

UT 11-11

Tax Type: Use Tax

Issue: Use Tax On Watercraft Purchase

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

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| THE DEPARTMENT OF REVENUE |) | Docket No. | 10-ST-0047 |
| OF THE STATE OF ILLINOIS |) | Account ID No. | 13072-53760 |
| v. |) | | |
| JOHN DOE, |) | John E. White, | |
| Taxpayer |) | Administrative Law Judge | |

RECOMMENDATION FOR DISPOSITION

Appearances: Carlos A. Vazquez, Sr. and Carlos A. Vazquez, Jr., Carlos A. Vazquez & Associates, appeared for John Doe; Shepard Smith, Special Assistant Attorney General, appeared for the Illinois Department of Revenue.

Synopsis:

This matter arose after the Illinois Department of Revenue (Department) issued a Notice of Tax Liability (NTL) to John Doe (John Doe or Taxpayer). The NTL assessed Illinois use tax against John Doe regarding the use, in Illinois, of a yacht. Taxpayer protested the NTL and asked for a hearing. Prior to hearing, Taxpayer filed a Motion to Dismiss the NTL, pursuant to § 2-619 of the Illinois Code of Civil Procedure. Taxpayer's Motion was fully briefed and the parties also presented oral argument at a hearing held at the Department's offices in Chicago.

After reviewing the evidence and arguments offered in support of and in opposition to Taxpayer's Motion, I am including in this recommendation findings of fact

and conclusions of law. I recommend that Taxpayer's Motion be granted, and that the Director dismiss the NTL issued to John Doe.

Findings of Fact:

1. On or about June 5, 2001, ABC Business (ABC Business) was incorporated under the British Virgin Islands' (BVI) International Business Companies Act. Department's Response to Taxpayer's Motion to Dismiss (Department's Response), pp. 16-19 (copy of ABC Business' Memorandum of Association, under seal of the BVI). On the date of incorporation, John Doe (John Doe) owned all of ABC Business' outstanding stock. Taxpayer's Motion, Ex. 2, p. 1 (copy of ABC Business' Share Certificate 1).
2. On or about July 31, 2001, ABC Business acquired a Ferretti motor yacht (Ferretti), and registered it with the BVI, as the Ferretti's owner. Taxpayer's Motion, Ex. 3, p. 10 (copy of BVI Certificate of British Registry for the Ferretti, bearing a stamp dated July 31, 2001).
3. In March 2003, John Doe entered into a Share Purchase Agreement with John Doe and ABC Business, pursuant to which John Doe purchased all of the outstanding shares of ABC Business from John Doe. Taxpayer's Motion, Ex. 3, pp. 1-10 (copy of Share Purchase Agreement between John Doe, John Doe and ABC Business). The Share Purchase Agreement provided that ABC Business was "the registered, legal and beneficial owner of Seller's Property" and that "Seller's Property" consisted of the Ferretti. *Id.*, pp. 1, 3-4.

4. On March 18, 2003, John Doe, as director of ABC Business, entered into a certified borrowing resolution, pursuant to which ABC Business authorized the borrowing of monies from North Fork Bank to be secured by the issuance of a mortgage on the Ferretti, and that John Doe would join as a party to such transactions, as a co-borrower. Department's Response, p. 10 (copy of executed Certified Borrowing Resolution).
5. On March 27, 2003, the BVI issued a new Share Certificate no. 2 certifying that John Doe was the registered holder of the outstanding shares of ABC Business. Taxpayer Motion, Ex. 2, p. 2.
6. After becoming aware that the Ferretti was physically present within Illinois, the Department began and conducted an audit to determine whether Illinois use tax or watercraft use tax¹ was due. Department's Response, pp. 12-15 (page 12 consists of a copy of the auditor's narrative report, and pages 13-15 consist of the auditor's audit history worksheet).
7. The auditor determined that the Ferretti was physically present within Burnham Harbor, after John Doe rented slips at Burnham Harbor, Lake Michigan, in Chicago, for the summer seasons of 2004 and 2005. Department's Response, p. 15. The auditor also determined that the Ferretti was physically present within Chicago in the fall of 2003. *Id.*

¹. The Watercraft Use Tax Act, 35 ILCS 158/15-1 *et seq.*, imposes a tax on persons who acquire ownership of watercraft via transactions that do not constitute sales at retail. 35 ILCS 158/15-10 (tax imposed "on the privilege of using, in this State, any watercraft acquired by gift, transfer, or purchase after September 1, 2004.").

8. On June 22, 2009, after being in contact with ABC Business' attorney regarding the Department's audit, the auditor wrote a letter to counsel. Department's Response, p. 8 (copy of letter from auditor to counsel). The body of that letter provided as follows:

We have received your response to our proposal of tax liability for your client and the purchase of the above listed watercraft. Your response references Watercraft Use Tax. However, from the information that we have been provided, we have determined that John Doe purchased all of the shares in the corporation, ABC BusinessMarine, Ltd. The purchase of shares in a corporation is not a purchase of tangible personal property and therefore would not be subject to use tax in Illinois in any form. However, ABC BusinessMarine Ltd purchased a watercraft and at some point in time the watercraft was brought into Illinois for use, thereby subjecting it to be taxed under the use tax statutes. Whereas Mr. John Doe purchased the assets belonging to ABC BusinessMarine Ltd when he purchased the shares, he also acquired any liabilities that belonged to ABC Business. However, from the information that we have been provided the tax liabilities in question appear to have arisen after Mr. John Doe's purchase of the corporation. Please note that "it is the taxpayer's burden to prove that it is entitled to the exemption that it seeks" (United Airlines Inc. 1981) and that "the taxpayer must produce competent evidence as identified with its books and records, and not mere testimony, in order to overcome the presumption of taxation" (A R Barnes and Co 1988).

Department's Response, p. 8.

9. On November 12, 2009, the Department issued an NTL to John Doe, assessing tax to him, individually, regarding the use of the Ferretti in Illinois, beginning on August 15, 2003. Department's Response, p. 7.
10. John Doe avers, and the documents of title reflect, that he "does not now own or has ever owned the [Ferretti] or any interest in [it] individually." Taxpayer's Response, Ex. 1 (John Doe affidavit, ¶ 4).

Conclusions of Law:

This matter involves Taxpayer's protest of the Department's determination that he

owes use tax regarding the purchase and use of a yacht in Illinois. The instant matter involves Taxpayer's Motion to Dismiss which asserts an affirmative defense to the use tax assessment the Department issued to him, individually. Before addressing the authority for and nature of Taxpayer's Motion, however, a brief explanation of the applicable tax law is in order.

What is colloquially referred to as Illinois sales tax actually consists of two complimentary taxes imposed by two separate tax acts, the Retailers' Occupation Tax Act (ROTA), and the Use Tax Act (UTA). The ROTA imposes a tax upon persons engaged in the business of selling tangible personal property at retail. 35 ILCS 120/2; Hagerty v. General Motors Corp., 59 Ill. 2d 52, 54-55, 319 N.E.2d 5, 6 (1974). The ROTA defines a "sale at retail" to mean "any transfer of the ownership of or title to tangible personal property to a purchaser, for the purpose of use or consumption, and not for the purpose of resale in any form as tangible personal property ... for a valuable consideration" 35 ILCS 120/1.

The UTA imposes a tax "upon the privilege of using in this State tangible personal property purchased at retail from a retailer" 35 ILCS 105/3. The tax applies regardless whether the property is purchased in Illinois or elsewhere. Turner v. Wright, 11 Ill. 2d 161, 142 N.E.2d 84 (1957). The purchaser incurs the primary liability for payment of use tax. Klein Town Builders v. Department of Revenue, 36 Ill. 2d 301, 222 N.E.2d 482 (1966). The UTA requires retailers maintaining a place of business in Illinois to act as the collector of use tax, and hold it in trust for the state. 35 ILCS 105/3a; 35 ILCS 105/8. That trust is satisfied when the retailer that has collected use tax from its customer pays its own, respective, retailers' occupation tax liability regarding the gross

receipts it received from making sales at retail. 35 ILCS 105/8; Hagerty v. General Motors Corp., 59 Ill. 2d 52, 55, 319 N.E.2d 5, 6 (1974). When a person purchases property from an out-of-state retailer for use in Illinois, the UTA requires the purchaser to report the transaction to the state. 35 ILCS 105/10.

The Illinois General Assembly incorporated into the UTA certain provisions of the complementary ROTA. 35 ILCS 105/11. Among the incorporated provisions is § 5 of the ROTA, which provides that the Department's determination of tax due constitutes prima facie proof that tax is due in the amount determined by the Department. 35 ILCS 105/12; 35 ILCS 120/5. The Department attached a copy of the NTL it issued to John Doe as an exhibit to its Response, under the certificate of the Director. Department's Response, pp. 6-7. That exhibit, without more, constitutes prima facie proof that Taxpayer owes Illinois use tax in the amount determined by the Department. 35 ILCS 105/12; 35 ILCS 120/5.

The Department's prima facie case is a rebuttable presumption. Copilevitz v. Department of Revenue, 41 Ill. 2d 154, 157, 242 N.E.2d 205, 207 (1968); DuPage Liquor Store, Inc. v. McKibbin, 383 Ill. 276, 279, 48 N.E.2d 926, 927 (1943). A taxpayer cannot overcome the statutory presumption merely by denying the accuracy of the Department's assessment. A.R. Barnes & Co. v. Department of Revenue, 173 Ill. App. 3d 826, 833, 527 N.E.2d 1048, 1053 (1st Dist. 1988). Instead, a taxpayer has the burden to present evidence that is consistent, probable and closely identified with its books and records, to show that the assessment is not correct. Fillichio v. Department of Revenue, 15 Ill. 2d 327, 333, 155 N.E.2d 3, 7 (1958); A.R. Barnes & Co., 173 Ill. App. 3d at 833-34, 527 N.E.2d at 1053.

Moving now to Taxpayer's Motion, § 200.185 of the Department's hearing regulations provides:

Any party to a proceeding pending before the Office of Administrative Hearings of the Department may raise an issue or seek to dispose of all or part of the proceeding by way of a timely motion. Any motion which is authorized under the Code of Civil Procedure [735 ILCS 5] that may be utilized in normal civil practice and is not otherwise inconsistent with administrative practice and procedure, contrary to the tax laws, or outside the scope of an Administrative Law Judge's authority may be employed. Such motions may include but are not limited to: summary judgment; dismissal; consolidation; motions in limine; etc.

86 Ill. Admin. Code § 200.185.

Taxpayer's Motion is based on § 2-619 of Illinois' Code of Civil Procedure (Code). Section 2-619 of the Code provides, in pertinent part:

§ 2-619. Involuntary dismissal based upon certain defects or defenses. (a) Defendant may, within the time for pleading, file a motion for dismissal of the action or for other appropriate relief upon any of the following grounds. If the grounds do not appear on the face of the pleading attacked the motion shall be supported by affidavit:

(9) That the claim asserted against defendant is barred by other affirmative matter avoiding the legal effect of or defeating the claim.

(c) If, upon the hearing of the motion, the opposite party presents affidavits or other proof denying the facts alleged or establishing facts obviating the grounds of defect, the court may hear and determine the same and may grant or deny the motion. If a material and genuine disputed question of fact is raised the court may decide the motion upon the affidavits and evidence offered by the parties, or may deny the motion without prejudice to the right to raise the subject matter of the motion by answer and shall so deny it if the action is one in which a party is entitled to a trial by jury and a jury demand has been filed by the opposite party in apt time.

735 ILCS 5/2-619.

A § 2-619 motion provides a means of disposing not only of issues of law but also

of easily proven issues of fact. Barber Coleman Co. v. A & K Midwest Insulation Co., 236 Ill. App. 3d 1065, 1072, 603 N.E.2d 1215, 1221 (5th Dist. 1992). The Barber Coleman court explained that motions to dismiss under § 2-619 involve essentially a summary judgment procedure, with certain differences. *Id.*² Summarizing those differences, the Barber Coleman court wrote:

- (2) a defendant's section 2-1005 motion admits the legal sufficiency of *the claim* but denies the truth of the facts alleged; and
- (3) a section 2-619 motion admits both the truth of the facts alleged in support of *the claim* and the legal sufficiency of *the claim*, but it raises affirmative matters which it asserts defeat the claim, and as to those affirmative matters, there is no admission of either truth or sufficiency.

Barber Coleman Co., 236 Ill. App. 3d at 1073, 603 N.E.2d at 1222 (italics original).

Using the terms of § 2-619 within the context of this contested case, the “claim” consists of the Department’s assessment of use tax regarding the use of the Ferretti in Illinois. Department’s Response, pp. 6-7. The “affirmative factual matter” that Taxpayer’s Motion asserts as a defense to that claim is John Doe’ assertion that he has never been the Ferretti’s owner or title holder. Taxpayer’s Motion, *passim*; Taxpayer’s Response, John Doe Affidavit. After taking into account Illinois law regarding § 2-619 motions, I do not consider John Doe’ Motion as claiming that the Ferretti was not brought into Illinois for use, or that such use was not subject to Illinois use tax (*see Barber Coleman Co.*, 236 Ill. App. 3d at 1073, 603 N.E.2d at 1222); he’s just saying that, since

² One difference not discussed by the court in Barber Coleman is the different burdens imposed on the respective movants. Section 2-1005 requires a movant to show a right to judgment as a matter of law. 735 ILCS 5/2-1005(c); *see also* Hon. Barbara McDonald, The Top 10 Ways to Avoid Losing a Motion for Summary Judgment, Ill. B.J. 128, 129 (March 2004) (“As a matter of law’ is the highest burden you ever have in the law.”). In contrast, under § 2-619, the movant is required to show, by a preponderance of the evidence, that a particular defect or defense negates a claim. Nosbaum v. Martini, 312 Ill. App. 3d 108, 122-23, 726 N.E.2d 84, 95 (1st Dist. 2000) (*quoting* 4 R. Michael, Illinois Practice (Civil Procedure Before Trial) § 41.8, at 336 (1989)).

he did not own the Ferretti, the Department cannot impose use tax directly against him, individually.

In its response to John Doe’ Motion, the Department posed no objection to the admissibility of the documents of title for the Ferretti, or to the admissibility of the documents reflecting Taxpayer’s purchase of ABC Business’ stock. *See* Department’s Response, *passim*. Indeed, the Department itself attached some of the identical documents to its response. *Id.*, pp. 16-20, 22-28. Further, the Department stipulated to the authenticity and relevance of such documents at hearing.

Here, the fact question — who owned the Ferretti? — is easily resolved. John Doe averred, and the documents of title reflect, that he has never personally owned the Ferretti. Taxpayer Motion, Exs. 1-3; Taxpayer’s Response, Ex. 1 (John Doe affidavit, ¶ 4). Instead, and based on the documentary evidence and John Doe’ factual averments, it is clear that, on the date identified on the NTL, ABC Business, a corporation, owned the Ferretti, and John Doe owned ABC Business. Taxpayer Motion, Exs. 1-3; Taxpayer’s Response, Ex. 1 (John Doe affidavit, ¶ 4). But that does not mean that John Doe owned the Ferretti.

Long ago, the Illinois Supreme Court recognized that “[t]he law is well settled that the tangible property of a corporation and its shares of stock held by the shareholders are separate and distinct kinds of property, and belong to different owners, the first being the property of the corporation and the latter the property of the individual shareholder” Illinois National Bank v. Kinsella, 201 Ill. 31, 43, 66 N.E. 338, 341 (1903). A relatively short time later, in Central Illinois Public Service Co. v. Swartz, 284 Ill. 108, 111, 119 N.E. 990, 992 (1918), the Illinois Supreme Court held, “The corporation is the

legal owner of all its property. The shareholder has a legal right to participate in the earnings of the corporation and the distribution of its property upon its dissolution, but he does not own any part of the property of the corporation.”

Both Kinsella and Swartz involved Illinois’ former personal property tax. While the citizens of Illinois have repealed that tax (*see Client Follow-Up Co. v. Hynes*, 75 Ill. 2d 208, 390 N.E.2d 847 (1979)), Illinois law remains clear that “[a] corporation is a legal entity that exists separately and distinctly from its shareholders, officers, and directors, who generally are not liable for the corporation's debts. Fontana v. TLD Builders, Inc., 362 Ill. App. 3d 491, 500, 840 N.E.2d 767, 775 (2nd Dist. 2005); *see also* 13 Ill. Law & Practice *Corporations* § 147 (August 2010) (“Shareholders do not own the property of the corporation. ... [footnotes omitted] The title to the corporate property is vested in the corporation itself, and the shareholders own not its property, but the shares of the corporation; ... that is, an intangible interest in the corporation, ... with a right to share the net profits on distribution and to secure a proportionate share of the net assets on dissolution.”) (and cases cited therein). The UTA is similarly clear that a natural individual and a corporation are distinct persons. 35 ILCS 105/1 (definition of “person”).³ For purposes of the UTA, therefore, John Doe, a natural individual, and ABC Business, a corporation, are not the same person. *Id.*

John Doe’ Motion is also correct on the law. Use tax is intended to be imposed on the owner of the tangible personal property purchased, at retail, for use in Illinois. That intent is reflected within the UTA’s definitions of the terms, “use” and “purchaser.”

³ The UTA defines “person” to “mean[] any natural individual, firm, partnership, association, joint stock company, joint adventure, public or private corporation, limited liability company, or a receiver, executor, trustee, guardian or other representative appointed by order of any court. 35 ILCS 105/1.

“Use” is defined as “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. “Purchaser,” in turn, is defined as “anyone who, through a sale at retail, acquires the ownership of or title to tangible personal property.” *Id.* Based on those definitions, the Illinois Supreme Court has held that “only the owner of property can be a user within the meaning of the Act.” Telco Leasing, Inc. v. Allphin, 63 Ill. 2d 305, 309-10, 347 N.E.2d 729, 731 (1976).

The competent evidence submitted with Taxpayer’s Motion shows that John Doe is not the owner of the Ferretti, and was not its owner when it was brought into Illinois for use. Taxpayer’s Motion, Exs. 1-3 Taxpayer’s Response, Ex. 1 (John Doe affidavit, ¶ 4). Instead, ABC Business, a corporation, owned the Ferretti both before and after it was brought into Illinois for use. *Id.* That John Doe is not the owner of the Ferretti, and was not its owner when it was brought into Illinois for use, is an affirmative matter that completely negates — and thereby rebuts — the Department’s determination that he is liable for use tax regarding the use of that property in Illinois. 35 ILCS 105/2; Telco Leasing, Inc., 63 Ill. 2d at 309-10, 347 N.E.2d at 731.

Once a taxpayer offers documentary evidence that overcomes the Department’s prima facie case, the burdens shifts to the Department to prove its case by a preponderance of the competent evidence. Miller v. Department of Revenue, 408 Ill 574, 581-82, 97 N.E.2d 788, 792 (1951). Here, the Department did not offer any competent evidence to show that John Doe owned the Ferretti. Nor has the Department supported the other three claims made in its Response, which were, in summary: (1) Taxpayer’s purchase of ABC Business’ stock was a sham transaction designed to avoid taxation

(Department's Response, ¶¶ 3, 5); (2) it is not required to first proceed against ABC Business before seeking to impose tax on John Doe, directly; and (3) it can pierce ABC Business' corporate veil and proceed against John Doe personally. *Id.*, ¶ 5.

First, the Department offered no competent evidence to support its contention that John Doe purchased ABC Business' stock intending to perpetuate a sham, and it provides no citation to any Illinois statute or case law which characterizes the pertinent transaction as a sham. Department's Response, p. 9. Nor has the Department supported its claim of authority to pierce ABC Business' corporate veil and proceed directly against John Doe for ABC Business' potential — although, as far as this record reveals, never assessed — use tax liability regarding the Ferretti.

Finally, the Illinois General Assembly has granted the Department the authority, under the Uniform Penalty and Interest Act (UPIA), to assess liability against certain individuals for a different taxpayer's tax liabilities, where such an individual is responsible for filing the different taxpayer's tax returns, or paying its tax liabilities, and where such an individual willfully fails to do so, or willfully acts to defeat or evade the collection of such a tax. 35 ILCS 735/3-7; *see also* Branson v. Department of Revenue, 168 Ill. 2d 247, 258, 659 N.E.2d 961, 966-67 (1995). However, the UPIA provides specific procedures for the Department to use when assessing a personal liability penalty against a responsible officer or employee of a distinct taxpayer. Specifically, § 3-7(b) provides:

Sec. 3-7. Personal Liability Penalty.

(b) The Department shall issue a notice of penalty liability for the amount claimed by the Department pursuant to this Section. Procedures for protest and review of a notice of penalty liability issued pursuant to this Section and assessment of the penalty due hereunder

shall be the same as those prescribed for protest and review of a notice of tax liability or a notice of deficiency, as the case may be, and the assessment of tax liability under the Act imposing that liability.

35 ILCS 735/3-7(b).

But here, the Department did not issue a notice of penalty liability to John Doe; it issued an NTL to him. Department's Response, p. 7. The Department, in other words, has not treated John Doe as a responsible person, but as the Ferretti's owner. There is nothing in this record which allows a conclusion that the Department may proceed in this manner.

Conclusion:

Based on the documentary evidence made part of Taxpayer's Motion, I recommend that the Director grant Taxpayer's motion to dismiss, and cancel the NTL the Department issued to assess tax against John Doe, individually, regarding the use of the tangible personal property at issue.

January 20, 2011

John E. White
Administrative Law Judge

