

UT 01-7

Tax Type: Use Tax

Issue: Use Tax On Aircraft Purchase

Rolling Stock (Purchase/Sale Claimed To Be Exempt)

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

THE DEPARTMENT OF REVENUE)	
OF THE STATE OF ILLINOIS)	
)	Docket No. 00-ST-0000
v.)	IBT # 0000-0000
)	NTL # SF-99000000000000
"FAHRQUAR ENTERPRISES, INC.")	
)	
Taxpayer)	

RECOMMENDATION FOR DISPOSITION

Appearances: Heidi Scott, Special Assistant Attorney General, for the Department of Revenue of the State of Illinois; Barry M. Barash of Barash & Everett, LLC for "Fahrquar Enterprises, Inc."

Synopsis:

"Fahrquar Enterprises, Inc." ("taxpayer") purchased an aircraft and did not pay use tax on it. The Department of Revenue ("Department") issued a Notice of Tax Liability to the taxpayer for the use tax, and the taxpayer timely protested the Notice. An evidentiary hearing was held during which the taxpayer argued that the aircraft qualifies for the rolling stock exemption to the use tax. After reviewing the record, it is recommended that this matter be resolved in favor of the Department.

FINDINGS OF FACT:

1. The taxpayer is in the business of leasing aircraft and equipment, primarily to one lessee, "Rocket Boy, Inc." (Tr. p. 10)

2. "Rocket Boy, Inc." is a commercial aviation business that does taxi, charter, and maintenance work. (Tr. p. 11)

3. "Rocket Boy, Inc." has authority from the Federal Aviation Administration to operate as an air carrier and conduct common carriage operations. (Taxpayer Ex. T-1)

4. "James Dean" and his wife are the sole shareholders of the taxpayer. Mr. "Dean" is the secretary of the taxpayer. He is also the president and a shareholder of "Rocket Boy, Inc." (Tr. pp. 9, 10, 40)

5. On August 1, 1994, the taxpayer and "Rocket Boy, Inc." entered into an "Aircraft Lease" where the taxpayer leased to "Rocket Boy, Inc." the "appropriate Cessna model Aircraft as acquired" to be used for transportation of passengers, freight, and other legitimate purposes. (Taxpayer Ex. T-2)

6. The lease provides that the rate to be charged by the lessor and paid by the lessee is a rate per hourly use of the aircraft. For a model 414 aircraft, the rate is \$125 per hour. (Taxpayer Ex. T-2)

7. The lease provides that it shall renew annually on August 1st unless either party gives a 30 day written notice to the other party that they wish to cancel the lease. (Taxpayer Ex. T-2)

8. On June 4, 1996, the taxpayer purchased a 1971 Cessna 414 aircraft for \$75,500. (Dept. Ex. #1; Tr. pp. 13-14)

9. At the time of purchase, the airplane was not airworthy. The taxpayer picked the plane up near Kansas City, Missouri, made the plane flyable, and flew it to

Galesburg, Illinois. Although it was flyable at this point, it still was not airworthy. (Tr. pp. 14-15)

10. Once the airplane arrived in Galesburg, "Rocket Boy, Inc." repaired the airplane to make it airworthy. The repair process took about three months and cost approximately \$48,000. (Tr. pp. 15-16; Taxpayer Ex. T-4)

11. During October and November of 1996, the aircraft was flown a total of seven times. Three of the flights were interstate flights. (Taxpayer Ex. T-3)

12. On November 25, 1996, the taxpayer sold the airplane for approximately \$126,000. (Tr. p. 22; Taxpayer Ex. T-5)

13. The Department prepared a corrected tax return for taxpayer for the additional tax due. The corrected return was admitted into evidence under the Director's Certificate. (Dept. Ex. #1)

CONCLUSIONS OF LAW:

The Use Tax Act (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 Use Tax Act incorporates by reference section 4 of the Retailers' Occupation Tax Act (35 ILCS 120/1 *et seq.*), which provides that the corrected return issued by the Department is *prima facie* correct and is *prima facie* evidence of the correctness of the amount of tax due, as shown therein. 35 ILCS 105/12; 120/4. Once the Department has established its *prima facie* case by submitting the corrected return 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 its 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 for an exemption. Id.

It is well-settled 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 clearly proving that it is entitled to the exemption, and all doubts are resolved in favor of taxation. Id.

The rolling stock exemption under the Use Tax Act provides in relevant part as follows:

"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:

* * *

(b) The use, in this State, of tangible personal property by an interstate carrier for hire as rolling stock moving in interstate commerce or by lessors under a lease of one year or longer executed or in effect at the time of purchase of tangible personal property by interstate carriers for-hire for use as rolling stock moving in interstate commerce as long as so used by the interstate carriers for-hire ***" (35 ILCS 105/3-55(b)).

Thus, if the taxpayer is a lessor, in order to qualify for the exemption the taxpayer must establish that (1) the vehicle is under a lease of one year or longer; (2) the vehicle was used by an interstate carrier for hire and (3) the vehicle in question moved in interstate commerce. In order to prove that the vehicle moved in interstate commerce, the taxpayer must show that its interstate use of the vehicle was regular and frequent or more than merely incidental. National School Bus Service, Inc. v. Department of Revenue, 302 Ill. App.3rd 820 (1998).

The Department contends that the aircraft does not qualify for the rolling stock exemption for the following reasons: (1) the lease is not valid; (2) if the lease is valid, then its duration is not one year or longer; (3) the lease was not executed or in effect at the time of the purchase of the aircraft; (4) the lessee was not an interstate carrier for hire; and (5) the aircraft did not move in interstate commerce.

The taxpayer presented a document titled "Aircraft Lease," which was entered into on August 1, 1994 and provides that the taxpayer is the owner of:

"Manufacturer: Cessna Aircraft Co.
Model: As available – 210, 310R, 414, 421B
Year Mfg: All years approved under FAA Cert. # [Number]
Registration N#. As assigned by FAA"

The document also provides that the taxpayer "does hereby lease the lessee ["Rocket Boy, Inc."] appropriate Cessna model Aircraft as acquired." (Taxpayer Ex. T-2) Under the agreement, the lessee pays the lessor for the use of the aircraft on an hourly basis. The hourly rate for a model 414 aircraft is \$125. In addition, the document states that "[t]his lease shall renew annually, on August 1st, unless either party gives a 30 day written notice to the other party that they wish to cancel the lease." (Taxpayer Ex. T-2)

The taxpayer also presented a document entitled "Tach Sheet," which lists the flights taken by the aircraft in question.¹ The Tach Sheet shows a total of seven flights taken during the months of October and November of 1996. The first two flights were for test flights for a total of three hours. The remaining flights are as follows:

10/23/96	for [Company]	[City], Kentucky	3.9 hours
10/24/96	for [Company]	[City], Iowa	1.7 hours
11/06/96	for [Person]	[City], Illinois	1.2 hours
11/12/96	for [Person]	[County], Illinois	2.4 hours
11/18/96	for [Person]	[City], Iowa	2.8 hours

(Taxpayer Ex. T-3; Tr. p. 19). The aircraft was sold on November 25, 1996.

¹ The Tach Sheet is named after a tachometer, which is a recording instrument in the airplane that is used to keep track of the maintenance and flight times. (Tr. p. 17)

The Department contends that the lease is not valid because the owners of the lessor are also the owners of the lessee and therefore an arm's length transaction did not take place. The Department also notes that the lease states that the "lessee shall have use of the aircraft at all times that the lessor does not have the aircraft prescheduled." The Department claims that this indicates that the lessor has the right to control the use of the aircraft. The Department also argues that the duration of the lease was not one year or longer because the taxpayer owned the aircraft less than a year.

The taxpayer argues that the lease is valid because nothing in the evidence indicates that an arm's length transaction did not take place. The taxpayer states that the lease is for a year or longer because the parties' intention must be determined at the lease's inception, and when the aircraft was acquired in June of 1996 the parties intended the lease to last at least one year. The fact that the aircraft was sold less than a year after it was acquired should not have any bearing on whether the aircraft qualifies for the exemption.

Nothing in the record indicates that the terms of the lease were not negotiated on an arm's length basis. Although the fact that Mr. "Dean" is a shareholder of both the lessor and the lessee calls into question the arm's length nature of the deal, this fact, in and of itself, is not enough to invalidate the agreement. The evidence does not indicate that the consideration under the lease is less than the fair market price or that any other term in the lease does not meet marketplace standards. Nothing in the record indicates that independent parties would not have negotiated similar terms.

It is not clear, however, from a review of the lease that the duration of the lease is one year or longer. The Illinois Commercial Code provides a definition of "lease" and

states that lease “means a transfer of the right to possession and use of goods for a term in return for consideration ****” (810 ILCS 5/2A-103(j)). As the Department has indicated, the lease provides that the “lessee shall have use of the aircraft at all times that the lessor does not have the aircraft prescheduled.” (Taxpayer Ex. T-2, ¶5) The lease further provides that the lessor “shall pay all necessary costs of fuel and oil for said aircraft during lessor’s use and lessee shall pay for all necessary costs of fuel and oil during lessee’s use.” (Taxpayer Ex. T-2, ¶11) Under these terms, the lessee clearly does not have possession and use of the aircraft for a period of one year or longer. The lessee may use the aircraft only when the lessor does not have it prescheduled. In addition, the rate paid by the lessee is an hourly rate. The lessor allows the lessee the use of the aircraft for an hourly term in return for a payment of \$125 per hour. The duration of the lease therefore appears to be on an hourly basis rather than a yearly basis.

Even assuming that the term under the lease agreement was for a year, the aircraft in question still would not qualify for the exemption because this aircraft was not leased for one year. The lease states that it applies to the appropriate aircraft “as acquired.” This particular aircraft was acquired in June of 1996 and sold in November of 1996. The taxpayer cannot lease something that it does not possess. Because the taxpayer did not possess the aircraft for at least one year, it would not be entitled to the exemption.

Finally, it is not clear from the Tach Sheet that "Rocket Boy, Inc." was the only user of the aircraft for the flights in question. The Tach Sheet lists the date, customer, destination, beginning and ending tach numbers, total hours, pilot, and the ticket number for billing purposes. Mr. "Dean" testified that the Tach Sheet is "Rocket Boy's" document “because they do the billing since they are the user of the aircraft.” (Tr. p. 18)

As previously stated, however, the lease agreement allows the taxpayer to use the aircraft. Nor is there any provision in the lease preventing the taxpayer from leasing this airplane to another entity. The testimony at hearing was that "Rocket Boy, Inc." was taxpayer's primary lessee, not sole lessee. The taxpayer did not present additional documentary evidence indicating that "Rocket Boy, Inc." was the operator of the aircraft. Mr. "Dean" testified that he is a shareholder of both the taxpayer and "Rocket Boy, Inc." and that he has access to "Rocket Boy's" documents. (Tr. p. 37) He explained that the retail customers are charged by the mile (Tr. p. 37), but he did not produce documents supporting this contention. No explanation was given for the failure to produce these documents. As previously stated, exemption provisions are strictly construed, and all doubts are resolved in favor of taxation. Heller at 579. Because the taxpayer did not clearly prove its entitlement to the exemption, the claim for the exemption must be denied.

Recommendation:

For the foregoing reasons, it is recommended that the aircraft does not qualify for the rolling stock exemption and the Notice of Tax Liability should be upheld.

Linda Olivero
Administrative Law Judge

Enter: May 18, 2001