

Managing Canadian Tax Risk

Addressing what your organization may be facing now and in the future

By Jacques Bernier

The global tax environment has seen fundamental changes in recent years. Base erosion and profit-sharing (BEPS), the digital economy, and US tax reform have caused changes around the world and, at the same time, fueled the insatiable appetite of governments for more tax dollars. Canada was not sheltered from this tax tsunami. It adopted many measures from BEPS and a plethora of domestic rules to curtail perceived abuse by multinational companies and to give extra powers (and funding) to its tax collector, the Canada Revenue Agency (CRA).

New tax rules mean uncertainty and more risk to manage. This is especially true when those new rules bring into play fundamental changes. In our experience, tax executives must consider both the technical and practical risks to manage tax risk properly. This article focuses on the practical risks with an emphasis on the realities of the CRA and the Canadian courts. We will also provide suggestions to best manage those practical risks in the current highly dynamic environment. In doing so, we hope to give you, the tax executive, a more comprehensive perspective on what your company may face in Canada in the years to come.

Context: New Canadian Rules of Significance

We have witnessed a heretofore unseen degree of change in Canadian tax legislation. Here are the key changes, divided into those driven by global tax reform and those driven domestically.

First, the changes that are driven by global tax reform:

- Canada's adherence to the multilateral instrument (MLI);
- digital services tax (DST);¹
- excessive interest and financing expenses limitation (EIFEL); and
- global minimum tax.²

And second, changes that are driven by domestic events:

- the general anti-avoidance rule (GAAR) to include economic substance, a new penalty, and an extended reassessment period;
- tightening of transfer pricing rules (proposal);
- mandatory disclosure rules for listed transactions and other tax-driven transactions (and related harsh consequences); and
- increase in CRA audit powers and more extensions of the reassessment period.

This list demonstrates that Canada has given itself more reach than before, more audit powers, more time to reassess taxpayers, more visibility into tax-driven transactions, and more penalties to deter aggressive tax planning or perceived tax avoidance.

Three changes on the list warrant closer attention to set the stage. First, with its adherence to the MLI, Canada has given itself a legislative framework to prevent treaty shopping. This is an important change, since Canadian courts have tolerated treaty shopping in the absence of specific anti-abuse provisions in the tax treaties.³ This change, however, will not necessarily mean an end to treaty shopping controversies. For example, since the United States is not a signatory of the MLI, the prior jurisprudence remains of relevance under the Canada–US Tax Treaty; additionally, the OECD's Principal Purpose Test, which the MLI brings into play, will also, no doubt, trigger controversies.

Second, the Canadian GAAR now contains an economic substance test that will grant the CRA more ammunition to challenge transactions and will inevitably create new controversies. Notably, a large penalty (twenty-five percent of the tax benefit) will now be part of the GAAR arsenal, although it can be avoided by making the prescribed disclosure of the relevant transactions.

Third, the Canadian government has proposed changes to the transfer pricing rule that would

make it easier for the CRA to recharacterize transactions before repricing them. In addition, proposals would incorporate the 2017 OECD Transfer Pricing Guidelines specifically into legislation as in certain other jurisdictions.⁴ This is a departure from existing jurisprudence, since the Guidelines were viewed as nonbinding guidance only.⁵

These three changes aim to define the line between acceptable and abusive tax planning and will remain a war zone for tax controversies until the courts settle their interpretation.

What Is the CRA's Reassessing Standard?

Unfortunately, no published guidelines exist on the minimum standard the CRA must follow in order to reassess taxpayers. In theory, the reassessment of a tax payable is generally subject to a standard of correctness.⁶ In practice, however, the author's own experience is that in attempting to issue a "correct reassessment," the CRA does not follow either a "should" level or a "more likely than not" standard. Instead, the standard that the CRA often follows is that of "an arguable position," the strength of which varies from case to case and often from one CRA auditor to the next.⁷ Unless a precedent (or published CRA policy on point) exists, taxpayers are left in a state of uncertainty, especially when new rules are created. Unpredictability also becomes a risk factor given the absence of some objective standard guiding the CRA before reassessing. These unknowns become long-term when we consider a typical cycle of a CRA audit and the related controversy and litigation cycle. This cycle may last a decade, if not longer,⁸ and, given that audits do not take place in real time, the delay from the time that the relevant transaction(s) took place is even longer.

In the meantime, the taxpayer will have its position and so will the CRA. During that interim period, there are no real checks and balances to contain CRA reassessing actions. This situation is especially problematic in the context of new rules or when CRA auditors take overly aggressive positions. Yes, a taxpayer can escalate the matter administratively within the CRA, but doing so has limitations. A taxpayer cannot challenge the CRA before reassessment. This means that the CRA can effectively reassess a taxpayer the way it thinks is right, and that reassessment will survive unless reversed on appeal or in litigation. While its reassessment is being challenged, a company must pay the tax reassessed (in whole or in part, depending on the circumstances) and deal with the financial disclosure consequences. A damages claim can exist

once the tax case is over, but Canadian courts will rarely intervene to award damages to condemn the CRA's assessing actions.⁹

THE EVER-MOVING TARGET: THE REASSESSMENT ITSELF

Not only is there no real or objective standard before the CRA can issue a reassessment, but the CRA also has very few restrictions when it comes to changing its reassessing positions. If the CRA is within the time to reassess, it can, in fact, reassess for more tax (without limitation). If no time is left to reassess, the CRA can defend the amount of tax reassessed on a different basis (in fact, law, or both), the only limitation on the CRA being a taxpayer's inability to lead evidence against the new basis. In fact, it is not unusual for the CRA to change the basis of its reassessment or adopt different positions during the administrative appeals stage or litigation. This flexibility creates more risk for taxpayers but also reinforces the wisdom of challenging a reassessment not based on the CRA's being wrong but instead on the taxpayer's affirmative case (that is, showing that the tax provision in question does not apply to the taxpayer's facts).

Given the absence of an objective minimum standard for the CRA to reassess, and the lack of performance indicators to prove otherwise, the existence of TEBA would suggest that the CRA is perhaps reassessing more than it should in its own self-interest.

IS TEBA A CONTRIBUTING FACTOR TO THE CRA'S REASSESSING ACTIONS?

Tax earned by audit (TEBA) is a metric used by the CRA apparently to measure the performance and allocate resources to CRA offices and programs. Note that this metric does not track the tax being "earned" through correct reassessments (as opposed to reassessments that CRA Appeals or the courts find to be incorrect). The term refers only to the tax reassessed by the CRA which can produce undesirable effects. There is no published

data on the number or the proportion of CRA reassessments that CRA Appeals or the courts uphold. Importantly, the watchdog of the Canadian government, the Auditor General, has criticized the CRA's failure to gauge its performance.¹⁰ Given the absence of an objective minimum standard for the CRA to reassess, and the lack of performance indicators to prove otherwise, the existence of TEBA would suggest that the CRA is perhaps reassessing more than it should in its own self-interest.¹¹ The unknown drivers of the CRA's behavior increase uncertainty for taxpayers.

The CRA: An IRS on Steroids

Over the last ten years, Parliament has consistently given the CRA additional resources. To justify those added funds, Parliament has vowed to raise more tax revenues. It is unknown whether these added revenues are in fact "correct" revenues (raised as a result of reassessments that would withstand scrutiny) or, perhaps, TEBA. One can wonder whether this additional funding will become a self-fulfilling prophecy for the CRA and, until there is evidence that the additional funding generates real (and correct) revenue and not just TEBA or paper revenue, the tax community will continue to suspect that the CRA is reassessing taxpayers more than it should.

These concerns are amplified when we compare the CRA to its US counterpart, the Internal Revenue Service. For instance:

- For the 2024–2025 fiscal year, the CRA has a planned budget of USD 12.77 billion (CAD 17.5 billion), whereas the IRS is projected to spend USD 22.7 billion (CAD 30.9 billion). Thus, the CRA's budget is more than half that of the IRS (fifty-six percent);
- The CRA's operating budget is expected to continue to grow by USD 510 million (CAD 700 million) in 2025–2026 and USD 1.24 billion (CAD 1.7 billion) in 2026–2027, whereas the forecast is in the opposite direction in the United States, narrowing the gap between the respective budgets and making the CRA's budget closer to that of the IRS;
- Consistent with the relative size of budgets, the CRA's workforce of 59,015 employees is about two-thirds that of the IRS' 91,670 employees (before the recent eleven percent reduction);
- In terms of operational scale, the CRA processes approximately 29 million tax returns yearly, whereas the IRS processes 143 million (or, in relative terms, Canada processes twenty percent of the number of returns the IRS processes); and

- By contrast, Canada’s population is 11.5 percent of that of the United States. Its GDP is even smaller by comparison (seven percent).

IS THE JUDICIARY A SOURCE OF UNCERTAINTY (AND UNPREDICTABILITY)?

A legal opinion is predicated on how a court, properly informed, would decide a matter. For instance, a lawyer’s opinion must not be based on the matter being decided by a particular judge, perceived bias, etc. The legal opinion is therefore objectively established. The question, in the author’s view, is whether this objective standard should be the only guide to the tax executive in managing tax risk. We propose that it should not.

Let us start by looking at the highest court in Canada, the Supreme Court of Canada (SCC). It hears a limited number of tax cases and only if leave is granted, that is, if the matter is of national importance. However, it sets the tone lower courts should follow in interpreting tax legislation. During the last twenty years, the SCC rendered fifteen tax decisions, of which eleven were decided in favor of the government and four in favor of the taxpayer.¹² These highly important decisions covered a multitude of topics, including the GAAR (six decisions), transfer pricing (one decision), and treaty shopping (one decision). Importantly, throughout this period, the SCC emphasized the proper approach to interpreting tax legislation. In particular, the SCC opted for an organic approach to the interpretation of the tax provisions focusing on their text, in particular the plain meaning of the words, their context, and the purpose of the provisions under scrutiny. This approach contrasts with a more purposive one where the interpreter first finds the intent or purpose of the legislation and then applies that intent or purpose to the interpretation exercise.

Remarkably, the composition of the SCC has completely changed in those last twenty years. In fact:

- Of the original panel of nine judges who decided *Canada Trustco*, the first decision in our survey, those judges represented the majority of the judges deciding the next six tax cases (2005–2012);
- Of the same original nine-judge panel, no more than two judges were part of the subsequent next three decisions (2012–2021); and
- None of those original judges were present on the remaining five tax cases (2021–2025).

This finding begs the question of whether this turnover among judges can become an added factor to consider in assessing and managing

Canadian tax risks. Two recent SCC decisions make that question highly relevant. In the first, *Alta Energy*, the SCC ruled that treaty shopping was permissible despite the GAAR. Six of the nine justices in that case determined that the intent or purpose of the relevant treaty provisions came from the text and validated their interpretation from the context and purpose. Notably, three justices dissented (their opinion written by Justice Malcolm Rowe) on the basis that there could be abusive treaty shopping in the absence of “genuine economic connection with the state of residence,” the rationale for that view being that Canada’s treaty partner could not have intended tax benefits in the absence of economic activity.

Second, in *Deans Knight Income Corp. v. Canada*, 2023 SCC 16, the SCC applied the GAAR to a tax-loss utilization plan. That decision triggered criticism in the tax community, with the SCC viewed as having found that the applicable test (the *de jure* control test, a concept clearly defined through the jurisprudence) was met by what it considered a “functional equivalent” based on the particular facts of that case. *Deans Knight* raises the questions of whether the SCC is moving philosophically from its previous “textual, contextual, and purposive” analytical framework to a more purpose-driven one and whether the decision constitutes a change of judicial thinking on tax questions, especially when it comes to delineating the line between acceptable tax planning and aggressive tax planning (or abusive tax avoidance). The single minority justice in *Deans Knight*, Justice Suzanne Côté, thought so. Notably, she wrote for the court majority in the earlier *Alta Energy* case. Note also that the majority decision in *Deans Knight* is that of Justice Rowe, who dissented in *Alta Energy*. Until the SCC makes a pronouncement on point, the apparent clash between these two decisions will add another level of uncertainty to the risk analysis.

As with the SCC, there has been high turnover among judges of the Tax Court of Canada (TCC), the court of first instance for federal tax cases. Over two-thirds of that twenty-two-judge court are recent appointments (five in 2025, four in 2024, three in 2023, and three in 2022). Given the recency of these appointments, it is too early to know what direction or philosophy the new judges will follow and whether their decisions will be upheld consistently, adding unpredictability into the mix. Thankfully, the intermediary court between the SCC and the TCC, the Federal Court of Appeal (FCA), has maintained a good and consistent core of tax-trained judges

in recent years. The FCA is multidisciplinary, and five of its current twenty-three judges have substantial tax expertise and experience, adding predictability in the risk analysis.

Five Suggestions for Navigating This Sea of Changes

1. ADD RESOURCES TO THE CANADIAN TAX FUNCTION

One of our clients, a large multinational enterprise (MNE), was recently frustrated that the last audits by the CRA consumed about eighty percent of the resources of the company's tax department globally even as Canada represented about only three percent of its global sales. We can attest that the CRA audit was wide reaching. However, the fact that the recent audit monopolized most of the client's tax department was not due to the CRA's behavior alone; rather, the client's tax department was simply too small to support its business. After living through this example and many similar ones, we think it is time for companies to allocate more resources to the tax function. It is no longer relevant to look at the tax function as a cost; it has now become a matter of risk for any MNE. The CRA routinely makes adjustments of CAD 100 million per year for any sizable MNE. The penalties for noncompliance are only going to increase, and the question of reputational risk often comes into play. Properly investing time and money to prevent penalties and defend tax positions has become more critical than ever.

2. BE FOCUSED AND STRATEGIC ABOUT UNCERTAIN TAX POSITIONS

Meeting minimal standards of compliance was once viewed as acceptable, and companies took advantageous (and uncertain) tax positions at every opportunity. This approach, in our experience, is becoming riskier, subject to more CRA scrutiny, and in the long run more expensive in costs and management time. Exercising judgment in the selection of uncertain tax positions is something to consider.

3. PICK THE BATTLE

In line with the previous point, there is merit in choosing the issues that companies are willing to fight. This choice is critical, since it will help companies to focus, manage and maximize the resources they devote to a particular matter. Focus will also help the execution. For example, document retention is often an afterthought, given

that companies often keep documents they do not have to (to avoid making decisions) and do not keep documents they should keep to affirmatively advance their case. Securing evidence of key witnesses while they are employees of the company is another good example. Early detection/decision is best.

4. PICK THE BATTLEGROUND

There were times where taking a one-step-at-a-time approach to tax controversy/litigation without fully assessing the merits of the case (including its evidence) was fine. This is no longer true. Picking the right forum and audience early on is also critical to the success of the defense strategy. Not all cases should be escalated or go through the administrative appeals process, competent authority, etc. Similarly, not all cases should go to court. Here, too, focus is key to selecting the optimum forum for a particular fight.

5. ASSESS RISKS, REASSESS RISKS, REASSESS AGAIN

Given the ever-changing nature of the current tax environment, whatever strategy is set at a given time needs to be reevaluated periodically. Several reasons exist for that: a new rule/interpretation can come into play; other taxpayers may be involved in a similar issue, and the fight needs to be coordinated; or the company's objectives may change.

Conclusion

In recent years, we have seen unprecedented changes in the tax world, Canada included. They will bring uncertainty and unpredictability until their interpretation is settled. In addition, the CRA and the courts have their own realities that are also changing, adding further risk and complexity to the equation. Aggressive CRA positions are, unfortunately, increasing in our experience. Given how the CRA operates and its constantly increasing funding, this won't change in the foreseeable future. One can also speculate as to whether the current trade war between Canada and the United States will bring more aggressive or retaliatory behavior on the CRA's part when dealing with US-based multinationals. Things will get worse before they get better, and the only thing within your control as a tax executive is a robust and comprehensive risk management process. We hope that our article has alerted you to the importance of assessing the practical tax risks in that process and that our five

suggestions will help you to manage them and advance your company's best interests. ●

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Endnotes

- 1 On June 29, 2025, the Canadian government announced its intention to rescind the digital services tax legislation as part of its trade negotiations with the US government.
- 2 On June 28, 2025, the G7 issued a statement endorsing a "side-by-side" approach to the OECD's Pillar Two framework, under which US-parented groups will be fully excluded from the application of both the Income Inclusion Rule and the Undertaxed Profits Rule, with respect to their domestic and foreign profits, in recognition of the existing US minimum tax regime.
- 3 See in particular: *Canada v. Alta Energy Luxembourg S.A.R.L.*, 2021 SCC 49 (*Alta Energy*), regarding the challenge of treaty shopping under the GAAR. See also the Department of Finance Technical Paper on Treaty Shopping—The Problem and Possible Solutions, August 12, 2013, for a summary of the non-GAAR relevant decisions.
- 4 See, for example: United Kingdom, *Taxation (International and Other Provisions) Act*, 2010, Part 4 at ss 164(4); Australia, *Income Tax Assessment Act 1997*, Section 815-135(2); Mexico, *Income Tax Act*, Chapter II.
- 5 *Canada v. GlaxoSmithKline Inc.*, 2012 SCC 52 at paragraph 20.
- 6 An exception exists for downward transfer pricing adjustments under subsection 247(10) of the ITA, which turns "on the opinion of the Minister." This language grants the Minister discretionary authority, and, as a result, such determinations are reviewed under the standard of reasonableness rather than correctness. Similarly, other CRA decisions (for example, requests for information, collection matters) are discretionary and subject to a standard of reasonableness.
- 7 In a recent file, the CRA advised that "a respectable argument could be made" to articulate its reassessment position.
- 8 Consider the passage of seventeen years between the time the Canadian GAAR was enacted and the first Supreme Court of Canada (SCC) decision on point: *Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54 (*Canada Trustco*). Similarly, the SCC interpreted the Canadian transfer pricing rule fourteen years after its enactment.
- 9 Currently, the courts have required bad faith or malicious intent before condemning the CRA to damages. The notable exception is the Province of Québec, because its particular legal regime allows for state liability based on fault and does not require bad faith or malice.
- 10 Canada, Office of the Auditor General of Canada, *2018 Fall Reports of the Auditor General of Canada to the Parliament of Canada* (Ottawa: OAG, 2018) at 7.83 to 7.91.
- 11 See also Neal Armstrong, "The ILBD Is Working on Reducing the Number of TEBA-Induced Unsustainable Assessments Made by Field Auditors," *Tax Interpretations* (2018), <https://taxinterpretations.com/content/516080>.
- 12 A more accurate count would be 10.5 decisions in favor of the government and 4.5 in favor of the taxpayer. This fractional split occurred because one case, *Lipson v. Canada*, 2009 SCC 1, decided two issues, one in favor of the government and the other in favor of the taxpayer.