Taxpayer Non-Compliance with Input Tax Credit Rules: Data and Policy Options for Canada

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PRÉCIS

Les crédits de taxe sur les intrants (CTI) sont un mécanisme qui permet aux entreprises de récupérer la taxe sur les produits et services (TPS) et la taxe de vente harmonisée (TVH) payées sur les dépenses liées à leurs activités commerciales. De nombreuses entreprises présentent leurs demandes de CTI en conformité avec les règles, mais ce n’est de toute évidence pas le cas de toutes les entreprises. Dans le système canadien, le demandeur doit conserver les documents à l’appui de sa demande qui pourront être vérifiés pour déceler toute surestimation du droit aux CTI. En l’absence de vérification, les entreprises ne sont généralement pas tenues de fournir aux autorités fiscales les détails de leurs opérations.

Cet article s’appuie sur une étude de la jurisprudence relative à l’article 169 de la Loi sur la taxe d’accise sur une période de cinq ans, de 2014 à 2019. L’article 169 contient les principes généraux et les règles relatives à la demande de CTI. L’étude met en évidence diverses raisons de non-conformité au régime des CTI au Canada, tant intentionnelles qu’involontaires. Plusieurs thèmes sont récurrents : la prédominance des pratiques frauduleuses dans certains secteurs, la lourdeur des exigences relatives à la documentation et à la vérification, et la mauvaise compréhension par les contribuables des règles de demande des CTI, en raison des critères juridiques ambigus ou autrement compliqués. En particulier, les règles de fond concernant ce qui constitue une « activité commerciale » aux fins de la demande de CTI sont souvent mal appliquées ou mal comprises par les demandeurs. Les relations de mandataire non divulguées posent également des problèmes lorsqu’elles entraînent l’inscription du mauvais nom sur les documents présentés à l’appui d’une demande de CTI. Ces problèmes mettent en évidence certaines failles dans la mise en œuvre des règles du régime de la TPS/TVH au Canada.

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En réaction à des cas de fraude présumée, les autorités fiscales canadiennes ont imposé aux fournisseurs des exigences de vérification de plus en plus lourdes, qui doivent être satisfaites pour pouvoir demander un CTI, en particulier lorsque le fournisseur n’a pas versé la taxe applicable. Cela contribue au lourd fardeau d’observation des contribuables. Des changements qui réduiraient les problèmes liés aux relations de mandataire non divulguées ont été proposés, mais il reste encore des problèmes à régler relativement aux exigences de documentation et d’autres règles de fond s’appliquant à la demande des CTI.

L’article se termine par un examen des options de réforme proposées ou adoptées dans d’autres juridictions ayant une taxe à la valeur ajoutée. Il aborde également une mesure d’observation mise en œuvre au Québec (l’attestation de Revenu Québec), qui pourrait être appliquée dans d’autres provinces. Des recommandations particulières sont faites pour l’adoption de la facturation électronique et l’augmentation des exigences de déclaration pour s’attaquer à certaines des raisons de l’inobservation au Canada. Un certain nombre de pays ont entrepris de mettre en œuvre des exigences de déclaration périodique ou en temps quasi réel. Ces mesures sont prometteuses et font penser que le Canada pourrait également choisir cette voie.

**ABSTRACT**

Input tax credits (ITCs) are a mechanism for businesses to recover the goods and services tax (GST)/harmonized sales tax (HST) paid on expenses related to their commercial activities. While many businesses claim ITCs in accordance with the rules, instances of non-compliance are apparent. Canada uses an invoice credit system that relies on the claimant’s retention of documentation that can be checked to detect any overstatement of ITC entitlement. Absent an audit, businesses are generally not required to provide tax authorities with details of their transactions.

This article draws on a study of case law relating to section 169 of the Excise Tax Act over the five-year period 2014-2019. Section 169 contains the general principles and rules for claiming ITCs. The study highlights various reasons for non-compliance with the ITC system in Canada, both intentional and unintentional. There are several recurring themes: the prevalence of fraudulent practices in certain industries, burdensome documentation and verification requirements, and taxpayers’ misunderstanding of the rules for claiming ITCs, owing to ambiguous or otherwise complicated legal tests. In particular, the substantive rules concerning what constitutes a “commercial activity” for the purposes of claiming ITCs are often misapplied or misunderstood by claimants.

Undisclosed agency relationships also cause problems where they result in the wrong name appearing on the documentation supporting an ITC claim. These issues point to certain flaws in the implementation of the rules under the GST/HST regime in Canada.

In response to instances of suspected fraud, Canadian tax authorities have been results-driven in implementing increasingly onerous supplier verification requirements that must be met before an ITC is claimed, particularly where the supplier did not remit the applicable tax. This contributes to a high compliance burden for taxpayers. Some proposals have been made for changes that would mitigate the issues associated with undisclosed agency relationships, but there are still problems with the documentation requirements and other substantive rules for claiming ITCs that need to be addressed.

The article concludes with a review of reform options proposed or adopted in other jurisdictions with a value-added tax. It also discusses a compliance measure implemented in Quebec (the attestation de Revenu Québec), which could be applied in
other provinces. Specific recommendations are made for the adoption of e-invoicing and increased reporting requirements to address some of the reasons for non-compliance in Canada. A number of countries have moved toward implementing periodic or near-real-time reporting requirements. These measures show promise and suggest that Canada could move in that direction as well.

**KEYWORDS:** GOODS AND SERVICES TAX (GST) ▪ HARMONIZED SALES TAX (HST) ▪ INPUT TAX CREDIT (ITC) ▪ COMPLIANCE ▪ POLICY ▪ REFORMS

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NON-COMPLIANCE WITH CANADA’S INPUT TAX CREDIT SYSTEM

Input tax credits (ITCs) are a mechanism for businesses to recover the goods and services tax (GST)/harmonized sales tax (HST) paid on expenses related to their commercial activities. Canada uses an invoice credit system that requires an ITC claimant to retain documentation that can be checked to detect any overstatement of ITC entitlement. Absent an audit, businesses are generally not required to provide tax authorities with details of their transactions. One Canadian parliamentarian has described this system as an “order form for a government cheque.”

In 2003, the Standing Committee on Public Accounts noted that substantial revenues were being lost through fraud related to the GST. These losses were mostly associated with businesses making false claims for ITCs and receiving refund payments above their entitlement. The Canada Revenue Agency (CRA) attributed the overstatement of registrants’ ITC entitlement to misunderstanding of the tax rules, clerical errors, or deliberate fraudulent activity.

This article is based on a study of ITC case law over a five-year period (2014-2019), which sought to identify and explore key administrative and compliance issues relating to Canada’s ITC system. The study reveals a variety of reasons for non-compliance with the system, both intentional and unintentional. It shows that the documentation requirements to be met in order to claim ITCs impose a disproportionate compliance burden on smaller businesses, and that various forms of fraud are prevalent in a number of industries. The substantive rules concerning what constitutes a commercial activity for the purposes of claiming ITCs are also misapplied or misunderstood by registrants. These forms of non-compliance result in businesses overstating their entitlement to ITCs and overpayments of net tax refunds.

Canadian tax authorities have responded to instances of suspected fraud by increasing the number of audits and by trying to impose onerous supplier verification requirements on ITC claimants, particularly where the supplier fails to remit the collected GST/HST. Increased audit activity is often self-defeating unless the benefits gained from taxpayer reassessments offset the administrative burden of carrying out the audits. The tax authorities have not addressed the other reasons for non-compliance.

For the 2002 taxation year, the CRA received 2.6 million GST/HST refund claims from small and medium-sized businesses, on which it paid out refunds totalling

1 Canada, House of Commons, Debates, November 20, 2002, at 1656 (Bill Casey).
2 Canada, House of Commons, Standing Committee on Public Accounts, GST Fraud: Seventeenth Report of Standing Committee on Public Accounts (Ottawa: Standing Committee on Public Accounts, June 6, 2003).
3 Office of the Auditor General of Canada, 2004 Report of the Auditor General of Canada (Ottawa: Office of the Auditor General of Canada, March 2004), chapter 5, “Canada Revenue Agency—Audits of Small and Medium Enterprises,” at paragraph 5.4.
$29.8 billion. Only 41,600 (or 1.6 percent) of those claims were audited, but the CRA still found approximately $247 million in claims that overstated the registrant's entitlement to a GST/HST refund. The CRA did not estimate the potential overstatement in the remaining 98.4 percent of claims that were not audited. In 2014, the CRA completed 70,421 GST/HST audits with a total additional fiscal impact of more than $2.2 billion. Again, there was no estimate of the potential revenue cost of overstated ITC claims among those that were not audited. More recently, however, the CRA has begun to calculate the extent of the broader GST/HST “tax gap.”

Beginning in 2017, the CRA estimated the tax gap for the 2014 taxation year relating solely to the GST to be $2.9 billion, or 7.1 percent of the corresponding revenues, with the combined GST/HST tax gap estimated to be $4.9 billion. The tax gap measures non-compliance and is the result of a number of factors: deliberate choices not to pay tax; taxpayers making claims above their entitlement for refunds; the underground economy; mistakes; ignorance of filing, reporting, and payment obligations; and an inability to comply. Between 2011 and 2015, the CRA reported that the total average value of ITCs claimed was approximately $206 billion each year. While the amount specific to ITCs remains unknown, considerable tax revenue is at stake through the misuse of ITC claims, whether fraudulent or not.

The GST is a form of value-added tax (VAT), which is a type of tax that has been susceptible to fraud and evasion in many jurisdictions. While all VAT schemes are to some extent unique, many have similar components, such as an invoice credit and refund mechanism (like the system adopted in Canada). A comparison of Canada’s

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4 Ibid., at paragraph 5.41.
5 Ibid. This figure refers to audit adjustments and does not reflect adjustments that were reversed on appeal.
6 Canada Revenue Agency, Annual Report to Parliament 2014-2015 (Ottawa: CRA, 2015), at 57. “Fiscal impact” refers to tax assessed, tax refunds reduced, interest and penalties, and present value of future tax assessable arising from compliance actions.
7 The CRA defines the tax gap as “the difference between the taxes that would be paid if all obligations were fully met . . . and the tax actually paid and collected”: Canada Revenue Agency, Tax Gap in Canada: A Conceptual Study (Ottawa: CRA, June 2016), at 7.
8 Canada Revenue Agency, “Estimating and Analyzing the Tax Gap Related to the Goods and Services Tax/Harmonized Sales Tax” (www.canada.ca/en/revenue-agency/corporate/about-canada-revenue-agency-CRA/tax-canada-a-conceptual-study/estimating-analyzing.html). The analysis was conducted for the 15-year period from 2000 to 2014 to account for changes in Canadian tax policy.
9 Canada Revenue Agency, “GST/HST Statistics Tables (2012 to 2016 Calendar Years),” table 3 (www.canada.ca/en/revenue-agency/programs/about-canada-revenue-agency-CRA/income-statistics-gst-hst-statistics/gst-hst-statistics/gst-hst-statistics-tables-2012-2016-calendar-years.html).
10 See, for example, Michael Keen and Stephen Smith, “VAT Fraud and Evasion: What Do We Know and What Can Be Done?” (2006) 59:4 National Tax Journal 861-87 (http://dx.doi.org/10.17310/ntj.2006.4.07).
ITC system with the VAT in other jurisdictions highlights weaknesses in the invoice credit system itself as well as options for reform.

This article first sets out the conceptual and legislative background of the ITC system in Canada. It then describes the methodology for the study of ITC case law on which the article is based and reports the results of the study. As noted above, the study focused on the case law for the period 2014-2019. Those cases revealed a number of problems inherent in Canada’s GST/HST scheme, particularly with respect to the imposition of a duty of verification on claimants for ITCs. Aggressive audits in response to alleged or actual fraud, and concerns about registrants’ understanding of and ability to comply with the requirements for claiming ITCs, were also recurring themes. The article concludes with an analysis of reform options that have been proposed or implemented in other VAT jurisdictions.

This article adds to the existing scholarship on the ITC system in two ways: first, to my knowledge, it is the only study of Canadian ITC case law to date;11 and second, it looks to other VAT jurisdictions as a potential source of reform options that could be adopted in Canada. Drawing on case law and international scholarship, the article highlights the reasons for non-compliance in Canada’s ITC system and makes some moderate recommendations for reform.

BACKGROUND ON THE GST AND HST
Canada’s federal government imposes a 5 percent GST on taxable supplies of goods and services. In provinces where HST applies (“participating provinces”), the tax rate includes an additional component reflecting the applicable provincial retail sales tax rate. The GST is considered to be a VAT because it is imposed on the value added to a good or service at each stage of production and distribution.12 The GST/HST is also a consumption sales tax, meaning that the tax is charged on the exchange or sale of goods and services, and is imposed on the party purchasing the good or service. Although the incidence of the tax (the burden of payment) is borne by the purchaser, the obligation to collect and remit the collected tax falls on the seller.

Conceptual Underpinnings of the GST/HST
In broad terms, as an instrument of fiscal policy, general consumption taxes on goods and services have certain advantages over personal and corporate income taxes because they tend not to change taxpayers’ behaviour. The conceptual underpinnings

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11 Prior studies have examined certain aspects of GST/HST evasion and the associated increase in administrative and compliance burdens in Canada. See, for example, Bahro A. Behran and Glenn P. Jenkins, “The High Costs of Controlling GST and VAT Evasion” (2005) 53:3 Canadian Tax Journal 720-36. My study represents a new approach, analyzing these issues through a review of the case law.

12 Peter W. Hogg, Constitutional Law of Canada, 5th ed. (Toronto: Thomson Reuters) (looseleaf), at 31-13.
of the GST/HST also represent an attempt to make the tax system fairer, more progressive, and more advantageous to businesses.

A GST/HST rate increase has been shown not to significantly change Canadian consumption patterns.\textsuperscript{13} The tax is unavoidable for consumers in that it applies to a vast range of goods and services. Specific consumption taxes on goods such as tobacco and alcohol (sometimes referred to as sin taxes) may also be viewed as unavoidable, but the reason is that the demand for these goods is inelastic.

**The Invoice Credit Method**

A key element of Canada’s GST is the use of an invoice credit mechanism. Each supplier of a good or service charges the tax at the rate specified for each supply and provides documentation to the purchaser showing the amount of tax charged, generally in the form of an invoice or receipt. The purchaser can credit that input tax against the output tax that it charges on its sales, remit the balance to the tax authorities, and receive a refund for any excess ITCs. The invoice credit method continues throughout the supply chain until the final sale. On the final sale, the applicable GST/HST is collected, and the consumer cannot claim a corresponding ITC for the amount of tax paid.

The invoice credit method is designed to discourage fraud, in that the invoices provided by the suppliers can be checked to detect any overstatement of ITC entitlement, by connecting the tax credit claimed on the purchaser’s inputs to the tax actually paid by the purchaser. This is partly why the documentation requirements for entitlement to ITCs are strictly enforced in Canada.

Canada’s invoice credit method is also described as self-enforcing: suppliers are, in theory, unable to evade tax on sales because purchasers will want evidence that the tax has been paid so that they can claim ITCs.\textsuperscript{14} This rationale applies to sales to registrants that can claim ITCs. On final sales to consumers where a claim for ITCs is not available, this rationale is likely inapplicable.

ITCs are critical to the functioning of the GST in Canada because they prevent cascading tax, or “tax on tax.” Cascading tax occurs when something is taxed at each stage of production and the price includes the tax charged at the previous stage, with the final consumer bearing the burden of the multiple taxes. This makes the GST a better alternative than its predecessor, the manufacturer’s sales tax (MST). Because the MST failed to prevent cascading tax, it raised business costs and thereby hindered the ability of Canada’s domestic exporters to compete in world markets.\textsuperscript{15}

\textsuperscript{13} See Ergete Ferede and Bev Dahlby, “The Costliest Tax of All: Raising Revenue Through Corporate Tax Hikes Can Be Counter-Productive for the Provinces” (2016) 9:11 SPP Research Papers [University of Calgary School of Public Policy] 1-27.

\textsuperscript{14} Behran and Jenkins, supra note 11, at 721.

\textsuperscript{15} Canada, Department of Finance, 1991 Budget, Budget Plan, February 26, 1991, at 142.
The conceptual underpinnings of the GST are reinforced by the provisions of the Excise Tax Act (ETA)\textsuperscript{16} outlining its operation. Several of these provisions set out the requirements that must be met in order for the claimant to be entitled to ITCs.

**Legislative Scheme of the GST/HST**

Canada’s GST regime is relatively complex, with many exemptions and “special cases.”\textsuperscript{17} A registrant that purchases goods or services that are consumed, used, or supplied in the course of a commercial activity (a taxable supply) may recover the GST/HST paid or payable by claiming ITCs. Every recipient of a taxable supply made in Canada is liable to pay the GST.\textsuperscript{18}

A “recipient” of a supply of goods or a service is the person who is liable to pay the consideration in the transaction.\textsuperscript{19} A “supply” occurs when a good or service is provided in any manner, including by “sale, transfer, barter, exchange license, rental, lease, gift or disposition.”\textsuperscript{20} As indicated above, a “taxable supply” is a supply made in the course of a commercial activity.\textsuperscript{21}

The ETA requires every “person”\textsuperscript{22} who makes a taxable supply in the course of a commercial activity to be registered for the GST/HST unless the person is a small supplier, makes a supply of real property outside the normal course of business, or is a non-resident that does not carry on business in Canada.\textsuperscript{23}

GST/HST is imposed on most supplies of goods and services that are either made or deemed to be made in Canada. No GST/HST is imposed on two categories of supplies, referred to as “exempt” or “zero-rated.” The main distinction between zero-rated supplies and exempt supplies relates to the availability of ITCs. No GST/HST is charged or collected on zero-rated or exempt supplies, but a person is entitled to recover the GST/HST incurred to make zero-rated supplies through a claim for ITCs. No ITCs are available in respect of exempt supplies.

Once registered, a registrant will complete and file a GST/HST return\textsuperscript{24} to claim ITCs in respect of tax paid on eligible inputs. The return is filed monthly, quarterly,

\textsuperscript{16} RSC 1985, c. E-15, as amended. Unless otherwise stated, statutory references in this article are to the ETA.

\textsuperscript{17} See, for example, sections 171-194.

\textsuperscript{18} Subsection 165(1).

\textsuperscript{19} Subsection 123(1), the definition of “recipient.”

\textsuperscript{20} Subsection 123(1), the definition of “supply.”

\textsuperscript{21} Subsection 123(1), the definition of “taxable supply.”

\textsuperscript{22} As defined in subsection 2(1), “person” means an individual, partnership, corporation, trust, estate, or a body that is a society, union, club, association, commission, or other organization of any kind whatever.

\textsuperscript{23} Subsection 240(1).

\textsuperscript{24} Canada Customs and Revenue Agency form GST-62, “Goods and Services Tax/Harmonized Sales Tax (GST/HST) Return (Non-Personalized).”
or annually, depending on the registrant’s GST/HST filing period. Basically, to claim ITCs, the registrant calculates the GST/HST collected or collectible on total sales for the period and subtracts the GST/HST paid on inputs. If the GST/HST paid exceeds the GST/HST collected or collectible, the registrant claims a refund of the difference; otherwise, the registrant must remit any balance of tax owing. In the absence of an audit, businesses are not required to submit documentation to support their ITC claim to the tax authority.

The general rule for claiming ITCs is contained in section 169. In essence, where a person acquires property or a service and that person is a registrant, the registrant can claim an ITC to the extent that it acquired or imported the property or service for consumption, use, or supply in the course of its commercial activities. A claimant must apportion its inputs between commercial and non-commercial uses. Additionally, a claim for an ITC must be reasonable.25

The Quebec Sales Tax (QST)

Effective in 2011, Quebec harmonized its sales tax (QST) with the GST but retained its separate legislation.26 For the most part, the QST provisions parallel the GST provisions in the ETA.

Revenu Québec (RQ) administers both the QST and the GST in Quebec; however, appeals relating to RQ assessments of GST are made to the federal courts (in the first instance, the Tax Court of Canada), while appeals relating to assessments of QST are made to Quebec’s provincial courts. Commonly, the parties agree to proceed initially with the Tax Court appeal and leave the Quebec appeal on hold, although an appellant can decide to proceed with both concurrently. An appeal of a Tax Court decision is heard before the Federal Court of Appeal, while an appeal of a Court of Quebec decision is heard before the Quebec Court of Appeal.

Once a decision has been rendered by either court, on an issue related to the GST or the QST as the case may be, an appeal to the other court on the same facts and issues with respect to the other tax will be dismissed as an abuse of process or on the basis of the doctrine of judicial comity.27 For example, in Construction SYL Tremblay inc. c. Agence du revenu du Québec, 2018 QCCA 552, the Quebec Court of Appeal refused to hear a QST appeal dealing with an issue that had been resolved in the Tax Court with respect to the GST, basing its decision on the doctrine of abuse of process.

25 Section 170.

26 See Department of Finance, Memorandum of Agreement Regarding Sales Tax Harmonization with a View to Concluding a Canada-Quebec Comprehensive Integrated Tax Coordination Agreement, signed on September 29, 2011. See also Jung Ah Kwon, Michael Tsao, and Simon Thang, “QST Harmonization” (2011) 1:3 Canadian Tax Focus 9.

27 Houda International Inc v. The Queen, 2010 TCC 622; and Congiu v. Canada, 2014 FCA 73; leave to appeal to the Supreme Court of Canada dismissed September 4, 2014.

28 Construction SYL Tremblay inc. c. Agence du revenu du Québec, 2018 QCCA 552.
Small Suppliers—Voluntary Registration for the GST

For the purposes of Canada’s GST, a small supplier is a person with business revenues in the prior year below a specified minimum threshold of $30,000, or $50,000 if the person is a public service body.29

Small suppliers are not required to register for the GST but may do so voluntarily. The rationale for this policy is that the administrative and compliance costs of mandatory registration would be too burdensome for many small suppliers. The forgone tax revenue is also perceived as being low.30

Voluntary registration for the GST may provide some benefits for small suppliers, although it means taking on filing and remittance obligations. Compliance with the GST/HST reporting and remittance requirements has been one of the top irritants for small businesses.31 A study of the VAT in the United Kingdom found that small suppliers were more likely to register voluntarily where they (1) purchased a high proportion of their inputs from VAT-registered suppliers; and/or (2) sold mostly to VAT-registered customers; and/or (3) operated in a competitive industry.32

In the Canadian context, a study by Satterthwaite surveyed 100 small suppliers based in Ontario to determine why a small-business owner might choose to register for the GST.33 Satterthwaite found that voluntary registration likely stems from a business’s relationships with customers that are themselves registered for the GST rather than from the potential monetary incentives created by the availability of ITCs.34

As discussed below, my study of the ITC case law indicates that 31 percent of all cases heard under the informal procedure (which was more likely to be used by smaller businesses) involved insufficient documentation to support an ITC claim. Small businesses may lack the resources to maintain proper record-keeping practices and follow up with suppliers where inadequate information to support an ITC claim was

29 Subsection 148(1).
30 Emily A. Satterthwaite, “ELECTING INTO A VALUE-ADDED TAX: EVIDENCE FROM ONTARIO MICROENTREPRENEURS” (2018) 66:4 Canadian Tax Journal 761–807, at 764–65.
31 Marvin Cruz, Nina Gormanns, Laura Jones, and Queenie Wong, Canada’s Red Tape Report 2015, 4th ed. (Toronto: Canadian Federation of Independent Business, 2015), at 4.
32 Li Liu, Ben Lockwood, Miguel Almunia, and Eddy H.F. Tam, VAT Notches, Voluntary Registration, and Bunching: Theory and UK Evidence, International Monetary Fund Working Paper no. 19/205 (Washington, DC: IMF, September 2019), at 38. The United Kingdom has a VAT registration threshold of £85,000 (approximately Cdn $144,000). The rationale for item (1) in the text above is that when input costs are significant, registration allows the business to offset those costs by claiming ITCs. The rationale for (2) is that if most customers are VAT-registered, the burden of an increase in VAT can be passed on in the form of higher prices because the ability to claim ITCs allows the customer to recover the cost of the increase.
33 Satterthwaite, supra note 30.
34 Ibid., at 804. Satterthwaite suggests, ibid., at 772, that “[t]he potential payoffs to expanding the business’s customer base or making it more attractive to future customers by registering voluntarily were sufficiently compelling to justify shouldering the added compliance burden.”
provided. Any difficulty in complying with the documentation requirements is compounded by the reverse onus in ITC cases, which allows the Crown to assume that the registrant lacks the required documentation and is not entitled to the claimed ITCs unless the registrant proves otherwise.

**METHODOLOGY FOR THIS STUDY**

This article reviews a study of case law relating to ITCs over the five-year period 2014-2019—specifically, cases that cited section 169, which sets out the general principles and rules for claiming and calculating ITCs. The study is restricted to cases in which the entitlement to ITCs was the main issue. Trial and appellate decisions are treated as one case.

With respect to cases in which the underlying matter arose in Quebec, many of the decisions are available in both French and English. Where both English and French versions are available, the French version has been excluded to avoid double-counting.

On the basis of the study criteria, a total of 59 cases were included. In reviewing these cases, the goal was to identify and analyze the themes and issues as they relate to the Canadian ITC system and to similar concerns arising in other VAT jurisdictions.

**RESEARCH FINDINGS**

The study identified four main themes within the set of cases selected for review. As will be seen, some of these themes are representative of intricacies within Canada's legislation and others are representative of issues faced by all VAT-collecting jurisdictions. The four main themes are:

1. entitlement or agency;
2. commercial activities, reasonable expectation of profit (REOP), and apportionment;
3. inadequate documentation; and
4. alleged or actual fraud cases.

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35 The cases were identified by a search of the Taxnet Pro, Tax Court of Canada, Federal Court of Appeal, and CanLII databases for all decisions that cited section 169 or any of subsections 169(1) through (5), and that were released between January 1, 2014 and December 31, 2019. A focus on section 169 precludes cases involving the CRA's attempts to collect GST/HST that was not remitted. Those cases do not deal explicitly with ITC issues. Several cases discussed later in the article involved situations where the supplier failed to remit collected tax and the tax authority denied the claim for ITCs in an attempt to recoup its loss. These cases were included in the study because they dealt with issues for ITC claimants.

36 The reviewed cases are available at https://www.ctf.ca/CTFWEB/Documents/CTJ%202020/Issue%20203/Kessler%20Non-Compliance%20with%20ITC%20Rules%20Data%20Spreadsheet.xlsx.
These themes exemplify the various reasons for non-compliance with the ITC rules in Canada, whether intentional or not. The inadequate documentation and commercial activities cases often involved unintentional non-compliance; that is, the ITC claimant either misunderstood or misapplied the rules. The themes also highlight the substantive rules whose interpretation and application often lead to disputes, suggesting that taxpayers find those rules ambiguous or otherwise difficult to comply with.

This study does not claim to be representative of all instances of non-compliance with the Canadian ITC rules; some types of non-compliance may be more or less common in the sample of cases reviewed in this study, compared to all GST/HST returns filed in Canada. Rather, this study seeks to understand the underlying actions of taxpayers and the reasons for non-compliance with the ITC rules. Further research using different research tools, such as randomized control trials and a top-down approach, should be considered to determine the full extent of the problem.

The entitlement or agency cases dealt with the question of who was entitled to claim the ITCs in question and whether those claims were reasonable. Generally, the cases considered whether the claimant or an agent of the claimant acquired the supply and whether GST/HST was payable or paid by the claimant in question.

The commercial activities, REOP, and apportionment cases all relate to the application of the definition of “commercial activity” in the ETA.37 (For simplicity, in the discussion that follows, this subset of cases may be referred to collectively under the label “commercial activities.”) To claim an ITC, the registrant must have acquired a property or service for consumption, use, or supply in the course of its commercial activity.38 The amount of the claim is generally based on the extent of the use of the property or service for such purpose. The ETA provides simplification rules to make this determination easier.39 As well, the definition of “commercial activity” requires an individual, a personal trust, or a partnership (all of the members of which are individuals) acquiring the supply to have a “reasonable expectation of profit.”40 The apportionment cases were included within this theme because they dealt, in essence, with what percentage of the registrant’s supplies were taxable supplies, which—as noted above—are defined as supplies made in the course of a commercial activity.

The inadequate documentation cases dealt with situations in which ITCs were denied owing to the registrant’s failure to provide supporting documentation as required by the ETA and the GST/HST regulations.41

37 The definition of “commercial activity” is found in subsection 123(1).
38 Subsection 169(1).
39 Sections 141 and 199.
40 Subsection 123(1), paragraphs (a) and (b) of the definition of “commercial activity.”
41 Input Tax Credit Information (GST/HST) Regulations, SOR/91-45, as amended (herein referred to as “the GST/HST regulations”).
In the alleged or actual fraud cases, the courts addressed allegations by the tax authorities that the taxpayer in question engaged in a fraudulent scheme to claim ITCs.

Of the 59 cases reviewed,

- 15 (25 percent) fell within the entitlement or agency theme;
- 21 (36 percent) fell within the commercial activities theme;
- 14 (24 percent) fell within the inadequate documentation theme; and
- 9 (15 percent) fell within the alleged or actual fraud theme.

This distribution by theme is illustrated in figure 1.

Among the 59 cases surveyed, 36 (61 percent) were heard under the informal procedure, and 23 (39 percent) were heard under the general procedure (figure 2). For GST/HST issues to be heard under the informal procedure, the person must elect into the procedure and the total amount in dispute must be less than $50,000.42 The informal procedure has less formal rules of evidence and procedure compared to the rules for the general procedure, and is intended to make the process more streamlined for self-represented litigants. The litigants in 17 (47 percent) of the 36 informal procedure cases were self-represented. None of the cases heard under the general procedure in this study involved self-represented litigants.

As shown in table 1, of the 36 informal procedure cases, 11 dealt with the claimant having inadequate documentation. Fifteen cases involved the tax authority’s allegation that the claimant’s supplies were not acquired for consumption, use, or supply in a commercial activity or that the claimant had no REOP. Eight cases dealt with issues of entitlement or agency, and only 2 involved allegations of fraud.

Among the 23 general procedure cases, the distribution by theme was more even, with 6 dealing with whether the claimant was engaged in a commercial activity and 7 dealing with issues of entitlement or agency. There was also an uptick in the number of alleged or actual fraud cases: 7 were heard under the general procedure, suggesting that instances of suspected fraud generally involved sums above $50,000. Only 3 cases dealt with inadequate documentation, suggesting that entities with amounts in dispute over $50,000 likely understood the documentation requirements or had better record-keeping practices than the litigants using the informal procedure. The disparate impact of the documentation requirements is discussed in a later section of this article.

Table 2 shows the amount of ITCs at issue under each hearing procedure. In total, approximately $38.2 million in ITCs was at issue in the 59 cases in the study sample. For the 23 general procedure cases, the total amount at issue was $37.6 million, or an average of $1.6 million per case. In contrast, in the 36 informal procedure cases, $0.061 million was at issue, or an average of $0.017 million per case. The general procedure cases accounted for 98 percent of the overall amount at issue.

42 Tax Court of Canada Act, RSC 1985, c. T-2, as amended, section 18.3001(c).
Within the specific themes, the total dollar amounts at issue are wide-ranging. As shown in figure 3, the 15 entitlement or agency cases involved approximately $7.1 million, or 18 percent of the total ITCs at issue. The 21 commercial activities cases involved approximately $29.1 million, or 76 percent of the total ITCs at issue. Large amounts were evidently at stake in the apportionment cases and cases dealing with the commercial activities of public or quasi-public bodies.\footnote{For example, in Sun Life Assurance Company of Canada v. The Queen, 2015 TCC 37, an insurance business claimed ITCs of approximately $1.28 million. In British Columbia Ferry Services Inc v. The Queen, 2014 TCC 305, the issue was apportionment between ferry services that are exempt under the ETA, schedule V, part VIII, section 1, and other taxable sales on board the ferries, such as retail sales; approximately $4.05 million in ITCs was at issue.} Stewardship Ontario,\footnote{Stewardship Ontario v. The Queen, 2018 TCC 59.} the case with the largest amount of ITCs at issue, dealt with the question of whether a non-profit organization that acted under a statutory arrangement to recycle goods used the goods and services in the course of its commercial activities.
The Tax Court allowed some $17.96 million in claimed input tax credits (ITCs) in that case. If Stewardship Ontario is removed from the data above, the total dollar amount at issue in the general procedure cases is approximately $19.6 million and the average dollar amount at issue in those cases is $0.891 million.

The 9 alleged or actual fraud cases involved only $1.7 million, or 5 percent of the total amount of ITCs at issue. The amount that the Canadian government was actually defrauded of during the study period could be significantly higher, owing to instances of non-compliance that went undetected, were in the process of being audited, or had not yet been resolved by the courts. In addition, as stated above, the study was limited to cases that cited section 169. Instances of ITC fraud also exist in cases that cite other provisions of the ETA, especially the administration and enforcement provisions.

The documentation cases dealt with the smallest amounts. The 14 documentation cases involved ITCs totalling about $0.29 million, or 0.75 percent of the total for all cases. Twenty-four percent of the total number of cases and 31 percent of the cases heard under the informal procedure involved issues with documentation. These findings suggest that the documentation requirements for claiming ITCs impose a disproportionate burden on smaller businesses.

Many of the cases dealt with numerous themes. Notably, documentation is generally at issue in an ITC case because of its status as a mandatory requirement. The

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45 See, for example, Cherniak v. The Queen, 2015 TCC 53, a director’s liability case under subsection 323(1), involving an alleged “carousel scheme” and some $6 million in fraudulent ITC claims. (Carousel schemes are discussed in a later section of this article.)
survey of cases by theme that follows provides further insight into the recurring problems within the ITC system.

**Entitlement or Agency Cases**

For taxable supplies over $150, which require the highest level of documentation to claim an ITC, the documentation must include

1. the name of the recipient, the recipient’s agent, or the name that the recipient does business under; and
2. the name of the supplier, the supplier’s intermediary, or the name that the supplier does business under.

Where this information is missing, the claim for ITCs will be denied. Similarly, ITCs have been denied where the name on the supporting documentation is not that of the party that actually received or made the supply. As discussed below, in cases involving a duty of verification, a purchaser must show both that the name on the invoice belongs to a supplier or the supplier’s intermediary and, if applicable, that the intermediary was acting on behalf of the supplier. In the subset of cases involving entitlement and agency, the court was asked to determine whether the party claiming the ITCs was acting as the agent of the party that acquired the supply, whether the ITC claimant was the party that acquired the supply, or whether the GST/HST was payable or paid by the claimant. Some cases also involved provisions of the ETA other than section 169 that restricted the claimant’s entitlement to ITCs.

**The Agency Test (the iPhone Exportation Cases)**

For the purposes of the ETA, a principal is entitled to claim ITCs in respect of supplies purchased by its agents on its behalf.46 Following the decision in *Merchant*

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46 See *Lobas Farm Inc. v. The Queen*, 2019 TCC 197, at paragraph 61.
Law Group, and in light of the CRA’s policy statement P-182R, checklist tests are used to determine whether an agency relationship exists. The existence of an agency relationship generally requires that

1. both the principal and the agent consent to the relationship;
2. the principal grants authority to the agent allowing the agent to affect the principal’s legal position; and
3. the principal controls the agent’s actions.

Conflicting decisions have been reached in cases where ITCs were claimed by companies whose alleged agents purchased Apple iPhones for resale on the grey market. Apple Inc. has rules that apply when new products are released, to protect against such practices. Two cases involved companies enlisting the owners’ friends, family, and acquaintances to make individual purchases of the most recent model of the iPhone through various retail stores in Canada. This was done to circumvent Apple’s resale rules. The phones were then resold in an overseas market where the new model had not been released. In both cases, the company exported the phones but did not collect GST/HST on the sales because exported goods are zero-rated (taxable at 0 percent). However, under the ETA, generally a business can claim ITCs in respect of a supply of such goods.

In 2253787 Ontario, a case heard under the informal procedure, the Tax Court of Canada found the contract of sale to be void, on the basis that Apple’s rules prohibited bulk purchases for resale or export, limiting purchases by any individual to a maximum of two per day at any retail store. The agents could not affect the principal’s legal position in that case, but the court should have considered that tax still applied to the transactions that actually took place, regardless of whether those transactions were illegal or violated the parties’ contractual obligations. In the court’s

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47 Canada v. Merchant Law Group, 2010 FCA 206.
48 GST/HST Policy Statement P-182R, “Agency,” June 23, 1995, revised July 2003.
49 See Club Intrawest v. The Queen, 2016 TCC 149, at paragraph 78 (citing Royal Securities Corp Ltd. v. Montreal Trust Co, 1966 CanLII 173 (ON SC), at paragraph 55); rev’d 2017 FCA 151.
50 The “grey market” refers to the trade of a product through channels that are not authorized by the original manufacturer. A grey market is created when multinational corporations sell their products into markets that are perceived to be lucrative and proprietary in advance of selling those products into markets that are perceived to “cutthroat” and less proprietary. See 2253787 Ontario Inc. v. The Queen, 2014 TCC 121, at paragraphs 1 and 2.
51 Ibid.
52 See, for example, Brizzi v. The Queen, 2007 TCC 226 (dealing with illegal income, forfeiture, and loss deductibility); Canada (National Revenue) v. Sifto Canada Corp., 2014 FCA 140 (addressing the issues of legality, morality, and taxation); and Demers v. The Queen, 2014 TCC 368 (involving the taxability of funds from a Ponzi scheme).
view, the non-disclosure of the alleged agency arrangement meant that it did not exist, despite case law establishing the opposite. The claim for ITCs was denied.

In Lohas Farm, a case heard under the general procedure, the Tax Court found that the rules merely stated that Apple could refuse or cancel a person’s order if it suspected that the purchases were made for resale. Accordingly, the contract in that case was voidable, but not void. The court therefore held that the agents could affect the principal’s legal position, even though Apple did not know that they were Lohas’s authorized agents. The claimant in Lohas also benefited from much stronger supporting documentation, compared to the claimant in 2253787 Ontario.

Some remedies have been proposed to deal with agency issues. In cases where no agency relationship is found, the Tax Court has held that the alleged agent holds collected GST in bare trust for its principal, entitling the principal to ITCs.

As discussed below, Quebec has also introduced requirements to disclose nominee agreements.

**Mandatory Disclosure of Nominee Agreements in Quebec**

Quebec has introduced new measures requiring the mandatory disclosure of nominee or agency agreements to address tax authorities’ concerns around the use of “prête-noms,” or nominees, in transactions. Under these new measures, there is a prescribed form that must be filed whenever an agent consents to act on behalf of an undisclosed principal under a nominee agreement, thereby giving the appearance that the agent is acting in its own name.

The form is required to be filed with RQ no later than 90 days after the date on which the nominee agreement was concluded, or by September 16, 2019 if the agreement was concluded prior to May 17, 2019 and the tax consequences of the transaction to which the agreement relates continue after that date. The parties to the agreement, a description of the transaction or series of transactions to which the agreement relates, and the identity of any person or entity for which the transactions have tax consequences must be disclosed.

Parties to a nominee agreement who fail to file the prescribed form within the specified time are jointly liable for a penalty of $1,000 and an additional penalty of $100 per day, up to a maximum of $5,000, beginning on the second day of the omission. Non-disclosure of the agency agreement results in the suspension of the normal reassessment period for the taxation years in which the taxpayers fail to comply with the disclosure obligations.

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53 Lussier v. The Queen, 2000 CanLII 517 (TCC).
54 See Lohas Farm, supra note 46.
55 See, for example, Edmonton (Town) v. The Queen, 2015 TCC 172.
56 Quebec, Finances Québec, Information Bulletin 2019-5 “Measures Designed To Protect the Integrity and Fairness of Québec’s Tax System,” May 17, 2019, at 4-5 (www.finances.gouv.qc.ca/documents/bulletins/en/BULEN_2019-5-a-b.pdf).
Undisclosed agency relationships are of particular concern where the tax authority denies a claim for ITCs because the name of the “true supplier” (the person that actually provided the goods or services) is not on the supporting documentation. As discussed below, the case law requires that the supplier named on the invoice actually supplied the goods or services in order for an ITC claim to be accepted. If an intermediary is used, the purchaser may have to show that the intermediary was acting on behalf of the supplier, a requirement that is easier to satisfy in Quebec as a result of the mandatory disclosure of nominee agreements.

Commercial Activity, REOP, and Apportionment Cases
The commercial activities subset of cases dealt with whether the goods or services for which ITCs were claimed (the taxable supplies) were consumed, used, or supplied in the course of the claimant’s commercial activities; whether a REOP existed; or whether the taxable and non-taxable supplies were apportioned properly. These cases involved taxpayers claiming ITC amounts above their entitlement owing to a misapplication of the rules.

Misunderstanding of What Constitutes Commercial Activities
As discussed above, to claim an ITC in respect of a supply, a person must have acquired the supply for consumption, use, or supply in the course of its commercial activity. The ETA defines “commercial activity” to mean a business carried on by a person, or an adventure or concern of the person in the nature of trade, other than one carried on without a reasonable expectation of profit by an individual, a personal trust, or a partnership (all of the members of which are individuals). A supply of real property also constitutes a commercial activity.

In 9124-0515 Québec, ITCs claimed for the tax paid on the purchase of a Winnebago were denied because the vehicle was not used in a commercial activity. The Tax Court was skeptical of the alleged commercial use of the Winnebago, noting that at least 70 percent of its use was personal. That use included a 4-week personal trip and a 9-week family trip across Canada. The Winnebago was also parked in Florida for 10 weeks so that the family of the director of the company could use it during the winter. The court denied the claimed ITCs.

In Gutbucket, a business claimed ITCs for the utility expenses on two condominiums where rare books were stored. The company’s sole shareholder, a lawyer, had his claim for ITCs denied. In the absence of evidence of an intent to sell the books, the Tax Court held that the storage of the books was not a “business” as defined in subsection 123(1) of the ETA and therefore was not a commercial activity, although the shareholder insisted that he planned to sell the books eventually.

57 Subsection 169(1).
58 Subsection 123(1), the definition of “commercial activity.”
59 9124-0515 Québec Inc. v. The Queen, 2016 TCC 208.
60 Gutbucket Inc. v. The Queen, 2015 TCC 156.
Gutbucket is also an example of a self-represented litigant who was unable to provide a credible defence of his position because he did not fully understand the ITC scheme. The appellant did not provide any documentation to support his claim that the properties were used for commercial activities and stated in his notice of appeal that the CRA “was not entitled to this information.” Clearly, the appellant was unaware of the requirements for claiming an ITC. Moreover, he admitted to the court that he was unfamiliar with tax litigation, even though he was a practising lawyer.

Gutbucket shows that, in the broad context of GST/HST appeals, even litigants with a legal education may have difficulties navigating the intricacies of the scheme of the ETA when they represent themselves before the Tax Court, including those who elect to use the informal procedure. This is concerning, given that when the informal procedure was introduced in 1991, the intention was to provide better access to justice for self-represented taxpayers.

A study by Gallant published in 2005 reported that 32 percent of all appeals filed in the Tax Court of Canada in 2004 involved self-represented litigants. My study indicates that 17 (47 percent) of the cases heard under the informal procedure, representing 29 percent of the 59 cases included in the study, involved self-represented litigants. Of the 17 cases involving self-represented litigants, 15 (88 percent) related to either inadequate documentation or the commercial activities of the ITC claimant. Only 1 (6 percent) of the 17 self-represented litigants in this study was successful. For the purposes of this study, a litigant was successful if more than one-half of the ITC claim at issue was allowed. Given that small businesses are more likely to choose to defend their claim under the informal procedure, this low success rate suggests that some small businesses find it difficult to comply with the documentation requirements or to determine whether they are engaged in a commercial activity. In the income tax context, Campbell has noted that there is a “cost trap” that likely constitutes a significant disincentive to the pursuit of income tax appeals beyond the stage of filing an objection to a CRA assessment. According to Campbell, few taxpayers in informal procedure appeals are represented by lawyers; as a result, their opportunity for a fully effective review may be diminished, and an additional burden may be placed on judges if they find it necessary to assist those appellants in presenting their case.

The cases discussed above suggest that at least some taxpayers lack a clear understanding of the GST/HST scheme, including what constitutes a commercial activity.

61 Ibid., at paragraph 7.
62 Ibid., at paragraph 9.
63 André Gallant, “The Tax Court’s Informal Procedure and Self-Represented Litigants: Problems and Solutions” (2005) 53:2 Canadian Tax Journal 333-66, at 340.
64 Ibid., at 336.
65 Colin Campbell, “Access to Justice in Income Tax Appeals” (January 2012) 63 University of New Brunswick Law Journal 445-58, at 454-55.
66 Ibid., at 455.
Other taxpayers may be better informed and may intentionally file claims above their entitlement in the hope that they will not be audited. In the cases reviewed, ITCs were also consistently denied where the CRA suspected that the business did not have a REOP, as discussed below.

The Application of a REOP Test Following the Stewart Decision

As discussed above, the definition of “commercial activity” in subsection 123(1) of the ETA explicitly requires certain individuals, a personal trust, or a partnership, all of the members of which are individuals, to have a “reasonable expectation of profit.” The application of a REOP test in the context of the Income Tax Act (ITA) was partially overturned by the Supreme Court of Canada in the Stewart case. That decision is relevant to the application of the test in the GST/HST context.

The Supreme Court in Stewart held that there is no statutory foundation for the application of a REOP test under the ITA where the nature of the activity undertaken by the taxpayer is clearly commercial. The REOP test is still applicable where the facts suggest that the taxpayer’s venture is a hobby or personal pursuit. Specifically, in such cases, the existence of a REOP is one factor to be considered in determining whether the venture was undertaken in a sufficiently commercial manner to qualify as a business.

In Stewart, the Supreme Court constrained the use of the REOP test in the income tax context because, in the court’s view, it had been applied too broadly—both to distinguish between commercial and personal activities, and to retrospectively challenge the business judgment of taxpayers, in order to deny losses incurred in legitimate but unsuccessful commercial ventures. That approach resulted in uncertainty and unfairness in the application of the test.

Following Stewart, in income tax cases an expense is still deductible in computing the income of a taxpayer from a business or property if it was incurred for the purpose of gaining or producing income from the business or property and is not otherwise statute-barred. Although the statutory REOP test remains, the concerns expressed in Stewart are reflected in the GST/HST cases applying a similar test.

The REOP issue arises in the GST/HST context when a registrant’s ITC claims consistently exceed the amount of tax collected, meaning that the registrant is purchasing more than it is selling and likely reporting losses each year. The resulting net tax refund is often denied on the ground that the individual had no REOP and

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67 RSC 1985, c. 1 (5th Supp.), as amended.
68 Stewart v. Canada, 2002 SCC 46.
69 Ibid., at paragraphs 2 to 4.
70 See ITA subsections 18(1) and 20(1).
71 This rationale does not apply to a business that supplies zero-rated goods since such a business will always be in a refund position.
thus no commercial activity. The CRA considers various factors in determining whether a REOP exists, including the following:72

- the profitability of the business in past years;
- the length of time over which a profit could reasonably be expected;
- the extent of the activity of the business, compared to businesses of a similar nature and size in the same locality;
- the claimant’s education, experience, and training; and
- whether the person has a business plan or has conducted market research.

In *Living Friends Tree Farm*,73 the Tax Court dealt with whether a partnership whose tree-farming business plans had been affected by ongoing litigation had a REOP. In 2009, the appellants purchased 160 acres of land and began construction of a barn and a house. Tradespeople were hired, but serious deficiencies were discovered in the course of an inspection, which resulted in the appellants suing the contractors. The construction was not completed until 2014, and no sales from the tree-farming business were reported in the intervening years. The CRA denied the claim for ITCs during the startup period in 2009 because it appeared that the business plans had been postponed and there was no REOP.

The Tax Court accepted that the initial startup phase of a tree farm would be longer than that of other commercial enterprises because of the length of time that it would take for the trees to reach maturity. However, the court was critical of the lack of clear steps in establishing a future business plan for the tree farm.

As Sherman has noted in his editorial comment on the case,74 the court used after-the-fact evidence about the business to deny the claims for 2009. In effect, the court determined whether the business had a REOP in 2009 on the basis of what happened in subsequent years. As discussed above, in rejecting a REOP test for income tax purposes in *Stewart*, the Supreme Court found the test to be unfair because it seemed to encourage a retrospective assessment of the business judgment of taxpayers in order to deny losses incurred in bona fide but unsuccessful commercial ventures.75 The same issues with respect to the application of a REOP test are clearly evident in both the income tax and the GST/HST contexts.

**Apportionment Cases**

GST/HST is imposed on almost all supplies of property and services that are either made or deemed to be made in Canada except exempt or zero-rated supplies. As

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72 Canada Revenue Agency, *GST/HST Audit and Examination Manual 2016-01*, chapter 44, at section 44.1.4 (available on Taxnet Pro).

73 *Living Friends Tree Farm v. The Queen*, 2016 TCC 116.

74 See David Sherman’s editorial comment on *Living Friends Tree Farm* case (available on Taxnet Pro).

75 *Stewart*, supra note 68, at paragraph 4.
noted above, the main distinction between zero-rated supplies and exempt supplies relates to the availability of ITCs.

Zero-rated supplies are taxable at a rate of 0 percent, and generally the supplier is entitled to recover the GST/HST incurred to make those supplies through a claim for ITCs. Zero-rating reduces the price of a good because tax is not added to it. Essential goods, such as groceries and prescription drugs, are typically zero-rated to ensure access to them by persons at all income levels.

Exempt supplies (which include financial, educational, child-care, and health-care services) are exempt from GST/HST; therefore, a seller of such services cannot claim ITCs in respect of supplies purchased and used in carrying on the business. Goods or services are exempted from a VAT when it is hard to define the value added by the service, or for policy reasons. Similar to zero-rated goods, exempt services, such as education, health care, and child care, serve a public good. Exemption from GST/HST means that they can be priced lower and remain accessible, although some writers have argued that financial services should be taxable, similar to models adopted by other countries.\textsuperscript{76}

Businesses (other than financial institutions) that provide a mix of taxable and exempt supplies must use the allocation rules in subsection 141.01(5) to determine the appropriate amount of ITCs to claim. The method chosen by the taxpayer must be a fair and reasonable way of determining which inputs were used in making taxable or exempt supplies.

For ITC apportionment purposes, where a combination of supplies (taxable, exempt, and/or zero-rated) is made, the claimant must determine whether the supplies are part of a “single supply.” As the Tax Court explained in \textit{Hurd Dentistry},\textsuperscript{77} the single supply doctrine asks whether the alleged separate supply is an integral part of the overall supply, such that it cannot be separated and still retain value. If the components of the supply are so interconnected that they cannot realistically be separated, they will be considered to be integral to a single whole rather than separate parts.\textsuperscript{78}

In \textit{Hurd Dentistry} and other allocation cases reviewed in this study, the single supply doctrine was used to determine that orthodontists provide only exempt services, not zero-rated orthodontic appliances, such as braces. The orthodontic appliances and adjustment services were determined not to be useful items on their own, since neither service alone could provide the required corrective treatment. Both the appliance and the adjustment services had to be combined in order

\textsuperscript{76} See, for example, Pierre-Pascal Gendron, “Policy Forum: Canada’s GST and Financial Services—Where Are We Now and Where Could We Be?” (2016) 64:2 Canadian Tax Journal 401-16. Gendron suggests, ibid., at 415, that Canada should adopt the South African model, which taxes all fee-based financial services and all property and casualty insurance, and exempts only margin-based services and term insurance.

\textsuperscript{77} \textit{Dr. Brian Hurd Dentistry Professional Corporation v. The Queen}, 2017 TCC 142.

\textsuperscript{78} Ibid., at paragraphs 16 and 17.
to benefit the patient; therefore, they constituted a single supply of “orthodontic treatment.” The single supply of orthodontic treatment was determined to be an exempt supply.

Other surveyed cases dealt simply with whether the apportionment method chosen by the taxpayer was “reasonable.” Several of these apportionment cases involved disputed amounts in the millions of dollars, with both sides using complex apportionment methods. Where the CRA has lost in previous cases, one response has been to ask the Department of Finance to introduce legislation that provides more consistent, and possibly more favourable, outcomes. For example, legislation was created to provide a consistent apportionment method for financial institutions.

The commercial activities cases represent a multitude of considerations that taxpayers must bear in mind prior to making a claim for ITCs. The strictly enforced documentation requirements are another consideration for ITC claimants.

**Inadequate Documentation Cases**

The documentation requirements to claim an ITC are mandatory, must be met before a claim for ITCs can be made, and are strictly enforced. Notwithstanding that the documentation has to be obtained before a claim for ITCs can be made, the documents do not have to be submitted to the tax authority unless the business is audited.

While some claimants simply lack the required documentation, issues also arise where the name on the invoice or the GST/HST registration number does not match the supplier. These discrepancies can occur where an undisclosed agent or intermediary acts for the supplier.

Before filing a return in which an ITC is claimed, a registrant must obtain sufficient information to enable the amount of the ITC to be determined. The information to be included is prescribed in the GST/HST regulations. For supplies over $150, which require the highest level of documentation, the requirements include the following:

- the name of the supplier or the supplier’s intermediary;
- the date of the invoice or, where no invoice is issued, the date on which tax was paid or payable;

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79 Ibid., at paragraph 21.
80 See, for example, *University of Calgary v. The Queen*, 2015 TCC 321; and *Sun Life Assurance*, supra note 43.
81 See *Jobs and Economic Growth Act*, SC 2010, c. 12, under “Input Tax Credit Allocation Methods (GST/HST) Regulations.”
82 *Davis v. The Queen*, 2004 TCC 662.
83 *Systematix Technology Consultants Inc. v. The Queen*, 2006 TCC 277, at paragraph 10.
84 Subsection 169(4).
85 GST/HST regulations, supra note 41, section 3(c).
the total amount paid or payable;
- the supplier’s or the intermediary’s GST/HST registration number;
- terms of payment;
- a brief description of each property or service sufficient to identify it;
- the name or trading name of the recipient of the supply or the recipient’s agent; and
- an indication of the status of each supply where the invoice includes both taxable and exempt supplies.

The required information does not have to be in the form of an invoice, nor does it have to be contained in a single document.\(^86\) If the information is contained in different documents, the ITCs will be allowed provided that the amounts reported can be reconciled with the claimed amount.\(^87\)

Some documentation cases involved the failure of the registrant to collect the required information. In *George*,\(^88\) the registrant operated a buffet restaurant and provided no documentation to support the claimed ITCs on her first tax return. This was likely because she did not keep proper records or did not believe that she had to. Before trial, she was able to adduce some invoices, and the CRA conceded the ITCs to the extent that the invoices supported them. Otherwise, claims for ITCs are generally denied where there is missing information.

In *Tan*,\(^89\) the registrant provided documentation that did not include the suppliers’ GST registration numbers. The registrant argued that the CRA knew the registration numbers and should have looked for them to fix the problem. The Tax Court rejected that argument and denied the ITC claim, noting that although the CRA is the entity that issues and records GST registration numbers, it is not responsible for tracking down the numbers of a registrant’s suppliers if the registrant fails to provide them.\(^90\) The court held this was too onerous a burden for those charged with administering the ETA.\(^91\)

In *THD Inc.*,\(^92\) a trucking company provided documentation that included invalid GST registration numbers for the company’s suppliers. When the CRA initially denied the ITC claim, the company requested and obtained new invoices, which also contained invalid registration numbers, and the ITCs were denied again. The Tax Court noted that before giving the CRA’s auditor and the court the new series of invoices, the appellant should have checked the GST/HST registry to ensure that the numbers

\(^86\) *McDavid v. The Queen*, 2014 TCC 112, at paragraph 27.

\(^87\) Ibid., at paragraphs 33–36.

\(^88\) *George v. The Queen*, 2014 TCC 19.

\(^89\) *Tan v. The Queen*, 2015 TCC 121.

\(^90\) Ibid., at paragraph 20.

\(^91\) Ibid.

\(^92\) *THD Inc. v. The Queen*, 2018 TCC 147.
were valid. This imposed a “duty of verification” on the claimant—a duty that was first asserted in *Salaison Lévesque*, discussed below.

Arguably, any duty to verify a supplier’s information that is imposed on a taxpayer should be constrained. Such a duty is overly burdensome if it extends beyond verifying the supplier’s GST/HST registration number. A requirement to verify the identity of a supplier to ensure that the name on the invoice is the name of the entity that provided the service in question appears to go too far, unless a comparatively easy verification system or clear verification guidelines are implemented.

Attempts by the tax authority to require an ITC claimant to ensure that a supplier is remitting the applicable tax also go too far, and essentially ask the taxpayer to perform the tax authority’s job. The case law has largely concluded that taxpayers are not required to monitor their suppliers, despite repeated attempts by tax authorities to impose various supplier verification requirements.

In *Salaison Lévesque*, a company with operations in Quebec had contracted with temporary help agencies to provide it with personnel to work in its meat processing plants during peak times. Four of these agencies disappeared without remitting the GST and QST that they had collected from Salaison. Before paying any agency, Salaison checked to make sure that the agency was registered under the GST/QST number shown. In denying Salaison’s claim for ITCs, RQ argued that the company had not taken adequate steps to verify the legitimacy of the suppliers prior to making a claim for ITCs. The verification steps that RQ proposed included the following:

- going to the supplier’s head office to see if there were actual commercial activities;
- paying attention to the handwriting on the invoices to try to detect differences between invoices from the same business;
- verifying that the invoices from the same business followed a numerical sequence;
- verifying whether the business had vehicles registered with the applicable vehicle registry;
- asking all of the agencies’ employees who came to work for the company to provide identification and their social insurance numbers; and
- obtaining compliance letters to ensure that the hours worked by the agencies’ employees were reported.

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93 Ibid., at paragraph 58.
94 Canada Revenue Agency, “Confirming a GST/HST Account Number” (www.canada.ca/en/revenue-agency/services/e-services/e-services-businesses/confirming-a-gst-hst-account-number.html#h1).
95 *Salaison Lévesque*, infra note 96.
96 *Salaison Lévesque Inc v. The Queen*, 2014 TCC 36; aff’d in part 2014 FCA 296.
97 Ibid. (TCC), at paragraph 72.
The Tax Court found that, in trying to impose the above verification steps, RQ would like Salaison to do the tax authority’s own work.98 RQ’s limited resources were apparently a consideration for the tax authority: one of the auditors who had acted on the Salaison file testified that “businesses that deal with employment agencies have more resources and powers than [RQ] to ensure that agencies are complying with the [ETA] and its Regulations.”99 With respect, the auditor’s position does not seem realistic.

The Tax Court ultimately held that the proposed verification requirements were too burdensome, but did accept that taxpayers should at least verify that the GST/HST numbers of their suppliers are valid by searching the GST/HST or QST registry.100 The ITCs were allowed in this case, confirming that taxpayers should not be required to police their suppliers’ GST/HST/QST remittances.

Following Salaison Lévesque, in Papier Reiss101 the Tax Court summarized the following principles regarding the duty of verification:

- The name of the true supplier or its intermediary, or the name under which the true supplier or intermediary does business, must appear on the supporting documentation submitted in respect of the ITC claim.102
- Registrants must have valid GST/HST registration numbers for their suppliers.103
- Registrants should implement appropriate risk management procedures; a registrant’s payment of GST “in good faith” is irrelevant.104

The court then expanded the requirements of the duty of verification to include105

- verification of the supplier’s tax registration online through the GST/HST or QST registry;
- an inquiry to the applicable provincial or federal government business registry; and
- verification of the supplier’s identity.

The court did not detail how a business should verify a supplier’s identity; however, it appears to have adopted RQ’s requirements that a purchaser should contact the

98 Ibid., at paragraph 73.
99 Ibid.
100 Ibid., at paragraphs 89-92.
101 Les Ventes et Façonnage du Papier Reiss Inc v. The Queen, 2016 TCC 289.
102 Ibid., at paragraph 189, citing Kosma-Kare Canada inc. v. Canada, 2014 FCA 225, at paragraph 7.
103 Papier Reiss, supra note 101, at paragraph 191, citing Systematix Technology Consultants Inc. v. Canada, 2007 FCA 226, at paragraph 4.
104 Papier Reiss, supra note 101, at paragraph 193, citing Comtronic Computer Inc. v. The Queen, 2010 TCC 55, at paragraph 29.
105 Papier Reiss, supra note 101, at paragraph 218.
applicable business registry to determine the business status of the supplier and to confirm the names of the supplier’s directors and officers. The business would then presumably cross-check the directors’ identity as provided by the applicable business registry against the names of the directors of the entity that the business had engaged to provide the goods or services.

The Quebec Court of Appeal has also stated in obiter that a registrant has a duty of verification that arises implicitly from the strict ITC eligibility requirements. None of the so-called requirements set out by RQ and by the Tax Court in Papier Reiss are explicitly stated in the ETA, the GST/HST regulations, or the equivalent Quebec legislation.

The high-water mark for documentation requirements may be found in Pro-Poseurs, in which ITCs claimed by a drywall installation company were denied. The Tax Court held that an invoice for construction services must state precisely where and when the work was done, including the specific floor or office in a building with multiple floors, and what kind of work was done.

Ironically, RQ has also denied the ITCs of prudent businesses that undertook steps to verify their suppliers. In SNF LP, the claimant was engaged in the business of recycling metals that it purchased from various sellers. SNF LP verified the GST registration numbers of all its suppliers and obtained photo identification, addresses, and telephone numbers to ensure that the suppliers were who they said they were. RQ denied the ITC claim on the basis that the suppliers in question did not have the resources to make the actual supplies and that the names of the suppliers on the invoices were not the names of the true suppliers, but were prête-noms (undisclosed agents) for the actual suppliers. RQ took issue with 12 out of the hundreds of suppliers that SNF LP transacted with, arguing that several of those suppliers did not have a scrapyard, trucks, or a sufficient number of employees to make the supplies. RQ took the position that a prête-nom was not an “intermediary” as defined in regulation 2 of the GST/HST regulations. Accordingly, in RQ’s view, the requirements to claim an ITC were not met because the name of the supplier or the supplier’s intermediary did not appear on the supporting documentation. Although SNF LP requested RQ’s help in identifying false suppliers and offered to remit the GST and QST directly to RQ, RQ did not take SNF LP up on this offer—likely because there is no legislative authority for a purchaser to remit tax payable directly to the tax agency rather than to the supplier.

In SNF LP, the Tax Court was firm in stating that a business with “hundreds, if not thousands, of suppliers” should not be expected “to make exhaustive inquiries

106 Ibid., at paragraph 28. RQ argued that the appellant should have attempted these measures.
107 Agence du revenu du Québec c. Système intérieur GPBR inc., 2015 QCCA 1402, at paragraphs 44-52.
108 Les Pro-Poseurs Inc. v. The Queen, 2011 TCC 113; aff’d 2012 FCA 200.
109 Ibid. (TCC), at paragraph 47. The Federal Court of Appeal did not address this point.
110 SNF LP v. The Queen, 2016 TCC 12.
of each potential supplier.”111 The court also noted that any obligation to verify the information provided by suppliers has no statutory basis in the ETA or elsewhere.112 Moreover, neither the ETA nor the GST/HST regulations set out the procedure to be followed in verifying suppliers’ information, although the court did suggest that a registrant is not required to make inquiries each time it makes a purchase. Rather, in the court’s view, a business should make inquiries prior to making its first purchase from a supplier. The court did state that a registrant must make inquiries when it suspects that its supplier is engaged in illegal, dishonest, disreputable, or corrupt business practices.113 A failure to make such inquiries means that the registrant purchases supplies at its own risk and may have its claim for ITCs denied. This suggests that if a registrant has actual or persuasive evidence of disreputable practices on the part of its supplier, the registrant must make reasonable inquiries to ensure that the supplier named on the supporting documentation (or the supplier’s intermediary) actually provided the supply. Otherwise, the claimed ITCs will be denied. With respect, the court’s statement on this point goes too far, particularly in circumstances where genuine goods or services are exchanged, and enforcing such a requirement would have far-reaching implications. Ultimately, the claim for ITCs in SNF LP was allowed because the business had taken “reasonable precautions” in verifying its suppliers.114

The duty of verification is an attempt by the tax authorities to indirectly ease their own administrative burden by having registrants ensure that their suppliers remit the applicable tax. As discussed further below, fraud is a real and recurring issue, but increasing the taxpayer’s compliance burden has the potential to harm businesses, particularly smaller enterprises, and is an inappropriate response. Rather than requiring purchasers to verify their suppliers, the tax authorities should more stringently scrutinize applicants for GST registration.

The case law has constrained a duty of verification to requiring the use of GST/HST registry searches and requiring that purchasers ensure that the invoices submitted to them by their suppliers actually originate from those who supply the services. Where the supplier uses an intermediary, the ITC claimant may need to show that the alleged intermediary acted on behalf of the supplier. In some cases, where the name on the supporting documentation does not appear to be that of the true supplier and the ITC claims are denied, the tax authorities allege that the registrant and the supplier are engaged in a fraudulent “invoice-of-convenience” scheme to manufacture ITCs. (Such schemes are discussed in the next section.)

Supplier verification can be important in refuting allegations of fraud by the tax authorities. One response has been Quebec’s creation of the attestation de Revenu Québec (also discussed below). The attestation verifies that businesses in certain

111 Ibid., at paragraph 82.
112 Ibid., at paragraph 78.
113 Ibid.
114 Ibid., at paragraph 81.
industries are compliant with Quebec’s tax laws, thereby signalling to other businesses that they are less likely to be fraudulent suppliers.

Alleged or Actual Fraud Cases

The issue of GST fraud in Canada has been recognized since the inception of the GST in 1991. As early as 1993, there was evidence of an increase in the underground economy and the purposeful evasion of the GST.\footnote{115}{Peter S. Spiro, “Evidence of a Post-GST Increase in the Underground Economy” (1993) 41:2 Canadian Tax Journal 247-58, at 256.}

The invoice credit method for ITC claims can result in unfairness to purchasers that have paid GST/HST in good faith, since it leaves the purchaser to bear the risk of any fraud committed by a supplier. As evidenced by the duty-of-verification cases, Canadian businesses are effectively required to adopt risk management procedures in order to verify each of their suppliers or take the chance of having their ITC claims denied. These enhanced verification norms inherently place a greater burden on businesses with many suppliers.

In response to media accounts of GST fraud, two reports were commissioned by the auditor general of Canada to review the CRA’s capacity to detect and deter GST errors, fraud, and abuse. The first report, completed in 1999, concluded that the CRA’s post-payment audits consume too many staff hours and that audit performance could be improved by “better selection of registrants for audit.”\footnote{116}{Office of the Auditor General of Canada, Report of the Auditor General of Canada to the House of Commons (Ottawa: Office of the Auditor General of Canada, September 1999), chapter 16, “Revenue Canada—Goods and Services Tax: Returns Processing and Audit,” at paragraph 16.4.}

The followup report in 2001 noted that “satisfactory” progress had been made in these areas.\footnote{117}{Office of the Auditor General of Canada, Report of the Auditor General of Canada to the House of Commons, Other Observations and Appendices (Ottawa: Office of the Auditor General of Canada, 2001), chapter 12, “Follow-Up of Recommendations in Previous Reports,” at paragraph 12.301.}

Two common forms of GST/HST fraud are situations where a registrant overstates the amount of GST/HST that it paid in an attempt to receive a larger refund, or where a supplier fails to remit the collected tax.

Tax authorities have been increasingly results-driven in trying to recover unremitted amounts by denying ITC claims. RQ has been particularly aggressive in denying ITCs and, as discussed further below, has been reprimanded in this regard by the Quebec ombudsman. Enforcement activities should not make the tax regime more difficult to administer, or shift the burden for compliance from dishonest to honest taxpayers. The danger is that overzealous enforcement will create an unfair tax system.

Certain types of fraud also exploit differing tax rates or the zero-rating of certain supplies. For example, goods purchased in provinces where HST applies (at rates ranging from 13 percent to 15 percent) may be resold in provinces where only GST
applies (at the rate of 5 percent). A fraudulent claimant could create false invoices and make a claim for ITCs based on the difference in the tax rates, thereby increasing the amount claimed by 8 percent to 10 percent. The business would also be in a refund position, and may be able to sustain the scheme for some time before being audited. Similarly, as discussed earlier in this article, no tax is collectible on zero-rated supplies, but a business making such supplies can still claim ITCs. Zero-rated export sales and the sale of refined gold have been abused in this manner.

A recent news story may best exemplify the extent of fraudulent claims for ITCs. In 2019, four members of a Nova Scotia family who owned multiple businesses were charged with 10 counts of fraud. They were accused of filing fraudulent GST/HST returns claiming ITCs that totalled more than $3.6 million, including one claim for $117,850 purportedly for services provided by a company named Vandalee Industries (an apparent play on the name of a fictional company featured in an episode of the *Seinfeld* television series).118

In Canada, and particularly in Quebec, other fraud cases have involved “missing traders” or allegations by the tax authorities that claimants were engaged in fraudulent invoice-of-convenience schemes. More sophisticated forms of fraud, such as carousel schemes (which are prevalent in the international community) and gold bullion schemes, also appear in the case law.

**The Problem of Missing Traders and Invoices of Convenience in Certain Industries**

A missing trader is simply a supplier that does not remit the collected GST/HST. This type of fraud can be particularly troubling for the tax authorities because they may lose the value of the GST/HST twice—first when the tax is not remitted, and a second time if a claim for ITCs is paid out. The innocent parties in these situations (the recipients of the goods or services) often have their claimed ITCs denied as the tax authority tries to recoup some of its loss.119 RQ has been particularly aggressive in this regard, notably in its attempt to impose more stringent duty-of-verification requirements in support of ITC claims.

In cases where a supplier does not remit the collected GST/HST, Canadian tax authorities often assert that the ITC claimant is participating in an invoice-of-convenience or invoice-of-accommodation scheme. This type of scheme involves an arrangement between a purchaser and a supplier whereby the supplier issues invoices to evidence a fictitious supply in order to manufacture ITCs.120 In effect, the supplier “accommodates” the purchaser’s demand for ITCs. Where an audit shows

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118 Richard Cuthbertson, “The $3.6M Fraud Case That Seems Right Out of a Seinfeld Episode,” *CBC*, March 1, 2019 (www.cbc.ca/news/canada/nova-scotia/cape-breton-cra-fraud-case-1.5032725).

119 See *Salaison Lévesque*, supra note 96; *Kosma-Kare*, supra note 102; *Pépinière A. Massé Inc. v. The Queen*, 2014 TCC 271; *SNF LP*, supra note 110; and *Syscomax Inc. v. The Queen*, 2014 TCC 202.

120 *Pro-Poseurs*, supra note 108 (FCA), at paragraph 3.
that no actual goods or services were supplied, the ITCs will be denied because the claimant did not “acquire” property or a service as required under subsection 169(1).

As the duty-of-verification cases make clear, the tax authority may allege that the person issuing the invoice is not the “true supplier,” but rather is an accommodation party. The case law now requires the purchasing to verify the supplier’s GST/HST/QST registration number and to confirm that the supplier named on the invoice was the entity that supplied the goods or services at issue. If an intermediary is used, the purchaser must show that the intermediary acted for the supplier.

Quebec encounters alleged invoice-of-convenience schemes primarily in relation to contractors in the construction industry and employment agencies. In Syscomax, ITCs claimed on payments to construction subcontractors purported to have been supplied by a company called TFX were denied because there was no evidence that anyone from TFX had worked on the site. The documentation examined in this case included the records of Quebec government inspections. The owner of TFX had also been convicted of providing false invoices to other companies. While the Tax Court upheld the denial of the ITCs, it found no evidence that Syscomax had participated in an accommodation invoice scheme as alleged by RQ.

In the employment agency context, ITCs are denied where there are suspicious circumstances in the arrangements, suggesting that no services were actually provided. These circumstances include the calculation of billings by the recipient of the services rather than the agency, and a reported hourly rate that was too low for the agency to have been able to pay the employees the legal minimum wage and still cover operating expenses.

In some situations, the invoice shows a valid GST/HST registration number, which the purchaser has verified using the GST/HST registry, but the tax authority argues that the number on the invoice is not the registration number of the true supplier. These situations are particularly troubling because they may involve ITC claimants that are innocent and not acting in concert with the supplier, but that nevertheless have their ITC claims denied.

In cases where actual goods or services are supplied but the invoices show the name and GST/HST registration number of an entity that does not appear to have the resources to provide the goods or services, that entity may be an intermediary of the true supplier under the GST/HST regulations. ITCs may be allowed if the invoices show the intermediary’s name and GST/HST registration number. However, if actual goods or services are supplied but the supplier provides a false GST/HST registration number, the ITC claim will be denied because the true supplier’s name and registration number are not shown on the documentation, as required by the GST/HST regulations.

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121 Syscomax, supra note 119.
122 Ibid., at paragraphs 1 and 23-28.
123 See Pépinière, supra note 119; Kosma-Kare, supra note 102; and Salaison Lévesque, supra note 96.
124 Salaison Lévesque, supra note 96 (TCC), at paragraph 44.
125 Ibid.
As discussed earlier, in Salaison Lévesque, RQ denied ITCs on payments to four employment agencies that had disappeared without remitting their GST and QST. ITCs were allowed for payments to other agencies that did remit the applicable taxes. RQ was results-driven in this approach. When it was unable to get the tax remittances from the agencies, it tried to get the tax from Salaison.

RQ’s attempt to expand the duty of verification in respect of suppliers’ information aimed in part to ensure that delinquent suppliers would remit the collected tax. In 2014, the Quebec ombudsman spoke out against this approach, noting that “[b]y requiring businesses to check whether subcontractors have fulfilled their tax obligations, Revenu Québec imposes a task that is not prescribed by law and that is practically impossible for businesses that subcontract to carry out.”

The Quebec ombudsman has also been critical of RQ’s auditing methods in these situations, noting that audit officials assume from the outset that the business is guilty and refuse to take into account documents or explanations that the business in question provides. These practices violate several basic taxpayer rights as well as principles of procedural fairness, and preclude a complete defence. The remittance of tax collected by the supplier should not be a prerequisite to an ITC claim, especially where the claimant is innocent of the fraud and actual goods or services are provided.

In 2010, the Quebec government introduced a new measure to combat fraudulent activities in certain industries. The attestation de Revenu Québec certifies that a person or business met the following conditions on the date of its application for the attestation:

- It had filed the returns and reports required under Quebec tax laws.
- It did not have any overdue account with Quebec’s minister of revenue in respect of a tax law or, if it did, it had reached and abided by a payment agreement, or the collection of its debts had been legally suspended.

An attestation de Revenu Québec is valid from the time of issue until the end of the third month following the month in which it is issued. A business can sign up for automatic renewal of the attestation if the business holds at least one valid attestation at the time the request is made. However, a person applying to use the automatic renewal service on behalf of a business must have a general power of attorney with respect to the business. Presumably, each automatic renewal is vetted by the tax authorities to ensure that the business has remained compliant.

126 Quebec, Ombudsman, 2013-2014 Annual Report (Quebec: Le Protecteur du Citoyen, September 2014), at 29.
127 Ibid.
128 Ibid., at 30.
129 Revenu Québec, “Contracts Requiring an Attestation de Revenu Québec” (www.revenuquebec.ca/en/attestation-de-revenu-quebec/contracts-requiring-an-attestation).
An attestation de Revenu Québec is required before a person or business can bid on or enter into certain construction contracts, public contracts, and contracts or arrangements with temporary help agencies and placement services. Where a supplier has applied for and received an attestation, a potential purchaser is reassured, to some degree, that the supplier is compliant with the tax laws and is less likely to engage in fraudulent practices.

While the attestation is currently limited to the construction and temporary help industries, it could be extended to other problem areas. For example, in the scrap metal industry, invoices of convenience are being used in situations where there is no actual transfer of goods between a supplier and a purchaser.130

**Gold Scams**

Canada has had to deal with a particular form of GST/HST fraud in the gold-trading industry.131 Scrap gold is subject to sales taxes, while pure gold is zero-rated as a precious metal.132 Dealers buy scrap gold, refine it, sell the pure gold, and claim ITCs for the tax paid to their suppliers. This creates an opportunity for unscrupulous parties to take advantage of the zero-rating of precious metals by creating fake invoices to evidence transactions where scrap gold is purchased, refined, and sold, but where no gold actually changes hands. The zero-rating of the supply means that the party making the ITC claim is almost always in a refund position, and the scheme may go undetected for some time. Alternatively, the supplier of the scrap gold may collect the tax, sell the pure gold, and then not remit the collected taxes.

In 2011, RQ initiated a series of searches and seizures of companies in the Montreal area, alleging that companies in the gold-refining and -trading industry engaged in tax fraud on transactions worth $1.8 billion.133 Approximately 125 companies were allegedly complicit in the scheme, which defrauded the Canadian government of an estimated $350 million.134 One of Quebec’s most prominent gold-trading companies, Métaux Kitco, was reassessed for $85 million in ITCs and $227 million in QST input tax refunds.135 Ultimately, the company negotiated an

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130 For similar examples, see Papier Reiss, supra note 101; and SNF LP, supra note 110.

131 See CC Gold Inc. v. The Queen, 2018 TCC 155 (full trial pending); National Money Mart Company v. 24 Gold Group Ltd., 2018 ONCA 812; TricomCanada Inc. v. The Queen, 2016 TCC 8; and Métaux Kitco inc. (Arrangement relatif à), 2016 QCCS 444.

132 See subsection 123(1), the definition of “precious metal.”

133 “Press Release: Revenue Québec Gold Fraud Investigation,” Financial Post, June 10, 2011 (https://business.financialpost.com/uncategorized/press-release-revenue-quebec-gold-fraud-investigation); and Nicholas Van Praet, “Kitco Metals Among Gold Traders Facing Québec Tax Fraud Allegations,” Financial Post, December 9, 2013 (https://business.financialpost.com/commodities/mining/kitco-metals-among-gold-traders-facing-quebec-tax-fraud-allegations).

134 Ibid.

135 See Métaux Kitco, supra note 131, at paragraph 14.
agreement with the CRA and RQ allowing it to settle the tax debt with a payment of $81.7 million.\textsuperscript{136}

In another case, TricomCanada (“Tricom”) bought $20 million worth of gold during an eight-month period in 2012.\textsuperscript{137} Companies participating at earlier stages of the sales chain had disappeared without remitting GST and QST. Despite evidence that the gold purchases were real, the minister of national revenue alleged that Tricom had knowingly, or acting with wilful blindness, participated in a false-invoicing scheme. In the Tax Court’s view, two of the suppliers were suspect, because they were run by people living on welfare, and evidence suggested that Tricom actually knew what was going on both up and down the supply chain. The court found that the invoices were used to mask the identity of Tricom’s true suppliers and did not disclose the names of the suppliers as required under subsection 169(4). Accordingly, the court denied ITCs totalling $995,000, along with $2 million of QST input tax refunds. The court’s decision is consistent with the duty of verification imposed in \textit{Salaison Lévesque} and subsequent cases. Businesses in the gold-trading industry should be wary: future cases may involve innocent parties that have been duped in a complex scheme or that do not fully understand the potential consequences of their activities.

\textbf{Carousel Schemes}

A carousel scheme involves false commercial transactions and a lengthy paper trail intended to convince government agencies that a business is eligible for large tax refunds on export sales. The fraudster creates fictitious sales and transfers to accomplice companies. The goods continue to be sold through a series of controlled companies, each liable to pay the GST, before the goods are finally exported as sales of zero-rated supplies. The companies in the chain disappear without remitting the GST, and the final supplier claims a refund. This process can be repeated many times, resulting in the goods circulating in the same fashion as a carousel.\textsuperscript{138}

Media reports in 2017 revealed a carousel scheme based in the United Kingdom that involved filing claims for ITCs in Canada.\textsuperscript{139} Eleven individuals in the United

\begin{itemize}
\item \textsuperscript{136} Sylvain Larocque, “Revenu Québec conclut un accord secret avec un marchand d’or,” \textit{Le Journal de Montréal}, April 25, 2018 (www.journaldemontreal.com/2018/04/25/revenu-quebec-conclut-un-accord-secret-avec-un-marchand-dor).
\item \textsuperscript{137} \textit{TricomCanada}, supra note 131.
\item \textsuperscript{138} In the European Union, “intracommunity transactions” (that is, transactions between businesses in different EU member countries) are zero-rated. In that context, an example might involve, say, company A located in France, which sells goods to company B, located in Germany. No VAT is charged because the transaction is zero-rated. Company B sells to company C, which is also located in Germany. Company B does not remit the VAT charged on the transaction. Company C then sells the goods back to company A, allowing company C to claim a VAT refund on zero-rated exports.
\item \textsuperscript{139} Douglas Quan, “Massive U.K.-Based Scheme Aimed To Swindle $52M in Tax Refunds from Canadian Government,” \textit{National Post}, June 16, 2017 (https://nationalpost.com/news/canada/massive-u-k-based-scheme-aimed-to-swindle-52m-in-tax-refunds-from-canadian-government).
\end{itemize}
Kingdom set up 84 corporations in Canada and overseas. Those corporations then created long paper trails to give the appearance of a series of international transactions involving the trade of telecommunications time and electronic equipment. The scheme aimed to defraud the Canadian government of some $52 million but obtained only $4.7 million in ITCs before the CRA caught on.

Carousel schemes are rare in Canada; however, in the European Union, it is estimated that carousel schemes and missing-trader fraud could account for €40 billion to €60 billion of annual VAT revenue loss and that 2 percent of organized crime groups could be behind 80 percent of the fraud. These figures might even be understated. Carousel and other VAT fraud schemes are increasingly using intangible property, such as carbon credits, making such schemes harder to detect.

The European Union has spent considerable resources trying to limit the perpetration of VAT fraud by organized crime groups, reflecting concerns that the stolen funds are often used to finance illegal activities such as human trafficking and terrorism. Canada has encountered such VAT fraud on a much smaller scale. Lessons from countries with greater experience in addressing the problem can inform how Canada might respond to prevent it from becoming a larger issue.

**OPPORTUNITIES FOR TAX REFORM**

Opportunities to address non-compliance in the ITC system in Canada are numerous, but wholesale reform of the GST/HST will not be considered here, owing in part to the amount of revenue that the tax provides ($38.2 billion, or 11.5 percent of all federal revenues, in the 2018-19 taxation year). Studies show that raising provincial sales tax rates, while politically contentious, would result in more revenue

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140 For two recent cases, see Cherniak, supra note 45, and Iris Technologies Inc. v. Canada (National Revenue), 2020 FC 532 (involving an alleged carousel scheme that sought a refund of $62.3 million).

141 Marie Lamensch and Emanuele Ceci, “VAT Fraud: Economic Impact, Challenges and Policy Issues,” European Parliament Think Tank, October 10, 2018, at 18.

142 Marius-Cristian Frunza, “Cost of the MTIC VAT Fraud for European Union Members” (April 2014) (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2758566). Frunza estimated that missing-trader intracommunity fraud alone accounted for almost €94 billion in 2014 across the (then) 28 EU member states; ibid., at 20.

143 See, for example, Katherine Nield and Ricardo Pereira, “Fraud on the European Union Emissions Trading Scheme: Effects, Vulnerabilities and Regulatory Reform” (2011) 20:6 European Energy & Environmental Law Review 255-89.

144 See Marius-Cristian Frunza, “Aftermath of the VAT Fraud in Carbon Emissions Markets” (2013) 20:2 Journal of Financial Crime 222-36 (https://doi.org/10.1108/13590791311322382); and Fabrizio Borselli, Silvia Fedeli, and Luisa Giuriato, “Digital VAT Carousel Fraud: A New Boundary for Criminality” (2015) 77:8 Tax Notes International 707-24.

145 Canada, Department of Finance, Annual Financial Report of the Government of Canada 2018-2019 (Ottawa: Department of Finance, 2019).
compared to an increase in corporate income tax rates.\textsuperscript{146} Any increase in the GST/HST rate may increase the potential revenue loss from non-compliance.

Worldwide, 169 countries currently impose a VAT, including 35 of the 36 member countries of the Organisation for Economic Co-operation and Development (OECD).\textsuperscript{147} Among OECD member countries, VATs raise, on average, approximately one-fifth of total tax revenues.\textsuperscript{148} Other VAT jurisdictions are arguably more proactive than Canada in confronting VAT fraud because their tax mix means that more revenue is at stake. According to the OECD, on average, VATs account for 30.7 percent of the total tax revenues of the Group of Seven countries (excluding the United States), compared to 13.4 percent in Canada.\textsuperscript{149}

The International Monetary Fund (IMF) has encouraged Canada to change its tax mix and to specifically consider increasing its reliance on the GST.\textsuperscript{150} Recommendations to change Canada’s tax mix rely on foreign evidence, and one Canadian study has suggested that the alleged gains that may accrue from changing the tax mix are “overstated, controvertible, or non-existent.”\textsuperscript{151} A shift of the tax mix toward the GST/HST would also result in uncertain gains in tax compliance and no savings in tax administration.\textsuperscript{152} However, taking into account the impact of the COVID-19 pandemic, increasing the GST rate (even temporarily) may be viewed as an option to decrease the federal debt incurred in responding to the economic crisis.

The discussion in this section of the article first reviews the situation in other VAT jurisdictions and then analyzes options for reform that some countries have implemented.

\textbf{Comparison of Other VAT Jurisdictions with Canada}

Europol, the European Union’s law enforcement agency, estimated that the VAT gap totalled approximately €160 billion in 2014.\textsuperscript{153} As noted above, missing-trader

\begin{itemize}
  \item\textsuperscript{146} See Ferede and Dahlby, supra note 13, at 6 and 20.
  \item\textsuperscript{147} Organisation for Economic Co-operation and Development, \textit{Consumption Tax Trends 2018: VAT/GST and Excise Tax Rates, Trends and Policy Issues} (Paris: OECD, 2018), at 18 (https://doi.org/10.1787/ctt-2018-en). The exception is the United States.
  \item\textsuperscript{148} Ibid.
  \item\textsuperscript{149} Ibid., at 14.
  \item\textsuperscript{150} International Monetary Fund, \textit{Canada: Selected Issues}, IMF Country Report no. 18/222 (Washington, DC: IMF, June 2018), at 23 (www.imf.org/en/Publications/CR/Issues/2018/07/16/Canada-Selected-Issues-46085). The IMF estimated that in Canada, a loss of revenue of 1 percent of gross domestic product would be recouped by a 1.2 percent increase in the GST. See ibid., at 26.
  \item\textsuperscript{151} Jonathan Rhys Kesselman and Peter S. Spiro, “Challenges in Shifting Canadian Taxation Toward Consumption” (2014) 62:1 \textit{Canadian Tax Journal} 1-41, at 4.
  \item\textsuperscript{152} Ibid., at 28.
  \item\textsuperscript{153} European Union for Law Enforcement Cooperation, \textit{Europol Review 2016-2017} (The Hague, the Netherlands: Europol, 2017), at 58. This number includes losses attributable to fraud, bankruptcies, and financial insolvencies.
\end{itemize}
and carousel fraud could account for €40 billion to €60 billion of the annual VAT losses in the European Union, with other forms of unintentional and intentional non-compliance making up the remainder.

India, whose national GST came into effect on July 1, 2017, has already encountered a significant problem of non-compliance with its ITC system. In 2018–19, 1,620 cases of fake invoices were registered, involving fraudulent ITC claims of Rs112 billion (approximately Cdn$2 billion) under the GST. In the first six months of 2019, 535 cases of fake invoices were detected, involving fraudulent ITC claims totalling approximately Cdn$478 million.

ITC fraud in India has led to the introduction of strict supplier verification requirements, thereby delaying or denying refunds. An increase in verification requirements and auditing powers is a common response to ITC fraud. In Canada, this is exemplified by the duty-of-verification cases discussed above and recent commitments to crack down on tax evasion and tax avoidance, through audits and other enforcement measures.

Increasing the resources available to the CRA to address the problem of non-compliance is an approach that has been endorsed in recent federal budgets. Specifically, the federal budgets between 2015 and 2019 committed $1.4 billion to combatting tax evasion and aggressive tax avoidance, and to improve compliance. This money would be used to hire additional auditors and specialists, develop business intelligence infrastructure, increase verification activities, and improve the quality of investigative work that targets criminal tax evaders. There was no breakdown of how much of this $1.4 billion commitment was to be allocated to addressing non-compliance with the GST regime more broadly or the ITC rules specifically.

The international tax dialogue (ITD) (an initiative sponsored by the IMF, the OECD, and the World Bank, to facilitate discussion of tax matters among national tax

154 See, for example, Press Trust of India, “GST Officials Detect Tax Fraud of Rs 224 cr by 8 Companies,” Economic Times (India Times), March 13, 2019 (https://economictimes.indiatimes.com/news/economy/finance/gst-officials-detect-tax-fraud-of-rs-224-cr-by-8-companies/articleshow/68388173.cms?from=mdr).

155 Press Trust of India, “535 Cases of Fake Invoices Involving ITC Claims of Rs 2,565 cr Detected in Current Fiscal,” Economic Times (India Times), July 1, 2019 (https://economictimes.indiatimes.com/news/economy/policy/535-cases-of-fake-invoices-involving-itc-claims-of-rs-2565-cr-detected-in-current-fiscal/articleshow/70024791.cms).

156 Ibid.

157 Shantanu Nandan Sharma and Suman Layak, “GST: The Challenges Before India’s Largest Indirect Tax Reform,” Economic Times (India Times), September 29, 2019 (https://economictimes.indiatimes.com/news/economy/policy/gst-the-challenges-before-indias-largest-indirect-tax-reform/articleshow/71353710.cms).

158 See, for example, Canada, Department of Finance, 2016 Budget, Budget Plan, March 22, 2016, at 216. The 2016 budget committed $444.4 million over five years for the CRA to enhance its efforts to constrain tax evasion and tax avoidance.

159 See supra note 158.
officials and international organizations) has counselled national tax officials against using their audit powers to control evasion. Specifically, a paper prepared for the 2005 ITD conference on the VAT argued that “massive checking of refunds and invoices is self-defeating. The benefits of such a program are very unlikely to offset the considerable administrative and compliance costs they involve.” Since 2005, however, advancements in technology and the rise in the use of electronic invoicing (e-invoicing) mean that checking invoices is less administratively burdensome than it was at the time that those views were expressed.

The continued ratcheting up of the compliance requirements related to the existing Canadian ITC system will impose increasing costs on business. An imposed duty of verification and RQ’s increasingly aggressive audits have had the effect of adding to the compliance burden for both taxpayers and the tax authorities. Neither of these strategies is a suitable long-term solution to the problem of non-compliance with Canada’s ITC system. Alternatives must be sought, because a broad toolkit for combatting non-compliance is essential.

The CRA’s voluntary disclosure program (VDP) is one tool that promotes a broader compliance strategy in Canada and seeks to strike a balance between fairness to taxpayers and revenue generation. The VDP allows taxpayers to disclose previous omissions or errors in their tax reporting, in exchange for protection from criminal prosecution and civil penalties, and partial relief for accrued interest, provided that they satisfy the conditions in Information Circular IC00-1R4. The VDP can result in lower costs for the tax authorities than a traditional audit and are a strong tool for taxpayers faced with a tax liability for their non-compliance. International sources provide other tested measures that Canada could add to its toolkit for combatting non-compliance with the GST/HST and ITC rules.

Moderate Reform Options Based on Other VAT Jurisdictions

Discussions on reform options routinely begin with the suggestion that the tax code should be simplified as a starting point. As revealed by the data above, some non-compliance is the result of a failure to understand the requirements for claiming an ITC. At least one study has measured the complexity of the GST regime. It found that between the tax’s inception in 1993 and 2011, the number of court cases related to the GST had increased by 56 percent. Some of those cases likely involved

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160 “The Value Added Tax: Experiences and Issues,” paper prepared for the International Tax Dialogue Conference on the VAT, Rome, March 15–16, 2005, at 26.

161 Canada Revenue Agency, Offshore Compliance Advisory Committee, Report on the Voluntary Disclosures Program (Ottawa: CRA, 2016), at 2–4 (www.canada.ca/content/dam/CRA-arc/migration/CRA-arc/gncy/ocac-ccoe/rprt-eng.pdf).

162 Information Circular IC00-1R4, “Voluntary Disclosures Program,” March 21, 2014.

163 François Vaillancourt, Marylène Roy, and Charles Lammam, “Measuring Tax Complexity in Canada” (April 2015) Fraser Research Bulletin 1-10, at 7 (www.fraserinstitute.org/sites/default/files/measuring-tax-complexity-in-canada.pdf).
problems with ITC claims. Consideration of wholesale reform options for the GST is beyond the scope of this article, but the OECD has proposed several changes in VAT collection methods as more moderate reform options to combat fraud.

International tax authorities are implementing a variety of responses to VAT fraud and non-compliance. The OECD has classified these responses within three areas:

1. Changes in VAT collection methods, such as domestic reverse charges and split payments;
2. Reinforcement in taxpayer’s reporting obligations; and
3. International administrative cooperation and exchange of information.\(^{164}\)

These areas are considered below, before a review of options proposed or implemented in Canada. As a general comment, it should be noted that, internationally, both VAT thresholds\(^ {165}\) and VAT rates are typically higher than the thresholds and rates for Canada’s GST/HST.\(^ {166}\)

**Domestic Reverse Charges and Split Payments**

Reverse-charge mechanisms for business-to-business transactions shift the liability to remit the VAT from the supplier to the purchaser. Practically, the recipient of the goods or services reports both its input tax and output tax on such transactions in its VAT return, and no net tax is payable on the transactions. This approach removes the possibility for suppliers to disappear without remitting the collected VAT.

Canada uses a reverse-charge mechanism with respect to certain sales of real property by non-residents and some supplies between provinces.\(^ {167}\) In the ITC context, the CRA could allow GST/HST registrants in certain problem industries to remit the tax payable on their inputs directly; however, if a reverse-charge mechanism is applied only to certain transactions or industries, it may simply shift the problem to other areas. The alternative—applying such a mechanism universally—would fundamentally change how the GST/HST is collected.

A split-payment mechanism has the supplier charge the VAT to its customers according to the usual rules, but the VAT paid by the customer is remitted directly to the tax authorities through the use of intermediaries. Intermediaries such as banks, credit card companies, and online service providers are organized to split the gross

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\(^{164}\) OECD, *Consumption Tax Trends 2018*, supra note 147, at 60.

\(^{165}\) In the EU member states, for example, the VAT thresholds range from nil to upward of Cdn$100,000.

\(^{166}\) See, for example, European Union, Council Directive 7166/18 of 10 April 2018 on Amending Directive 2006/112/EC on the Common System of Value Added Tax as Regards the Obligation To Respect a Minimum Standard Rate. This directive mandates that the minimum VAT rate among EU members is 15 percent. Many states have a VAT rate in excess of 20 percent.

\(^{167}\) See, for example, subsection 221(2).
amount paid by the customer into a net amount and a VAT amount. The latter is remitted to the tax authorities. This mechanism also prevents suppliers from disappearing with unremitted VAT.

The downside to a split-payment mechanism is the potential high cost of implementation, since this measure would substantially change the way businesses and tax administrators handle the GST/HST. It would also shift the compliance burden from the taxpayer onto intermediaries. Canada does not currently use a split-payment mechanism.

Canada could also defer the payment of ITC refunds, rather than provide full immediate credit. In France, the tax authorities must issue a refund within six months of the claim, but that time limit can be extended for an additional three months. This approach could affect the cash flow of some businesses and would require some adjustment, but it may deter fraudulent suppliers since there would be more chance of a suspect claim being flagged for audit. The COVID-19 pandemic has highlighted cash flow concerns in some businesses, which have been addressed by federal and provincial aid packages. Possible cash flow issues with respect to the deferred issuance of an ITC refund would need to be researched further prior to implementing a deferred refund regime similar to the one adopted in France.

In the Iris Technologies case, the taxpayer cited cash flow concerns in seeking an order of mandamus that would compel the CRA to pay an ITC refund that was withheld during an audit. The results of the audit suggested that the business was engaged in a carousel scheme. The business argued that the withholding of the ITC claim was causing financial hardship and would force the company into bankruptcy. The company was ultimately unsuccessful, in part because it appeared to have exaggerated the impact of the delayed refund.

**Increasing Reporting Requirements**

Several countries have increased their reporting obligations for certain VAT registrants so that transactions are reported to the tax authority periodically or in near-real time. E-invoicing is one real-time reporting method being adopted internationally. E-invoicing regimes require “businesses to issue invoices in a prescribed electronic format containing mandatory information and transmit these invoices to a specified electronic system in real time.” The invoices are approved by the tax authority prior to being sent to customers. Paper returns are not valid for the purposes of claiming a VAT refund. Increased reporting allows for almost instantaneous auditing, meaning that tax authorities can detect overstatements or anomalies sooner.

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168 Iris Technologies, supra note 140.

169 See Melina de Souza Rocha Lukic, “Canada Should Consider E-Invoicing for GST/HST” (2020) 10:3 Canadian Tax Focus 12.

170 See Caterina Scotti, “Italy: Mandatory E-Invoicing” (January 2019) KPMG Tax Alert 1-2 (https://home.kpmg/content/dam/kpmg/xx/pdf/2019/01/tnf-italy-jan25-2019.pdf).
E-invoicing is one method that the European Union has implemented in response to an estimated VAT gap of €137.5 billion in 2017.171 As of April 18, 2020, all business-to-government transactions in the EU member states must be reported in the form of an e-invoice.172 Worldwide, a 2018 survey found that in 82 surveyed jurisdictions, 57 had a regulation related to e-invoicing and e-invoicing was mandatory in 10 states.173

Mandatory reporting has been implemented in Italy for business-to-business and business-to-consumer transactions.174 In Italy, registrants must transmit their draft invoices via the Sistema di Interscambio (SDI) platform, which is run by the Italian tax authorities. The SDI acts as an invoice pre-approval mechanism. Each draft invoice is validated by SDI; then, if it is approved, it is transmitted to the purchaser. Accordingly, in Italy, a valid invoice cannot be issued and sent to a purchaser without prior approval from the tax authorities. Failure to comply can result in penalties up to 180 percent of the charged VAT.

France plans to follow Italy’s lead in implementing real-time reporting.175 Beginning in 2023, all business-to-business transactions in France will require that e-invoices be submitted to the tax authorities’ Chorus Pro portal for clearance before they are sent to the customer. The collected data will then be used to complete draft VAT returns, which will be sent to the registrant for review. This approach reduces the compliance burden for registrants since they do not have to complete the returns themselves. In case of error, the registrant will be able to apply for an adjustment to the draft VAT return.

The approaches described above would reduce the number of disputes over ITC claims arising from missing information. A proposed e-invoicing system could prevent the transmission of a document where certain information is missing or invalid (such as the supplier’s GST/HST registration number). The system could be linked with the GST/HST registry to ensure that the supplier’s name listed on an e-invoice matches the listed GST/HST registration number. Where the applicable tax is not

171 European Commission, \textit{VAT Gap Report September 2019} (Brussels: EC, September 2019) (https://ec.europa.eu/taxation_customs/sites/taxation/files/vat-gap-factsheet-2019_en.pdf). The VAT gap is the difference between the expected VAT revenue and the amount actually collected.

172 “eInvoicing: New Electronic Invoicing Standard Facilitates Public Procurement Contracts in Europe,” \textit{European Commission}, April 17, 2019.

173 Ernst & Young, \textit{Worldwide Electronic Invoicing Survey 2018} (EY, 2018), at 5 (www.ey.com/Publication/vwLUAssets/ey-Worldwide-electronic-invoicing-survey-2018/%24File/ey-Worldwide-electronic-invoicing-survey-2018.pdf).

174 Cristina Palazzi, “Italy: Mandatory e-Invoicing in Italy: Final Implementation Phase,” \textit{Mondaq}, December 19, 2018.

175 See, for example, KPMG, “France: Electronic Invoices Mandatory for Business-to-Business Transactions; Proposed Effective 2023,” September 27, 2019 (https://home.kpmg/us/en/home/insights/2019/09/tnf-france-electronic-invoices-mandatory-for-business-to-business-transactions-proposed-effective-2023.html).
remitted, the Canadian tax authorities may still allege that the supplier was not the true supplier. The administrative resources gained by Canadian tax authorities through the implementation of an e-invoicing system could be directed to more stringent verification of the information provided by registrants.

An obvious downside to real-time and near-real-time reporting is the initial compliance cost and the administrative cost of developing and implementing the system. In most VAT jurisdictions, including Canada, businesses are not required to provide tax authorities with details of every transaction, unless they are audited. Ongoing costs once the system is implemented may not be as burdensome.\footnote{Lukic, supra note 169.}

The additional costs of increased reporting obligations for large companies may not be significant where those businesses are able to integrate the process into their sales and accounting software and point-of-sale equipment. Italy has a VAT threshold of €65,000 (approximately Cdn$99,000), so many smaller businesses are not required to use the SDI system. Canada could consider raising the GST registration threshold to leave some of the smallest businesses outside this system.

In recognition of the potential impact of mandatory e-invoicing on small businesses, the Italian authorities created a smart phone application (app), App FatturaE, which enables businesses to create and transmit e-invoices on their phone.\footnote{Fattura Elettronica.} The possibility of introducing smart phone invoicing apps suggests that the compliance burden associated with enhanced reporting obligations for small businesses may not be as great as previously thought, and the use of this technology merits further research.

Another alternative is the adoption of the SAF-T (standard audit file for tax), which is a standardized format promoted by the OECD to facilitate the collection of information from businesses’ accounting systems (invoices, payments, and general ledger) for submission to tax authorities.\footnote{Organisation for Economic Co-operation and Development, Committee on Fiscal Affairs, \textit{Guidance Note: Guidance for the Standard Audit File—Tax}, prepared by Forum on Tax Administration Compliance Sub-Group (Paris: CFA, May 2005).} The SAF-T format is meant to simplify tax compliance and tax audits, since the information is more accessible. The data are required to be transmitted either at the request of the tax authority or periodically. Portugal’s tax revenues increased by 13 percent in 2013 following the implementation of this model, and the cost to both the tax authority and taxpayers was lower than expected.\footnote{Filipe Abreu, “Deploying Effective Strategies in Tackling VAT Fraud: Portugal’s Experience,” presented at the Second Meeting of the OECD Global Forum on VAT, Tokyo, April 17-18, 2014.} Periodic reporting in an international standardized format allows for administrative cooperation among countries that have implemented the SAF-T format. In theory, standardized e-invoicing schemes may eventually allow for all international transactions to be reported and transmitted to the tax authorities of
the relevant countries in real time. This may reduce the use of some international schemes that rely on the zero-rating of exports or certain cross-border supplies.

**International Administrative Cooperation**

International administrative cooperation to combat international VAT fraud has already been undertaken. The rise of digitization has expedited this need for international cooperation, as the OECD has recognized.\(^{180}\) In 2017, Canada joined more than 90 other jurisdictions in implementing the OECD’s common reporting standard\(^{181}\) and began data sharing in 2018. This initiative allows for coordinated efforts against fraudulent transnational schemes.

The ITD has also recommended higher thresholds for VAT registration and an increased audit focus on high-risk taxpayers.\(^{182}\) This would leave the majority of businesses free of compliance costs.\(^{183}\) The data from my study suggest that Canada’s documentation requirements impose a disproportionate burden on smaller businesses. Non-compliance with the applicable substantive rules for claiming ITCs is also apparent among smaller businesses. Canada could consider implementing different GST thresholds for businesses that provide only services and those that sell only goods. More research would have to be done to determine the viability of increasing or otherwise changing the GST registration thresholds in Canada.

**Reform Options Implemented or Proposed in Canada**

A number of reform options are already being implemented in Canada, namely, the attestation de Revenu Québec, education efforts aimed at registrants, and the use of data collection and reporting technology.

**Attestation de Revenu Québec**

The federal government should follow Quebec’s lead in introducing a form of the attestation de Revenu Québec. The attestation is currently required only for certain construction contracts, public contracts, and contracts or arrangements with temporary help agencies, but could be expanded to encompass other problem industries with reported evidence of GST fraud. A free, publicly accessible electronic database could be created in which the attestations could be stored for search and verification,

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180 See Organisation for Economic Co-operation and Development, *Addressing the Tax Challenges of the Digital Economy, Action 1—2015 Final Report* (Paris: OECD, 2015).

181 See Organisation for Economic Co-operation and Development, *Standard for Automatic Exchange of Financial Information in Tax Matters, Implementation Handbook*, 2d ed. (Paris: OECD, 2018). The common reporting standard calls on jurisdictions to obtain information from their financial institutions and automatically exchange that information with other jurisdictions annually. This is done to facilitate cross-border tax transparency on financial accounts held abroad. Ibid., at paragraph 1.

182 “The Value Added Tax,” supra note 160, at 28.

183 Ibid.
similar to the “My Account” program maintained by RQ.184 Businesses could rely on the information held in the database to verify their suppliers, thereby resolving some of the issues in the duty-of-verification cases discussed earlier.

The attestation is limited in that it only certifies that the business is compliant as of the date of the application. This limitation is mitigated to some extent by the relatively short validity period (roughly three months) for each attestation, although, as mentioned earlier, a business can apply for automatic renewal. Because a business has to reapply every few months, there is some ongoing confirmation that the business has remained compliant. Automatic renewal eases some of the compliance burden on taxpayers who would otherwise have to reapply every few months, although the corresponding administrative requirement to verify a business’s ongoing compliance remains.

Similar to the reverse-charge mechanism, while the attestation can address industry-specific situations, it may have the effect of shifting fraudulent activities to other industries.

**Educational and Other Measures To Remedy Unintentional Non-Compliance**

The cases reviewed in this article show, in part, that there is some misunderstanding of the applicable rules for claiming ITCs. In Satterthwaite’s study, the complexity of the GST/HST scheme was one reason cited by small suppliers for why they had not registered.185 Further education may be required to ensure that the ITC rules are not misapplied by registrants.

Satterthwaite proposed various options to remedy misconceptions about the complexity of registering for the GST.186 These options included providing a dedicated GST/HST help line for entrepreneurs to call or offering education on voluntary GST registration to small suppliers. The CRA already provides a GST/HST help line to assist taxpayers with technical inquiries. It should be noted, however, that the auditor general’s 2017 fall report on the CRA’s call centres found that 30 percent of the information provided by agents was incorrect;187 and at least two of the cases reviewed in this study involved taxpayers relying on erroneous advice from the CRA, to their detriment.188 Care must be taken to ensure that any proposal for further education is accurate in its content and that taxpayer relief is available where CRA errors lead to a tax debt.

184 See Revenu Québec, My Account (www.eveneasier.ca).
185 Satterthwaite, supra note 30, at 801.
186 Ibid., at 803.
187 Office of the Auditor General of Canada, 2017 Fall Reports of the Auditor General of Canada to the Parliament of Canada, report 2, Call Centres—Canada Revenue Agency (Ottawa: Office of the Auditor General of Canada, November 2017), at paragraphs 2.33, 2.39, and 2.45 (www.oag-bvg.gc.ca/internet/English/parl_oag_201711_02_e_e-42667.html).
188 See, for example, By-Pass Ranch Ltd. v. The Queen, 2017 TCC 14; and Academy of Applied Pharmaceutical Sciences v. The Queen, 2014 TCC 171.
Remission orders are one form of taxpayer relief, providing a remedy for incorrect advice or information from a Canadian tax authority with respect to the application of technical tax rules. A recent study by Singer found that 65.6 percent of remission orders that specified government error or delay as the reason for granting the order related to the application of the GST/HST. Access-to-justice concerns arise where a misunderstanding of complex ITC rules results in a tax debt.

In 2016, the CRA piloted a GST/HST compliance letter campaign in which 6,000 letters were sent to registrants with suspected errors. The campaign was meant to help taxpayers understand their obligations and correct any errors. It is unclear whether the letter campaign has continued, but media reports suggest that similar soft-toned nudge letters have failed to change taxpayers’ behaviour. Other studies have shown that letters sent from the tax authority to taxpayers providing audit rates and penalty rates have substantially reduced the rate of evasion, at least in the short run.

On the other hand, tax practitioners are not sure that written material is sufficient to properly educate the public on the underground economy and fraud; instead, they prefer seminars or workshops as a more effective way of communicating with taxpayers about compliance issues. Studies in the United States and Colombia have also shown that in-person contact is more effective than letters where the goal is to educate.

Measures to remedy unintentional non-compliance with the ITC rules could include informational sessions hosted by industry organizations. The federal government could also develop an app that uses decision-making trees to help registrants to determine whether they can claim an ITC on a specific supply. This could automate the application of legal tests. Registrants may feel more comfortable using an app than calling the CRA. An app would also provide consistent advice to taxpayers and may provide a safeguard against CRA agents giving incorrect technical advice.

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189 Samuel Singer, “Evaluating Canadian Tax Remission Orders: A Debt Relief Vehicle for Taxpayers” (2019) 42:2 Dalhousie Law Journal 397-426, at 420. An alternative vehicle for relief from incorrect advice or information from the CRA is described in Information Circular IC07-1R1, “Taxpayer Relief Provisions,” at paragraph 26.

190 Canada Revenue Agency, “Businesses—Tax Information Newsletter, Issue: 2016-03,” December 12, 2016 (www.canada.ca/en/revenue-agency/news/e-services/canada-revenue-electronic-mailing-lists/businesses-tax-information-newsletters/businesses-tax-information-newsletter-issue-2016-03.html).

191 Dean Beeby, “Underground Economy Players Impervious to CRA’s ‘Nudge’ Experiment,” CBC, April 26, 2017 (www.cbc.ca/news/politics/nudge-economics-underground-economy-canada-revenue-agency-tax-1.4084932).

192 Joel Slemrod, “Tax Compliance and Enforcement” (2019) 57:4 Journal of Economic Literature 904-54, at 912-23.

193 Canada Revenue Agency, Public Affairs Branch, Background Qualitative Research with Tax Practitioners, prepared by Milward Brown (Ottawa: CRA, February 2007).

194 Slemrod, supra note 192, at 919-23.
Different research methodology should also be canvassed as a means to determine the extent of non-compliance with the ITC rules and the GST/HST regime in Canada. Random audits are an integral starting point for measuring non-compliance. Slemrod has advocated for randomized controlled trials and the wider availability of administrative data as a methodology to study non-compliance in the tax system. Although one can never know what methodologies the CRA is implementing for its internal use, the available public information suggests that Canada is not currently using the best research tools, particularly with respect to the estimations of the tax gap.

Canada currently measures its GST/HST tax gap using a top-down methodology as opposed to a bottom-up methodology. Top-down methodology uses independent external data (such as national accounts data) to estimate the tax base, which is then used to calculate a theoretical value of tax that should be paid and collected by applying the relevant tax rate. Bottom-up methodology uses the tax administration’s taxpayer data (such as audit results, accounting data, and assessment data) to estimate the taxes theoretically owing. These calculations contribute to overall knowledge on non-compliance with the GST/HST system, but more could be done.

The CRA, in its tax gap report, admits that the best methodology to determine the tax gap would be a bottom-up approach (which is generally more reliable than the top-down approach) using a “representative sample of taxpayers, randomly selected from a known population that is subject to audit.” A more reliable estimate of the tax gap would better inform decision makers as they consider how to address the problem of non-compliance. The relative attractiveness of a particular reform option depends on how bad the problem is. Consequently, it is necessary to consider the different research methodologies that may be used to determine the extent of non-compliance with the ITC rules and the GST regime before selecting any reform options.

195 Ibid. The justification for randomized controlled trials is that a control group is required for research purposes. For example, if a particular tax authority action (A) was followed by a change in the level of non-compliance (B), there would be data that could, in theory, show that A caused B, or that there were other events that caused B. See Alan Macnaughton’s review of Slemrod’s article, supra note 192, in the Current Tax Reading feature, (2020) 68:1 Canadian Tax Journal 391-408, at 403.

196 See “The Tax Gap—Definition and Conceptual Issues,” in CRA, Tax Gap in Canada, supra note 7, at 7-14.

197 Ibid.

198 Ibid. The CRA notes that “top-down estimates are limited in their usefulness from a tax administration perspective because the estimates are aggregate and can only indicate whether the tax administration collects a significant portion of the taxes that should be paid”: ibid., at paragraph 2.2(a).
Technology and Increased Reporting Obligations

Analytics and blockchain technology could be developed and used. Canada already uses data analytics to some extent in selecting which files to audit. Ainsworth has argued that blockchain technology could solve weaknesses in VAT schemes by creating a registry of digital invoices that would allow tax authorities to both see and verify the taxes paid on a given transaction, thereby increasing audit efficiency. The European Union has committed some €340 million to developing blockchain technology to combat VAT fraud.

One of the primary questions relating to the use of blockchain technology is how to move data into the blockchain. The answer may be to add a new reporting requirement, that data be uploaded prior to or immediately following each transaction. Real-time or periodic reporting requirements along with the adoption of e-invoicing should be considered in Canada. These additional requirements may impose a burden on businesses, but (as noted earlier) many large companies would likely be able to integrate the process into their sales and accounting software. For smaller businesses, the advancement of technology may mitigate the compliance burden.

A smart phone app similar to Italy’s App FatturaE could be developed, which would allow transactions to be completed and transmitted only if all relevant data were included, thereby ensuring that small businesses met the documentation requirements for claiming ITCs. The completed invoices could be uploaded periodically for review by the tax authority or for approval before being sent to customers. Various smart phone invoicing and billing apps are already in use in Canada, so a transition to e-invoicing and real-time reporting may be easier than it seemed to be when these options were initially proposed. The compliance cost of increased reporting requirements in Canada merits further research.

Quebec has already implemented certain enhanced reporting measures in the restaurant and bar industry to address concerns with unreported and underreported sales. In 2009, RQ began testing sales recording modules (SRMs), which were meant to address the erasure of sales records by programs embedded into electronic cash registers. Establishments that have an SRM must file a sommaire périodique des...
ventes (periodic sales summary) with RQ each month, even if no commercial transactions are recorded. Failure to file the periodic sales summary results in a penalty of $25 per day late up to a maximum of $2,500.\(^{203}\) Evidently, Canada already has some experience with enhanced reporting obligations in particular industries.

If the compliance burden of implementing increased reporting obligations is still perceived to be too high for smaller businesses, the GST threshold could be raised. An increased GST threshold would allow many businesses to operate outside the proposed reporting system. The upfront cost of an increased reporting system may be high, but Canada could copy existing reporting programs being used internationally instead of developing its own.

A benefit of enhanced reporting is that pre-filled GST/HST returns could be provided by Canadian tax authorities to registrants, as has been proposed in other countries.\(^{204}\) These draft returns could be sent to registrants, and registrants could apply to amend them if necessary. The use of pre-filled forms could substantially reduce the compliance burden for registrants.

E-invoicing may also reduce the number of disputes with the CRA relating to claims for ITCs. The specified information that would be mandatory in the e-invoices, such as the supplier’s GST/HST registration number, could be verified in real time by the tax authority. Pre-validated invoices would reduce the number of cases with respect to the documentary requirements needed to claim an ITC. Certification of suppliers’ compliance through a system similar to the attestation de Revenu Québec, in conjunction with e-invoicing and more stringent vetting of applicants for GST registration, may also reduce instances of fraudulent behaviour by suppliers.

E-invoicing and enhanced reporting obligations are becoming more popular among tax authorities in VAT jurisdictions around the world. They have the potential to increase compliance, and in turn increase revenue. More research is required before Canada considers whether to implement such reforms, but the potential benefits are promising.

**BALANCING THE NEED FOR REFORM AND THE INTERESTS OF HONEST TAXPAYERS**

This article provides evidence of significant problems in Canada’s GST regime relating to registrants’ non-compliance with the ITC rules. The reliance of tax authorities on increasingly aggressive audits and increased supplier verification

\(^{203}\) Revenu Québec, Penalties and Fines in the Restaurant Sector (www.revenuquebec.ca/en/fair-for-all/ensuring-tax-compliance/penalties-and-interest/penalties/penalties-specific-situations/penalties-and-fines-in-the-restaurant-sector).

\(^{204}\) See, for example, Victor Italo Villalon Mendez, “Pre-Filled VAT Form in Chile,” Inter-American Center of Tax Administrations, January 29, 2018 (www.ciat.org/pre-filled-vat-form-in-chile/?lang=en). Chile is one of a few countries (Spain and Italy are two other examples) in which it is proposed that the tax authorities will provide pre-filled VAT returns to registrants for review, approval, and amendment if required.
requirements is at least partly self-defeating, in that these approaches arguably increase the administrative costs of the GST and make the rules harder to enforce. When the GST regime becomes difficult to enforce, the compliance burden is shifted unfairly from dishonest to honest taxpayers.

Estimates have shown that in 2015 Canadian businesses spent more than $37.1 billion and, on average, 105 business days a year in complying with regulations from all levels of government, including GST/HST reporting and remittance obligations. These numbers are simply too high. Recent policies implemented in response to the COVID-19 pandemic show that swift change and reduced bureaucracy are possible, although they come with risks.

This article concludes with proposals to improve the GST regime in Canada by addressing various issues with non-compliance relating to ITC claims. Among these proposals are legislative changes with respect to the collection and remittance of GST/HST, based on methods used abroad. Admittedly, the reform options may significantly alter how the GST/HST is collected and remitted in Canada and would have a corresponding impact on how ITCs are claimed.

E-invoicing and enhanced reporting obligations should be considered in Canada, since the documentation requirements would be fulfilled immediately and the tax authorities could both see and verify the taxes paid on any given transaction. The mechanisms available take many forms, as discussed above. The adoption of a modified version of Quebec’s attestation de Revenu Québec in other provinces and the creation of a central, publicly available electronic database would allow taxpayers to discharge any duty of verification with respect to their suppliers. The problems are multifaceted, and while some solutions may decrease fraudulent activity or the need for more stringent supplier verification requirements, they would not address other areas of concern. Maintaining a balance between preventing non-compliance and ensuring economic efficiency and fairness is difficult, but possible, with the reforms proposed here. Honest GST/HST registrants require solutions that do not unduly increase their compliance burden as the tax authorities seek to prevent losses from fraudulent activities and overstatements resulting from misunderstanding or error.

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205 Cruz et al., supra note 31, at 6. These statistics are based on a 2014 survey of Canadian businesses undertaken by the Canadian Federation of Independent Business (CFIB). Between the time of a similar survey conducted in 2012 by the CFIB and the 2014 survey, the annual compliance costs for businesses in Canada had risen by more than $5 billion, and the hours that the average business spent on compliance had increased by 12 percent. See ibid., at 6.

206 See, for example, Canada Revenue Agency, “CRA and COVID-19: Electronic Signatures” (www.canada.ca/en/revenue-agency/campaigns/covid-19-update/covid-19-electronic-signatures.html).