

Section 3 of the Use Tax Act (35 ILCS 105/3) imposes a tax upon the privilege of using in this State tangible personal property purchased at retail from a retailer. (This is a GIL).

September 17, 2002

Dear Xxxxx:

This letter is in response to your letter dated August 9, 2002. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c), which can be accessed at the Department's Website at <http://www.revenue.state.il.us/Laws/regs/part1200/>.

In your letter, you have stated and made inquiry as follows:

Pursuant to Section 1200.110 of the Department of Revenue (DOR) Regulations, DDD, by counsel¹, hereby requests a private letter ruling concerning the application of the Illinois Use Tax (UT) to the ownership and use of fractional shares in two airplanes managed by COMPANY. For the following reasons, DDD believes that UT is not applicable.

1. Facts.

AAA is an Illinois-based limited liability company whose primary business is investing in securities. It is the sole member of DDD which owns a five percent (5%) undivided fractional interest in a PLANE1, and a PLANE2, The fractional program of which these airplanes are a part is managed by COMPANY. Federal Aviation Administration (FAA) aircraft registration data indicate that COMPANY also retains an interest in each of these airplanes. COMPANY is headquartered in CITY/STATE and the airplanes are based there. In addition to being used to transport fractional owners, COMPANY also offers the airplanes for charter to the general public under the FAA air carrier certificate (##). However, we do not know what percentage of each airplane's flight are charters conducted by the air carrier.

COMPANY has informed us that neither airplane was located in Illinois at the time of the share purchase and that no sales tax was paid to any state. The airplanes come into Illinois only infrequently to pick up and discharge passengers, and seldom (if at all) remain there overnight.

AAA plans to organize a new related entity (BBB) to conduct its investment investigation and consummation activities. AAA would continue to hold the investment assets and

would pay BBB a consulting fee for its services. DDD will lease² the fractional share interests to BBB and BBB will enter into the applicable fractional program documents (such as the management agreement) in place of DDD. BBB will operate the fractional share airplane, using COMPANY's management services, in furtherance of its consulting activities on behalf of AAA and for the personal transportation of the principal owner of AAA. This structure is intended to (a) ensure compliance with Part 91 of the FAA's regulations, (b) accomplish certain business planning objectives, and (c) provide certain federal tax benefits.

2. The ROT and UT

Illinois has both a sales tax on retail sales of tangible personal property (the ROT) and a use tax (UT) levied on the use of tangible personal property within the state. These taxes are intended to be complementary. If a retail sale of tangible personal property occurs within Illinois, the ROT applies to that sale unless a specific exemption makes the sale free of the tax. If a sale of tangible personal property occurs outside of Illinois no ROT is due; however, if the property is then brought into Illinois by a resident for use within the state, UT is due upon the value of the property.³ However, for constitutional reasons, UT is not due on property owned by an Illinois resident which is not brought into the State or whose presence within the state is *de minimis*. 35 ILCS §2-60.

Illinois law also provides for what is known as the 'rolling stock' exemption (RSE). 35 ILCS §20-50. This exemption applies to 'rolling stock used by an interstate carrier for hire, even if just between points in Illinois, if the rolling stock transports, for hire, persons whose journeys or property whose shipments originate or terminate outside Illinois.' *Id.* There is no clear guidance in Illinois law or regulations concerning the percentage of use necessary to support this exemption. However, the Department of Revenue (DOR) has indicated that an airplane must be used on a 'regular and frequent basis' for charter flights in order to qualify for this exemption.

3. Analysis.

DDD believes that the use of the fractional aircraft shares is not subject to UT for several reasons.

First, we believe that the use of the shares within the state is *de minimis*. The airplanes are not based in Illinois, come into Illinois only infrequently, and do not remain in Illinois for any extended period. DDD owns a mere 5% share in each of the airplanes. Thus, DDD's use of either airplane represents only approximately 5% of the airplane's total use; the airplane is used by other owners or for charter 95% of the time. For this reason, we do not believe that there is sufficient nexus established between either airplane and Illinois to permit Illinois to subject DDD's share in either airplane to UT.

Next, we believe that the sale of shares in either airplane should be exempt from either ROT or UT under the RSE. It appears that the majority interest in either airplane has been retained by COMPANY. At the time of DDD's share in the PLANE1, only 35% of the airplane was owned by fractional share owners. Each of these share owners, like DDD, owned a 5% share in the airplane. When DDD purchased its share in the PLANE2, only 30% of the airplane was owned by fractional share owners. Each of these owners had a 5% interest in the airplane. Thus, it seems apparent that COMPANY retains the majority interest in each of the airplanes. While COMPANY may

use the airplanes from time to time for its own purpose, it is reasonable to presume that the majority of the use of the airplanes must be in charter service to the general public under CCC air carrier certificate. Thus, we believe that the airplanes are 'regularly and frequently' used for charter and should be exempt from tax.

If the purchase of the share is exempt from ROT because of the RSE, DDD's proposed lease of the share interests should also be exempt from UT. Most states consider a lessee of personal property to be the user of such property and impose their use taxes upon such lessee. The tax is ordinarily based on the value of the lease payments and paid over time as such lease payments become due.

In contrast, Illinois considers the lessor of personal property to be the user of such property.⁴ Section 150.305(e) DOR Regulations. For this reason, Illinois UT must be paid by a lessor of property on the value of such property, unless the use of the property is exempt from tax. However, because the ROT and UT are intended to be complementary, if a purchase of tangible personal property is not subject to the ROT, any subsequent use of that property is also exempt from UT. Section 150.101(c) DOR Regulations. Thus, DDD's use-leasing them to BBB-should be exempt from UT.

Finally, we believe there is another reason why the purchase and use of the 5% fractional shares should not be subject to either ROT or UT. While the transaction is termed a purchase of an undivided interest in each airplane, the small size of the share and the resulting substantial limits on the 'ownership' rights of DDD leads to the conclusion that the transaction is really a purchase of transportation rather than a purchase of tangible personal property. Texas has recently adopted such a view of fractional ownership as has New York in proceedings against The Gap.⁵ In addition, one United States Court of Appeals has held that a fractional owner relinquishes possession, command and control of the aircraft to the fractional program manager. For this reason, the Court ruled that the owner was really purchasing transportation and that federal transportation tax was due on the purchase. *Executive Jet Aviation v. United States*, 125 F.3rd 1463 (Fed. Cir., 1997) We believe that Illinois should adopt this view of the transaction between COMPANY and DDD.

4. Miscellaneous.

5.

While the sale of the fractional share occurred in January 2002, the establishment of BBB and DDD's lease of the share has not yet transpired. For this reason, the applicable tax period is unknown at this time and there is no pending audit or litigation concerning this transaction. Neither DDD nor its counsel has previously sought a ruling from the DOR on these issues or any related issues. Finally, counsel for DDD is not aware of any controlling precedent relating to these issues.

6. Conclusion

For the reasons stated in this request, DDD believes that the purchase and subsequent lease of the aircraft fractional shares should be exempt from both the ROT and UT. If you require any additional information to provide us with a ruling to that effect, please let us know. Thank you for your assistance.

We are unable to issue a private letter ruling on the issue of whether your client's use of its fractional share ownership interest in two airplanes is exempt from Illinois Use Tax. The ruling you request is so fact intensive and dependent upon assertions of percentages of ownership and assertions of use that we respectfully decline to make a determination. We believe that a Department tax auditor would be the appropriate person to review all relevant information and documents in order to consider your allegations of fact.

You represent that the client purchased a 5.00% interest in two separate airplanes, and now is considering leasing its ownership interest in the planes to a related entity. The seller of the fractional shares maintains an ownership interest in the planes and they are hangered in CITY/STATE. There are other partial owners of the plane and the seller administers the fractional ownership program.

You make three arguments on behalf of the client. To sum up your arguments, you contend that (1) use of the fractional share ownership of the plane in Illinois is de minimis and does not constitute nexus; (2) the plane qualifies for the rolling stock exemption by virtue of the charter use of the plane by a separate owner; and (3) the purchase of the 5% fractional share is so small it should constitute the purchase of transportation and not the purchase of tangible personal property.

We do not concur with your first and third arguments. It is the position of the Illinois Department of Revenue that the Department has the authority to tax a partial ownership interest in an airplane, so long as there is use of the tangible personal property in Illinois. Section 3 of the Use Tax Act (35 ILCS 105/3) imposes a tax upon the privilege of using in this State tangible personal property purchased at retail from a retailer. Section 2 of the Use Tax Act (35 ILCS 105/2) begins by stating:

“Use’ means the exercise by any person of any right or power over tangible personal property incident to the ownership of that property...”

We conclude that this definition of Use in Section 2 of the Use Tax Act is broad enough to encompass a partial ownership interest. However, for a fractional share of an airplane to be subject to tax in Illinois, there must be sufficient physical presence of the airplane in Illinois. Without examination of the plane's flight logs and other documents, a determination on this issue cannot be made. Your assertion that the planes “come into Illinois only infrequently” is not adequate to document that the use of the airplanes in Illinois is not sufficient to enable the Department to impose the Use Tax.

Relative to your argument about the rolling stock exemption, the determination you request is about the tax liability of your client and we do not believe the usage of the planes by another fractional owner is relevant to this determination.

I hope this information is helpful. The Department of Revenue maintains a Web site, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Karl W. Betz
Associate Counsel

KWB:msk

¹ A copy of Form IL-2848 is enclosed.

² This will be a true operating lease and not a capital lease.

³ A non-resident of Illinois is not subject to UT on property purchased outside Illinois and subsequently brought into the state if more than 90 days has elapsed since the purchase.

⁴ This assumes that the lease is a 'true lease' rather than a conditional sale.

⁵ In this regard, it is worth noting that the dominant fractional ownership programs (such as those at issue in Texas and New York) require a minimum share purchase larger than the 5% sold by COMPANY.