

A separate issue for the court was the testimony of Ms. Dias. In the court's view, she did not truly understand who loaned what to whom, and her testimony was generally unreliable. The court also wondered why Mr. Anslem did not testify, given that he was the majority shareholder of Dandy and Indiva and was, according to Ms. Dias, the one responsible for the finances of the business and the one who dealt with the accountant. The court did not seem pleased that Mr. Anslem did not testify, and it drew an adverse inference from that.

The Crown's position was that 201's purpose was to earn interest income on its loans to Dandy. The Diases agreed that this was correct at an earlier stage of the dispute. The court found that, on the basis of the record, it was more likely than not that 201 loaned monies to Dandy for the purposes of earning interest income.

What does this decision teach us? It teaches us that to claim an ABIL, it makes abundant sense to loan the funds directly to the active corporation. In situations where a conduit must be used, it is imperative that the parties (1) document who the ultimate recipient of the loan is, (2) establish that the funds did in fact end up where the parties intended, and (3) remain consistent. It is not wise to tell one story at audit and then change that story, because this change may suggest retroactive tax planning.

It is worth noting that the conduit may be a bare trust, and that the February 4, 2022 draft legislation proposes additional reporting requirements for bare trusts. Using a conduit therefore may simply increase the compliance burden. Loaning the funds directly to the active corporation may be the better choice.

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## A Proposed Four-Part Test for Evaluating ITC Eligibility

### Introduction

Input tax credits (ITCs) are critical to the financial survival of many owner-managed businesses, but many owner-managers do not know the legal and evidentiary requirements that they must satisfy to claim an ITC. Likewise, we have seen several audit reports that do not clearly specify why the auditor is denying certain ITCs, or what legal source the auditor is relying on to do so.

Any lack of clarity on the auditor's part can leave ITC claimants and their representatives guessing at what they must prove and what arguments they must refute. The result is tax disputes in which the auditor and claimant are like two ships passing in the night.

In this article, we propose a step-by-step test for determining whether a claimant is entitled to an ITC. If auditors were

to adopt this test and use it explicitly in their communications with claimants, it would assist them and owner-managers alike.

### Step 1: Did the Claimant Obtain the Documentation Required Under Subsection 169(4) of the ETA Before Filing the Return Claiming the ITC?

Subsection 169(4) of the ETA requires GST/HST registrants, before they claim an ITC, to have supporting documentation that includes certain information. Invoices, receipts, written contracts, and computerized records all count as "supporting documentation" under section 2 of the Input Tax Credit Information (GST/HST) Regulations (SOR/91-45). A list of the required information is in section 3 of the regulations and includes

- the supplier's or intermediary's name and GST/HST registration number;
- the invoice date, or the date on which tax was paid for the supplies;
- the total amount paid for the supplies, with the amount of tax specified;
- the claimant's name, the business's name, or the agent's or representative's name; and
- the terms of payment and a description of the supplies.

To receive an ITC, a claimant must first comply with this most basic documentation requirement.

### Step 2: Did the Suppliers Have Valid GST/HST Numbers at the Time of Payment?

The next step is to determine whether the GST/HST numbers provided by the suppliers were valid. Although the legislation does not explicitly require the GST/HST number to be valid, the FCA, in *Systematix Technology Consultants Inc. v. Canada* (2007 FCA 226), interpreted the requirement that the supplier provide a GST/HST registration number to mean a *valid* registration number. The result is that, for claimants to be sure that they are entitled to an ITC, they must use the CRA's online GST/HST registry search to check the supplier's GST/HST number.

The requirement is that the supplier's number *be valid*, not that the claimant *check* that the number is valid. Therefore, we believe that if the claimant does not check the validity of the number, but the number turns out to have been valid at the time, the claimant is still entitled to an ITC. Also, former Chief Justice Rip of the TCC said in *SNF LP v. The Queen* (2016 TCC 12) that claimants need to confirm the validity of their supplier's registration number only if (1) it is the first time they are paying GST/HST to that supplier or (2) they become suspicious of the supplier's legitimacy.

Nonetheless, we recommend that claimants err on the side of caution. By checking the GST/HST numbers of each new supplier and then conducting routine checks (perhaps quarterly or annually) of the registration numbers of their major suppliers, claimants will ensure that their ITCs proceed to the next step of the test.

### **Step 3: Was the Claimant Involved in a Scheme with Invoices of Accommodation?**

The third step assesses whether a claimant is involved in a scheme with the invoice issuer to defraud the tax authority through “invoices of accommodation” (sometimes referred to as “invoices of convenience”).

Courts have found many possible scenarios in which these schemes play out (*Canada v. Salaison Lévesque Inc.*, 2014 FCA 296). In *Pro-Poseurs Inc. v. Canada* (2012 FCA 200), for example, suppliers issued false invoices and then returned the money while the contractor claimed ITCs for work that was never done.

Sometimes, however, auditors assume that a scheme is underway when one is not. Tardif J in *Salaison Lévesque Inc. v. The Queen* (2014 TCC 36) observed that “the tax authorities have a tendency to assume that a certain degree of negligence or even a lack of vigilance amounts to collusion,” but a claimant’s negligence does not amount to invoices of accommodation.

What assumptions about invoices of accommodation can auditors make without evidence?

Although the CRA has broad authority to make assumptions, there should be some basis for those assumptions when it comes to invoices of accommodation, with their fraudulent intent. We recently read an audit report in which the auditor stated, “[A]lthough not proven, it is surmised that the claimant received a ‘kickback’ from the subcontractor for the accommodation invoicing scheme.” But no evidence of any actual kickback or scheme was provided.

We find this insufficient. Our opinion is supported by *Stamatopoulos c. Agence du revenu du Québec* (2015 QCCQ 13237), which suggests that auditors need evidence to assert that a claimant was involved in a false billing scheme.

### **Step 4: Did the Supplier in the Supporting Documentation Actually Make the Supply?**

Finally, if the first three steps are satisfied, the fourth step is to confirm that the supplier whose name and GST/HST number are listed in the supporting documentation is the one that actually made the supply. A supplier may use employees, subcontractors, or agents and intermediaries to provide its supply. Concern arises when suppliers use someone else’s registration number to collect and then keep GST/HST. In these instances, the owner of the GST/HST number has little or nothing to do with providing the supply.

If the purported supplier did not actually make the supply, even a claimant acting in good faith may have its ITC denied.

To take an extreme example, a supplier may use a stolen name and registration numbers, as was the case in *Comtronic Computer Inc. v. The Queen* (2010 TCC 55). However, purported suppliers also have more subtle ways of using the registration numbers of others to collect GST/HST.

Establishing that the supplier made the supply in question is much easier if the claimant prepares in advance. In his commentaries on subsection 169(1), David Sherman recommends

- entering into a written contract with each major supplier, and
- confirming through identity checks that the supplier’s director of public record is signing the contract.

For claimants who have not taken these precautionary measures, there is contradictory jurisprudence on the standard that they will have to meet to satisfy this final step of the test.

Tardif J held that we cannot ask claimants to effectively audit their suppliers: Parliament did not intend for the ITC legislation to compel claimants to act as taxation police (*Salaison*, 2014 TCC 36). The Court of Quebec offered a similar view, stating that the tax authority should not “confuse a taxpayer’s normal risk management measures . . . with its own risk management, which is to identify . . . tax evaders” (*Stamatopoulos*).

The Quebec Court of Appeal held differently in *Agence du revenu du Québec c. Système intérieur GPBR inc.* (2015 QCCA 1402), stating that the mandatory nature of the information requirements in the ITC Information Regulations indirectly implies that businesses have a duty to perform audit functions.

For claimants facing an allegation that the entity they paid was not the entity that made the supply, courts have found several factors to be relevant (as shown in *Stamatopoulos* and *SNF*):

- whether the purported supplier was incorporated and responsive to communications,
- whether the claimant issued cheques to the corporation named on the invoice, and
- whether the purported supplier cashed the cheques at a bank, as opposed to at a cheque-cashing business.

### **Conclusion**

As the steps set out above indicate, the evidentiary requirements for an ITC can be complex. The four-part test that we have proposed would help owner-managers better understand the legal and evidentiary burden they bear when claiming an ITC, and it would help them develop effective risk-management strategies. If the test were employed by auditors, it would make the audit and dispute process more transparent and efficient.

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