

UT 04-5

Tax Type: Use Tax

Issue: Use Tax On Aircraft Purchase

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

**THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS**

v.

**ABC AVIATORS, LLC.,
Taxpayer**

**No. 03-ST-0000
IBT # 0000-0000
NTL: 0 0 0000000000000**

**Charles E. McClellan
Administrative Law Judge**

RECOMMENDATION FOR DECISION

Appearances: George Foster, Special Assistant Attorney General, for the Illinois Department of Revenue; Kevin P. Shea of Ungaretti & Harris for ABC Aviators, LLC.

Synopsis:

This matter comes on as the result of a timely filed protest to a Notice of Tax Liability issued to ABC Aviators, LLC. on February 18, 2003 for use tax due in connection with the purchase of an aircraft. Taxpayer asserts that a mistake was made in the original Aircraft Bill of Sale documenting its purchase of the aircraft in that an aircraft retailer was identified as the seller making the transaction taxable. Taxpayer asserts that the named seller should have been a company related to the retailer and that documentation prepared and filed after the fact establishes that it purchased the aircraft from a non-retailer in an occasional sale that was not taxable. The Department asserts that the original Aircraft Bill of Sale governs and that the transaction was taxable. An

evidentiary hearing was held on April 14, 2004. Neither party filed post-hearing briefs. I am recommending that the Notice of Tax Liability be made final.

Findings of Fact:

1. ABC Aviators, LLC. (“Taxpayer”) is engaged in the aircraft leasing business, and John Doe is the managing member of Taxpayer. Tr. p. 11.
2. The Division of Aeronautics of the Illinois Department of Transportation forwarded an Illinois Aircraft Registration Application for a 1977 Cessna model 340A aircraft with the serial number 000000000 (the “Aircraft”) to the Department of Revenue. Taxpayer indicated it purchased the Aircraft from Airplanes, Ltd. in Nebraska on January 25, 1999. An RUT –25 Use Tax return was not filed for the Aircraft so the Department commenced an audit. Dept. Ex. No. 3.
3. On February 18, 2003 the Department issued a Notice of Tax Liability, Form EDA-95, (“NTL”) to Taxpayer assessing use tax¹ in connection with the purchase of the Aircraft. Dept. Ex. No. 1.
4. The NTL assessed use tax of \$20,300, late filing penalty of \$250 and interest calculated March 20, 2003 of \$3,565 for a total assessment of \$24,115. *Id.*
5. On January 14, 1997 the Federal Aviation Administration (“FAA”) recorded an Aircraft Bill of Sale for the Aircraft that was filed on November 21, 1996. This Aircraft Bill of Sale listed XXX, Inc. of Nebraska as the seller² and Aircrafts, Ltd. as the purchaser. The Aircraft Bill of Sale is dated November 20, 1996. Dept. [Group] Ex. No. 2, Taxpayer [Group] Ex. No. 8.

¹ Unless otherwise noted, all statutory references are to the Illinois Use Tax Act (UTA) 35 ILCS 105/1, *et seq.* sometimes referred to as *use tax*, or to the Retailers’ Occupation Tax Act (ROTA), 35 ILCS 120/1 *et seq.*, sometimes referred to as *sales tax*.

² XXX, Inc. is not involved in this matter.

6. On January 26, 1999, an Aircraft Bill of Sale for the Aircraft dated January 25, 1999 was filed with the FAA. This Aircraft Bill of Sale listed Aircrafts, Ltd. as seller and Taxpayer as the purchaser of the Aircraft. *Id.*
7. On January 25, 1999 the amount of \$290,000 was wire transferred from a personal account of John. and Jane Doe, his wife, to Aircrafts Power Systems, Inc. for the purchase of the Aircraft. Tr. pp. 21-25, Taxpayer Ex. No. 1.
8. Aircrafts, Ltd. and Aircrafts Power Systems, Inc. were affiliated companies. Tr. pp. 29, 57.
9. Aircrafts, Ltd. had a dealer's permit from the FAA and it had registered with the state of Nebraska claiming a resale exemption for the Aircraft when it purchased it.³ Tr. p. 56.
10. On March 25, 1999 the FAA issued a certificate of registration for the Aircraft identified on the Aircraft Bill of Sale filed on January 26, 1999. It listed Taxpayer as the applicant. Dept. [Group] Ex. No. 2, Taxpayer [Group] Ex. No. 8.
11. John Doe, representing Taxpayer, and Joe Blow, as president of Aircrafts, Ltd. and as president of Aircrafts Power Systems, Inc., an affiliated company, executed a document entitled an "Amendment to Bill of Sale Dated 1-25-99" for the Aircraft, stating that the name of the seller of the Aircraft to Taxpayer should have been Aircrafts Power Systems, Inc., not Aircrafts, Ltd. This document is dated May 26, 2000. Tr. p. 57, Taxpayer Ex. Nos. 3, 8.
12. In a letter dated July 31, 2000, the FAA issued a letter declining to record an Amendment to Bill of Sale Dated 1-25-99 as being an inappropriate document. Taxpayer [Group] Ex. No. 8.

13. On July 24, 2000 the FAA recorded a Set-Aside Statement dated July 13, 2000, filed on July 14, 2000, and signed by Joe Blow representing Aircrafts, Ltd. as president. The Set-Aside Statement states that the sale of the Aircraft recorded on January 25, 1999 incorrectly listed Taxpayer as purchaser. Dept. [Group] Ex. No. 2, Taxpayer Ex. Nos. 8, 10, 11.
14. On July 31, 2000 the FAA recorded an identical Set-Aside Statement dated July 13, 2000, filed on July 14, 2000, and signed by John Doe representing ABC Aviators, LLC. as manager. The Set-Aside Statement states that the sale of the Aircraft recorded on January 25, 1999 incorrectly listed Taxpayer as purchaser. *Id.*
15. Also on July 31, 2000 the FAA recorded An Aircraft Bill of Sale for the Aircraft dated January 24, 1999, filed on May 30, 2000, listing Aircrafts, Ltd. as seller and Aircrafts Power Systems, Inc. as purchaser. *Id.*, Taxpayer Ex. Nos. 4, 8.
16. On July 31, 2000, the FAA recorded an Aircraft Bill of Sale for the Aircraft dated January 26, 1999, filed May 30, 2000, listing Aircrafts Power Systems, Inc. as seller and Taxpayer as purchaser. *Id.*, Taxpayer Ex. Nos. 2, 8.
17. On July 31, 2000 the FAA recorded an Aircraft Bill of Sale for the Aircraft dated March 29, 2000, filed August 17, 2000, listing Taxpayer as seller and Flying Service, Inc. as purchaser. *Id.*
18. Under date of April 13, 2004 the title Co., of Oklahoma City, Oklahoma issued an abstract of the chain of ownership of the Aircraft that includes the following FAA recordings:

³ The record does not indicate what type of business Aircrafts Power Systems, Inc. engaged in.

<u>Document</u>	<u>Seller</u>	<u>Purchaser or Applicant</u>	<u>Document Dated</u>	<u>Date Filed</u>	<u>Date Recorded</u>
Bill of Sale	`	Aircrafts, Ltd.	11/20/96	11/21/96	1-14-97
Bill of Sale	Aircrafts, Ltd.	Taxpayer	1/25/99	1/26/99	3/25/99
Application for Aircraft Registration		Taxpayer	1/25/99	1/26/99	3/25/99
FAA Letter rejecting amendment to bill of sale received 5/3/00			7/31/00		
Set-Aside Statement executed by Aircrafts, Ltd. ⁴			7/13/00	7/14/00	7/24/00
Set-Aside Statement executed by Taxpayer ⁵			7/13/00	7/14/00 ⁶	7/31/00
Bill of Sale	Aircrafts, Ltd.	Aircrafts Power Systems, Inc.	1/24/99	5/30/99	7/31/00
Bill of Sale	Aircrafts Power Systems, Inc.	Taxpayer	1/26/99	5/30/00	7/31/00
Bill of Sale	Taxpayer	Flying Service, Inc.	3/29/00	4/7/00 ⁷	7/31/00

Taxpayer Ex. No. 8.

Conclusions of Law:

Early in the calendar year 1999, the Division of Aeronautics of the Illinois Department of Transportation forwarded an Illinois Aircraft Registration Application to the Department for the Aircraft. This led to the Department determining that Taxpayer

⁴ Statement that the named purchaser of the Aircraft in the bill of sale dated 1/25/99 is incorrect.

⁵ Statement that the named purchaser of the Aircraft in the bill of sale dated 1/25/99 is incorrect

⁶ This document was refiled on 7/25/00. The abstract does not state why refiling was necessary.

⁷ This document was refiled on 5/16/00. The abstract does not state why refiling was necessary.

had purchased the Aircraft from Aircrafts, Ltd., in Nebraska and that Taxpayer had not paid sales tax in connection with the purchase nor had it filed a use tax return. After the Department's auditor commenced his audit and determined that Aircrafts, Ltd. was an aircraft retailer and that the transaction was taxable, and conveyed that information to Taxpayer, Taxpayer informed the Department's auditor that it had purchased the Aircraft from Aircrafts Power Systems, Inc. not Aircrafts, Ltd. Tr. pp. 57-66.

Sometime during that time period after John Doe became aware of the fact that the transaction was taxable, he and Joe Blow as president of Aircrafts, Ltd. and as president of Aircrafts Power Systems, Inc. began preparing, or caused the preparation of, the documents filed with the FAA to recast the transaction as a non-taxable occasional sale from Aircrafts Power Systems, Inc. to Taxpayer. I find that the Taxpayer has failed to overcome the Department's *prima facie* case, and I am recommending that the Notice of Tax Liability be made final.

The hearing in this matter began with the admission into evidence of the Notice of Tax Liability under the certificate of the Director. The admission into evidence of the records of the Department under the certification of the Director at a hearing before the Department or any legal proceeding establishes the Department's *prima facie* case. 35 ILCS 120/8⁸ *Central Furniture Mart v. Johnson*, 157 Ill.App. 3d 907 (1st Dist. 1987); *Copilevitz v. Department of Revenue*, 41 Ill.2d 154, 242 N.E.2d 205 (1968).

When a taxpayer claims that it is exempt from a particular tax, it has the burden of proof. This derives from the fact that deductions and exemptions are privileges created by statute as a matter of legislative grace. Statutes granting such privileges are to be strictly

⁸ The Use Tax Act makes numerous sections of the Retailers' Occupation Tax Act (35 ILCS 120/1 *et seq.*) applicable to the Use Tax, including 35 ILCS 120/8. 35 ILCS 105/12.

construed in favor of taxation. *Balla v. Dept. of Revenue*, 96 Ill. App. 3d 293, 295 (1st Dist. 1981).

To overcome the Department's *prima facie* case, the taxpayer must present consistent, probable evidence identified with his books and records. *Copilevitz v. Department of Revenue*, *supra*; *Central Furniture Mart v. Johnson*, *supra*. Testimony alone is not enough. *Mel-Park Drugs, Inc. v. Department of Revenue*, 218 Ill.App.3d 203, (1st Dist. 1991), *A.R. Barnes & Co. v. Department of Revenue*, 173 Ill. App. 3d 826, 833-34 (1st Dist. 1988).

Thus, when the Department introduced the Notice of Tax Liability under the Director's certificate, the Department's *prima facie* case was established. I conclude that Taxpayer has failed to provide consistent and probable evidence identified with its books and records sufficient to overcome the Department's *prima facie* case.

The ROTA and the UTA are complementary taxes. *Weber Stevens Products, Inc. v. Dept. of Revenue*, 324 Ill.App.3d 893, 756 N.E.2d 321 (1st Dist. 2001) When a purchase is made by an Illinois user from an out-of-state vendor that has no obligation under the ROTA or the UTA to collect Illinois use tax on the transaction, the Illinois user is obligated to pay use tax directly to the state. 35 ILCS 105/10.

The ROTA and the UTA both provide an exception to the application of the tax in the case of an isolated or an occasional sale by a person that does not hold himself out as being engaged in retailing or does not habitually engage in selling tangible personal property at retail. 35 ILCS 120/1, 35 ILCS 105/2.

The term “sale at retail” is defined in the ROTA and in the UTA as “any transfer of the ownership of or title to tangible personal property to a purchaser, for the purpose of use, and not for the purpose of resale . . .for a valuable consideration. . . .” *Id.*

In this case Taxpayer purchased the Aircraft from Aircrafts, Ltd. which was a non-Illinois aircraft retailer located in Nebraska. When title was transferred from Aircrafts, Ltd. to Taxpayer a taxable sale occurred. 35 ILCS 105/2. That sale, which is at issue in this case, is established by the Aircraft Bill of Sale dated January 25, 1999 that was filed on January 26, 1999 and recorded by the FAA on March 25, 1999. Also on January 25, 1999, John Doe, acting on behalf of Taxpayer, transmitted \$290,000 to Aircrafts Power Systems, Inc., an affiliate of Aircrafts, Ltd. for the purchase of the Aircraft.

John Doe testified that he intended to purchase the Aircraft from Aircrafts Power Systems, Inc. However, there is no document in the record, such as a written contract or offer to purchase, to support that assertion. He relies heavily on the January 25, 1999 transfer of funds that he made to Aircrafts Power Systems, Inc., rather than Aircrafts, Ltd. to purchase the Aircraft. Aircrafts, Ltd. and Aircrafts Power Systems, Inc. are affiliates, and the record does not contain any information regarding the arrangement of funds transfers between them if there was any. However, the fact that Mr. Doe caused the transfer of funds on January 25, 1999 to Aircrafts Power Systems, Inc. rather than to Aircrafts, Ltd. does not prove that the sale was by Aircrafts Power Systems, Inc. rather than by Aircrafts, Ltd. Furthermore, the pattern of the documents of record and the recorded chain of title to the Aircraft, analyzed below, leads to the conclusion that Mr. Doe’s testimony is not credible. The pattern of documents demonstrates a clear attempt to

reformat a series of transactions for the sole purpose of converting a taxable sale of the Aircraft into a non-taxable occasional sale.

Whether Mr. Doe, acting for Taxpayer, intended the sale to be taxable or not, the transfer of title to the Aircraft from Aircrafts, Ltd., a retailer, to Taxpayer as reflected on the Aircraft Bill of Sale dated January 25, 1999, was a taxable sale under the clear language of the statute. The chain of title for the Aircraft established by the aircraft bills of sale and the abstract of the chain of ownership of the Aircraft establish that on January 25, 1999, Aircrafts, Ltd., not Aircrafts Power Systems, Inc., owned the Aircraft. Therefore, Aircrafts Power Systems, Inc. could not have sold the Aircraft to Taxpayer on that date.

It was only after John Doe learned from the Department's auditor that the transaction was taxable that he contacted Mr. Blow and the two of them caused the series of documents to be prepared to restructure the original transaction into a non-taxable transaction. This group of documents starting with the document entitled "Amendment To Bill of Sale Dated 1-25-99, Filed 1-26-99, Recorded 3-25-99, As FAA Conveyance Number II013419". The attempt to register that contract with the FAA failed. This failure led to the subsequent filing of the Set-Aside Statements, and the obviously backdated bills of sale creating a chain of title from Aircrafts, Ltd. to Aircrafts Power Systems, Inc. to Taxpayer.

Aircrafts Ltd. purchased the Aircraft on November 20, 1996. The next day it filed a registration with the FAA that was recorded on January 14, 1997. Three years later, Aircrafts, Ltd. sold the Aircraft to Taxpayer. After the sale to Taxpayer by Aircrafts, Ltd. was determined to be taxable, the parties recast the transaction so it would appear to be a

non-taxable occasional sale. The amendment to the bill of sale is dated May 26, 2000, four months after the original sale. The Aircraft Bill of Sale that reflected this transaction between Aircrafts, Ltd., as seller, and Aircrafts Power Systems, Inc., as buyer, is dated January 24, 1999, but was not recorded by the FAA until July 31, 2000. (Taxpayer Ex. Nos. 4, 8) This trail of back-dated documents indicates that it was done solely for the purpose of recasting a taxable transaction that occurred on January 25, 1999 between Taxpayer and Aircrafts, Ltd. into a non-taxable occasional sale transaction.

Aircrafts, Ltd. and the next party in the chain of title, Aircrafts Power Systems, Inc., are affiliated companies having the same individual as president. Considering the relationship between these two entities, the dates of the subsequently prepared documents and the dates they were filed and recorded by the FAA, it is reasonable to conclude that recasting the transaction in this fashion was simply an attempt by the parties to alter the form of the transaction to avoid paying tax on the purchase of the Aircraft by Taxpayer.

This pattern of transactions has been tried before to avoid Illinois use tax and failed. In *In Re: William Stoecker*, 179 F.3d 546 (7th Circ. 1999) the Court analyzed a similar pattern of title transfer to avoid tax. In that case, an Illinois resident solicited an out-of-state aircraft retailer to purchase an aircraft on its behalf. The aircraft retailer was successful and purchased an aircraft that was satisfactory to its customer. The customer had trouble financing the transaction, so the retailer transferred title to an affiliate, a non-retailer, that was in the business of financing aircraft purchases. The affiliate and the original customer worked out the details, and the affiliate transferred title of the aircraft to the original customer. The parties treated the sale as an occasional sale by the non-retailer and did not pay Illinois use tax.

The Court examined the transactions and applied the substance over form doctrine first adopted in federal income tax cases. That doctrine holds that in determining the true nature of a transaction for tax purposes, the courts must look at the underlying economic substance of the transaction and not merely its form. *Id.* at 550. The Court noted that if such a three-party sales transaction were allowed to stand any out of state retailer could structure a transaction to avoid Illinois sales and use tax. *Id.* The Court said that looking at the “real” sale, the transfer of title to the financing affiliate was merely a security device for financing the sale and that the substance of the transaction was a sale from the retailer to the original customer.

The same analysis applies to this case. The “real” sale was from Aircrafts, Inc., the aircraft retailer in Nebraska, to Taxpayer in Illinois. The transfer of title to Aircrafts Power Systems, Inc. was for the sole purpose of avoiding Illinois use tax.

Recommendation

For the reasons set forth above, I recommended that the Notice of Liability be made final.

Charles E. McClellan
Administrative Law Judge