept the risk –amnesty, administrative hearing, litigation or inaction. After all, Taxpayer is exercising statutorily provided due process rights by participation in the current proceeding whereby it is challenging the assessment of tax, interest and penalties, none of which has been previously paid.

Commerce Clause Argument

Taxpayer argues that imposition of the UT imposes a burden on interstate commerce so as to violate the Commerce Clauses of the United States and Illinois Constitutions because the Department did not apportion the "tax to reflect the minimal time the Aircraft spent in Illinois." TP Br. p. 12. The Department disagrees. Both parties do, however, agree that the standard determinative of this issue is enunciated in Complete Auto Transit v. Brady, 430 U.S. 274 (1977). Complete Auto states the four criteria that must be met in order for a state to survive a commerce clause challenge. The four criteria require the tax: 1) have a substantial nexus with the state, 2) be fairly apportioned, 3) not discriminate against interstate commerce, and 4) be fairly related to the services provided by the state.[5]

[5] Taxpayer requests that "Comments to the Returned Audit file note" attached to its Post Hearing Brief as Exhibit B be made a part of the record. TP Br. p. 14. At the very least, pursuant to Department regulation,

Taxpayer asserts that it lacks a substantial nexus with Illinois because it has no "physical presence in the State of Illinois." TP Br. p. 12. The Department counters that the presence of Taxpayer's airplanes in Illinois during the audit period "constituted substantial nexus." Dept. Br. p. 7. Both parties cite Brown's Furniture, Inc. v. Wagner, 171 Ill. 2d 410 (1996), in support of their positions. Brown's Furniture challenged Illinois' ability to require it to collect use tax alleging a lack of physical presence in Illinois. The Court, citing Orvis Co. v. Tax Appeals Tribunal, 86 N.Y. 2d 165, 178 (1995), stated that "[w]hile a physical presence…is required, it need not be substantial. Rather, it must be demonstrably more than a 'slightest presence'….And it may be manifested by the presence in the taxing State of the vendor's property or conduct of economic activities in the taxing state performed by the vendor's personnel or on its behalf." Brown at 424. In the present matter, it is undisputed that Taxpayer's planes were present in Illinois for approximately two to five months during the audit period and, as such, one of the two alternative tests necessary to establish substantial nexus – the presence of Taxpayer's property in Illinois – was satisfied.

Taxpayer alleges "imposition of the use tax on the Aircraft also "fails to meet the requirement that the tax be 'fairly related to the services provides by the state'….[because there was no] apportionment to reflect the minimal time spent by the Aircraft in Illinois." TP Br. pp. 12-13. The Department counters that the law does not support Taxpayer's contention but rather recognizes that the fairly apportioned requirement is satisfied when the tax provides a credit for tax paid elsewhere so as to avoid multiple taxation. Dept. Br.

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this document is not made a part of the record and admitted into evidence because the Administrative Law Judge is not to "accept or consider evidence of any form or nature which is received or submitted outside of or subsequent to the hearing itself." 86 Ill. Admin. Code, Sec. 200.155(f).

pp. 8-10. While Taxpayer acknowledges that Illinois courts have held that the requirement that a tax be fairly apportioned is met when a state provides a credit for use tax paid to other states (TP Br. p. 13), Taxpayer disagrees with the rationale for such a holding because it views use tax as more akin to a property tax, and as such alleges that apportionment based upon time within the jurisdiction is mandated. *Id.* at 14. Taxpayer is afforded a credit for any tax paid another state with respect to the planes pursuant to 35 ILCS 105/3-55. However, Taxpayer admits that it paid no sales or use tax to any other state for the planes. Hence, there is no risk of multiple taxation because the planes have not been subjected to any state's sales/use tax, and as such the UT can be found to be "inherently fairly apportioned." Geja's Café v. Metropolitan Pier and Exposition Authority, 153 Ill. 2d 239, 255 (1992); Archer Daniels Midland v. Department of Revenue, 170 Ill App. 3d 1014 (1st Dist. 1988) (upholding use tax on the full price of airplanes purchased out of state and ignoring the amount of time the aircraft actually spent in Illinois found tax was fairly apportioned because Taxpayer had no claim for payment of the tax elsewhere to be subjected to multiple taxation).

Taxpayer contends the application of the UT is discriminatory because "Florida-domiciled property" is taxed on an unapportioned basis so that the "incidence of the tax falls not on Illinois residents, but on ATP USA, a Florida resident." TP Br. p. 15. The Department, citing Brown, *supra,* counters that no discrimination can be said to exist because "Illinois' use tax rate is equal to the Retailers' Occupation Tax applicable to the same tangible personal property purchased in state….Thus, the most which the Act can require from out-of-state vendors is the collection of the same tax as the Illinois vendor. Accordingly, there is no merit to the circuit court's conclusion that the Act discriminates against interstate commerce. See D.H. Holmes, 486 U.S. at 32, 100 L. Ed. 2d at 28, 108 S. Ct. at 1624 (use tax does not discriminate against interstate commerce when imposed at the same rate as in-state sales tax)." Brown at 428.

As to Taxpayer's argument regarding the minimal time the aircraft had been in Illinois, the Philco court rejected an argument that assessment of a use tax should be related to the length of time the property is in the state. Philco at 319-320. The court stated that "tax is imposed 'upon the privilege of using in this State tangible personal property purchased at retail' (Turner v. Wright, 11 Ill. 2d 161, 163, 142 N.E. 2d 84, appeal dismissed, 355 U.S. 65, 78 S. Ct. 140, 2 L. Ed. 2d 106.) It is a nonrecurrent tax; once the tax is paid, the owner of the property may use it in Illinois, continuously or intermittently, without incurring a further use tax ." Philco at 319-320. The court further stated that it was relying on the "Morf principle in Bode v. Barrett, 412 Ill. 204, 106 N.E. 2d 521, affirmed (1953), 344 U.S. 583, 73 S. Ct. 468, 97 L.Ed. 567, stating that 'even when the tax is imposed upon a nonresident and wholly with respect to interstate commerce, a State may tax the full measure of the privilege granted regardless of how little the privilege is exploited.'" Philco at 321. Lastly, citing Aero-Mayflower Transit Co. v. Georgia Public Service Com., 295 U.S. 285, 289 (1935), the Philco court reasoned that "[o]ne who receives a privilege without limit is not wronged by his own refusal to enjoy it as freely as he may." Philco at 320. After all, "the tax is not on the use…but on the privilege of using…without specific limitation" like mileage or days (as in the instant case). Philco at 320, (citing Morf v. Bingaman, 298 U.S. 407, 412 (1936)). Inasmuch as this is a tax on the "privilege" of use, whether the use is inconsequential or substantial, the UTA is due, regardless of the amount of usage Taxpayer or Parent opted to employ.

Moreover, the court in Philco, *supra,* stated that:

> a State may tax the owner of property "having a situs within its limits, whether (the property is) employed in interstate commerce or not" (Helson v. Commonwealth of Kentucky (1928), 279 U.S. 245, 249…), and whether the owner is a resident or not. (Pullman's Place-Car Co. v. Commonwealth of Pennsylvania (1891), 141 U.S. 18…). Just as unassailable is the power of using such property within the State…." The tax is not upon the operations of interstate commerce, but upon the privilege of use after commerce is at an end. Things acquired or transported in interstate commerce may be subjected to a property tax, non-discriminatory in its operation, when they have become part of the common mass of property within the state of destination….For like reasons they may be subjected, when once they are at rest, to a nondiscriminatory tax upon use or enjoyment." Henneford v. Silas Mason Co. (1937), 300 U.S. 577, 582. Philco at 322.

Philco, also recognized the "inconsequence of the shortness of time that a taxed article remains within the state as a factor in determining the tax's validity," (citing Atlantic Gulf & Pacific Co. v. Gerosa, 16 N.Y. 2d 1 (1965) which upheld a New York use tax on equipment purchased eight years prior to being brought to New York for use on projects that lasted less than one and a half months). Philco at 323.

Taxpayer argues apportionment of the UT in proportion to its activities or presence in Illinois is the only way in which satisfaction of the "fairly-related to state provided services" requirement of Complete Auto, *supra,* can be satisfied. The Department disagrees. Satisfaction of the last requirement does not require a "detailed accounting of the services provided to the taxpayer on account of the activity being taxed." Oklahoma Tax Commission v. Jefferson Lines, Inc., 514 U.S. 175, 199 (1995). Rather the "usual and usually forgotten advantages conferred by the State's eminence of a civilized society" (*id* at 200) like fire and police services, a judicial system, roads, etc.

are justification enough for imposition of the UT. Taxpayer benefited from all of these state services and more when its airplanes were used for flight instruction in Illinois.

In light of the above, no violation of the United States and Illinois Commerce Clause provisions can be said to exist because all four prongs of Complete Auto, *supra*, are satisfied.

Uniformity and Equal Protection Clauses' Arguments

Taxpayer alleges that the UT violates the Uniformity Clause of the Illinois constitution but has posited no reason for such an allegation at the evidentiary hearing or in its briefs.

Taxpayer also contends that the UT violates the Equal Protection Clauses of the United States and Illinois constitutions but again has offered no reason for this assertion either at the hearing or in its briefs.

New Arguments

Taxpayer, in its reply brief and for the first time, raises two new arguments. The first is that the Department violated both the spirit and intent of the Taxpayers' Bill of Rights ("Bill"). 20 ILCS 2520 *et seq.* The second new argument is the assertion that there is no evidence that the planes were "used" by Taxpayer "in Illinois within the meaning of the Use Tax Act." TP Reply Br. pp. 2-3.

It should be noted that Department regulations state that "[n]o party shall have the right to file any supporting argument not contemplated by order without obtaining leave." 86 Ill. Admin Code, Sec. 200.155(g). These arguments were not part of the parties' April 8, 2008 Pre-trial order which established the issues relevant to these proceedings. While these arguments are deemed not properly a part of these proceedings, the record clearly reflects that neither the spirit nor the intent of the Bill has been violated and it cannot be said that the record reflects the absence of evidence regarding the use of the planes by Taxpayer.

Taxpayer alleges that the NTLs were issued to an improper party – Parent. Taxpayer further alleges that the Department had a change in the "theory of taxation after an audit, Informal Conference Board[6] review and an evidentiary hearing" had occurred. TP Reply Br. p. 2. Taxpayer alleges that the new theory asserted by the Department is that Taxpayer "is subject to use tax on the Aircraft because it 'used' the Aircraft in Illinois." *Id.* at pp. 1-2. Taxpayer, therefore, concludes that the Department's actions were contrary to section 4 of the Bill's requirement "to include on all tax notices an explanation of the tax liabilities and penalties." 20 ILCS 2520/4(b).

Taxpayer's claim of a notice to an improper party, namely Parent, is unsupported by the record. While the Department's audit began as a review of Parent, in a letter dated December 9, 2005, before the conclusion of the audit, Taxpayer was informed that it was the subject of the audit. This letter further stated that the reason for Taxpayer's replacement of Parent as the object of the audit was because Taxpayer, not Parent, purchased the planes and as such held title/ownership of the planes. At the hearing, the Department auditor testified that it was his intent to only assess Taxpayer and such intent was reflected in the Auditor's Narrative (the official audit report) of March 12, 2007. He stated that: 1) an audit of Parent would have required its own separate Auditor's Narrative (and there was none for Parent), and, 2) he requested that copies of the NTLs

[6] Inasmuch as no evidence was submitted regarding what, if any, theories may or may not have been posited before this Board, the record cannot acknowledge or accept inclusion of any statement as to theories alleged before this Board, which is separate and apart from the Office of Administrative Hearing process/section wherein the current matter is being disputed. 20 ILCS 2505/505; 86 Ill. Admin. Code, Sec. 215.105(e).

be sent to Parent and this request was the likely reason both Taxpayer's and Parent's name appeared on the NTLs. TP Ex. No. 18; Tr. pp. 59-62. The auditor also testified that the EDA 95's he prepared only identified Taxpayer. He further testified that the EDA 95's served as the basis of and explanation for the NTLs which were prepared in Springfield. Tr. pp. 43-45. Moreover, the NTLs clearly state that they are "Notice[s] of Tax Liability for Form EDA-95." Taxpayer had copies of the EDA 95's which it presented as part of its Exhibit 8 at the hearing. It is, therefore, apparent that Taxpayer had ample notice during and after the audit that it was the object of the audit and would be the one assessed should a liability be found.

At hearing the Department clearly stated in its opening statement that the "case involves a corporation, [Taxpayer]… [and t]here's also another entity in this case. It's [Parent who]…operates a flight instruction school in Aurora, Illinois. And it uses in its training…six airplanes that were purchased by [Taxpayer], and we believe that the use of those airplanes in Illinois constitutes a taxable event, subjecting [Taxpayer] to the use tax." Tr. p. 5. This statement clearly indicates the Department is only seeking to have Taxpayer found liable for the UT. This position was reiterated in the Department's post hearing brief (IDOR Br. p. 2) based upon evidence and testimony presented at the hearing.

While Taxpayer asserts that the "spirit" and "intent" of the Bill has been violated no violation exists because Taxpayer was assessed and an explanation was provided in the EDA 95's, in compliance with section 4(b) of the Bill. Part of the Bill's "Legislative Declaration" is stated to be the protection of taxpayers "during the process of assessment and collection of taxes." 20 ILCS 2520/2. To this end the Bill provides that while one has an administrative matter pending with the Department, a taxpayer must have adequate information (20 ILCS 2520/4(a)-(b)) and a remedy (20 ILCS 1520/4(c)) so as to ensure a taxpayer will not be continuously subject to Department mistakes/misinformation during the administrative process. Thus, the Bill provides for the Department to be able to correct any misinformation/mistake made during the administrative process.

It is of great interest that Taxpayer was able to fully avail itself of the administrative process and all arguments it deemed appropriate, including its own argument that Parent must be viewed as the "taxpayer" along with Taxpayer for the nonresident exemption to be applicable. The Department, through the administrative process, possibly before the actual hearing began,[7] but most certainly at the hearing, was clear that it sought to hold Taxpayer, not Parent, liable for the UT. As intended by the Bill, the Department, in the administrative process was able to correct misinformation communicated to Taxpayer on the face of the NTLs.

Thus, it is evident, that not only did no direct violation of the Bill occur but also no violation of its "spirit" or "intent." Correction of mistakes/misinformation, during the administrative process, is the "intent" of the Bill, be it before, during or after the administrative hearing but before rendition of a final and appealable Department decision.

Taxpayer's second new argument, that no evidence exists that the aircraft were "used" as required by the UTA, is based upon two premises. The first premise is that the

[7] Not being privy to all of the parties' discussions, it may have been discussed that only Taxpayer was the object deemed responsible for the UT by the Department. But Taxpayer's possession of the EDA 95's and the Auditor's Narrative (which Taxpayer clearly had before the hearing because it made such documents a part of its case), Taxpayer was aware that it was the only one the Department was seeking to hold accountable for UT with respect to the aircraft.

record does not reflect that Taxpayer exercised any power over the planes in Illinois because it was the Parent who entered a lease in Illinois for office space and tie-downs for the operation of Parent's flight school. TP Reply Br. p. 3. Taxpayer's second premise, or basis for belief that it did not "use" the planes in Illinois, is its assertion that it did not receive "any financial benefit" from the planes being in Illinois. *Id.* Taxpayer, therefore, concludes that because the active use of the planes was in Parent's flight school operations, coupled with the absence of a lease agreement between Taxpayer and Parent for use of the aircraft along with the absence of an economic benefit to Taxpayer, no "use" within the ambit of the UTA exists which could subject Taxpayer to tax. *Id.* at p. 4.

This argument is contradicted by Taxpayer's own testimonial evidence given by the Vice President of Operations of Parent who was "not sure…as the arrangement, as far as being able to use the airplanes" between Taxpayer and Parent. Tr. p. 24. So, while there is hazy evidence of the existence of a lease arrangement between Taxpayer and Parent it is reasonable to conclude that some sort of arrangement existed that permitted Parent to use Taxpayer's airplanes in the flight school's operations. Furthermore, Taxpayer's admission that it was "a wholly-owned subsidiary of [Parent] which elected to have [Taxpayer's] assets, liabilities and items of income, deduction and credit be treated as assets, liabilities and credits of [Parent] in the preparation of its federal income tax returns" (TP Br. p. 9; *see also* Tr. pp. 12, 64) clearly evidences the existence of an economic arrangement that provides tax benefits for Parent's use of Taxpayer's aircraft.

Taxpayer states that the cases of Philo and Telco, *supra*, cannot be relied upon to find Taxpayer subject to the UT because these cases involved lease arrangements and such is not the case in the instant matter. Taxpayer also argues that the Department should not be able to rely upon Miller Brewing v. Korshak, 35 Ill. 2d 86 (1966) because it can also be distinguished from the current matter because "there is no allegation that the Aircraft were used in Illinois to benefit" Taxpayer. TP Br. p. 4. Again Taxpayer misreads the law. Philco, *supra*, defines use as "power to allow property one owns to be used for one's benefit…is the 'exercise' of an 'incident of ownership' under the [Use Tax] act." Philco at 317 (citing Miller Brewing, 35 Ill. 2d 86, 93).

The Philco court, citing Keesling, Conflicting Concepts of Ownership in Taxation (1956), 44 Cal. L. Rev. 866, 867, further stated that "when a person buys property in one state for which the purpose of leasing it and transporting it to a person in another state where a use tax law is in effect, the lessor is considered as using the property in the second state for the production of income and hence is subject to such state's use tax even though he personally makes no physical use of the property in such state." Philco at 317-318. Taxpayer bought aircraft outside of Illinois which it allowed Parent to transport to Illinois for use at Parent's flight school in Aurora. While there is no evidence of whether a leasing arrangement among Taxpayer and Parent existed, it is clear that there existed some type of arrangement that allowed Parent the use of Taxpayer's planes, and as such, this arrangement should be deemed as beneficial to the parties whether or not this arrangement produced income. Neither a direct economic benefit to Taxpayer (as from leasing) nor actual physical use by Taxpayer of the airplanes in Illinois is necessary to establish its use of airplanes in Illinois for use tax purposes. Rather use to Taxpayer's benefit that is incident to its ownership of the planes is all that is necessary to establish use. Philco at 317.

Taxpayer asserts the establishment of Taxpayer and Parent as two, distinct corporate entities[8] "so as to avoid the imposition of use tax" is not improper inasmuch as such an arrangement to either lower or avoid one's tax obligations is not "an injustice or inequitable circumstance." TP Br. p. 9. This admission reflects that Taxpayer's benefit from the planes was, at the very least, its retention of ownership while permitting another, Parent, to have active use of the planes so that Parent would avoid sales/use tax while also preserving federal tax benefits Parent would receive from such an arrangement. Tr. pp. 41, 63-64. Taxpayer's use is its retention of ownership so that it and Parent may avoid the necessity of having to pay either a sales or use tax in any state while permitting Parent to actively utilize the aircraft. As the undisputed owner of the planes, Taxpayer did, in fact, use the aircraft to its benefit and purpose --aircraft available to Parent free of sales/use taxes while conferring other federal tax benefits upon Parent. It should also be remembered that Taxpayer has the burden to prove, by documentary evidence that there was no "use" which it failed to do.

In light of the above, it cannot be said that Taxpayer did not use the airplanes in such a manner as to not be subject to the UT.

Conclusion:

WHEREFORE, for the reasons stated above, it is recommended that all six (6) NTLs be finalized as issued only for Taxpayer while these same NTLs are cancelled with respect to Parent.

Julie-April Montgomery
March 31, 2009 Administrative Law Judge

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[8] This argument is in direct conflict with the claim that Taxpayer and Parent be combined as on entity for purposes of the nonresident exemption.