ILLINOIS INDEPENDENT
TAX TRIBUNAL

TEXAS CAPITALIZATION RESOURCE GROUP INC **Petitioner,** **v.** **ILLINOIS DEPARTMENT OF REVENUE,** **Respondent.**	**No. 20 TT 93** **Judge Brian Barov**

Department's Response to Petitioner's Motion for Summary Judgment

Respondent, Illinois Department of Revenue (the "Department"), by and through its attorneys, Michael Coveny and Tina Tsatsoulis, respectfully submit this Brief in Response to Petitioner's Motion for Summary Judgment ("MSJ") and states as follows:

Background

Petitioner, Texas Capitalization Resource Group, (the "Petitioner") is a Texas corporation with its principal place of business in Fort Worth, Texas. TCRG SN4057, LLC (the "LLC") is an indirectly wholly owned subsidiary of Petitioner. The LLC is a disregarded entity for federal income tax purposes, meaning it does not file a separate federal income tax return, as its earnings are reported on its parent/owner's return and it uses its parent's or owner's federal identification tax number. See 26 C.F.R. § 301.7701-3(a); 26 C.F.R. § 301.6109-1(h)(2)

After conducting an audit as described below, the Department issued its Notice of Tax Liability (the "NTL") to Petitioner for use tax under the Use Tax Act in the amount of $ 1,661,874.71 including tax of $ 1,196,250, late payment penalty of $ 239,250.50 and interest computed through the date of the NTL, June 9, 2020, in the amount of $ 226,374.21. The NTL was issued to Petitioner as the purchaser or owner of a 2006 Gulfstream Aerospace G450 (the "Aircraft").

Petitioner timely filed a protest (the "Petition") in this Tribunal alleging six separate errors. Error 1 presents a threshold legal issue in that Petitioner states that it is not the owner of the Aircraft, and as such, the Department's NTL is not valid. Because Error 1 presents a threshold legal issue, Petitioner has filed a Motion for Summary Judgement ("MSJ") addressing solely Error 1. As a threshold issue, if Petitioner prevails in establishing that it should not be considered the Aircraft's owner, then the NTL is not valid and the remaining Errors in the Petition are moot because the use tax can only be assessed as an "incident of ownership." 35 ILCS 105/2.

Department Audit

At some point in November of 2018, the Department began an audit of Petitioner for its use of the Aircraft in Illinois. The Petitioner was represented in the audit by Phil Crowther, an attorney licensed in Kansas. On January 17, 2019, Mr. Crowther submitted a Department Power of Attorney form signed by Petitioner's President as the taxpayer's authorized agent. See attached DOR

Exhibit A. Under the heading for "taxpayer information," the Petitioner is the only entity listed, there is no mention of the LLC.

Also attached in DOR Exhibit B are copies of various email chains between the Department's auditor and Mr. Crowther. DOR Exhibit E includes a legal memo prepared by Mr. Crowther and sent to the Department's auditor. Throughout DOR Exhibit B, Mr. Crowther repeatedly referred to Petitioner as the taxpayer. It is clear from this email that both the auditor and Mr. Crowther regarded Petitioner as the Aircraft's owner since there is no mention of the LLC's existence.

Attached as Exhibit C is an email chain between the Department's auditor and a Mathew Sennett at Franklin Monroe, discussing the audit. The emails included in DOR Exhibit C are consistent with the email chain in Exhibit B, as there is no mention of any entity other than Petitioner. Statements such as "TCRG put the plane into service on March 13, 2016. . . " clearly suggest Petitioner is the Aircraft's owner, not the LLC, which is not referenced in the email.

Exhibit D is yet another email between the auditor and Mr. Crowther where counsel refers to the taxpayer as TCRG, i.e., the Petitioner, and with no reference to any LLC. Finally, per Exhibit E, which includes an email from Mr. Crowther to the auditor, counsel once again makes reference to what the Petitioner, TCRG, intended with regard to the Aircraft.

In Mr. Crowther's memo to the auditor, Exhibit E, he explicitly referred to Petitioner as the purchaser of the Aircraft. The tax return or returns that likely

alerted the Department to the existence of the Aircraft in the first place are attached as Exhibit F and consist of a RUT-25 and RUT-7-A. Notably both of these returns, while listing the taxpayer/Aircraft owner as the LLC andz not Petitioner, contained the federal tax identification number of the Petitioner. And while the use of the federal tax identification number is required under IRS regulations, the Department, as do most tax agencies, uses federal tax identification numbers, which are unique, rather than names, including business names, which potentially are not unique.

Aircraft Purchase Agreement

After filing its Petition, Petitioner's counsel provided the Department's counsel a redacted copy of its purchase agreement ("Purchase Agreement") for the Aircraft, attached hereto as an Exhibit. Petitioner's counsel requested that this document remain confidential. The Department does not object to withholding it from the Tribunal's website, provided the Department is allowed to make reference to the fact that Petitioner co-signed the Purchase Agreement as the sole member of Petitioner.

Standard for Summary Judgment

Summary judgment is appropriate when, and only when, the court finds that, based on the pleadings, depositions, and affidavits, no genuine issue of material fact exists between the parties. 735 ILCS 5/2-1005(c); *Neofotistos v. Metrick Electric Co.,* 217 Ill.App.3d 506, 513, 577 N.E.2d 511 (2nd Dist. 1991). In deciding the whether the movant is entitled to summary judgment, the court will construe all the evidence against the summary judgment movant and in

favor of the nonmovant. *Purtill v. Hess,* 111 Ill.2d 229, 240, 489 N.E.2d 867 (1986).

Equitable Estoppel

While courts generally recognize that state law controls or determines ownership of real and personal property, there are exceptions where they will apply the longstanding legal doctrine of equitable estoppel to avoid an unjust result. One treatise described it as:

> the effect of the voluntary conduct of a party whereby he is absolutely precluded, both at law and in equity, from asserting rights which might perhaps have otherwise existed, either of property, of contract, or of remedy, as against another person, who has in good faith relied upon such conduct, and has been led thereby to change his position for the worse, and who, on his part, acquires some corresponding right, either of property, of contract, or of remedy.

J. Pomery, A Treatise on Equity Jurisprudence § 804 (5th ed. 1941).

Applying this principle to the ownership of property, another treatise provides:

> Where the true owner of property clothes another with apparent title or authority over it and a third person in good faith relies on such ostensible ownership, the true owner is estopped to assert title or power over the property or to deny the title of the ostensible owner.
>
> As a general rule, where the true owner of property holds out another, or allows the other to appear as the owner of, or as having full power of disposition over, the property, and innocent third persons are thus led into dealing with such apparent owner or person having such apparent power of disposition, they will be protected, regardless of whether the true owner has been negligent in entrusting the property to the wrongdoer.
>
> In such cases, the rights of such third persons do not depend on the actual title or authority of the party with whom they deal directly, but are derived from the act of the real owner, which

> precludes the real owner from disputing as against them the existence of the title or power which, through negligence or mistaken confidence, the owner caused or allowed to appear to be vested in the party making the conveyance. The rule is especially applicable where the owner has encouraged the parties to deal with each other.

31 C.J.S. Estoppel and Waiver § 141.

Am Jur further explains the doctrine:

> Such an estoppel against the real owner arises only where he clothes the person assuming to dispose of or deal with the property, with the apparent title to it, or with indicia of ownership, or with apparent authority to dispose of it or otherwise deal with it, if the person acting in reliance upon such apparent ownership or authority parts with value or extends credit to the person in possession or control, in good faith, and The Department is without knowledge or information sufficient to form a belief as to the allegations contained in paragraph 13 and therefore neither admits nor denies the allegations. knowledge of the true ownership of the property or of the limitations upon the authority of the possessor to deal with it.

19 Am Jur 696, Estoppel, § 68.

The doctrine has long been recognized in Illinois. See *Anderson v. Armstead,* 69 Ill. 452, 454-455 (1873) ("The law is familiar, that where the owner of property holds out another, or allows him to appear, as the owner of, or as having full power of disposition over the property, and innocent parties are thus led into dealing with such apparent owner, or person having the apparent power of disposition, they will be protected."); *National Bond & Investment Company v. Shirra, et al.,* 255 Ill.App. 415, 419 (1st. Dist. 1930) (citing *Drain v. LaGrange State Bank,* 303 Ill. 330, 335 (1923)) ("As a general rule, where the true owner of the property allows another to appear as the

owner of or to have full power to dispose of the property, so that a third party is led into dealing with the apparent owner, an estoppel may operate against the true owner which would preclude him from disputing the existence of a title which he has caused or allowed to appear vested in another."); *Mori v. Chicago National Bank,* 3 Ill.App.2d 49, 51 ("It is based upon the conduct of the true owner, whereby he has allowed another to appear as the owner, or as having full power of disposition over the property, so that an innocent person is led into dealing with such apparent owner."); *Santiago v. E.W. Bliss Company,* 2012 IL 111792, ¶ 50 ("For equitable estoppel to apply, it is not enough to show that there has been some misrepresentation by the opposing party. The doctrine will not act as a bar unless the party seeking to raise it can show that the misrepresentation was material to the dispute at hand and operated to that party's detriment."); *General Finance Corporation v. Nimrick,* 319 Ill.App. 98, 100 (1st. Dist. 1943) ("Estoppel may operate to defeat a superior title where the conduct of the superior owner allows another to appear as owner and thereby deceive, to his damage, a third person.")

It has also been recognized by federal courts applying Illinois law. *In re Pubs, Inc., of Champaign,* 618 F.2d 432, 436 (7th Cir. 1980); *In re Standard Foundry Products, Inc.,* 206 B.R. 475, 479 (Bankr. N.D. Ill. 1997); *Chicago Dist. Council of Carpenters Pension Fund v. Monarch Roofing Co., Inc.,* 601 F.Supp. 1112, 1117 (N.D. Ill. 1984).

Equitable Estoppel in Tax Cases

In federal income and estate tax cases, the courts have long recognized a tax version of estoppel, sometimes called quasi-estoppel or duty of consistency. It has been applied to place an affirmative duty to disclose in some situations:

> The courts which have approved of the quasi-estoppel doctrine have ruled that while willful representation is not necessary, where the duty to disclose exists and disclosure is not made, the doctrine will apply.

15 Mertens Law of Fed. Income Tax'n § 60:5. Courts have imposed or recognized that in certain circumstances, taxpayers have an affirmative duty of disclosure:

> To raise this duty of consistency in tax accounting we do not think a willful misrepresentation need be proven, or all the elements of a technical estoppel. It arises rather from the duty of disclosure which the law puts on the taxpayer, along with the duty of handling his accounting so it will fairly subject his income to taxation.

Wichita Coca Cola Bottling Co., v. U.S., 152 F.23d 6, 8 (5th. Cir. 1945).

One of the first decisions to recognize a tax duty of consistency was *R.H. Stearns Co. v. United States,* 291 U.S. 54 (1934). Although the Supreme Court never used the term "duty of consistency" in its opinion, it is considered the first income tax case to apply an estoppel against a taxpayer based on a taxpayer's representation, which the Internal Revenue Service had clearly relied on. *Id.* at 61-62.

As articulated by various federal courts in income tax cases, the duty of consistency or quasi-estoppel has three requirements or elements: (i) non-taxpayer parties that are in privity with a taxpayer can also makes statements that are binding on the taxpayer; (ii) the Internal Revenue Service's position that taxpayers have a duty to disclose, which duty can be violated by omission as well commission, has been upheld in multiple decisions; and (iii) quasi-estoppel or the duty of consistency will not apply if the taxpayer has provided the Service with adequate information to discover that a different, subsequent or previous representation was incorrect. See Michael E. Baillif, *The Return Consistency Rule: A Proposal for Resolving the Substance-Form Debate,* 48 Tax Law. 289, 291 (1995); Steven R. Johnson, *The Taxpayer's Duty of Consistency,* 46 Tax L. Rev. 537, 543, 549 (1992).

A good case illustrating the doctrine and the duty to disclose is *Hollen v. Commissioner,* T.C. Memo, 2000-99, 79 T.C.M. 1719. In this case, a partnership that had long claimed ownership of a ranch on its federal income tax returns by taking regular depreciation deductions failed to inform the IRS auditor during an audit of its 1988 partnership returns that it did not have title to or own the ranch. The Tax Court determined that it would apply the estoppel doctrine and hold the individual taxpayer petitioners to the position taken on the partnership returns, i.e., that the partnership, not the individual partners, were the owners, regardless of who actually owned the property under state law

> In this case, once we determine that the duty of consistency applies, we no longer care who actually owned the ranch, since for Federal income tax purposes, they duty of consistency

> requires petitioners to be bound by their prior representations regarding the ranch's ownership. For this reason, we need not and do not decide who actually owned the ranch or whether State law applies in deciding that issue.
>
> On these facts, we hold that the duty of consistency applies, and, therefore, petitioners are estopped from claiming that the ranch was not partnership property at the time of its sale in 1988.

Hollen, 2000-99, 5.

In a similar situation, the taxpayer/petitioner failed to inform the IRS during an audit that his S Corporation status was in doubt and the U.S. Tax Court applied the doctrine to bar the taxpayer from subsequently challenging the S corporation status corporation. *Baldwin v. Commissioner,* T.C. Memo, 2002-162, 83 T.C.M. 1915:

> Petitioner did not inform respondent during the audit that the validity of BAC's S corporation election was an issue. Petitioner also represented, under oath, in formal discovery proceedings in this case that BAC was an S corporation. Petitioner now seeks to repudiate BAC's S corporation status, in an effort to deprive this Court of jurisdiction over the BAC issues and respondent of the opportunity to obtain a ruling on the BAC issues raised in this case.

Baldwin, 2002-162, 16, 83 T.C.M. 1915.

Several state courts, including Illinois, have applied or at least recognized the rule at the state level. See *Department of Revenue Envirodyne Industries,* 56 Collier Bankr. Cas. 2d 1770, 2006 WL 3147696 (N.D. Ill. 2006)(where the court recognized the rule as urged by the Department, but declined to apply it to facts in case before it); *In Estate of Bracken v. Department of Revenue,* 175 Wash.2d 549, 569 (2011); *Pogorelc v. Commissioner of Revenue,*98 Mass.

App.Ct. 41, 45; *State of Florida Technical Assistance Advisement* 11C-007, 2011 WL 5984698.

Petitioner's Conduct During the Audit Estop it From Denying Ownership of the Plane

As set out above, throughout the audit process Phil Crowther, Petitioner's counsel and primary contact person, affirmatively represented and held out Petitioner as the Aircraft's owner, not the LLC, the true owner, at least according to the Purchase Agreement. But as the emails in Exhibits B-E indicate, Mr. Crowther repeatedly referred to Petitioner as the Aircraft's owner, and in his memo referred to Petitioner as the Aircraft's purchaser. See Exhibit E. Due to the auditor's reliance on Petitioner's representations regarding ownership of the Aircraft, the Department issued the NTL in Petitioner's name.

It also should be noted that the Purchase Agreement, which shows the titleholder and actual owner as the LLC, was apparently never provided to or disclosed to the auditor during the audit or anyone else at the Department prior to this litigation. This Tribunal should apply the duty of consistency or quasi-estoppel and find that the Petitioner and the LLC both had a duty to disclose the Aircraft's true owner to the Department during the audit. Their failure to do so violates that duty, estopping Petitioner and its wholly owned LLC from now asserting the LLC's sole ownership of the Aircraft. Consequently, the Petitioner's MSJ should be denied on the grounds that allowing Petitioner to disavow ownership of the Aircraft would permit the very type of "tax

gamesmanship" the duty of consistency was intended to prevent. See *Baldwin,* T.C. Memo. 2002-162, at 16.

Respectfully submitted,

/s/ Michael Coveny
/s/ Tina Tsatsoulis
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CERTIFICATE OF SERVICE

I, Michael Coveny, an attorney for the Illinois Department of Revenue, state that I served a copy of the attached Department's Motion for Summary Judgment upon:

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By email attachment to the email addressees listed above on May 10, 2021.

_/s/ Michael Coveny
Department Counsel