

UT 11-12

Tax Type: Use Tax

Issue: Use Tax On Property Titled To A Corporation Shareholder

Use Tax On Watercraft Purchase

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

THE DEPARTMENT OF REVENUE)	Docket No.	10-ST-0027
OF THE STATE OF ILLINOIS)	Account ID No.	03257-80384
v.)		
JOHN DOE,)	John E. White,	
Taxpayer)	Administrative Law Judge	

RECOMMENDATION FOR DISPOSITION

Appearances: John Sheldon, Foreman Friedman, PA, appeared for John O'Hara; George Foster, 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 purchase of a watercraft for use in Illinois. Taxpayer protested the NTL and asked for a hearing. In a pre-hearing order, the parties identified the issues as whether Taxpayer owes Illinois use tax regarding the purchase and use of the property in Illinois, and, if so, whether the Department correctly determined the selling price of the property purchased.

The hearing was held at the Department's offices in Chicago. Taxpayer testified and offered documentary evidence. I have reviewed the evidence, and I am including in this recommendation findings of facts and conclusions of law. I recommend that the

Director cancel the NTL, because John Doe is not the person that purchased and owned the property used in Illinois.

Findings of Fact:

1. On or about May 17, 2007, a United States Coast Guard Bill of Sale form, number XXXXXX (bill of sale), was completed to document the sale of a 2001 Azimut yacht named ABC Boat. Taxpayer Ex. 2 (copy of bill of sale).
2. The bill of sale names XYZ Business (XYZ Business), whose address was in the Cayman Islands, as the seller of the ABC Boat. Taxpayer Ex. 2 (§ 3). XYZ Business owned a 100% interest in the ABC Boat, prior to the sale. *Id.* The bill of sale names JKL Business (JKL Business), whose address was in the Marshall Islands, as the buyer of the ABC Boat. *Id.* (§ 4). JKL Business owned a 100% interest in the ABC Boat, after the sale. *Id.*
3. JKL Business is a foreign corporation that was incorporated “[p]ursuant to section 32 of the Marshall Islands Business Corporations Act ...” on December 22, 2006. Taxpayer Ex. 1 (copy of Consent of Incorporator of JKL Business); *see also* 735 ILCS 5/2-102 (“A foreign corporation not authorized to transact business in this State is a nonresident of this State.”).
4. John Doe was JKL Business’s president upon incorporation, and remains so. *Id.*; Hearing Transcript (Tr.) pp. 9-10 (John Doe). John Doe’s wife was, and remains, JKL Business’s secretary. Taxpayer Ex. 1; Tr. p. 11 (John Doe).
5. On May 17, 2007, Brown & Brown Marine, a division of Brown & Brown Insurance, issued a Marine Insurance Confirmation # XXXXXX (confirmation) to JKL Business

to confirm marine insurance coverage for the ABC Boat. Taxpayer Ex. 8 (copy of confirmation). The confirmation identifies the named insured as follows:

JKL Business Charter Ltd.
John Doe

Id.; Tr. pp. 37-38.

6. The confirmation identifies the policy coverage for the ABC Boat's hull and machinery as being in the amount of \$1,150,000. Taxpayer Ex. 8. John Doe explained at hearing that that coverage amount was chosen for the watercraft because that was the price JKL Business paid for the ABC Boat. Tr. p. 36 (John Doe).
7. On May 25, 2007, JKL Business registered the ABC Boat with the Office of the Maritime Administrator of the Republic of the Marshall Islands. Taxpayer Ex. 3 (copy of signed and stamped Port Authority Private Yacht Registration) (private yacht registration); Taxpayer Ex. 4 (copy of signed and stamped Private Yacht Certificate of Registry) (registry certificate); Tr. pp. 14-18 (John Doe).
8. The private yacht registration and registry certificate name JKL Business as the ABC Boat's owner. Taxpayer Exs. 3-4; Tr. pp. 17-18 (John Doe).
9. On May 29, 2007, the United States Customs and Border Protection (Customs) issued Cruising License number XXXXXXXX, authorizing "Motor-Yacht ABC BOAT belonging to JKL BUSINESS CHARTERS ..." to cruise in the waters of the United States. Taxpayer Ex. 5 (copy of cruising licenses), p. 1. JKL Business applied for and received cruising licenses from Customs for subsequent annual periods. *Id.*, p. 2; Tr. p. 19 (John Doe).
10. Since its purchase, the ABC Boat has been kept at Burnham Harbor in Chicago, Illinois, during some months. Department Ex. 3 (copies of six invoices from Chicago

Park District to John Doe for slip fees); Tr. pp. 21-26 (John Doe). John Doe is the lessee of the slip at which the ABC Boat is docked when it is physically present in Illinois. Department Ex. 3; Tr. pp. 21, 34-35, 71-73 (John Doe).

11. John Doe has filed an Illinois use tax return regarding watercraft he, personally, owns. Department Ex. 4 (copy of filed Department form ST-556, dated July 1, 2007, which John Doe filed regarding a 2007 Seadoo personal watercraft he purchased for use in Illinois).
12. The Department conducted an audit of watercraft physically present within Illinois, and compared such watercraft with returns filed with the Department and with registration forms filed with the Illinois Department of Natural Resources. Department Ex. 2, p. 1 (copy of Audit Narrative). Glen Phillips, since retired, conducted the audit. *Id.*; Tr. p. 42 (testimony of audit supervisor Dan Olivero (Olivero)).
13. Based on the audit, Phillips made certain determinations about the purchase of the ABC Boat. Department Ex. 2. Philips documented his determinations, generally, within his audit narrative report (*id.*), and more specifically, on form EDA-95 (titled, Auditor Prepared Vehicle Use Tax Return). Taxpayer Ex. 6 (copy of EDA-95 return).
14. During the audit, Phillips received from John Doe copies of the registration certificate and cruising licenses issued to JKL Business for the ABC Boat. Department Ex. 2. Philips wrote in his audit narrative that he had not received the following documents from John Doe: “corporate charter or articles of incorporation, operating agreements, purchase contract, invoice, bill of sale, payment medium, closing statement, insurance policies[.]” *Id.*

15. Phillips determined that John Doe owned the ABC Boat when it was brought into Illinois for use, and that no use tax return had been filed to report the ABC Boat's purchase for use in Illinois. Department Ex. 2; Taxpayer Ex. 6.
16. Phillips determined that John Doe brought the ABC Boat into Illinois on June 15, 2007. Department Ex. 2; Taxpayer Ex. 6.
17. Phillips determined that the selling price John Doe paid for the ABC Boat was \$2,000,000. Taxpayer Ex. 6. Phillips determined this selling price based on the best available information, after receiving no documentation from John Doe about the actual selling price for the vessel. Department Ex. 2; Tr. pp. 54, 56-57 (Olivero).
18. The Department thereafter issued an NTL to John Doe, which assessed tax in the amount of \$140,000, a late filing penalty in the amount of \$250, a late payment penalty in the amount of \$28,000, plus interest. Department Ex. 1 (copy of NTL).

Conclusions of Law:

This matter involves Taxpayer's protest of the Department's determination that he owes use tax regarding the purchase of the ABC Boat for use in Illinois. The Illinois Use Tax Act (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. However, where a person purchases property from an out-of-state retailer

for use in Illinois, the UTA requires the purchaser to report the transaction directly to the state, and to pay the use tax due. 35 ILCS 105/10.

The Illinois General Assembly incorporated into the UTA certain provisions of the complementary Retailers' Occupation Tax Act (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 offered into evidence a copy of the NTL it issued to John Doe, under the certificate of the Director. Department Ex. 1; Tr. pp. 7-8. 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). 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. A.R. Barnes & Co., 173 Ill. App. 3d at 833-34, 527 N.E.2d at 1053.

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." "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 statutory 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).

Here, the fact question — who purchased and owns the ABC Boat? — is easily resolved by reviewing the documentary evidence admitted at hearing. The bill of sale, the registry certificate and documents, and the cruising licenses all reflect that John Doe was not the purchaser and owner of the ABC Boat. Taxpayer Exs. 3-5. Instead, those documents reflect that JKL Business, a corporation, purchased and owned the ABC Boat when it was brought into Illinois for use. Taxpayer Exs. 3-5.

Illinois law recognizes John Doe as a different person than JKL Business, the corporation. “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). And since the UTA defines “person” to include both “public and private corporations” and “natural individuals” (35 ILCS 105/2), a natural individual is not the same person as either a public or private corporation. JB4 Air LLC v. Department of Revenue, 388 Ill. App. 3d 970, 974, 905 N.E.2d 310, 314 (2d Dist. 2009) (“We read the Use Tax Act in its entirety and determine that it did not intend for ‘individual’ to include limited liability companies, because it uses the terms separately and distinctly.”) (*citing* 35 ILCS 105/2). John Doe does not own the ABC Boat; JKL Business, a corporation, does. Taxpayer Exs. 1-5. Since John Doe has offered documentary evidence showing

that he was not the purchaser of the ABC Boat, and was not its owner when it was brought into Illinois for use (Taxpayer Exs. 1-5), he has rebutted 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 burden 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). As explained more fully below, the Department did not do so here.

After Taxpayer rested, Olivero testified, on cross examination, that he knew of no documents which show that John Doe, personally, owned the ABC Boat. Tr. p. 68 (Olivero). Instead, the Department offered testimonial evidence, through John Doe, regarding JKL Business's activities and governance. Tr. pp. 26-32 (John Doe). The Department also offered evidence to show that John Doe paid for the slip at which the ABC Boat was kept when it was physically present in Illinois. Department Ex. 3 (copies of bills from the Chicago Park District to John Doe); Tr. pp. 51 (Olivero), 71-73 (John Doe). It also offered evidence showing that John Doe had filed an Illinois use tax return to report tax due on a different watercraft that he, personally, purchased and owns. Department Ex. 4.

During its closing argument, the Department reinforced the audit supervisor's explanation of why the Department disregarded the documentary evidence showing that the ABC Boat was purchased and owned by JKL Business, a corporation. *Compare* Tr. pp. 43-44 (Olivero) *with* Tr. pp. 76-92 (closing argument). Specifically, the Department

argued that the JKL Business was organized and operated to hold title to the ABC Boat as a sham, solely to avoid the payment of Illinois use tax. Tr, pp. 76-77. It asserted that there was no economic substance to JKL Business, and that the Department could pierce the corporate veil and tax John Doe, directly, because he was the true owner of the ABC Boat. Tr. pp. 77-82, 84, 90, 92. Finally, the Department contended that it could, and I should, ignore documents it considers fraudulent, such as the bill of sale, registration certificates, and cruising licenses. Tr. p. 92.

I address the last argument first. Regarding the Department's allegation of fraud, in Brown Specialty Co. v. Allphin, 75 Ill. App. 3d 845, 851, 394 N.E.2d 659, 663 (3rd Dist. 1979), the Illinois appellate court held that the Department has the burden to prove fraud by clear and convincing evidence. *Id.* ("We conclude that the 'clear and convincing standard' is to be applied to actions, such as the instant one, wherein fraud is asserted under Section 443 of the Retailers Occupation Tax Act."). The court did not find that the Department satisfied its burden simply by offering its determinations into evidence under the Director's certificate. *See id.* at 851-53, 394 N.E.2d at 663-65; accord Racine Fuel Co. v. Rawlins, 377 Ill. 375, 380, 36 N.E.2d 710, 713 (1941) ("Fraud is not presumed but must be proved like any other fact by clear and convincing evidence.").

Here, the Department has not shown, by clear and convincing evidence, that the documents showing that JKL Business, a corporation, purchased and owns the ABC Boat, are fraudulent. Those documents reflect that the Republic of the Marshall Islands and the United States accept that JKL Business is the owner of the ABC Boat. Taxpayer Exs. 3-5. The Department has not established that the views of those sovereign nations are incorrect, or that they have revised their records to show that John Doe was the ABC

Boat's owner. On this point, therefore, the Department has offered only argument, unsupported by any evidence.

Similarly, the Department offered no clear and convincing evidence showing that JKL Business was created and operated as a sham. For example, John Doe testified that JKL Business did not have a board of directors, did not hold director's meetings, and did not keep director's minutes. Tr. pp. 26-29 (John Doe). If JKL Business had been incorporated pursuant to Illinois law, such evidence might be probative of whether JKL Business failed to observe corporate formalities. *See* 810 ILCS 5/8.05(a) ("Except as provided in Article 2A of this Act, each corporation shall have a board of directors"). But the Department did not establish that corporations formed under the laws of the Republic of the Marshall Islands, such as JKL Business, must have directors. Nor is the corporation law of the Republic of the Marshall Islands an issue on which an administrative law judge may take official notice. 5 ILCS 100/10-40(c) ("Notice may be taken of matters of which the circuit courts of this State may take judicial notice. ***"); 735 ILCS 5/8-1007 ("Foreign country. The law of a jurisdiction other than those referred to in Section 8-1003 of this Act shall be an issue for the court, but shall not be subject to the foregoing provisions concerning judicial notice."); Vrozos v. Sarantopolous, 195 Ill. App. 3d 610, 618-19, 552 N.E.2d 1093, 1099 (1st Dist 1990) ("The law of a foreign country may not be judicially noticed in Illinois, but is an issue for the court which must be proven as any other fact."). The Department offered no evidence to rebut the documentary evidence showing that JKL Business was incorporated (Taxpayer Ex. 1), or to rebut the presumption of corporate regularity. Gass v. Anna Hospital Corp., 392 Ill. App. 3d 179, 186, 911 N.E.2d 1084, 1091 (5th Dist. 2009).

Nor did the Department cite authority holding that a natural individual who presides over a foreign corporation formed to purchase and hold title to an expensive and potentially dangerous item of tangible personal property is engaging in a sham transaction. Because Taxpayer has rebutted the Department's determination that he owes use tax regarding property he does not own, there is no need to address the propriety of the Department's determination of the ABC Boat's selling price.

Conclusion:

Based on the documentary evidence admitted at hearing, and for reasons expressed above, I respectfully recommend that the Director cancel the NTL the Department issued to assess use tax against John Doe, individually.

July 5, 2011

John E. White
Administrative Law Judge

