CBAA BRIEFING TO MEMBERS
TAXABLE BENEFITS FOR THE PERSONAL USE OF AN AIRCRAFT

Introduction

On March 7, 2018, the Canada Revenue Agency ("**CRA**") released the long-awaited **Internal Communiqué AD-18-01 – Taxable Benefit for the Personal Use of an Aircraft,** which outlines its administrative guidance to its auditors in respect of the taxation of the personal use of business aircraft. This communiqué, while intended as an internal CRA document, is also being provided to CBAA members to assist them when structuring their affairs and preparing their required returns and other filings required by the *Income Tax Act* (Canada).

Disclaimer

The following is not legal advice and is only intended to provide a basic summary of the Canada Revenue Agency's administrative policy in respect of the taxation of the personal use of aircraft. Taxpayers are encouraged to seek their own professional advice in respect of their own particular circumstances from a qualified professional tax advisor.

History

In 1992 the CRA published IT160R3 – Personal Use of Aircraft, which detailed the administrative policy of the CRA in respect of the taxation of the personal use of aircraft. Twenty years later, on September 30, 2012, IT160R3 and 138 other interpretation bulletins that described the CRA's various administrative policies, were cancelled. With no published guidance following the 2012 cancellation of IT160R3, the CRA undertook an audit program to examine how Canadian taxpayers were valuing and reporting the personal use of aircraft. In many cases, this resulted in negative reassessments for the affected taxpayers. On March 3, 2015, the CRA issued an internal income tax ruling in respect of a Quebec-based taxpayer's personal use of a business aircraft (Interpretation-internal, 2014-052784l7). That document signalled, for the first time since 1992, that the CRA had changed its approach to the question of the valuation of the personal use of an aircraft. This internal tax ruling is not available to the general public and is only available on private fee-

for-service tax information databases used by Canadian tax lawyers and tax accountants. Therefore, taxpayers at large were not informed of the CRA's change in administrative policy. Additionally, this interpretation ruling was only available in French and not translated into English until October 2016. Members of the Canadian Business Aviation Association ("**CBAA**") began reporting to the CBAA that they were being targeted by the CRA in respect of the personal use of their business aircraft and that the audit approach and guidance auditors were providing CBAA members lacked consistency, predictability and fairness.

By the summer of 2016, the CBAA had enough data to demonstrate that there was an identifiable CRA audit trend that was harming its members. Immediately, the CBAA opened up a dialogue with certain elected members of Parliament and then later the CRA's senior leadership team to raise alarm over the manner in which its members were being targeted. The first of several technical meetings with the CRA's bureaucrats occurred in September 2016 and over the course of the next 17 months the CBAA and its technical advisors worked with the CRA, the office of the Minister of National Revenue and other key stakeholders such as the Tax Executives Institute, the Canadian Tax Foundation and the Canadian Payroll Association, to highlight its members concerns. In 2017, the CRA proposed an administrative policy that would have done significant harm to CBAA members. We strongly argued against that policy (the policy and our arguments are described in our letter to the CRA on September 5, 2017).

CBAA members were part of a wide consultation conducted by the CBAA's senior leadership team and advisors. The fruit of that consultation was a series of detailed discussions and submissions to the CRA that concluded with the development and publication of the CRA communiqué that was distributed to you on March 7, 2018 and is available by clicking the following link.

We sincerely thank all of our members for your support and assistance during this challenging and lengthy process. Significant and substantial efforts were made on your behalf, but we would not have been successful without your support. Thank you.

Overview of AD-18-01 – Taxable Benefit for the Personal Use of an Aircraft

AD-18-01 is a compromise, and will result in higher personal benefit valuations, in most circumstances, than were available under IT160R3, which generally required that taxpayers report an amount equal to a business class ticket purchase from an airline for the route of flight flown by a taxpayer on a business aircraft.

AD-18-01 also poses certain compliance challenges that were not significant under the former policy, which are reviewed below. Both of these circumstances were anticipated by the CBAA. The present situation is a result of two precedent-setting decisions of the Federal Court of Appeal (*Schroter* v. *R.* 2010 CarwellNat 908 FCA 98 81 CCPB 159 2010 4 CTC 143 2010 and *Spence* v. *R.* 2011 CarswellNaat 2040 2011 FCA 200 89 CCPB 192 2011 DTC 5111) which, by law, must be followed by the CRA and taxpayers.

There are three categories contained in AD-18-01 and the applicability of a particular category is a question of fact. Where a taxpayer does the following:

1. purchases or leases an aircraft in support of its business activities; and

2. provides personal use of an aircraft to an employee, shareholder or another person, then the taxpayer is required to calculate and report the value of the benefit.

To comply with this requirement, the taxpayer is required to measure the amount flight time attributable to business use and the amount of flight time attributable to personal use. To the extent that the personal use is less than fifty percent (<50%) of the overall aircraft use during a taxation year, then the valuation of the benefit received by a shareholder or employee or another person is calculated on the basis of category 1 or 2 described below:

1. Where the shareholder or employee takes a flight on the aircraft in circumstances where there is a business purpose for the flight and their presence on the flight, and there is a personal purpose for others taking the flight, the value of the taxable benefit for the personal use would be equal to the highest priced ticket available

in the marketplace for an equivalent commercial flight.

2. Where the shareholder or employee takes a flight on the aircraft in circumstances where there is no business purpose for the flight, the value of the taxable benefit would be equal to the price of the charter of an equivalent aircraft for an equivalent flight.

In circumstances where the personal use flight time exceeds fifty percent (>50%) of the total flight time on the aircraft in a particular taxation year, the taxpayer is directed by the CRA to calculate the value of the benefit in accordance with category three which states:

3. Where the shareholder or employee uses the aircraft primarily for personal purposes relative to the aircraft's total use during the calendar year ("primary purpose test"), either alone, or in combination with other persons not dealing at arm's length, the value of the taxable benefit is equal to the personal use portion of the aircraft's operating costs plus an imputed available-for-use amount.

Categories 1 and 2 do result in reasonable valuations that are consistent with the current statute and common law. However, category 3 results in valuations that, in certain circumstances, exceed fair market value by as much as 433%.

In so far as it is meaningful, we were able to persuade the CRA to reduce the value of the available for use benefit prescribed rate of interest to a value determined by reference to paragraph 4301(a) of the *Income Tax Regulations*. The current rate is 5% and updated quarterly by the Government of Canada. The CRA's original approach would have added a further 2% interest to this calculation and resulted in a valuation that exceeded the fair market value by 487%.

CBAA members are strongly encouraged to consult their professional tax advisors to ensure that they do not inadvertently end up in category 3.

***Bona Fide* Security Concern for an Employee**

Where there is a *bona fide* security concern for an employee that requires they not travel in any other manner other than by way of a business aircraft, valuations that would

otherwise be determined by applying category 2 may be determined using category 1. What is required to establish a *bona fide* security concern has not been addressed by the CRA in its policy. CBAA members who have a security issue are encouraged to consult their professional tax advisors to determine the best method to document and establish such a security concern and the implications arising from this circumstance on the personal freedom of their employees to avail themselves of other modes of travel (which may give rise to unintended negative tax consequences).

Relative Use is Problematic

The concept of personal use versus business use as the gateway into one of the three categories used to determine personal benefit value poses some tax risk to CBAA members. Where a gateway concept is relative, it makes it difficult to tax plan in advance, and if the number of personal use flight hours exceeds a total of fifty percent of the total flight hours in the taxation year, the taxpayer will find themselves inadvertently in category 3 with a usurious benefit valuation. There are strategies that might be employed to mitigate any tax risk. Which strategy is to be employed by a taxpayer to mitigate this tax risk must be determined by reference to your own personal circumstances.

CBAA members are strongly encouraged to consult their own professional tax advisors to determine a suitable strategy to mitigate any tax risk.

Applicability of AD-18-01 to Prior Taxation Years

The CRA committed to us, on a telephone call with all of the stakeholders on March 7, 2018, that it would employ its "One Plus One" audit policy for years prior to the publication of AD-18-01. This means the CRA will not necessarily audit all non-statute barred taxation years but just the current year available for audit plus the prior year. In such a circumstance, AD-18-01 will only be applied retroactively with the consent of the taxpayer. In other words, taxpayers should expect that any audits in progress for the 2012, 2013, and 2014 taxation years that are looking at this issue would be dropped, to the extent

that the taxpayer made reasonable and documented efforts to comply with IT160R3 and can demonstrate that fact to the CRA. For 2015 and 2016 taxation years, audits that are in progress should apply the logic contained in the income tax ruling issued in March 2015 (Interpretation-internal, 2014-052784117) which uses the charter rate as the basis for its valuation. The CBAA requests that anyone affected immediately inform the CBAA if auditors fail to apply the One Plus One audit policy or apply different audit logic than described above to the 2015 and 2016 taxation years. We will then take those concerns immediately to the CRA's senior leadership team. The 2017 taxation year for most taxpayers has not yet been filed and you can expect that, to the extent the CRA audits your business, the logic contained in Interpretation-internal, 2014-052784117 should be applied by the CRA auditors (i.e. charter rate). It is unclear how the CRA will proceed in the transition years from 2015-2017 for circumstances that fall outside the fact patterns identified in Interpretation-internal, 2014-052784117. However, we intend to seek further clarification from the CRA.

AD-18-01 will be applied to the 2018 taxation year and beyond, we encourage CBAA members to review AD-18-01 with their professional tax advisors and ensure that their operating structures have the intended tax consequences they desire.

Administrative Challenges of the New Policy

How Can You Determine an Applicable Charter Rate for a Prior Year?

One suggested approach is to call a charter operator and ask them what their charter rates were for a particular taxation year. This may not work very well as these rates are generally never published and it is unclear whether charter operators keep records of past charter rates. The other option is to determine what the 2018 charter rate is on your particular aircraft type for a particular route of flight (by obtaining three charter quotations) and then subtract the rate of inflation on a compounded basis to the required prior taxation year. This should provide a reasonable approximation of value in most circumstances.

Please let us know if you employ this method or any other method and whether or not it is accepted by the CRA.

How Do You Determine the Applicable Charter Rate for the Current Taxation Year?

One suggested approach is to call three charter aircraft operators in Canada and obtain three charter price quotations and retain those quotations in your files at the beginning of each taxation year. You might then use those amounts as the basis for your personal benefit valuations during the current taxation year.

Information Sessions

There are a number of technical issues contained within the communiqué that are not reviewed in this document, but will be discussed with you during one of the CBAA's forthcoming information sessions. We encourage all members to attend. More information on these sessions will follow. In the interim, we want to hear from you - please direct your questions to Rudy Toering – Interim President and CEO.

Jamieson Collins, Barrister and Solicitor - Jamieson Collins & Company

Rudy Toering, Interim President & CEO -Canadian Business Aviation Association