CANADA'S LUXURY TAX ON AIRCRAFT: A PRIMER FOR NON-CANADIAN SELLERS AND BROKERS

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I recently attended the annual National Business Aviation Association conference where I had the opportunity to catch up with my non-Canadian contacts in business aviation. A comment I heard from many of them was: "While I still don't quite understand the luxury tax, it is already costing me a lot of my sales."

Canada's federal *Select Luxury Items Tax Act* (commonly referred to as the "**Luxury Tax**"), took effect on September 1, 2022, subject to certain transitional relief available for pre-2022 agreements. This law generally applies a tax of up to 10% of the value of certain passenger aircraft and automobiles having a value of over $100,000, and boats having a value of over $250,000, upon the sale, lease, or importation of such vehicles, unless a specific exemption applies under the law. The tax should only apply once on a subject luxury conveyance (whether on sale, lease, or import).

Notwithstanding the terminology used, the Luxury Tax is not actually a tax on wealthy consumers but, rather, it applies to the vendors or lessors of aircraft sold or leased in Canada and importers of aircraft into Canada (subject to certain exclusions, exemptions, and adjustments/rebates). That makes it important that registered vendors and lessors include appropriate contractual language for having recourse against purchasers and lessees for reimbursement or indemnification of the Luxury Tax.

While more than one year has passed since the Luxury Tax came into effect, it is still not yet well understood, even by members of the agencies that are responsible for administering the Tax (namely, the Canada Revenue Agency (**CRA**) and the Canada Border Services Agency (**CBSA**)). This lack of understanding can be attributed in large part to a lack of clear and timely guidance on how the tax is to be applied, as well as oversights or deficiencies in the legislation and regulations. The Department of Finance sought to address a limited scope of deficiencies with the release of draft regulations on August 4, 2023 (nearly a year after implementation).

Outlined below are the Luxury Tax implications of some common aircraft transactions that frequently involve non-Canadian parties:

(1) Sales and importations of new aircraft

An aircraft purchased under an agreement entered into prior to January 1, 2022 is grandfathered from the application of the Luxury Tax. It would be advisable to maintain credible evidence to support the actual date of the agreement, such as the payment of a deposit before January 1, 2022.

(2) Sales and importations of pre-owned aircraft

Sales and importations of pre-owned aircraft are grandfathered from the application of the Luxury Tax where the following conditions are met:

a. The Aircraft was registered with any government (not simply in Canada) prior to September 1, 2022; and
b. The Aircraft was in the use of a "user" prior to September 1, 2022 other than for a purpose incidental to the sale or manufacture of the Aircraft (i.e., demonstrators would not qualify).

(3) Importations into Canada of aircraft which meet the exemption criteria for the Luxury Tax

The Luxury Tax generally does not apply in respect of the sale or importation of a "qualifying subject aircraft", which includes certain aircraft which, at the time of sale and for the year that follows, are expected to be used 90% or more of the time for "qualifying flights". In broad terms, "qualifying flights" are required to be used in the course of a business carried on with a reasonable expectation of profit by the aircraft owner. However, the transportation of the owner, or someone related to the owner, for purposes of their leisure or other enjoyment would not count towards "qualifying flights", even if those flights are fully paid for at arm's length charter rates. Moreover, it should be noted that this is not a "one and done" test since, if at any point in time the aircraft ceases to constitute a "qualifying subject aircraft", the Luxury Tax would then become payable.

Ordinarily, upon the importation of an aircraft to Canada, CBSA would collect the applicable Luxury Tax. However, if the aircraft would meet the criteria for a "qualifying subject aircraft", the Luxury Tax should not apply, provided that the importer presents CBSA with a Special Import Certificate at the time of importation. The following should be noted as regards this process:

a. In order to obtain an exemption certificate, the importer would first need to complete and submit to the CRA an application in Form L502.
b. The CRA has as yet given no guidance as to how long the application and review process to receive the certificate may take. In my experience, this process could take a minimum of six to eight weeks, which should be considered when scheduling a ferry flight.
c. Adding to the potential delay is that the CRA will only issue the certificate by regular mail, and CBSA will only accept a certificate in original form, so emailed or faxed copies are not an option.

d. It should be expected that the CRA will contact the applicant to discuss the details underlying the exemption request, which might also add to potential delays. It is strongly advisable that the importer engage a professional who is well familiar with the exemption process and the underlying criteria which must be satisfied, otherwise the importer may risk a denial of the request.

(4) Sales of aircraft in Canada involving non-Canadian buyers and sellers

It is not uncommon for the non-Canadian seller of an aircraft to have the aircraft temporarily located in Canada for maintenance or other purposes and to propose that the sale of that aircraft to a non-Canadian buyer close in Canada for convenience purposes. However, paradoxically, such a transaction might technically be subject to the Luxury Tax.

More specifically, as currently drafted, the Luxury Tax legislation might arguably apply in respect of the sale of an aircraft by a vendor that is a non-resident of Canada and a non-registrant for Luxury Tax purposes to a non-resident purchaser solely by virtue of the delivery taking place in Canada, irrespective of whether the aircraft is promptly exported from Canada for use outside Canada.[1] However, it does not appear to be the intent of the drafters that a transaction between non-residents should be subject to the Luxury Tax in such circumstances, and we understand that the Canadian Department of Finance has already issued comfort letters to that effect.

Even so, as a practical matter, there may be no means by which the Canadian tax authorities could enforce the application of the Luxury Tax against a non-resident of Canada. In particular, irrespective of whether the non-resident resides in a jurisdiction which has a tax collection agreement with Canada, it is of note that the tax collection clauses of bilateral tax treaties generally apply in respect of taxes on income and capital, the scope of which should not include the collection of any Luxury Tax liability.

(5) Exports

One helpful change in the draft Regulations (previously announced) are the prescribed circumstances for the outright exemption of a purchase from a registered vendor of a subject aircraft exported from Canada where the purchaser provides an exemption certificate in the prescribed form to the vendor. The certificate would set out the identification number of the subject aircraft.

The certificate would include a declaration that certain conditions surrounding the exportation are satisfied. The export conditions fortunately match with those for obtaining point-of-sale GST/HST relief for a zero-rated supply of an aircraft exported from Canada. In addition, the purchaser must declare that the subject aircraft is not to be registered with the Government of Canada or a province before the exportation except if the registration is done solely for a purpose incidental to its manufacture, offering

for sale, transportation, or exportation. Under the certificate, the purchaser acknowledges that the purchaser is assuming liability to pay any amount of tax in respect of the subject aircraft that is or may become payable by the purchaser under the Act. The vendor should retain the certificate on file for audit purposes to substantiate the exemption.

(6) Lease transactions

The Luxury Tax generally becomes payable by a lessor upon providing a right to use an aircraft under a lease (unless the transaction is otherwise exempt). This upfront imposition of tax creates particular challenges for the cashflow of lessors, in terms of timing (i.e., will the lessor seek to recover its Luxury Tax cost upfront, or will it do so as part of the lease payments, in which case it is financing that cost until it is fully recovered?), and in terms of the amount recovered from a lessee (since the Luxury Tax that will be due is based on the full value of the aircraft, as opposed to the value of the lease contract).

The foregoing are just a sampling of potential transactions involving non-Canadians where the Luxury Tax could apply. As time passes, it is becoming clear that the Luxury Tax may apply to a broader range of transactions than initially anticipated, including in instances where it is apparent that it was likely not intended to apply. In some instances, the Canadian authorities have shown a willingness to issue comfort letters, but that of course takes time, which is not always a practical option given the typically rapid pace of aircraft transactions.

That notwithstanding, the most prudent course of action would be to engage in proper planning and analysis as soon as is reasonably possible, with a view to managing and mitigating the potential application of the Luxury Tax so as not to impede commercial transactions.

[1] Subsections 7(1) and 18(1) of the Luxury Tax legislation provide that the sale of an aircraft is generally subject to the Luxury Tax (unless otherwise exempt) if (i) ownership of the aircraft is transferred by way of sale under an agreement, and (ii) the aircraft is delivered or made available in Canada “in relation to” the agreement.

by Steven Sitcoff

A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.