UT 02-3
Tax Type: **Use Tax**
Issue: **Rolling Stock (Purchase/Sale Claimed To Be Exempt)**

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

THE DEPARTMENT OF REVENUE OF THE STATE OF ILLINOIS	**No. 01-ST-0000**
v.	**NTL: 00 0000000000000**
ABC AVIATION, INC.,	
Taxpayer	**Kenneth Galvin Administrative Law Judge**

RECOMMENDATION FOR DISPOSITION

Appearances: Ms. Mary Kay M. Martire and Ms. Tracy D. Williams on behalf of ABC Aviation, Inc. and Mr. John Alshuler on behalf of the Department of Revenue of the State of Illinois.

Synopsis:

This matter comes on for hearing pursuant to ABC Aviation Inc.'s (hereinafter "Aviation") protest of Notice of Tax Liability ("NTL") No. 00 0000000000000 issued by the Department of Revenue (hereinafter the "Department") on October 25, 2000, for Illinois use tax on the purchase of a Falcon 50 Aircraft. Aviation's position is that it was exempt from use tax on the purchase because it is an interstate carrier for hire entitled to a rolling stock exemption. A hearing was held in this matter on March 12, 2002, with Mr. John Doe, Vice President of Tax for ABC Corporation, and Mr. Gary Garofalo, principal attorney with Boros and Garofalo, an aviation boutique law firm, testifying. Following a careful review of the evidence, testimony and Aviation's and the Department's Post Hearing Briefs, Aviation's Reply and the Department's Surreply, it is recommended that

NTL No. 00 0000000000000 be finalized as issued. In support thereof, the following "Findings of Fact" and "Conclusions of Law" are made.

Findings of Fact:

1. The Department's *prima facie* case, inclusive of all jurisdictional elements, is established by the admission into evidence of NTL No. 00 0000000000000, dated October 25, 2000, issued to Aviation and showing a use tax due of $962,227, late filing penalty of $250, interest of $20,463 and a payment of $982,104 leaving a balance due of $836. Tr. pp. 7-9; Dept. Ex. No. 1.

2. Subsequent to the issuance of the NTL and Aviation's payment, Aviation filed a claim for credit. On December 28, 2001, the Department issued a "Notice of Tentative Denial of Claim for Sales Tax" to Aviation stating that the Department had established that the tax had not been paid in error. Tr. pp. 9-10; Dept. Ex. No. 1.

3. ABC Corporation has three major business segments: insurance brokerage, employee benefit consulting and insurance underwriting. Aviation is a wholly owned subsidiary of ABC Corporation. Tr. pp. 12-13.

4. "ABC Aviation, Inc." was incorporated on May 30, 1986. On August 26, 1987, ABC Aviation, Inc. changed its name to "ABC Aviation, Inc." The purpose of Aviation, as stated in its Articles of Incorporation, is "[T]o own, operate and lease aircraft (but not to offer transportation to the general public)." Tr. pp. 13-15; Taxpayer's Ex. Nos. 1, 2 and 3.

5. In years 1999-2000, Aviation maintained and operated two aircraft, a Falcon 50 and a Gulf Stream 4. The Falcon was delivered on August 9, 1999 and cost $18,771,100. It had three engines, held approximately 10 people and could fly cross-country nonstop. The Falcon was sold on May 9, 2000. Tr. pp. 18-21, 23; Taxpayer's Ex. Nos. 4, 5, 6 and 9.

6. The Falcon was registered with the Department of Transportation-Federal Aviation Administration on August 10, 1999, and assigned registration number N 17AN. The Falcon was also registered with the Illinois Department of Transportation-Division of Aeronautics on August 24, 1999. Tr. pp. 21-23; Taxpayer's Ex. Nos. 7 and 8.

7. Aviation kept a flight log and passenger manifest for every flight. The flight log recorded the time the flight took off, the time it landed, the mileage, and the date of the flight. The passenger list included the passenger's names on each flight. Tr. pp. 24-25, 28-30; Taxpayer's Ex. No. 20.

8. The passenger manifest for September, 1999, shows the following flights: Chicago to Teterboro to White Plains (Flight Number 14); White Plains to Chicago (15); Chicago to Denver to Atlanta (16); Atlanta to Denver to Chicago (17); Chicago to Philadelphia and return (18); Chicago to Redmond and return (19 and 20); Chicago to Akron and return (21); Chicago (Midway) to Chicago (Palwaukee) to Flagstaff to Phoenix (22); Phoenix to Sedona to San Antonio to Chicago (Palwaukee) to Chicago (Midway) (23); Chicago (Midway) to Chicago (Palawaukee) to Denver to Chicago (Palwaukee) to Chicago (Midway) (24); Chicago to Bermuda and return (26 and 27); Chicago to St. Louis and return (28). Tr. pp. 23-27; Taxpayer's Ex. No. 10.

9. The Falcon was used by employees of ABC Corporation's operating companies for business and personal use and for personal guests. For example, the September, 1999, manifest shows that Flight 14 had one passenger, an ABC Corporation employee, on a business flight. Flight 21 had three passengers, all "ABC guests" (not employees of ABC), on an ABC business flight. The Flagstaff to Phoenix leg on Flight 22 had one passenger, not an employee of ABC, on a personal flight. Tr. pp. 31-34; Taxpayer's Ex. No. 10.
10. Aviation incurred the following expenses for the Falcon: fuel, pilot salaries, maintenance and repairs, travel expenses for the crew, lodging, meals, catering, telephone, landing fees, training expenses, depreciation. Tr. pp. 35-42; Taxpayer's Ex. Nos. 30, 31, 32 and 33.

11. Aviation had four officers / directors. Three of the Aviation officers / directors were also the CEO, CFO and General Counsel of ABC Corporation, and these three used the Falcon. Tr. pp. 42-44.

12. ABC Service Corporation ("Service") is a wholly owned subsidiary of ABC Corporation and provides shared services such as accounting, accounts payable, tax, law and human resources to ABC Corporation. Aviation submitted bills for the Falcon to Service's accounts payable department and Service paid the bills and set up a receivable from Aviation to Service. Aviation would record a corresponding accounts payable. Aviation recovered all of its expenses for the Falcon, including depreciation. In years 1999 and 2000, Aviation charged Service $6,943,000, and $6,690,000, of which $588,406 and $886,000, respectively, related exclusively to the Falcon. When Aviation sold the Falcon, it made a profit of about $700,000. Tr. pp. 44-50, 58-59, 70-71; Taxpayer's Ex. Nos. 30, 31, 32 and 33.

13. The charges from Aviation to Service in 1999 and 2000 included charges for personal use of the Falcon. Charges for personal use were also included in an employee's W-2 as additional taxable income and the employee would be responsible for paying income tax on the amounts. Employees did not reimburse or pay Aviation for the charges. If an employee took other passengers on a flight for personal reasons, the total charge for the employee and passengers would be charged to the employee's W-2. These charges were based on an Internal Revenue Service formula using factors such as miles traveled, the type and weight of the aircraft, and landing fees. Tr. pp. 51-53, 64-66; Dept Ex. No. 2.

14. The charges made to Service only offset the expenses incurred in operating the aircraft, including depreciation, a non-cash expense. Service and employees using the Falcon did not reimburse Aviation. Tr. pp. 59-62.

15. Joe Blow was "Chief Executive Officer" of ABC Corporation and President of Aviation. He set the policy for who could use the aircraft and for what purposes and his assistant would approve use of the Falcon, consistent with the guidelines. The general public could not use the aircraft. Tr. pp. 68-69.

16. On September 15, 1999, Aviation filed a RUT-25, "Use Tax Transaction Return" with the Department, stating that the purchase of the Falcon was exempt from use tax because "the item is used as rolling stock." Tr. pp. 54-58; Taxpayer's Ex. No. 61-2.

17. On November 4, 1999, Mark Russell, Revenue Auditor in the Department, wrote to Mr. Doe, stating that the RUT-25 had been received but that Aviation had failed to submit a copy of its FAA ("Federal Aviation Administration") Air Carrier Certificate "to document that ABC Aviation, Inc. is recognized by the FAA as an interstate carrier for hire." Taxpayer's Ex. No. 52.

18. On November 17, 1999, Mr. Doe responded to the Department stating that Aviation did not have a Certificate of Authority. The Department responded on November 22, 1999, as follows: "To provide on demand air charter you would be required to obtain an Air Carrier Certificate for operation under FAR ("Federal Aviation Regulations") 135. Operations under FAR 91 are not considered 'for hire' transportation." Taxpayer's Ex. No. 52.

19. On December 3, 1999, the Department sent Aviation an EDA-25, "Auditor-Prepared Motor Vehicle Use Tax Report" for the unpaid use tax. A letter from the Department to Aviation states "You had previously claimed the aircraft is exempt as rolling stock. However, ABC Aviation is not recognized by the FAA as an interstate air carrier for hire... Based on conversations with the FAA, you can not operate an aircraft on a 'for hire' basis without securing the proper certification from the FAA (FAR 135)." Tr. pp. 55-58; Taxpayer's Ex. No. 61-3.

20. On March 3, 2000, Mr. Doe wrote to the Department stating that "although Aviation operates under a FAR 91 Air Carrier Certificate, we discovered in reviewing FAA rules that, apparently, it should have a FAR 135 Certificate." Tr. p. 66; Taxpayer's Ex. No. 56.

21. Aviation never received a FAR 135 Certificate from the FAA. Tr. pp. 66-67.

Conclusions of Law:

The fundamental issue in this case is whether Aviation's Falcon 50 is subject to the Illinois Use Tax Act's rolling stock exemption. 35 ILCS 105/3-55(b). Before addressing the text of the exemption, it is important to note "that the [Use Tax Act], as written, unambiguously intends to tax all property purchased from an out-of-state retailer for use in Illinois, even if that property is also used in interstate commerce." Square D Co. v. Johnson, 233 Ill. App. 3d 1070, 1080 (1st Dist. 1992). The Use Tax Act's rolling stock exemption provides, in part:

> 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 … and equipment operated by a telecommunications provider, licensed as a common carrier by the Federal Communications Commission, which is permanently installed in or affixed to aircraft moving in interstate commerce.

35 ILCS 105/3-55(b). The statute is an exemption statute, and as such, it is an exception to the general rule that property purchased from an out-of-state retailer for use in Illinois is taxable. Taxation is the rule; tax exemption is the exception. Rogers Park Post No. 108, American Legion v. Brenza, 8 Ill. 2d 286 (1956). Every presumption is against the intention of the state to exempt property from taxation and the burden of sustaining the right to an exemption rests upon the party seeking it; he must show clearly that specific property for which the exemption is claimed is within the contemplation of the statute. Reeser v. Koons, 34 Ill. 2d 29 (1966).

Aviation argues that it meets the statutory requirements for exemption from use tax. According to Aviation, the Falcon was "rolling stock" within the plain meaning of the Use Tax Act and the Department's

regulations. The Falcon was regularly and frequently used in interstate commerce and Aviation used the aircraft as a "carrier for hire" within the meaning of the Use Tax Act. Taxpayer's Brief, p. 2. The Department's position is that Aviation is a private carrier, and not a carrier for hire. The Department also argues that Aviation is not in the business of transporting persons "for hire" because it receives no payment for the service it renders and is not engaged in a profit-making enterprise. Department's Response, p. 6.

It is necessary in this case to look to Illinois commercial transportation statutes and cases to see how the General Assembly, courts and agencies have distinguished the activities of carriers for hire from the activities of carriers who provide transportation other than for hire. A cursory review of the statutes and cases reveals that not every carrier is a carrier for hire. For example, the Illinois legislature has classified carriers into three groups: common carriers, contract carriers and private carriers. 625 ILCS 5/18c-1104. Essentially, common and contract carriers are in the business of transporting or shipping property for others while the transportation provided by a private carrier is incidental to another purpose. XL Disposal Corp. v. Zehnder, 304 Ill. App. 3d 202 (4th Dist. 1999). Common carriers serve the needs of the general public. They are prohibited from unjustly discriminating or establishing undue or unreasonable preferences to any person, place or description of traffic. Their rates must be just and reasonable. Brink's, Inc. v. Commerce Comm. 103 Ill. App. 3d 851 (1st Dist. 1981). There is no question that Aviation is not a common carrier. The purpose of Aviation, as stated in its Articles of Incorporation, is "[T]o own, operate and lease aircraft (but not to offer transportation to the general public)." Taxpayer's Ex. No. 1. Aviation did not hold itself out to the public as an aircraft carrier. Tr. p. 17. The general public did not use the aircraft. Tr. p. 69.

The distinction between a common carrier and a contract carrier is that a common carrier must hold itself out to provide service to the general public, while a contract carrier provides service only under written bilateral contracts. *Id.* at 853. The relationship between a contract carrier and its shippers is determined by the individual contracts between the two. Allied Delivery System, Inc. v. Commerce Com. 93 Ill. App. 3d 656 (1st Dist. 1981). Aviation has provided no evidence that its activities fall within the definition of a contract carrier.

The chief executive officer of ABC Corporation, who was also president of Aviation, set the policy for who could use the Falcon and for what purposes. "Then his assistant would – consistent with his guidelines would approve certain uses of the aircraft." Tr. p. 68. "If the [chief executive officer] wanted to use the aircraft, he would call out and make arrangements to go." "If anyone else wanted to use the aircraft, they would have to find out if he was using it and whether or not they had the authority to use it. And if it was somebody that was borderline, they would have to get permission, and they'd ask his assistant, and she might clear it through him." In the "final analysis," the chief executive officer made the determination as to who used the aircraft. Tr. p. 69. It is clear that Aviation was not operating pursuant to a written bilateral contract, and accordingly, is not a contract carrier.

The Department's position, as stated in its Response and Surreply is that the term "carrier for hire" as used in the statute is synonymous only with "common carrier," but not "contract carrier." Department's Surreply, p. 2. Aviation argues, on the other hand, that "contract carriers" may also be deemed "carriers for hire." In its Reply Brief, Aviation states: "… the Court in XL Disposal indicated that both 'common' carriers (*i.e.*, carriers that provide services to the general public) and 'contract' carriers (*i.e.*, carriers that provide transportation only to a limited group) qualify for the rolling stock exemption because both are "in the business of transporting or shipping property for others." Taxpayer's Reply, p. 6. After making this statement, however, Aviation fails to make any argument that it is, in fact, a "contract carrier."

The evidence and testimony presented at the hearing clearly support the conclusion that Aviation is a private carrier. A private carrier is any person engaged in the transportation of property or passengers by motor vehicle other than for hire, in furtherance of the person's primary business, other than transportation. 625 ILCS 5/18c-1104. "A private carrier makes no public profession to carry all who apply for carriage, transports only by special agreement, and is not bound to serve every person who may apply." Doe v. Rockdale, 287 Ill. App. 3d 791 (3d Dist. 1997). Aviation is a private carrier because it made no public profession to carry all who apply for carriage. The general public did not use the aircraft. Tr. p. 69. Aviation transported passengers in accordance with the policy set by the chief executive officer of ABC. Tr. p. 68. Aviation was not bound to serve every person who applied for carriage. Mr. Doe testified that in the "final analysis," the chief executive officer made the determination as to who used the airplane. Tr. p. 69.

The distinction between common and contract carriers and private carriers is important to this matter because rolling stock used by private carriers in interstate commerce is not subject to the Use Tax Act's ("UTA") rolling stock exemption. Square D. Co. v. Johnson, 203 Ill. App. 3d 1070 (1st Dist. 1992). In Square D, the first district appellate court upheld the constitutionality of a 1967 amendment to Illinois' UTA which limited the applicability of the rolling stock exemption used by carriers for hire, and denied the exemption to rolling stock used by private carriers. The court in Square D discussed the differences between private carriers and carriers for hire:

> Contrary to Square D's argument that both private carriers and carriers for hire perform the same activity, carriers for hire carry passengers and goods as a profit-generating activity, whereas private carriers, though most likely to facilitate or increase the profits of their business, do not fly solely to generate a profit. Although all airplanes run basically the same and need similar equipment, the use of those airplanes by carriers for hire and private carriers is significantly different. As the circuit court found, Square D will not be required to tax its passengers since its passengers pay no charge for flying. A carrier for hire, on the other hand, has to pay tax on ticket sales; it pays income taxes on the profits earned from those ticket sales; and it pays additional licensing, and permit fees in its residence as well as at other locations.
> *Id.* at 1082-1083.

According to the court in Square D, the carrier for hire / private carrier classification is reasonably related to the purpose behind the rolling stock exemption, "to prevent actual or likely multistate taxation" of carriers for hire. "Because a carrier for hire is susceptible to greater taxation than a private carrier, the classification is justified." *Id*. at 1083.

The differences between carriers for hire and private carriers delineated by the court in Square D are evident in Aviation's operations. Aviation did not carry passengers as a "profit generating activity." Aviation did not fly solely to generate a profit. In fact, Aviation did not make a profit from transporting passengers and Mr. Doe testified that Aviation was not instructed by its owner that it had to make a profit. Tr. p. 66. Nor was

evidence presented that Aviation was required to tax its passengers which is characteristic of a carrier for hire. Although Aviation argued that its flights were subject to the "ticket" tax because they fell within the federal excise tax definition of taxable transportation, it stated that "[A]viation was not required to collect the tax by virtue of a separate exemption for affiliated companies." 26 I.R.C. §§ 4262, 4272, 4282. Taxpayer's Brief, p. 16, n. 4. Either way, Aviation was not subject to "actual or likely multistate taxation" or "susceptible to multistate taxation" as a carrier for hire would be.

Aviation distinguishes Square D because the airplane at issue in that case was owned by Square D Corporation itself, not by a separately incorporated subsidiary. Aviation contends that Square D did not, and could not argue that it was a carrier for hire because use of the airplane was incidental to Square D's corporate business. Taxpayer's Brief, p. 13. Aviation's attempts to distinguish Square D are not compelling and are not a reason to disregard the case. The fact that Aviation is a separately incorporated subsidiary does not mean that it cannot be a private carrier. Aviation is a private carrier organized as a separately incorporated subsidiary. A separately incorporated carrier that transports only in accordance with the guidelines set by the chief executive officer is still a private carrier. The court in Square D outlined the differences between a carrier for hire and a private carrier in its discussion of the purpose and the constitutionality of the rolling stock exemption. The court's discussion of the purpose of the exemption, "to prevent actual or likely multistate taxation," is certainly relevant to Aviation's argument that it is entitled to the exemption, without presenting any evidence that it is, in fact, susceptible to multistate taxation.

Aviation argues in its brief that New York law provides "persuasive guidance" in support of its position that the purchase of the Falcon 50 should be exempt from use tax. This "persuasive guidance" comes from three opinion letters issued by the New York State Department of Taxation and Finance: Pasquale & Bowers, Ad. Op. Comm. T&F, August 1, 1996, TSB-A-96(49)S; Citiflight, Inc. , Ad. Op. Comm. T&F, August 3, 2000, TSB-A-00(30)S; Philip Morris Management Corp., Ad. Op. Comm. T&F, October 11, 2000, TSB-A-00(38)S. Each of these cases were concerned with, *inter alia,* an interpretation of the New York statute which provides an exemption from sales and use tax for the purchase of "commercial aircraft primarily engaged in intrastate,

interstate or foreign commerce…" (Section 115(a)(21) of New York's Tax Law). The law conferring the exemption requires a determination as to whether the aircraft is "commercial," in accordance with New York law, but no determination is made as to whether the aircraft is a private, contract or common carrier. The terms "carrier for hire" and "commercial aircraft" are obviously not comparable, and thus the cases do not provide "guidance" in reaching a decision in this case.

Aviation argues further that "where a taxpayer is in the 'primary business' of providing transportation services, it is a 'carrier for hire' within the meaning of the Use Tax Act." "If providing transportation is merely incidental to the taxpayer's primary business, however, the taxpayer does not qualify for the rolling stock exemptions." Taxpayer's Brief. pp. 10-11. In its brief, Aviation examines several criteria used to determine "primary business" from Admiral Disposal Co. v. Dept. of Revenue, 302 Ill. App. 3d 256 (2d Dist. 1999) and reaches the conclusion that Aviation was in the primary business of providing transportation, and thus qualifies for the rolling stock exemption. The "primary business test" was initially developed as an interpretation of an Interstate Commerce Commission regulation in response to carriers who resorted to sham "buy and sell" arrangements to avoid regulation as a common carrier. *Id.* at 260.

In Admiral, the court evaluated the "primary business" criteria to determine whether the transportation involved was Admiral's primary business or merely in furtherance of that business. "If transportation is not Admiral's primary business, it is not a carrier for hire and is not entitled to the rolling stock exemption." *Id.* After considering the criteria in Admiral and the testimony presented at the evidentiary hearing, I am unable to conclude that Aviation is in the primary business of providing transportation. It is clear that one of the most important factors in Admiral for determining "primary business" is "whether the carrier performs any real service other than transportation from which it can profit." *Id.* at 261. It is suggested that this factor is included in the "primary business test" as a means of ascertaining whether the organization's profit is generated by "real service other than transportation" or by transportation itself. With regard to this criteria, Aviation contends that it "performed no service other than providing transportation services from which it could profit. In fact, it performed no other services at all." Taxpayer's Brief, p. 12.

The testimony and evidence presented at the hearing show, in fact, that Aviation did not profit from providing transportation services. Mr. Doe testified on direct examination as follows:

> Q. And in fact, did ABC Aviation, Inc. make a profit on the Falcon aircraft?
> A. Yes.
> Q. And how?
> A. Well, it charged depreciation for use of the aircraft, and then it sold the aircraft in the year 2000. And it recouped in the sales price the value of the depreciation, so it made – ABC Aviation made about $6 or $700,000 during the period of its ownership of those eight or nine months.
> Tr. pp. 45-46.

On cross-examination, Mr. Doe testified that "[T]he charging for the depreciation is in a sense a built-in profit because the aircraft doesn't depreciate as much as the amortization charged." "…we owned one aircraft for ten years. We bought it for $4 million. We sold it ten years later for $5 million. So we charged depreciation all those years, recouped $3, $4 million, sold it for a million profit, so we made $5 million over the period--ABC Aviation made $5 million" Tr. p. 60.

The testimony establishes that Aviation did not earn a profit from providing transportation services. Aviation made a profit from owning and depreciating the aircraft.

In operating the aircraft, Aviation incurred the following expenses: fuel, pilot salaries, maintenance and repairs, travel expenses for the crew, lodging, meals, catering, telephone, landing fees, training expenses and depreciation. Tr. pp. 35-42. When Aviation billed ABC Services for these charges, no profit factor was included:

> Q. Now, with respect to the provision of those services [Aviation] made charges; is that correct?
> A. Yes.
> Q. And those charges related only to its expenses with

respect to the operating of the aircraft; isn't that correct?

A. Yes.

Q. So that whatever charges were made only offset the expenses that it incurred in operating the aircraft itself; isn't that also correct?

A. Other than the depreciation comment.

Tr. pp. 61-62.

The testimony shows that Aviation's profit was not generated from transporting passengers. Charges for use of the airplane were billed to ABC Services at cost plus a factor for depreciation. Aviation's profit was in fact generated from owning and depreciating the airplane. It is obvious that the Falcon would have depreciated, and Aviation would have earned a "profit," if the aircraft had never left the ground and no transportation services had been provided. If a company's "primary business" is where it generates its profits as Admiral suggests, then Aviation's primary business is owning airplanes. Providing transportation, a non-profit making activity for Aviation, is incidental to Aviation's primary business.

Another factor in the "primary business test" is "[W]hether the carrier transports or holds out to transport for anyone other than itself." *Id.* at 261. Aviation evaluates this factor by arguing that it did not provide transportation for itself. Rather, Aviation was available to officers and employees of members of the [ABC] Group. Taxpayer's Brief, p. 12.

Aviation's evaluation of this factor is misleading. Aviation argues that it meets this criteria because the Falcon, owned by Aviation, did not transport Aviation officers on Aviation business. Aviation had four officers / directors. Three of the Aviation officers / directors were also the CEO, CFO and General Counsel of ABC Corporation. Tr. pp. 42-44. Mr. Doe testified that "Aviation's business is nothing that would require any of those gentlemen to fly anywhere to make any decisions that might relate to Aviation's activities." Tr. p. 44. In other words, to the extent that the officers flew on the aircraft, it was related to the principal businesses of ABC Corporation, but not of Aviation. Tr. p. 44. I presume that Aviation's argument, then, is that by transporting these officers and holding out to transport these officers, this Admiral criteria is met.

However, the factor, as written, presupposes that the transportation service being offered is being "held out" or offered to either the public or some segment of the public. For example, the court in Admiral

stated that "Admiral services several hundred businesses, condominiums, and apartment complexes in Chicago." *Id.* at 258. Aviation, on the other hand, did not transport or "hold out to transport" any segment of the public. The Falcon only transported "officers and employees of the [ABC] Group." In the "final analysis," the chief executive officer made the determination as to who used the aircraft. Tr. p. 69. There was no "anyone" for Aviation to transport or hold out to transport. An evaluation of this factor in relation to the extremely limited users of Aviation's services does not lead to the conclusion that Aviation was in the "primary business" of providing transportation.

I am also unable to conclude that the Falcon was "for hire," as the rolling stock exemption requires. 35 ILCS 105/3-55(b). It is suggested that "for hire," as used in the Use Tax Act implies that the individual using the service compensates the service provider. This is not the case with Aviation. When an employee used the aircraft, the charges for use were included in the employee's "W-2's" as additional taxable income. Tr. p. 52. Mr. Doe testified as follows:

> There's as IRS formula called a SIFL formula. I don't remember what it stands for, but it's an IRS formula that is based on miles, the type and weight of the aircraft, and landing fees are all taken into account to determine what should be included in an individual's compensation.
> Tr. p. 52.

On cross-examination, Mr. Doe was asked specifically about Flight No. 7 on August 14, 1999, in which Joe Blow, CEO of ABC Corporation and an officer of Aviation, traveled with 7 other individuals to Providence, Rhode Island. Dept. Ex. No. 2. Mr. Doe testified that account code "PGR" on the manifest indicated that the purpose of the trip was "personal." Tr. p. 64. "We would look at the SIFL charge for a control employee which is $570.88, multiply that by the number of passengers … eight, so it would be over $4,000 would go on his W-2 for that trip." Tr. p. 65. Mr. Doe stated that the employee would be responsible for paying federal and presumably Illinois income tax on the amount added to the W-2. Tr. p. 65. No money changed hands between the recipients of the transportation service and Aviation. Tr. p. 62. I find no support in Illinois case law for the proposition that Aviation was "for hire" or "compensated" by including the cost of the service in the employee's W-2.

In addition to the inclusion of the "SIFL" ("Standard Industry Fare Level") charge in the ABC employee's W-2, Aviation also billed ABC Service Corporation ("Service") for charges incurred in operating and maintaining the Falcon. Tr. pp. 44-45. Even when the Falcon was used for personal reasons and the charges

added to an employee's W-2, the charges were also billed to Service. Tr. p. 51. Service provided shared services to all of the ABC companies. Tr. p. 45. Mr. Doe testified that Service would pay Aviation's bills and book an account receivable from Aviation. Aviation would then book a corresponding accounts payable to Service. Tr. pp. 70-71. Service used this procedure "with respect to other companies within the corporate group." Tr. p. 71.

ABC Corporation's consolidated financial statements would have one subsidiary with an accounts payable and one subsidiary with a corresponding accounts receivable. These accounts would be cleared through an intercompany transaction. No money was exchanged between Aviation and Service. Tr. pp. 62, 73. The Department points out in its Reply that "[I]f payments were actually made by other corporate affiliates within the ABC corporate umbrella, they would amount to no more than moving money from one pocket to another, with no net effect on the corporate balance sheet." Department's Reply, p. 14. I can find no support in Illinois case law for the proposition that accounting procedures used to clear intercompany receivable and payable accounts constitute "for hire" as required by the Use Tax Act. "The term 'rolling stock' includes the transportation vehicles of any kind of interstate transportation company for hire (railroad, bus line, air line, trucking company, etc.) but not vehicles which are being used by a person to transport its officers, employees, customers or others **not for hire** (even if they cross state lines)… 86 Ill. Adm. Code § 130.40(b). (emphasis added). The inclusion of the "SISL" amount in the employee's W-2 and the intercompany accounting procedures followed by ABC are not sufficient for me to conclude that Aviation was a carrier "for hire" as required by the statute.

Department of Revenue regulations require that "if the carrier is a type which is subject to regulation by some Federal Government regulatory agency other then the Interstate Commerce Commission, the carrier must include its registration number from such other Federal Government regulatory agency in the certification claiming the benefit of the rolling stock exemption." "The giving of such certificate does not preclude the Department from going behind it and disregarding it if, in examining such purchaser's records or activities, the

Department finds that the certification was not true as to some fact or facts which show that the purchase was taxable and should not have been certified as being tax exempt." "The Department reserves the right to require a copy of the carrier's…Federal Government regulatory agency Certificate of Authority…(or as much of the certificate as the Department deems adequate to verify the fact that the carrier is an interstate carrier for hire) to be provided whenever the Department deems that to be necessary." 86 Ill. Adm. Code § 130.340(f). Aviation is subject to regulation by the Federal Aviation Administration ("FAA").

On November 4, 1999, Mark Russell, Revenue Auditor in the Department, wrote to Mr. Doe stating that an "RUT-7 Rolling Stock Exemption Form" had been received from Aviation, but that Aviation had failed to submit a copy of its FAA Air Carrier Certificate "to document that ABC Aviation, Inc. is recognized by the FAA as an interstate carrier for hire." "If you are not so recognized, you can not claim the rolling stock exemption." On November 17, 1999, Mr. Doe responded stating that "ABC Aviation, Inc. does not have a Certificate of Authority and it is not required to have one under state or federal law." Mr. Doe argued that in the last sentence of Section 130.340(f), the Department reserved the right to require a copy of the carrier Certificate of Authority, "but it does not specifically provide that having one is a prerequisite to obtaining the exemption." Taxpayer's Ex. No. 52.

The Department responded on November 22, 1999, noting that Section 130.340(f) states that, if the carrier is subject to regulation by some Federal government regulatory agency, the carrier **must** include its registration number from such other Federal Government regulatory agency in the certification claiming the benefit of the rolling stock exemption. "To provide on demand air charter you would be required to obtain an Air Carrier Certificate for operations under FAR 135. Operations under FAR 91 are not considered 'for hire' transportation." Taxpayer's Ex. No. 52. Enclosed with this response were several letter rulings, including 92-0366, which "specifically addresses aircraft," and states: "Please note that the [rolling stock] exemption requires that the purchaser must have a Certificate of Authority from a regulatory agency which recognizes the purchaser as an interstate carrier for hire." Letter Ruling 92-0366 (1992).

In a March 3, 2000, letter from Mr. Doe to the Department, he states that "although Aviation operates under a FAR 91 Air Carrier Certificate, we discovered in reviewing the FAA rules that, apparently, it should have a FAR 135 Certificate." Taxpayer's Ex. No. 56. Although Aviation "discovered" that they should have a FAR 135 Certificate, they never applied for one. Mr. Doe was asked on cross-examination: "To your

knowledge, did ABC Aviation, Incorporated ever get a Part 135 license from the FAA?" He responded: "They did not get such a license." Tr. p. 66. When asked why Aviation did not get a FAR 135 Certificate, Mr. Doe responded:

> I believe that they were under the impression that they would need that license if they were going to charter the aircraft and let other people use it. But they didn't want to use it for that purpose. So we were not aware of any other reason why we would require at this period of time, during 1999 and 2000. Tr. p. 67.

This testimony differs from Mr. Doe's March 3, 2000 letter, where he "discovered" that Aviation needed a FAR 135 Certificate. Not getting a FAR 135 Certificate put Aviation in the untenable position of arguing at the evidentiary hearing that although they applied for and were certified under FAR 91 as aircraft not 'for hire,' which would not entitle them to the rolling stock exemption, in reality, they qualified for and "apparently," should have operated under a FAR 135 Certificate, which they never applied for.

Aviation owned the Falcon 50 aircraft for nine months. They certified the aircraft under FAR 91, which, along with the other factors discussed previously in this Recommendation, excluded them from the rolling stock exemption. Three months after purchasing the aircraft, on November 22, 1999, Aviation was told by the Department that in order to claim the rolling stock exemption, they needed to obtain an Air Carrier Certificate under FAR 135, and that operations under FAR 91 were not considered "for hire" transportation. Taxpayer's Ex. No. 52. Seven months after purchasing the aircraft and two months before selling it, on March 3, 2000, Mr. Doe, ABC's Vice-President of Tax, wrote to the Department that Aviation had discovered that it should "apparently" have a FAR 135 Certificate. Tr. p. 23; Taxpayer's Ex. No. 56. Aviation now asks this tribunal to conclude that they qualified for a FAR 135 Certificate, although they never applied for one. Tr. p. 23. The conclusion that must be drawn from their not applying for it is that they did not, in fact, qualify for the Certificate and were not an interstate carrier for hire.

Mr. Garofalo described the FAR 135 Certificate as follows:

> Part 135 would apply to any company that's operating an airplane, carrying passengers for compensation; and where the sole purpose or the primary purpose of that company is to provide transportation, it would require a certificate for the company whether it be engaged in private carriage for hire or common carriage for hire.

> But in either case, where the primary business of the company is to operate airplanes and they're charging for it and they're carrying passengers, 135 is the area that is the governing regulation.
> Tr. p. 107.

As discussed in this Recommendation, the Department rebutted the contention that Aviation was in the "primary business" of providing transportation or of operating airplanes. Aviation was in the primary business of owning airplanes. Furthermore, Mr. Garofalo's comments indicate that Aviation could have acquired a FAR 135 Certificate under the FAA regulations even if "engaged in private carriage for hire." Illinois exemptions are determined according to Illinois law and FAA regulations would not dictate whether Aviation was entitled to the rolling stock exemption. Rolling stock used by private carriers in interstate commerce is not subject to the Use Tax Act's rolling stock exemption. Square D. Co. v. Johnson, 203 Ill. App. 3d 1070 (1st Dist. 1992). Accordingly, if Aviation had qualified for and received FAR 135 Certification as a private carrier, the giving of this certificate would not preclude the Department from going behind it and disregarding it. 86 Ill. Adm. Code § 130.340(f).

With regard to the differences in FAR 91 and FAR 135 Certificates, Mr. Garofalo testified as follows:

> I mean, for example a pilot can be qualified under an operation that's governed by Part 135. He'd have to have certain proficiency checks. These are periodic checks where he's examined by an independent party, in some cases the FAA.
>
> Whereas, if it was pure Part 91 operation, he could simply rely on his pilot licenses and that would make him qualified. But if he was engaged in an operation under Part 135, in addition to his pilot licenses, he would have to undergo these proficiency checks, and that's just one of the differences.
> Tr. p. 108.

As Mr., Garofalo's testimony indicates, there are many factors that go into the determination of whether an aircraft qualifies for certification under FAR 91 or FAR 135. I know that Aviation qualified for a FAR 91 Certificate because they applied for and were certified under it. Based on Mr. Garodfalo's testimony at the evidentiary hearing about the "differences" between the FAR 91 and FAR 135, with pilot proficiency and periodic checks being "just one of the differences," I am unable to conclude that Aviation actually qualified for the FAR 135 Certificate.

Aviation was a private carrier engaged in the business of owning airplanes. As an incident to that business, Aviation provided transportation services in accordance with the guidelines set by the chief executive officer of ABC Corporation. Equipment used by private carriers is not entitled to the rolling stock exemption. Square D at 1081-83. Aviation operated the aircraft under a FAR 91 Air Carrier Certificate. Operations under FAR 91 are not considered 'for hire' and are not entitled to the rolling stock exemption. I conclude that Aviation has not rebutted the *prima facie* correctness of the Department's corrections of taxpayer's use tax returns. Department Ex. No. 1.

WHEREFORE, for the reasons stated above, I recommend that Notice of Tax Liability No. 00 0000000000000 dated October 25, 2000, be finalized as issued and that the Department's "Notice of Tentative Denial of Claim for Sales Tax" issued December 28, 2001 be affirmed.

ENTER:

August 6, 2002

Kenneth J. Galvin
Administrative Law Judge