ILLINOIS INDEPENDENT TAX TRIBUNAL

TCRG SN4057, LLC, Petitioner, v. ILLINOIS DEPARTMENT OF REVENUE, Respondent.	))))))))))	Case No. _________

PETITION

The Petitioner, TCRG SN4057, LLC (the "Petitioner" or "TCRG"), hereby petitions the Illinois Independent Tax Tribunal to review and reverse the Notice of Tax Liability (Letter ID: CNXX X122 5465 7127#) (the "Notice") issued by the Illinois Department of Revenue (the "Department") on November 16, 2021, for the reasons stated below:

INTRODUCTION

1. The Notice was issued by the Department on November 16, 2021, assessing a deficiency in the amount of $1,196,250.00 of Aircraft Use Tax, $239,250.50 of late payment penalties, an additional $250.00 late filing penalty, and $278,622.00 of interest with respect to an aircraft brought into Illinois on March 3, 2016. A copy of the Notice is attached to this Petition as Exhibit A.

2. TCRG is a Delaware limited liability company. TCRG is not an Illinois entity, it has no Illinois office, it has no Illinois employees, it has no Illinois "locations," and it has no business operations in Illinois.

3. TCRG is an indirectly wholly-owned subsidiary of Texas Capitalization Resource Group Inc. ("Parent"). TCRG is disregarded as an entity separate from Parent for U.S. federal

income tax purposes. Parent's principal place of business is in Texas. It is located at 4916 Camp Bowie Blvd. Ste 200, Fort Worth TX 76107-4109, and its telephone number is (817) 626-9898. Parent's federal employer tax identification number is 20-1765214.

FACTUAL BACKGROUND

A. TCRG's Purchase of the Aircraft in Connecticut to Use for New York-Based Executives

4. TCRG purchased a 2006 Gulfstream Aerospace G450 (the "Aircraft") on December 18, 2015, from Gulfstream Aerospace Corp. in Connecticut. The purchase price was $16,500,000.

5. The Aircraft was purchased to replace a similar aircraft based in New York and for the purpose of transporting New York-based business executives. For this reason, the Aircraft was intended to be based in New York itself.

6. Upon purchase, the Aircraft was registered with the FAA using an Illinois address. TCRG registers its aircraft with an Illinois address because TCRG's management service provider is centralized in Illinois. The purpose of an FAA registration is not to tell the FAA where the aircraft is based, but rather to give the FAA an address to mail notices primarily related to aircraft maintenance. It serves an entirely administrative purpose. Neither TCRG nor Parent have any employees or business operations in Illinois.

7. TCRG took delivery of the Aircraft in Hartford, Connecticut on the purchase date, December 18, 2015. That same day, the Aircraft was flown to Appleton, Wisconsin for Gulfstream to perform further repairs and modifications, where it remained for 75 days. These extensive repairs and modifications included, among other items, maintenance on landing gear, electronic equipment and other hardware, repairs to address various fluid leaks, and modifications to the Aircraft's interior and paintjob.

8. The State of Wisconsin has not attempted to assert any use tax on the presence of the Aircraft in Wisconsin for the time period described in Paragraph 7.

9. On March 2, 2016, the Aircraft was then flown to Cincinnati, Ohio for Part 135 Certification.

10. During this initial period of time, the Aircraft had no physical presence in Illinois.

B. Aircraft's Break-In Period at Midway Airport Solely Because Its Service-Provider Was Located There

11. Prior to TCRG's purchase of the Aircraft in December of 2015, the Aircraft had been stored in Gulfstream's used aircraft inventory in Savannah, Georgia, since June of 2014. This long period of time required that the Aircraft undergo additional significant repairs and maintenance. Planned maintenance and repairs were performed at Gulfstream's facilities prior to TCRG taking possession of the Aircraft, but the extended period that the Aircraft spent out of service in Gulfstream's facilities required other unplanned repairs as well.

12. Thus, the Aircraft was intermittently brought to Midway Airport from March 3, 2016 to May 17, 2016, as and when necessary for maintenance and repairs, ***for the sole reason that Midway was the only location where TCRG's maintenance and repair contractor, Jen-Air, had the appropriate level of staff and facilities to repair and maintain the Aircraft***.

13. On behalf of TCRG, Parent contracted with Jen-Air, LLC ("Jen-Air"), a provider of aircraft maintenance and inspections, to staff aircraft operations in several states, including New York. Jen-Air's team in Illinois was the only one during the break-in period, however, which had the necessary equipment, manpower, and expertise to perform the substantial inspections, maintenance, and repairs required for this Aircraft after being in storage for more than year and a half.

14. Greg Adams of Jen-Air explained the need for break-in flights in general as follows: "Aircraft that are flown infrequently are more prone to experience failures of the various systems and components on the aircraft. An aircraft that has been taken out of service for weeks or months for inspections, avionics upgrades, paint, or other reasons, can be expected to have more than the usual number of mechanical and other failures during the first several weeks or few months upon resuming normal flying activity." In this case, the Aircraft was out of service not merely for a few weeks or months, but rather a year and a half in the hands of Gulfstream.

15. Ryan Majchrowski of Jen-Air also explained the need for break-in flights with respect to the Aircraft as follows: "During [the break-in period] N2LA was a new aircraft to TCRG. This aircraft had just re-entered service after a long stay in used aircraft inventory with Gulfstream followed by a several month modification process done at Gulfstream ATW for TCRG. Those aforementioned two events (idle time in used aircraft inventory and heavy modification maintenance input for new owner) typically lead to additional maintenance needs as the aircraft returns to daily flight usage. That was [the] case here with N2LA. We were able to address many of these maintenance needs by having the aircraft at MDW for the first few months where we have a robust maintenance staff."

16. Again, the break-in process required that the Aircraft intermittently be brought to Jen-Air's team at Midway Airport in Chicago, as it was the only Jen-Air team capable of performing the extensive inspections, repairs, and maintenance necessary for the Aircraft. According to an email from Greg Adams at Jen-Air, Jen-Air had "zero manpower at the SWF [New York] base" prior to May 2, 2016, at which point an aircraft maintenance manager was hired and began training in Jen-Air's procedures and equipment.

17. The Aircraft's presence in Illinois during this limited period was purely "coincidental"—and had nothing to do with TCRG's business operations in Illinois (it has no such operations in Illinois). Indeed, the Aircraft's time in Illinois had nothing to do with the basic purpose and function for which the Aircraft was purchased, namely to be a New-York based aircraft serving New York-based clients.

18. A flight log showing flights taken during the break-in period is attached as Exhibit B. During that time, the Aircraft made 13 trips comprising 31 total legs. During the first month, 4 of the trips were maintenance, training, or ferry flights. Of the remaining trips the next month, the Aircraft made several long trips outside of Illinois to test the functioning of the Aircraft, the longest of which was a charter trip to South America that began April 6, 2016, in New Jersey and ended April 12, 2016, in California. Of the 31 total legs, only 9 originated in Illinois and only 9 ended in Illinois. These numbers drop to only 7 legs originating or ending in Illinois if the test and ferry flights that both originated and ended in Illinois are ignored. Either way, these Illinois legs represent only a small portion of flights, which occurred only because the Aircraft's maintenance was being performed at Midway.

19. None of the passengers flown during the break-in period were employees, officers, or directors of TCRG or any entity legally affiliated with TCRG.

20. None of the flights during the break-in period supported or benefited any business operations of TCRG or Parent in Illinois, as neither TCRG nor Parent have any business operations or employees in Illinois.

21. Moreover, consistent with the fact that the Aircraft was in Illinois intermittently for the sole reason that its service provider was located there, during the break-in period, the Aircraft

was ferried or flown to the maintenance shop in Midway after almost every trip and generally spent several days in the shop.

22. In fact, during the break-in period, extensive maintenance and repairs were performed on the Aircraft. In addition to post flight inspections, a number of substantial maintenance needs were discovered and addressed, including but not limited to repairs to address issues with landing gear components, various sensors, leaking actuators, and an inoperative oil system. Exhibit B shows that 21 items, including the landing gear blowdown bottle, required replacement after an early flight. An email from Ryan Majchrowski of Jen-Air describing such repairs is also attached hereto as Exhibit C. He noted that such maintenance items, which required a total of 200 hours of work, "took three maintenance [personnel] to accomplish" whereas "[t]ypically 1 ½ maintenance technicians are needed for daily Post Flight Inspections once an aircraft is back to normal flight operations."

C. Aircraft's Flights Out of New York After the Break-In Period

23. After the break-in period ended on May 17, 2016, the Aircraft was flown to New York to take up its new permanent place at a hangar at Stewart International Airport to fulfill its purpose of transporting New York-based business executives, as was the plan all along.

24. A flight log showing flights taken between the end of the break-in period and the end of 2017 is attached as Exhibit D. During that period, the Aircraft made 98 trips, of which 62 (66%) originated in New York and 17 (18%) originated in Illinois. That averages out to less than one trip originating in Illinois per month. And during this same timeframe, the Aircraft spent 278 days on the ground in New York and only 35 days on the ground in Illinois.

25. None of the passengers flown from May 17, 2016 through the end of 2017 were employees, officers, or directors of TCRG or Parent, or of any entity legally affiliated with TCRG

or Parent. None of the flights during the period supported or benefited any business operations of TCRG or Parent in Illinois, as neither entity had any business operations in Illinois.

D. In 2018, the Aircraft is Moved to Illinois, TCRG Applies for the Rolling Stock Exemption, and the Department Audits the Wrong Entity Based Upon the Wrong Timeframe for the Rolling Stock Exemption

26. At the beginning of 2018, TCRG decided to base the Aircraft in Illinois because a primary customer wanted to base a longer-range aircraft in New York instead.

27. In 2018, in connection with moving the Aircraft to be based in Illinois, TCRG applied for the rolling stock exemption (the "Exemption Application"), which accurately listed the sale price of the Aircraft as $16,500,000 and was completed in accordance with the instructions thereto. The Exemption Application properly listed TCRG as the purchaser and owner of the Aircraft and did not mention Parent.

28. Prior to submission of the Exemption Application, the Department had not attempted to assert Aircraft Use Tax on the use of the Aircraft.

29. On November 19, 2018, despite TCRG disclosing that it was the purchaser of the Aircraft on the Exemption Application, the Department issued an audit notice informing Parent that the Department would be auditing Parent regarding use of the Aircraft.

30. The Department issued a request for documentation on November 19, 2018, and then again on January 3, 2019, each requesting ***only*** documentation to support a rolling stock exemption for the Aircraft for the period between December 18, 2015 and December 17, 2016. These document requests were misplaced from the start, as neither TCRG nor Parent had ever claimed that the rolling stock exemption applied to that period. Instead, as set forth in the Exemption Application, TCRG asserted that Illinois Aircraft Use Tax did not apply to the Aircraft prior to 2018 and was seeking an exemption only for 2018 going forward.

31. Following correspondence, on June 9, 2020, the Department issued Parent (not TCRG) a notice of tax liability, which imposed Aircraft Use Tax in the amount of $1,196,250, plus interest and penalties. Despite Parent pointing this out to the Department, it is unclear how the Department arrived at this number, as the notice of tax liability to Parent listed the correct purchase price of $16,500,000 (but 6.25% of $16,500,000 is $1,031,250, not $1,196,250).

32. On August 30, 2019, Parent submitted Form ICB-1, Request for Informal Conference Board Review.

33. On April 21, 2020, following a telephonic hearing, the Informal Conference Board issued its decision in support of the Department's determination. The Informal Conference Board provided ***only a single sentence*** in support of this determination, which stated in its entirety that "[t]he Taxpayer failed to provide documentation to support the rolling stock exemption (§130.340) as claimed on the filed RUT-25 return," ***despite the fact that neither TCRG nor Parent ever claimed the rolling stock exemption for any period prior to 2018***.

34. Parent thus filed a petition before this Tribunal on August 7, 2020, seeking reversal of the faulty notice of tax liability (hereinafter the "Parent Petition" or, more generally, the "First Parent Action"). In that petition, among other errors, Parent identified that (i) the Department issued the notice of tax liability to the wrong entity, and (ii) under prevailing law, there was no basis to find any tax liability was due under the Aircraft Use Tax Act.

E. After Parent Files its Petition and Identifies the Incorrect Taxpayer Issue, the Department Scrambles to Issue New Notices to TCRG Without Affording Any Due Process

35. Upon receipt of the Parent Petition, the Department never withdrew its position that Parent was the proper taxpayer. Thus, the parties had a conference before Judge Barov on

November 25, 2020, at which point a briefing schedule was set for Parent's motion for summary judgment on the incorrect taxpayer issue.

36. Five days later, on November 30, 2020, finally recognizing that the first audit against Parent was flawed, the Department issued a Notice of Audit Initiation and Audit Records Request to TCRG regarding the 2015 purchase of the Aircraft.[1]

37. After issuing the Notice of Audit Initiation and Audit Records Request to TCRG ***on November 30, 2020***, the Department issued both the Notice of Proposed Audit Findings and Notice of Proposed Audit Liability to TCRG ***on December 7, 2020—just one week later***. In fact, TCRG's representative did not even receive the Notice of Audit Initiation and Audit Records Request until the middle of December because he was working remotely. (Despite repeated requests by TCRG's representative that communications be sent to him electronically because he was working from home during the COVID-19 pandemic, the Notice of Audit Initiation and Audit Records Request was sent only by physical mail.)

38. The Department effectively issued the Notice of Audit Initiation, Audit Records Request, Notice of Proposed Audit Findings, and Notice of Proposed Audit Liability to TCRG all before TCRG had even received notice that an audit against it had been initiated.

39. Prior to issuance of the Notice of Proposed Audit Findings and Notice of Proposed Audit Liability, TCRG had no opportunity to respond or defend itself. The Department never afforded TCRG the right to respond within 30 days to the Audit Records Request, which requested documents solely related to the rolling stock exemption for the ***wrong timeframe*** in any event.

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[1] According to the Department's prior positions, Parent, as the indirect parent of the purchaser TCRG, cannot be subject to the use tax on the purchase of the Aircraft. In *Department of Revenue of the State of Illinois v. ABC Business Taxpayer*, UT 11-08 (Aug. 26, 2011), the administrative law judge held that "[a]s the Department has stated, nothing in the Use Tax Act or case law requires that an LLC that is treated as a disregarded entity for income tax purposes must be treated as a disregarded entity for use tax purposes." The Department failed to follow this guidance in pursuing a two-year audit against Parent.

That is, for the second time, despite TCRG and Parent stating multiple times that the rolling stock exemption was only being claimed for 2018 going forward, the Department's Record Requests asked for documents prior to that timeframe.

40. These actions by the Department violated its own rules and procedures. *See, e.g.*, "Illinois Audit Information" ("***You have the right to fair and equitable treatment during an audit***. We will treat you courteously and professionally throughout the audit process. The audit function is to determine whether the correct amount of tax has been reported and paid. ***Therefore, we acknowledge tax overpayments and underpayments, as well as any errors on our part. We may ask you to provide additional information to verify amounts shown on your returns. You have the right to know why we are asking for this information, how it will be used, and what will happen if you fail to furnish it***."). And at no time did the Department provide TCRG with audit workpapers relating to its audit.

41. Given these serious errors, on February 5, 2021, TCRG filed a request for review by the ICB of the Notice of Proposed Audit Liability that was issued on December 7, 2020. *See* Exhibit E (February 5, 2021 Submission to the ICB).

42. Following a conference before the ICB, on April 23, 2021, the ICB failed to withdraw the Notice of Proposed Audit Liability, but conceded that given TCRG's objections, the Department would have to review whether TCRG owed any tax liability.

43. On April 29, 2021, the ICB issued a new Document Request, seeking "any other information that would support non-taxable status of the aircraft for activities in Illinois prior to the 2018 claimed exemption." In an email that same date, the ICB requested that "[f]rom this point, please work with the audit team to address your questions about this matter. The Informal Conference Board will not be taking any other actions until the audit is completed by the auditor."

F. In Initial Communications, the Department Admits TCRG Was Deprived of Due Process Because the Statute of Limitations Was About to Expire

44. Consistent with the ICB's direction, on May 7, 2021, TCRG reached out to the Department to re-engage on the issue of whether Aircraft Use Tax could be imposed for TCRG's purchase of the Aircraft. In that email, TCRG indicated that, given the Notice of Proposed Audit Liability was already issued, it requested that the Department "please provide a basis for that finding" because TCRG needed to know that information to respond to the Department's recent Document Request. It was critical to TCRG that it understand why and how the Department had determined that tax liability was owed so that it could properly address and rebut that finding.

45. In the Department's email on May 10, 2021, the Department explicitly admitted that, following Parent pointing out in its petition that the Department was pursuing the wrong taxpayer: "I was instructed by management to move forward with a new audit under a pseudo-FEIN. ***Due to the close statute, I was unable to allow the normal timeframes to respond and determined taxability based on the information already submitted under the parent FEIN***."[2] (*Id.*) The Department has yet to offer any authority in support of the propriety of this truncated process.

46. That admission is noteworthy because it establishes that the Department issued the Notice of Proposed Audit Findings against TCRG, knowing full well that it was depriving TCRG of any opportunity to respond or be heard, because the Department did not pursue the first audit against the correct entity.

47. While the Department's May 10, 2021, email addressed a number of exemptions, none of which TCRG had ever claimed applied, it failed entirely to explain why, assuming no

[2] Of course, TCRG, as a wholly owned subsidiary of Parent that is disregarded for U.S. federal income tax purposes as separate from Parent, does not have its own FEIN. It instead shares a FEIN with Parent, as the Department knows.

exemption applies, imposing tax liability is consistent with the Aircraft Use Tax Act itself. Accordingly, on May 12, 2021, TCRG asked the Department a second time to explain "how it was determined that it would be correct and consistent with prevailing authority to ***subject the aircraft to Aircraft Use Tax as an initial matter***."

48. The Department sent a response letter on May 18, 2021. *See* Exhibit F.

G. Department's May 18, 2021 Letter Reveals There is No Reasonable Basis to Impose Tax Liability Against TCRG

49. The May 18, 2021 letter is highly significant because it exposes that the primary basis upon which the Department intends to impose tax liability is incorrect.

50. That is, the Department claimed that a substantial tax liability was being levied against TCRG on the basis that an exemption under 35 ILCS 105/3-55(h-2) (hereinafter, the "(h-2) Exemption") did not apply—even though TCRG never has claimed, and does not claim, that this exemption applies. For context, the (h-2) Exemption applies in relevant part only where, among other requirements, the aircraft leaves the State of Illinois within 15 days after the later of either the issuance of the final billing for the purchase of the aircraft or the authorized approval for return to service, completion of the maintenance record entry, and completion of the test flight and ground test for inspection, as required by 14 C.F.R. 91.407.

51. In the analysis, the Department claimed the relevant test to "determining taxability" of the Aircraft is whether the Aircraft was stored or used in Illinois ***more than 10 days during the 12 months following purchase of the Aircraft***—which is based off of the definition of "Based in this State" for purposes of the (h-2) Exemption. In relevant part, the Department's letter stated:

> "After reviewing the flight logs that were provided, there were 87 logs in the first year of purchase, 36 of which including an Illinois segment. If I were to instead review by trip number, there were 53 total trips, 26 of which had an Illinois segment. ***In either calculation, it exceeds 10 days in the 12-month period, which confirms there is proper nexus to determine taxability of the aircraft in***

> ***Illinois. In addition, the aircraft was "stored" at Midway airport from 03/03/2016 to 05/17/16, which is also more than 10 days in a 12-month period***."

52. Reliance on the test used for applying the (h-2) Exemption was incorrect for three reasons.

53. First, the definition of "Based in this State" and the "10-day test" are specific to the (h-2) Exemption; it is not a broader principle that applies in circumstances such as this where TCRG is not contending the (h-2) Exemption applies. Put differently, a review of the plain language of the statute makes it abundantly clear that the "10-day test" only applies if the (h-2) Exemption is being claimed. TCRG pointed out to the Department that this was a legally incorrect standard to apply and results in imposing tax liability against TCRG without reasonable basis. The Department ignored this point and never responded.

54. Second, the Commerce Clause analysis under *Irwin*, which must be passed to impose tax liability if no exemption applies, has nothing to do with the 10-day test relevant to the (h-2) Exemption. In noting that the Department for the third time had failed to provide a clear basis for imposing tax liability, TCRG pointed out in its May 24, 2021 email: "I want to emphasize that (1) whether a statutory exemption to imposition of tax liability applies, and (2) whether, absent an exemption, imposing tax liability is Constitutional and aligned with applicable law are **entirely different issues**. For example, even if no exemption applies, no tax can be imposed unless it is consistent with the Commerce Clause. 'Exemptions' and 'constitutionality' of imposing tax (in the event no exemption applies) are **completely separate**."

55. In an email dated May 27, 2021, the Department failed to provide an explanation to this critical issue.

56. This lack of a response, and frustration that the Department was not clearly disclosing its reasoning for imposing tax liability, led TCRG to respond as follows on May 28, 2021:

> As a threshold issue, we would appreciate an answer to our inquiry below. Again, your May 18, 2021 letter states: "After reviewing the flight logs that were provided, there were 87 logs in the first year of purchase, 36 of which including an Illinois segment. If I were to instead review by trip number, there were 53 total trips, 26 of which had an Illinois segment. ***In either calculation, it exceeds 10 days in the 12-month period, which confirms there is proper nexus to determine taxability of the aircraft in Illinois. In addition, the aircraft was "stored" at Midway airport from 03/03/2016 to 05/17/16, which is also more than 10 days in a 12-month period***." That analysis is based upon exemption (h-2), which does not apply here. As we request below, can you please confirm you agree that exemption (h-2), and its provisions, are not a proper basis to impose use tax against TCRG?
>
> TCRG and its indirect parent, Texas Capitalization, have been subjected to audits spanning years now and have incurred significant costs and expenses in the process. It is apparent that the Department's basis to impose alleged tax liability, in this audit and the audit involving Texas Capitalization, relies completely on the assumption that exemption (h-2) controls the analysis. There is no reasonable cause to assess tax liability on that basis, so we once again urge you to reconsider this position.
>
> Moreover, the Department has evidently decided to assess a tax liability against TCRG SN 4057, LLC (a conclusion we strongly believe is incorrect). To arrive at that conclusion, the Department necessarily must have analyzed and concluded that imposing tax liability was proper under the Commerce Clause and/or applicable law. Please provide us a copy of the Department's analysis of the Commerce Clause issue, including the date on which the analysis was performed. We expect such an analysis would include, at a minimum, a discussion of the *Irwin* case and reasons why the aircraft purchase here satisfied the test in *Irwin*. If the Department has not performed an analysis of the Commerce Clause issue as to TCRG SN 4057, LLC, please let us know. Either way, once we get your response on this issue, we are glad to prepare a memorandum on the Commerce Clause issue (which, given it was requested yesterday, obviously will not be completed by June 1).

H. The Analysis of the Constitutionality of Imposing Tax Against TCRG That the Department Finally Provides Is Incorrect

57. After a month of requests from TCRG, on June 1, 2021, the Department provided a conclusory email purporting to analyze why the "imposition of tax [against TCRG] is consistent with the Commerce Clause."

58. TCRG formally responded on July 7, 2021, submitting a detailed letter establishing why no tax liability could be assessed against TCRG under applicable law. *See* Exhibit G. Among other points, TCRG's letter highlighted specifically why the Department misapplied Illinois law.

59. First, as mentioned above, TCRG's July 7, 2021, letter established that the Department's reliance on the "10-day" test for the (h-2) Exemption "has nothing to do with this audit" and applying that test here is the "wrong standard to determine taxability of the Aircraft." At no time during the audit did the Department meaningfully respond to this obvious error.

60. Second, in justifying imposition of use tax, the Department's May 18, 2021 letter stated that "[t]he law does not rely on any certain percentage of use in the State." In response, TCRG pointed out that this statement ignores binding Illinois law. As explained in TCRG's July 7, 2021 letter, "in *Irwin*, the Supreme Court of Illinois went through a detailed analysis explaining that, for there to be a 'substantial nexus' between the Aircraft and taxpayer, on the one hand, and Illinois, on the other hand, the Department (and any reviewing tribunal or court) must consider the *extent* and *purpose* of the aircraft's 'physical presence' in Illinois." The fact that the Department failed to cite or apply *Irwin* in finding tax liability also establishes the decision was without any reasonable basis.

61. Third, the May 18, 2021 letter states that "per Brown's Furniture Inc., ***only the 'slightest' presence is necessary to create nexus***, therefore, nexus has been established." TCRG responded, in part, that this statement "…misstates applicable law. The *Irwin* decision plainly states: '*Quill* reaffirmed that the 'slightest' physical presence within a state is ***not enough*** to

establish substantial nexus.' The Department's reliance on this mistaken legal principle establishes that it lacks any reasonable cause to assess the tax against TCRG." Thus, TCRG's correspondence with the Department established in this additional way that the Department was applying the wrong legal standard.

62. Fourth, a key factual predicate for the Department's analysis in the May 18, 2021 letter was that "TCRG had locations and/or operations in several states, <u>including Illinois</u> at the time the aircraft was purchased and subsequently used in Illinois." TCRG responded: "This statement is false. We insist that you provide the factual basis for this assertion. TCRG is not an Illinois entity, it has no Illinois office, it has no Illinois employees, it has no Illinois 'locations,' and it has no business operations in Illinois. [Citing TCRG SN4057, LLC's Delaware Certificate of Formation.] The Department's continued refusal to acknowledge even basic facts in conducting this analysis is highly prejudicial and results in an attempt to assess a tax without reasonable cause."

63. After addressing these deficiencies in the Department's analysis, TCRG included a detailed analysis of why, under *Irwin*, there is not a "substantial nexus" between Illinois, on the one hand, and the Aircraft and TCRG, on the other hand. *See* Ex. G at 4-7. TCRG respectfully refers the Tribunal to that analysis and incorporates it herein.

I. Department Issues Notice of Tax Liability Against TCRG

64. On July 13, 2021, the Acting General Counsel of the Department sent an email responding to TCRG's letter of July 7, 2021, asking both why the Aircraft was "registered with an Illinois Address" and attempting to place the responsibility for the Department's audit of the incorrect taxpayer on TCRG by noting that TCRG used the EIN it shared with Parent on the Exemption Application.

65. On July 26, 2021, TCRG responded to both points. TCRG noted once again that the address on the FAA registration was only a notice address (as had previously been explained to the Department on numerous occasions, *see, e.g.,* the February 12, 2019, memo from Phil Crowther included in Exhibit E). TCRG also explained to the Department the basic concept of federal EINs in the context of disregarded entities. TCRG further emphasized that it had fully complied with the instructions to the Exemption Application and noted that any inability of the Department to correctly identify the relevant taxpayer based upon forms promulgated by the Department and correctly completed by the taxpayer was solely the responsibility of the Department.

66. Over a month and a half later, on September 16, 2021, the Department sent a note in response, which did not respond to TCRG's points regarding the FAA registration or EIN, but instead repeated again the Department's errors in (i) asserting that only "the slightest presence [was] required for nexus under *Complete Auto Transit Inc. v. Brady,*" and (ii) imposing tax liability without actually applying the four factors in *Complete Auto*, but rather stating in conclusory fashion that "[a]bsent strict compliance with the requirements contained in 35 ILCS 105/3-55(h-2)(3), the taxpayer will be considered subject to use tax on the aircraft." The Department's note further provided that the auditor would be instructed to complete the audit and begin issuing notices.

67. On September 20, 2021, TCRG received a notice from the Informal Conference Board providing that the Department had determined there would be no adjustment to the original proposed assessment and requesting confirmation of whether TCRG wished to continue with the Informal Conference Board process. On September 29, 2021, TCRG confirmed via email it did not wish to continue with the Informal Conference Board Process.

68. On October 14, 2021, the Department sent a Notice of Audit Results reflecting the assessment via e-mail to TCRG (including both TCRG's management provider and TCRG's counselors), as well as by mail. *See* Exhibit H. On October 28, 2021, TCRG sent a note to the Department clarifying that, despite disagreeing with the findings, TCRG had no further documentation or analysis to provide in support of that disagreement and confirming that the Department could proceed to issue the Notice.

69. On November 16, 2021, the Department issued the Notice, only by mail and only to TCRG's management provider (and not its lawyers), despite multiple requests by TCRG that the Department provide copies of all relevant documents via email given current remote working arrangements.[3] TCRG's representative received the Notice around the middle of December.

APPLICABLE LAW

70. Pursuant to the Illinois Independent Tax Tribunal Act of 2012, this Tax Tribunal has jurisdiction over the matters presented here.

A. Aircraft Use Tax Act Generally

71. The Illinois Aircraft Use Tax Act imposes a tax "on the privilege of using, in this State, any aircraft as defined in Section 3 of the Illinois Aeronautics Act acquired by gift, transfer, or purchase after June 30, 2003," in an amount equal to 6.25% of the selling price. *See* 35 ILCS 157/10-15.

72. Use tax in Illinois complements the Retailers' Occupation Tax Act (35 ILCS 120/1 et seq.), which is Illinois' primary means of taxing the retail sale of tangible personal property. The primary purpose of the use tax is to prevent avoidance of the retailers' occupation tax by those making out-of-state purchases and to protect Illinois retailers against diversion of business to out-

[3] With issuance of the Notice, the Department withdrew the notice of tax liability previously submitted to Parent.

of-state retailers. *Brown's Furniture, Inc. v. Wagner*, 171 Ill.2d 410, 418 (1996). The use tax and aircraft use tax are imposed at the same rate as the retailers' occupation tax. 35 ILCS 105/3-10; 35 ILCS 120/2-10; 35 ILCS 157/10-15. *See also Irwin Industrial Tool Co. v. Department of Revenue*, 238 Ill.2d 332 (2010).

73. The Department generally only assesses Aircraft Use Tax on regular and systematic use of an aircraft in Illinois. For example, in a letter to Parent dated February 20, 2019 (Letter ID: CNXXXX416X4X88X1), the Department asserted that "[t]he proposed tax is being imposed on the aircraft both on its physical presence and its regular and systematic use in Illinois." *See* Exhibit I.

74. States generally do not impose use tax on property brought into the State for the purpose of repairs, even where the property remains in the State for several months. *See Dep't of Revenue v. Yacht Futura Corp.*, 510 So. 2d 1047 (Fla. Dist. Ct. App. 1987) (Florida; no tax where a boat was having warranty repairs performed over a period of 85 days); *Grudle v. Iowa Dep't of Revenue & Fin.*, 450 N.W.2d 845 (Iowa 1990) (Iowa; no tax where the trucks "were at rest either awaiting another trip or being repaired to keep them in condition for interstate use"); *Union Pac. R. Co. v. Utah State Tax Comm'n*, 110 Utah 99, 169 P.2d 804, 806 (1946) (Utah; no tax where train engines were temporarily standing idle while being repaired).

B. The *Complete Auto* Framework

75. The Commerce Clause of the Federal Constitution (Art. 1, § 8) expressly authorizes Congress to "regulate Commerce with foreign Nations, and among the several States."

76. Because aircraft are used in interstate commerce, imposition of a Use Tax must comply with the U.S. Constitution's Commerce Clause and precedent applying it. As the Supreme Court of Illinois explained in *Irwin*, "to withstand a claim that it has unconstitutionally burdened

interstate commerce, a state tax must satisfy the four-part test articulated in *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274 (1977)." *Irwin*, 238 Ill. 2d at 341.

77. "Under *Complete Auto,* the tax must: (1) be applied to an activity with a substantial nexus with the taxing state; (2) be fairly apportioned; (3) not discriminate against interstate commerce; and (4) be fairly related to the services provided by the state."[4] *Id.* Simply having a "nexus" with Illinois is not sufficient—it must be "substantial." *See* SUBSTANTIAL, Black's Law Dictionary (11th ed. 2019) ("Considerable in extent, amount, or value; large in volume or number"); *e.g.*, *National School Bus Service. Inc. v. Dep't of Revenue*, 302 Ill. App. 3d 820 (1998) ("The case law interpreting the rolling stock exemption has required some ***substantial use*** of the rolling stock in interstate commerce. The Department has therefore required ***proof of regular and frequent such use*** of the rolling stock.") (emphasis added).

78. Under *Irwin*'s substantial nexus requirement, the court must review: (i) the extent of the ***Aircraft's*** "physical presence" in Illinois (including the "purpose and function" of that presence); and (ii) the extent of the ***taxpayer's*** connection to Illinois.

C. Analyzing the Aircraft's Physical Presence in Illinois

79. In determining whether an aircraft has a sufficient connection to Illinois, use tax cannot be imposed based on how the Aircraft was used over a few months. Instead, Illinois must consider the usage of the Aircraft over a period of years—in many cases, the entire period of ownership. In *Irwin*, the Supreme Court of Illinois considered how the aircraft was used over the entire two-year period of ownership. *Irwin*, 238 Ill.2d at 332. And in *Director of Revenue v. Superior Aircraft Leasing Co.*, 734 S.W.2d 504 (Mo. 1987) (cited by the court in *Irwin*), the

[4] While all of these factors support TCRG's requested relief, reserving all rights, for the sake of brevity, TCRG focuses primarily on the "substantial nexus" prong in this petition.

Missouri Supreme Court considered how the aircraft was used over the first year and a half of ownership.

80. Moreover, in *Irwin*, the court noted that presence of an aircraft in Illinois supports imposing the use tax ***only if*** such presence is not "coincidental":

> The airplane's frequent physical presence in Illinois, through the many takeoffs and landings from Illinois runways, as well as the nights that it spent in Illinois, ***was not coincidental, but was inherent in its basic purpose and function in this state. The airplane was owned by ATC Air [(a wholly-owned subsidiary of Irwin)], whose corporate purpose was to provide transportation services to Irwin's officers and employees. Thus, the airplane frequently and regularly flew to Illinois at the behest of Irwin's corporate officers (four of whom had their offices in Illinois) to transport them to and from destinations throughout the United States.***

Irwin, 238 Ill. 2d at 343 (emphasis added).

81. Here, the Aircraft's limited presence in Illinois was only because it was being maintained and serviced there. Unlike *Irwin*, the Aircraft's presence in Illinois during the break-in period had nothing to do with the Aircraft's "basic purpose and function," which was to be a New York-based aircraft servicing New York-based clients.[5] And further unlike *Irwin*, the Aircraft did ***not*** "frequently and regularly" fly into Illinois "at the behest" of Illinois-based officers to "transport them" throughout the United States in order to conduct TCRG's business.

82. As explained above, after the break-in period, the Aircraft made, on average, less than one Illinois trip per month. That is far less than what is required to constitute a "substantial nexus" under *Irwin*. For example, in *Irwin* the court found a substantial nexus with Illinois because, over a two-year period, the aircraft took off or landed at Illinois airports ***272 times*** and on ***half*** of the days on which flights were made, they were in or out of Illinois.

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[5] The Aircraft was also never hangared at Midway Airport. It merely returned to Midway Airport intermittently for maintenance and servicing after the break-in flights.

83. Other cases in which the use tax was imposed further illustrate why it does not apply here. In *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), the taxpayer was a Delaware corporation that had no offices in North Dakota but gained over $1 million in sales from over 3,000 customers in North Dakota, to whom it delivered merchandise by mail or common carrier. There is no comparison to TCRG, which conducts no business in Illinois. And in *Brown's Furniture, Inc. v. Wagner*, 171 Ill. 2d 410 (1996), the Supreme Court of Illinois held imposing the use tax did not violate the Commerce Clause because the taxpayer (a Missouri company) made over 940 deliveries into Illinois during a 10-month period, valued at more than $675,000, and placed more than "2,800 individual advertisements in Illinois media outlets." *Id.* at 413-414. While the taxpayer in *Brown's* made about ***940 deliveries per month into Illinois***, here TCRG made ***less than one trip into Illinois per month***.

84. Furthermore, it should be noted that the question in *Brown's Furniture* and *Quill* is different than the question involved here. In those cases, the question was whether a retailer doing business in a State could be Constitutionally required to act as a collecting agent for the State, which generally requires an analysis focused on whether the in-state activity, considered alone, is sufficient to justify imposition of the collection obligation. In this case - as in the *Irwin* case - the question is whether tax can Constitutionally be imposed on property used in the State, which requires a focus not only on the use of the asset in the State, but also on whether such in-State use, compared to the total use of the asset, is significant enough to justify imposition of the tax.

D. Analyzing the Extent of the Taxpayer's Connection to Illinois

85. In determining whether the aircraft owner has a sufficient connection to Illinois, the Court must consider where the legal entity was formed and whether the entity is doing business in

the State. In both *Irwin* and *Superior Aircraft Leasing*, the entity was either formed or doing business in the state imposing the tax.

86. With respect to the connection between the taxpayer and State, the Court in *Irwin* observed:

> [A]lthough ATC Air is not an Illinois corporation, the record establishes that ATC Air had a demonstrated physical presence in Illinois. ATC Air's sole director, and its chairman and CEO, had his office in Illinois, as did its CFO and general counsel. Moreover, ATC Air did a substantial portion of its business in Illinois, in that its pilot-employees frequently and regularly flew its airplane into and out of Illinois to transport Irwin's corporate officers and directors to and from their offices in Illinois.

Irwin, 238 Ill. 2d at 345.

87. As explained above, TCRG has no offices in Illinois, no employees in Illinois, no officers or directors in Illinois, and no business operations in Illinois.

E. "Reasonable Cause" for Assessing Penalties

88. Finally, as a legal matter, the failure to pay taxes on or before their due date will not give rise to penalties if the failure was due to "reasonable cause." 35 ILCS 735/3-8.

COUNT 1

The Department Erred in Determining That the Aircraft Use Tax Applies to the Aircraft

89. Paragraphs 1 through 88, inclusive, are hereby incorporated by reference.

90. For the reasons set forth herein, the Department was incorrect in relying on the break-in period as a basis to impose use tax. For example: (i) states generally do not impose use tax on transporting property into the State for the purpose of repairs, even where the property remains in the State for several months; (ii) Wisconsin has not asserted that any tax liability is due and the Aircraft was in Wisconsin for 75 days for repairs; (iii) Illinois cannot impose use tax based upon the Aircraft's use over a few months; rather, usage of the Aircraft over years, and in many

cases the entire period of ownership, must be reviewed; and (iv) the Aircraft's limited presence in Illinois was solely because the service and maintenance provider was located here and was coincidental to the purpose of the Aircraft, which was to be based in New York for the purpose of transporting New York-based executives.

91. Moreover, as discussed in this Petition and its exhibits, the Department incorrectly:

- Found that imposition of tax was proper because the (h-2) Exemption did not apply, even though that exemption was never at issue;
- Sent out the Notice of Proposed Audit Findings and other notices to TCRG in violation of TCRG's right to notice and being heard, because the statute of limitations was "close";
- Relied upon the legal framework that applies to the (h-2) Exemption in finding that tax liability is owed, which does not apply in this case; rather, the Constitution's Commerce Clause analysis, as set forth in *Irwin*, is the applicable framework;
- Stated, in support of its justification that use tax applies, that "[t]he law does not rely on any certain percentage of use in the State," which is directly contrary to the Supreme Court of Illinois' *Irwin* decision;
- Claimed that under Illinois law, "***only the 'slightest' presence is necessary to create nexus***" to impose tax liability, even though that misstates Illinois law; the *Irwin* decision held: "*Quill* reaffirmed that the 'slightest' physical presence within a state is ***<u>not enough</u>*** to establish substantial nexus."
- Imposed tax liability based upon the Department's finding that "TCRG had locations and/or operations in several states, <u>including Illinois</u> at the time the aircraft was purchased and subsequently used in Illinois"; the Department persisted in this position and provided no supporting evidence despite TCRG conveying multiple times that TCRG is not an

Illinois entity, it has no Illinois office, it has no Illinois employees, it has no Illinois "locations," and it has no business operations in Illinois;

- Failed to fully consider that the Aircraft has extremely attenuated and episodic presence in Illinois (at best) and the taxpayer has absolutely no nexus to Illinois, which requires a finding of no tax liability under binding Illinois law;
- Failed to analyze in any meaningful detail the facts regarding the Aircraft's extremely limited and coincidental presence in Illinois, including the facts that distinguish this case from the taxpayer's extensive contacts with Illinois in *Irwin* (for a point-by-point comparison distinguishing *Irwin*, *see* pages 8-9 of February 5, 2021 Letter to the Informal Conference Board included in Exhibit E); and
- Other errors as set forth herein.

92. As more fully explained in Paragraphs 79-87 and in Exhibit G, prior to being moved to Illinois in 2018, neither TCRG nor the Aircraft had the requisite connection with the state of Illinois to give rise to the "substantial nexus" required to support an imposition of Aircraft Use Tax. The Aircraft's physical presence in Illinois was minimal and intermittent compared to cases in which an imposition of use tax has been sustained, and its presence in Illinois was wholly coincidental to its intended purpose and function: to be a New York-based aircraft servicing by New-York based customers. Instead, the Aircraft's physical presence in Illinois was occasioned only by the fact that Jen-Air, TCRG's maintenance provider, was unable to perform necessary repairs and maintenance at any of its other facilities. Neither Parent nor TCRG itself has any physical presence, officers, directors, employees or operations in Illinois.

93. The Department's errors identified in this Petition establish that the Department was incorrect and without reasonable basis in imposing tax liability against TCRG.

94. If the imposition of Aircraft Use Tax in this case is upheld based on the minimum physical presence of the Aircraft in Illinois over the time period at issue, where neither Parent nor TCRG have any employees or business operations in Illinois, it will incentivize aircraft owners to avoid Illinois airports out of fear of becoming liable for Aircraft Use Tax despite minimal connections to or presence in Illinois. This would directly contradict the purpose of imposing use taxes as it would divert business to out-of-state retailers and take business away from skilled technicians and professionals in Illinois by imposing additional, severe costs on repairs and maintenance that would otherwise be performed in Illinois. It would also incentivize businesses that operate their own aircrafts to avoid organizing or attending meetings or events in Illinois, out of worry that one-too-many landings in Illinois could suddenly give rise to millions of dollars in taxes, since any business bringing its own employees into Illinois on a company-owned aircraft would have a stronger nexus with Illinois than TCRG.

COUNT 2

In the Alternative, the Department Erred in Calculating the Amount of Aircraft Use Tax

95. Paragraphs 1 through 88, inclusive, are hereby incorporated by reference.

96. The Illinois Aircraft Use Tax Law imposes a tax "on the privilege of using, in this State, any aircraft as defined in Section 3 of the Illinois Aeronautics Act acquired by gift, transfer, or purchase after June 30, 2003," in an amount equal to 6.25% of the selling price. 35 ILCS 157/10-15.

97. The selling price of the Aircraft was $16,500,000.00.

98. 6.25% of $16,500,000.00 is $1,031,250.00.

99. The Department assessed Aircraft Use Tax in the amount of $1,196,250.00.

100. This is incorrect. The Department has known about this error since at least August of 2020, yet has failed to offer any justification for this calculation and has refused to correct it on the Notice.

101. TCRG respectfully suggests the Department's failure to revisit this obvious error is indicative of how the Department has conducted this entire audit, which has needlessly forced TCRG (and Parent) to incur substantial attorneys' fees to identify and correct the Department's errors, only for the Department to ignore compelling authority to the contrary.

COUNT 3

In the Alternative, the Department Incorrectly Determined that Penalties Apply to TCRG's Failure to Pay the Aircraft Use Tax

102. Paragraphs 1 through 88, inclusive, are hereby incorporated by reference.

103. The failure to pay taxes on or before their due date will not give rise to penalties if the failure was due to "reasonable cause." 35 ILCS 735/3-8.

104. TCRG had reasonable cause not to pay the Aircraft Use Tax, as established herein. Assuming that the Tribunal finds that tax liability is owed (despite there being no basis for such finding, as shown herein), it should find that TCRG does not owe any penalties.

CONCLUSION AND RELIEF REQUESTED

WHEREFORE, TCRG respectfully requests that this Tribunal:

- Enter judgment in favor of TCRG and against the Department, resulting in cancellation of the Notice and a finding that TCRG owes no tax liability, interests, penalties, or any other payment.
- In the alternative, if the Tribunal determines that the Aircraft Use Tax applies to TCRG's ownership of the Aircraft, TCRG respectfully requests that the Tribunal determine the

proper amount of Aircraft Use Tax to be $1,031,250 (or a lesser, apportioned amount taking into account the minimal time spent by the Aircraft in Illinois compared to other states).

- In the alternative, if the Tribunal determines that the Aircraft Use Tax applies to TCRG's ownership of the Aircraft, TCRG respectfully requests that the Tribunal find that TCRG had reasonable cause not to timely pay such Aircraft Use Tax such that no penalties apply to TCRG's failure to timely pay the Aircraft Use Tax.
- Any other relief that the Tribunal determines is appropriate and just.

Dated: January 14, 2022

Respectfully submitted,

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