

# GST Disputes and Litigation: What to Expect

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March 2026

OSLER

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## Plan of the Presentation

- Overview of the Tax Court process
- Hot Topics
  - Assumptions
  - Denials of ITCs
  - Valuations
  - Wash Transactions
  - Retroactive Legislation
  - Audit Powers

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# Overview of the Tax Court Process

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## Overview of the Tax Court Process



Hot Topics

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## Pinning down the CRA/Crown case early

- Importance and effect of Minister's assumptions of fact
- Assumptions are deemed to be true unless the taxpayer "demolishes" them (reverse onus in tax litigation)
- Crown must list all the assumptions in the Reply
- Is the Crown bound by the assumptions?
  - *DEML Investments* suggests yes:
    - "[45] In my view, it is not appropriate for the Crown, at this stage (when the matter is before this Court), to attack its own pleading and argue that an improper assumption of mixed fact and law was made that should, presumably, have been struck from the Reply. Therefore, even if this is an assumption of mixed fact and law, the underlying fact (the ACB of DEML's partnership interest in DERP 2 included the income allocation of \$9,084,659) is an assumption of fact made by the Minister in reassessing DEML to deny the capital loss based on the application of the GAAR."
    - "[49] Given the Minister's assumption of fact in paragraph 19(s) of the Reply, the Crown cannot now take the position that the ACB of DEML's partnership in DERP 2 did not include this income that was allocated to DEML by DERP 2. ..."

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## Denials of ITCs

- Crown has lost several recent cases:
  - *Fiera Foods Company v. The King*
    - CRA denied ITCs to Fiera for GST paid to various GST-registered employment agencies
    - CRA alleged the services were never actually provided
    - The Court heard from 28 witnesses to determine that the services were actually provided
  - *Entrepôt Frigorifique International Inc. c. Le Roi*
    - Another case with employment agencies—the CRA argued the invoices were “invoices of convenience” and that the agencies did not provide the services
    - Tax Court found that CRA had actual knowledge of the fraud and failed to do anything about it (e.g. informing the public, deregistering the wrongdoers)
  - *SNF L.P. v. The Queen*
    - Taxpayer in the scrap metal recycling business; CRA denied ITCs arguing that various suppliers did not have the resources to make the supplies and were not the real suppliers
    - Court determined that the taxpayer had acted in good faith and noted that Revenu Quebec had failed to make any inquiries before registering the fraudulent suppliers in the first place

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## Valuations

- Subject of much recent litigation, both with respect to income tax and GST
- On the GST side, comes up for example in the context of real-property self-assessments
- Failing to do a proper valuation can have serious consequences—*e.g.* the *Lauria* case:
  - “[97] Notwithstanding the above evidence, neither Appellant chose to seek independent confirmation of the value of such shares in issue, either before the transfer to their trusts on April 1, 2006 nor at the time of filing their 2006 tax returns which I strongly believe a wise and prudent person in their circumstances would do and thus I find the Respondent has strongly proven the Appellants were careless and negligent in making the misrepresentation of the fair market value of the shares in issue.”

## Wash Interest and Related Party Transaction Issues

What are we seeing?	What can you do?
<ul style="list-style-type: none"><li>• CRA auditors increasingly assessing for wash interest and related party transactions<ul style="list-style-type: none"><li>• Example: Corporation A and Corporation B (both registered for GST/HST) are in the same corporate group. Corporation A claimed ITCs.</li><li>• CRA audit takes the position that Corporation B, and not Corporation A, should have claimed ITCs</li><li>• CRA assesses wash interest (4%) even though no new net revenues to the CRA</li></ul></li></ul>	<ul style="list-style-type: none"><li>• Don't ignore related party transactions</li><li>• Structure transactions and legal agreements carefully</li></ul>
<ul style="list-style-type: none"><li>• CRA auditor only audits Corporation A and denies ITCs but doesn't audit Corporation B</li></ul>	<ul style="list-style-type: none"><li>• Escalate within CRA to seek consistency</li></ul>

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## Wash Interest and Related Party Transaction Issues

What are we seeing?	What can you do?
<ul style="list-style-type: none"><li>• CRA auditor asks for a waiver of the normal reassessment period from Corporation A</li></ul>	<ul style="list-style-type: none"><li>• Consider the use of waivers and the consequences:<ul style="list-style-type: none"><li>• If Corporation A files a waiver, the CRA can reassess beyond the normal reassessment period and Corporation B would be out of time to claim the ITCs – possible double taxation</li><li>• If Corporation B files a waiver (or claims the credits), and the CRA denies the ITCs in Corporation A, Corporation B can get the ITCs and Corporation A can object to the denial of ITCs – possible double recovery</li></ul></li></ul>

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## Retroactive Legislation

- Some of the major examples include:
  - July 2010—amendments adding several paragraphs to the *financial service* definition, including many new exclusions, with effect retroactive to December 17, 1990
  - Budget 2023—introduced new paragraph (r.6) of the *financial service* definition, effectively overturning the *CIBC Visa* decision from the Federal Court of Appeal, with effect retroactive to the inception of the GST
  - *Hootsuite* case about BC PST—
    - In 2023, BC Supreme Court found that software as a service, including cloud computing, was not “software” and therefore not taxable
    - In 2024, BC enacted legislation expanding the definition of “software” retroactive to 2013
  - *Proctor & Gamble* case about Ontario RST—
    - In 2007, the Ontario Court of Appeal determined that pallets were not “returnable containers”, which meant that P&G fit into a particular exemption and was entitled to a refund of tax
    - In 2008, Ontario amended the definition of “returnable container” to include a pallet, with retroactive effect to 1997

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## Audit Powers – Current Audit Powers and Recent Developments in the Income Tax context

- Minister may:
  - Inspect, audit, or examine documents and premises, require assistance, and compel answers (Section 288)
  - Issue a formal requirement to provide documents or information (Section 289)
  - Apply to judge for a compliance order if a person did not comply with an audit request (Section 289.1)
    - If the person does not follow the compliance order, they may be held in contempt of court (subsection (4))
- *Cameco* decision:
  - Court found that CRA could not compel persons to submit to oral interviews except in specific limited circumstances
  - Parliament reacted in 2022 by expanding the audit powers; CRA may now compel oral interviews and demand answers to questions in a particular format
- So why the need for more proposed amendments?
  - Budget 2024: “The 2018 Report of the Office of the Auditor General noted that the provision of information by some taxpayers lagged for months or even years, making it more difficult for the CRA to collect tax owing. ”

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## Audit Powers – What kinds of things are auditors requesting?

- Interviews with numerous employees
- Broad documentary requests (akin to documentary discovery), including requests for descriptions of materials withheld on the basis of privilege
- Preparation of information that does not exist
- Specific GST concerns:
  - Requests for third-party information, including about unnamed persons (*e.g. Shopify case*)

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## Proposed Amendments from Budget 2024

### Notice of Non-Compliance

- New notice that CRA can issue at any time to a person that it considers to be non-compliant with a requirement or notice to provide assistance or information to the CRA

### Compliance Order Penalty

- If CRA is successful in obtaining compliance order, a significant new penalty applies
- Penalty is in addition to potentially being held in contempt of court if the compliance order is not followed

### Other Amendments

- CRA may require questioning under Oath or for answers to be in the form of a sworn Affidavit

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## Practical Takeaways

- Tips for responding to audit queries:
  - Maintain good document hygiene. Address errors/flaws in key documents that could impact tax position early and proactively (when detected)
  - Protect privilege
  - Be intentional with your responses
    - Document your attempts to comply
    - Consider the scope of the questions carefully
- Key takeaway: It is important to carefully consider a coherent position as early as possible, particularly at the audit stage, that will carry through to the objection and litigation stages

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# Thank You

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