

This letter discusses the application of the Interim Use and Demonstration Exemption to aircraft. 86 Ill. Adm. Code 150.306(c). (This is a GIL.)

December 9, 2011

Dear Xxxxx:

This letter is in response to your letter dated November 3, 2011, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings (“PLRs”) are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department’s regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter (“GIL”) is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at www.tax.illinois.gov to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

The purpose of this letter is to request clarification in reference to use taxes and the application of Illinois law in this particular situation. We have reviewed the law in this area and have come to our conclusions but wish to confirm with the Illinois Department of Revenue what is required under the circumstances.

Our client is a regional distributor of aircraft and powered gliders (collectively—‘aircraft’) under an exclusive distribution contract in a four-state region with the manufacturer. Our client does not manufacture the aircraft—rather; the company simply purchases the aircraft and gliders for sale to end users. The aircrafts [sic] are not used for personal use by the company owners or employees. The aircrafts [sic] are hangared awaiting sale. In some instances, the aircrafts [sic] are repositioned to other geographic regions where there is a better concentration of potential buyers. While at the other geographic locations, the client company may conduct demonstration flights for qualified prospects. In some instances, two aircrafts [sic] will be flown to the geographical site for the purpose of leaving one of the aircrafts [sic] behind for viewing by potential buyers. The second aircraft is then used to transport the pilot of the first aircraft back to Illinois. The aircrafts [sic] are also displayed at flight schools or other areas where potential buyers are present. The aircrafts [sic] are recorded as inventory on the books of account of the taxpayer and are not depreciated. Due to the overall downturn in the economy in Illinois and across the country, sale of aircrafts [sic] is slow. There will be occasions

where the aircrafts [sic] are held for 18 months or longer awaiting sale. When sold, ROT is collected and remitted to the Illinois Department of Revenue.

As we understand, the use of property by its owner for demonstration purposes is not subject to UT or SUT, except that demonstration watercraft and aircraft used by a retailer for more than 18 months are subject to use tax on the retailer's original cost of the watercraft or aircraft. An interim use exemption rule provides that UT and SUT are not imposed on (1) the interim use of property by a retailer before the property is sold, provided the property is carried on the books of the retailer or is otherwise available for sale or (2) the physical incorporation of property (to the extent not first used for the purpose for which it was purchased) as an ingredient or constituent into other property which is sold in the regular course of business. See 35 ILCS 105/2; 35 ILCS 110/2; 86 Ill. Adm. Code 150.201; 86 Ill. Adm. Code 150.306.

We also understand that the interim use exemption may not be claimed if (1) title to the item is held by any party other than the retailer, the manufacturer of the item, or a captive finance company; (2) the retailer elects to claim an IRC Sec. 179 deduction on the item as a depreciable business asset; or, (3) if the item is leased, the aggregate gross receipts from leasing exceeds the retailer's selling price of the item. See 86 Ill. Adm. Code 150.306(a).

But then we read, 86 Ill. Adm. Code 150.306(c), which provides that a retailer, who uses an aircraft for demonstrative or interim use for a period that exceeds 18 months, shall pay Use Tax on the original cost of the aircraft, and no credit for that tax is permitted if the aircraft is subsequently sold by the retailer.

This will confirm that our client company is a retailer and that the aircrafts [sic] are held for sale in the ordinary course of business and carried on the books of account as inventory; that title to the aircraft is held by our client company and no other; that no IRC Sec. 179 deduction has been taken; and, that the aircraft are not leased. This will also confirm that the aircraft are not used for any personal purposes.

With regard to the aircraft inventory held for more than 18 months while awaiting sale, our client company is concerned that UT is applicable. Specifically, the client company does not understand why it will be penalized for inability to turn aircraft within 18 months given the current and projected state of the economy. Also, 86 Ill. Adm. Code 150.306(c) seems in conflict with *DuPage Aviation Corporation v. Department of Revenue*, Appellate Court of Illinois, Second District, No. 74-80, 346 N.D. 2d 8, 37 Ill. App. 3d 587.

We are interested in your opinion as to what the law requires of our client company under these circumstances. If your conclusion is that they must pay Use Tax for inventory held for a period of 18 months or more, we want to know this. If you agree with the position that the holding of aircrafts [sic] for resale for a period of 18 months or more is exempt from paying Use Tax, we want to know this as well.

Please advise us of your opinion.

DEPARTMENT'S RESPONSE:

The Illinois Retailers' Occupation Tax Act imposes a tax upon persons engaged in this State in the business of selling tangible personal property at retail to purchasers for use or consumption. 86 Ill. Adm. Code 130.101. In Illinois, a Use Tax is also imposed on the privilege of using, in this State, any kind of tangible personal property that is purchased anywhere at retail from a retailer. 86 Ill. Adm. Code 150.101. These taxes comprise what is commonly known as "sales" tax in Illinois

Section 2 of the Use Tax Act states, in part:

"'Use' does not mean the demonstration use or interim use of tangible personal property by a retailer before he sells that tangible personal property. For watercraft or aircraft, if the period of demonstration use or interim use by the retailer exceeds 18 months, the retailer shall pay on the retailers' original cost price the tax imposed by this Act, and no credit for that tax is permitted if the watercraft or aircraft is subsequently sold by the retailer."

35 ILCS 105/2. The 18-month statutory provision has been in effect since 1994. The 18-month rule regarding watercraft and aircraft contained in Section 2 of the Use Tax is codified at subpart (c) of 86 Ill. Adm. Code 150.306. I would point out that *DuPage* was decided in 1976, and the court in its decision noted "there was at the time of audit no valid rule or regulation of the Department of Revenue which restricted the length of time property could be held before use tax liability would accrue." *DuPage* at 591. This is no longer the case.

Based upon statute and the rule, the demonstration or leasing of an aircraft by a person primarily engaged in the business of selling such property at retail falls within the scope of the demonstration use exemption from Use Tax provided that the aircraft is carried as inventory on the books and ultimately sold, or is otherwise available for sale during the relevant period. The ultimate sale of the aircraft subsequent to the demonstration use will result in Retailers' Occupation Tax liability.

The 18-month period for demonstration or interim use of aircraft begins at the time of purchase. Therefore, if an aircraft were not sold prior to expiration of the 18-month period, the retailer would incur Use Tax liability on the aircraft pursuant. Based on the facts contained in your letter we see no reason why the 18-month rule would not apply.

I hope this information is helpful. If you require additional information, please visit our website at www.tax.illinois.gov or contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Richard S. Wolters
Associate Counsel

RSW:mks