

BETWEEN:

ZHEN ZHEN FASHION COMPANY LTD.,

Appellant,

and

HIS MAJESTY THE KING,

Respondent.

Appeal heard on February 19, April 7 and 8, 2026, at Toronto, Ontario

Before: Associate Judge Andrew Miller

Appearances:

Agent for the Appellant: Quan Fa Yang

Counsel for the Respondent: George Lin

JUDGMENT

Further to the attached Reasons for Judgment, the appeals of the reassessments made under the *Excise Tax Act* of the appellant's quarterly reporting periods ending March 31, 2017, June 30, 2017, September 30, 2017, December 31, 2017, March 31, 2018, June 30, 2018, September 30, 2018, and December 31, 2018, are allowed, without costs, and the reassessments are referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that the appellant is not liable for the penalties totaling \$22,471.48 assessed pursuant to section 285 of the *Excise Tax Act*.

Signed this 30th day of June 2026.

“Andrew Miller”

Miller A.J.

Citation: 2026 TCC 124
Date: 20260630
Docket: 2022-2614(GST)I

BETWEEN:

ZHEN ZHEN FASHION COMPANY LTD.,

Appellant,

and

HIS MAJESTY THE KING,

Respondent.

REASONS FOR JUDGMENT

Miller A.J.

I. Introduction

[1] The appellant appeals its notices of reassessment made under the *Excise Tax Act* (the “ETA”) disallowing input tax credits (“ITCs”) claimed in respect of the quarterly reporting periods ending March 31, 2017, June 30, 2017, September 30, 2017, December 31, 2017, March 31, 2018, June 30, 2018, September 30, 2018, and December 31, 2018 (the “Periods”). The appellant is also appealing penalties assessed pursuant to section 285 of the ETA.

II. Facts

[2] The appellant operates a garment-sewing business. Ms. Xiu Zhen Zheng is the sole shareholder and sole director of the appellant. Her husband, Mr. Quan Fa Yang, runs the appellant’s day-to-day operations.

[3] The appellant files its Goods and Services Tax/Harmonized Sales Tax (“GST/HST”) returns on a quarterly basis. In filing its returns for the Periods, the appellant claimed ITCs totaling \$104,961.46. Following an audit, the Minister of

National Revenue reassessed the appellant to disallow ITCs totaling \$89,886.06 and assessed penalties totaling \$22,471.48 pursuant to section 285 of the ETA.¹

[4] The appellant is a subcontractor of Artex Sportwear Inc. (“Artex”), a company engaged in sewing government uniforms.² The ITCs in dispute relate to payments the appellant alleges to have made, inclusive of GST/HST, to three subcontractors: 9274-7872 Québec Inc., 9352-2944 Québec Inc. and 9386-8396 Québec Inc. (together the “subcontractors”).³ The appellant’s evidence is that the subcontractors provided sewing services for orders it received from Artex that the appellant could not complete in-house. The appellant had difficulties finding and retaining workers to work in its factory, which is why it relied on the subcontractors.⁴

[5] The operations of the appellant that are material to the disputed ITCs were described as follows:

- i) The appellant received orders from Artex. Materials were received by the appellant at its factory with an accompanying Artex production order that provided detailed instructions for the sewing services to be completed.⁵
- ii) In addition to the production orders, the appellant received Artex cutting reports.⁶ The cutting reports were used by the individual worker responsible for completing the work.
- iii) Throughout the Periods, the appellant had employees and independent contractors. The appellant would prioritize giving work to its employees and independent contractors. Any orders it could not complete would be sent to the subcontractors.⁷
- iv) For the work sent to the subcontractors, the appellant completed a packing slip, which was addressed to one of the three subcontractors.⁸ The original packing slip accompanied the materials, and a carbon copy of the packing slip was retained by the appellant.⁹

¹ Exhibit R-3: Letter from CRA dated October 21, 2020.

² Notice of Appeal, para. (c)1; Reply to the Notice of Appeal, para. 11(c)(iv). The respondent’s reply refers to a second company called Expansion Enterprises (Canada) Inc. of which the appellant was also a subcontractor. The evidence submitted was only in respect of Artex.

³ Reply to the Notice of Appeal, para. 11(s).

⁴ Cross-examination of Mr. Yang, February 19, 2026.

⁵ Exhibit A-1: Artex Sportwear Inc. production orders, pages 124-129 of appellant’s book of documents.

⁶ Exhibit A-5: Artex Sportwear Inc. cutting reports, pages 239-247 of appellant’s book of documents.

⁷ Cross-examination of Mr. Yang, February 19, 2026.

⁸ Exhibit R-1: Packing slips, pages 263-266 of appellant’s book of documents.

⁹ Cross-examination of Mr. Yang, April 7, 2026.

v) Once the work was completed by the subcontractors, the work product was delivered to the appellant's factory along with an invoice.¹⁰ The appellant would conduct a quality check of the work and if that exercise revealed no issues, the appellant would pay the subcontractors by way of cheque.¹¹

vi) The completed work would then be picked up by Artex. The appellant would create a delivery note that an Artex employee would sign at the time of pick-up.¹²

[6] The appellant was referred to the subcontractors through an agent whose role was described as that of a "middleman" between the appellant and the subcontractors. The agent was referred to the appellant through a friend of Mr. Yang's. This agent has since disappeared, and the appellant is no longer using his services.¹³

III. Issues

[7] The issues in this appeal are:

1. whether the appellant is entitled to ITCs in the total amount of \$89,886.06 for the Periods; and
2. whether the appellant is liable for penalties in the amount of \$22,471.48 pursuant to subsection 285 of the ETA.

IV. Analysis

A. Grounds raised in the appeals

[8] The appellant, a corporation, chose to be represented by Mr. Yang. Mr. Yang is not a lawyer. This choice of representation is permitted for appeals governed by the informal procedure rules of this Court.

[9] The appellant says that it paid the subcontractors, including GST/HST, for sewing services they provided. The arrangement it had with the subcontractors was a common practice in the garment-sewing industry, and the Canada Revenue Agency (the "CRA") treated it unfairly by disallowing the ITCs given that the appellant is a

¹⁰ Exhibit A-2: Invoices from 9352-2944 Québec Inc., pages 141-142 of appellant's book of documents.

¹¹ Exhibit A-3: Cheques from appellant, pages 272-283 of appellant's book of documents.

¹² Exhibit A-4: Delivery notes, pages 194-214 of appellant's book of documents.

¹³ Cross-examination of Mr. Yang, April 7, 2026.

small business and does not have the same accounting and record-keeping capabilities as larger companies. The appellant says that it provided the CRA with the necessary documentary evidence to support the ITCs it claimed.¹⁴ The appellant says that it is entitled to the disallowed ITCs.

[10] The respondent's grounds for dismissing the appeals are the following:

- a) The appellant participated in sham transactions to claim ITCs and reduce its net tax for the Periods.
- b) The appellant did not acquire any property or service from the subcontractors, as required by subsection 169(1) of the ETA.
- c) In the alternative, the appellant is not entitled to ITCs as it does not meet the requirements for ITCs pursuant to subsection 169(4) of the ETA and the *Input Tax Credit Information (GST/HST) Regulations* (the "ITC Regulations").
- d) The appellant made false statements or omissions in its GST/HST returns and in its supporting documentation and is therefore liable for penalties totaling \$22,471.48 pursuant to section 285 of the ETA.

B. Does the sham doctrine apply

[11] The respondent argues that the appellant, along with the subcontractors and the agent, engaged in a scheme to represent the existence of transactions they knew did not reflect the legal rights and obligations they intended in order to enable the appellant to claim ITCs to lower its net tax. The respondent says that there was no supply of sewing services to the appellant by the subcontractors. Accordingly, the doctrine of sham applies, and the ITCs should remain disallowed.

[12] The following passage from this Court's decision in *Lee* is a helpful synopsis of the sham doctrine:

[A] transaction is a sham when the parties to the transaction present the legal rights and obligations of the parties to the transaction in a manner that does not reflect the legal rights and obligations, if any, that the parties intend to create. To be a sham, the factual presentation of the legal rights and obligations of the parties to the sham must be different from what the parties know those legal rights and obligations, if any, to be. The deceit is the factual representation of the existence of legal rights

¹⁴ Notice of Appeal, para. (f).

when the parties know those legal rights either do not exist or are different from the representation thereof.¹⁵

[13] The evidence does not support a finding that the sham doctrine applies. The appellant's evidence came mainly from the testimony of Mr. Yang. His testimony was not without deficiencies. Certainly, there was much confusion, and many questions were left unanswered. However, nothing struck me as dishonest in his account, and nothing arose that leads me to believe that the appellant knowingly attempted to present rights and obligations between it and the subcontractors that did not exist.

[14] The evidence reveals that the appellant was a subcontractor of Artex and provided Artex with sewing services. Orders from Artex to complete sewing services were received by the appellant, and materials for garments were dropped off by Artex at the appellant's factory. The appellant either completed the sewing services in-house or subcontracted out the orders it determined it could not complete in-house.

[15] The subcontractors the appellant relied on during the Periods were identified by an agent who acted as a middleman between the appellant and the subcontractors. Someone working for the subcontractors picked up the materials at the appellant's factory, that person was provided with instructions for the work to be completed and the completed work was returned to the appellant days or weeks later accompanied by an invoice. The appellant conducted quality checks of the completed garments and then paid the subcontractors by way of cheque. The completed work was then picked up by Artex at the appellant's factory.

[16] The respondent argues that the appellant's business practices are not the practices of a reasonable businessperson. For example, the respondent says that a reasonable businessperson would not blindly rely on an agent it did not previously know to act as middleman between it and the subcontractors. The evidence also reveals that neither Mr. Yang nor Ms. Zheng visited the factories of the subcontractors. Accordingly, I should not accept the appellant's account of what took place. Instead, the respondent argues, what took place was a sham to permit the appellant to reduce its net tax for the Periods by claiming ITCs it was not entitled to.

[17] Additionally, the respondent argues that the appellant's documentary evidence recording the alleged transactions between the appellant and the

¹⁵ *Lee v. Her Majesty the Queen*, 2018 TCC 230, at para. 59.

subcontractors suffers from several deficiencies.¹⁶ The respondent says that these deficiencies highlight the appellant's attempt to mislead or to represent rights and obligations that it knew to be otherwise. I do not agree. I find that the errors, inconsistencies and unanswered questions surrounding the appellant's documents are the result of disorganization and inadequate bookkeeping and record-keeping practices by the appellant and not an attempt to mislead.

[18] I agree with the respondent that the appellant's decisions, practices and bookkeeping are not reflective of a reasonable businessperson. However, for the purposes of determining whether the sham doctrine applies, reasonableness plays no part. The question I need to answer is whether the appellant represented rights and obligations between it and the subcontractors that it knew did not exist.

[19] Perhaps evidence from the agent or the subcontractors would have revealed the requisite deceit to conclude that sham applies, but all that is before me is the testimony of Mr. Yang and the appellant's business records.¹⁷ That evidence reveals that while the appellant ran a poorly organized business and kept records in a substandard and disorganized manner, the appellant also acquired and paid for sewing services from the subcontractors. On a balance of probabilities, I find that the appellant did not knowingly represent rights and obligations it knew did not exist. Therefore, sham is not engaged to disallow the ITCs.

C. Did the appellant acquire property or services from the subcontractors

[20] My conclusion that sham does not apply in the present matter is premised, in part, on factual findings that the appellant acquired services from the subcontractors. There is no need to repeat in detail those findings. Based principally on the testimony of Mr. Yang and the evidence of payments being made to the subcontractors, the appellant has discharged its burden of proof. On a balance of probabilities, the evidence reveals that the appellant acquired sewing services from the subcontractors during the Periods and paid GST/HST on the acquired services.

D. Are the ITC requirements met

¹⁶ At the time the documents relied on by the appellant for its ITCs were tendered as evidence the respondent agreed that they be marked as exhibits but noted that the respondent was not conceding that they were authentic or conceding to the truth of their contents. Generally, a document that is not authentic is not relevant. However, in light of the grounds raised by the respondent, they are relevant and were marked as exhibits.

¹⁷ Ms. Zheng also testified but her testimony was of little assistance.

[21] In *Systematix Technology Consultants Inc.* the Federal Court of Appeal found that the requirements in paragraph 169(4)(a) of the ETA and the ITC Regulations (together the “ITC requirements”) are mandatory.¹⁸ The documents provided by the appellant to support its ITCs fall well short of the ITC requirements.

[22] The documents provided by the appellant to substantiate the claimed ITCs consist of the appellant’s general ledger, packing slips, invoices and cheques. I note, however, that not all of the ITC amounts were accounted for by way of documentary evidence. In any event, there is a sufficient number of unanswered questions, inconsistencies and inexplicable errors in many of the appellant’s documents to cause me to have no confidence in the accuracy of the information contained in any of them. The following is a review of the most glaring problems with the appellant’s documents.

i) Packing slips

[23] The appellant’s evidence is that it created packing slips when materials were picked up by a subcontractor. The subcontractor’s worker charged with picking up the materials from the appellant’s factory was provided with an original packing slip, and the carbon copy was retained by the appellant. According to the appellant, the packing slips in evidence are the carbon copies it retained, and the appellant relies on these to show that it hired the subcontractors to complete sewing services.

[24] The packing slips in evidence undermine the appellant’s account of how and when they were created. Indeed, some of the packing slips are clearly not carbon copies, which suggests that they were created by the appellant after its dealings with the subcontractors.¹⁹ Other packing slips are carbon copies but have obviously been modified after their original creation.²⁰ There are also packing slips that have the subcontractors incorrectly identified either in name or by address.²¹

[25] I have been provided with no acceptable explanation for these inconsistencies and errors in the information contained on the packing slips. As a result, I cannot

¹⁸ *Systematix Technology Consultants Inc. v. Her Majesty the Queen*, 2007 FCA 226, at paras. 4-6.

¹⁹ Exhibit R-11: Packing slip, page 798 of respondent’s book of documents; Exhibit R-12: Packing slip, page 802 of respondent’s book of documents; Exhibit R-13: Packing slip, page 806 of respondent’s book of documents.

²⁰ Exhibit A-1: Packing slips, pages 131 and 133 of appellant’s book of documents; Exhibit R-4: Packing slip, page 669 of respondent’s book of documents; Exhibit R-8: Packing slip, page 770 of respondent’s book of documents; Exhibit R-9: Packing slip, page 773 of respondent’s book of documents; Exhibit R-10: Packing slip, page 778 of respondent’s book of documents.

²¹ Exhibit A-1: Packing slip, page 131, Invoice, page 139 of appellant’s book of documents; Exhibit A-2: Invoices, pages 141-142 of appellant’s book of documents; Exhibit R-5: Packing slip, page 677 of respondent’s book of documents.

rely on any of the packing slips as authentic documents, nor can I rely on them for the truth of their contents.

ii) Invoices and cheques

[26] The appellant's evidence is that once the subcontractors completed their work, the completed garments were returned to the appellant's factory with an accompanying invoice from the subcontractor. The appellant would then conduct quality checks of the work and then pay the subcontractor by way of cheque.

[27] Many of the invoices and cheques submitted to substantiate the claimed ITCs contain inconsistencies with the appellant's account of its dealings with the subcontractors. Others contain errors or inaccuracies for which no reasonable explanation was provided. The following is a list of some of the deficiencies of these records:

- i) Invoices from a subcontractor with the same date as the corresponding packing slip sending materials to the subcontractor.²²
- ii) Invoice from a subcontractor dated weeks before the corresponding packing slip sending materials to the subcontractor.²³
- iii) Name and address of the subcontractor on the invoice that does not match the subcontractor's address found on the corresponding packing slip.²⁴
- iv) Cheques to subcontractors that pre-date the invoice from said subcontractor.²⁵
- v) Two invoices with different dates from a subcontractor for the same work order.²⁶
- vi) Cheque made in payment to a subcontractor in respect of an invoice from a different subcontractor.²⁷

²² Exhibit R-8: Packing slip and invoice, pages 770 and 771 of respondent's book of documents; Exhibit R-10: Packing slip and invoice, pages 778 and 779 of respondent's book of documents; Exhibit R-11: Packing slip and invoice, pages 798 and 799 of respondent's book of documents; Exhibit R-12: Packing slip and invoice, pages 802 and 803 of respondent's book of documents.

²³ Exhibit R-13: Packing slip and invoice, pages 806 and 807 of respondent's book of documents.

²⁴ Exhibit R-9: Packing slip and invoice, pages 773 and 774 of respondent's book of documents.

²⁵ Exhibit R-7: Invoice and cheque, pages 754 and 755 of respondent's book of documents.

²⁶ Exhibit R-9: Invoices, pages 774 and 775 of respondent's book of documents.

²⁷ Exhibit R-9: Invoices and cheque, pages 774, 775 and 776 of respondent's book of documents.

vii) Cheque made out to a subcontractor but recorded in the appellant's general ledger as a payment to a different subcontractor.²⁸

viii) Invoice from a subcontractor recorded in the appellant's general ledger as paid to a different subcontractor.²⁹

[28] The appellant has provided no acceptable explanation for these inconsistencies and errors in the information contained on the invoices and cheques. As with the packing slips, I cannot rely on them as authentic documents, nor can I rely on them for the truth of their contents.

iii) Conclusion on ITCs

[29] While I accept that the appellant paid GST/HST on the supplies of sewing services it acquired from the subcontractors, the ITC requirements mandate that the supporting documentation contain information that will enable the amounts of ITCs to be determined.³⁰ The state of the appellant's records leaves me with no confidence in the accuracy of the information contained therein, namely the name of the supplier, the date of the invoice or the date the tax was paid or payable, and the total amount paid or payable for the supplies.³¹

[30] Mr. Yang accepts that there are errors in the appellant's records, but those errors and his inability to explain why those errors occurred lead me to believe that these are not random anomalies and are a reflection of general substandard record-keeping practices. For these reasons, I cannot rely on any of the documents tendered by the appellant in support of the claimed ITCs. Therefore, the appellant is not entitled to the claimed ITCs on the basis that it did not comply with the ITC requirements.

E. Liability for section 285 penalties

[31] Section 285 of the ETA applies to a person who "knowingly, or under circumstances amounting to gross negligence, makes or participates in, assents to or acquiesces in the making of a false statement or omission in a return, application, form, certificate, statement, invoice or answer". The respondent argues that the

²⁸ Exhibit R-9: Cheque, page 776 of respondent's book of documents; Exhibit R-2: Appellant's General Ledger, page 615 of respondent's book of documents.

²⁹ Exhibit R-15: Invoice, page 810 of respondent's book of documents; Exhibit R-2: Appellant's General Ledger, page 618 of respondent's book of documents.

³⁰ See subsection 169(4) of the ETA and sections 2 and 3 of the ITC Regulations.

³¹ See section 3 of the ITC Regulations.

appellant is liable for penalties under section 285 of the ETA because the appellant, either knowingly or due to gross negligence, made false statements or omissions in its GST/HST returns for the Periods and in the documentation used to support its claim for ITCs.

i) GST/HST returns

[32] Further to my findings that the sham doctrine is not engaged in these appeals, I do not believe that the appellant knowingly made any false statements or omissions in its GST/HST returns for the Periods. I find that the appellant acquired and paid for sewing services from the subcontractors and claimed ITCs in its GST/HST returns it believed it was entitled to claim.

[33] Moreover, I concluded that the appellant is not entitled to the ITCs it claimed because the documents submitted in support of them do not meet the ITC requirements. My finding in that regard does not go so far as to conclude that the appellant made a false statement or omission in its GST/HST returns. Indeed, the amounts claimed by the appellant as ITCs may reflect the GST/HST it paid in respect of the sewing services it acquired during the Periods. Where the appellant fails is in its ability to substantiate the amounts it claimed as mandated by the ITC requirements.

[34] This distinction is important as it would be inconsistent, on the one hand, to say that the ITCs are disallowed because it is impossible to determine the correct amount, and, on the other hand, to conclude that the appellant misrepresented the correct amount in its GST/HST returns. The latter would require certainty of the correct amount, and in the present instance there is none due to the inadequate documentation. Failure to comply with the ITC requirements based on inadequate books and records does not necessarily lead to the conclusion that the appellant, in its GST/HST returns, made false statements or an omission in respect of the GST/HST paid for the supplies.³²

[35] Because I am unable to determine the correct amount of ITCs for the Periods, I also cannot determine whether the appellant misrepresented anything in respect of the ITCs claimed in its GST/HST returns. The inability to determine the correct amount of ITCs, and thus the inability to determine whether there was a false statement or omission in its GST/HST returns, precludes the need to determine

³² *Urpesz v. Her Majesty the Queen*, [2001] T.C.J. No. 334, at para. 16.

whether the appellant was grossly negligent in claiming its ITCs in its GST/HST returns.

ii) Supporting documentation for ITCs

[36] I have no confidence that the documents relied on by the appellant to support the ITCs it claimed are an accurate reflection of what they purport to be. As such, they qualify as false statements or omissions. Therefore, I need to determine whether these false statements and omissions were done knowingly by the appellant or due to its gross negligence.

[37] Once again, consistent with my findings with respect to the application of the sham doctrine, I find that the appellant did not knowingly make false statements or omissions in the documentation it relied on in support of the ITCs. The evidence reveals that the false statements and omissions contained in the appellant's documents are the result of substandard record-keeping and bookkeeping practices and a generally disorganized business.

[38] What remains to determine is whether the false statements and omissions contained in the documentation relied on by the appellant was the result of gross negligence. In *Venne*, the Federal Court stated that gross negligence "must be taken to involve greater neglect than simply a failure to use reasonable care. It must involve a high degree of negligence tantamount to intentional acting, an indifference as to whether the law is complied with or not."³³

[39] I would describe the appellant's record-keeping and bookkeeping practices as negligent, and many other adjectives might also apply. I also find that the false statements and omissions contained in the documents are due to these negligent record-keeping and bookkeeping practices. However, I find that this negligence is not such that it amounts to gross negligence as described above by the Federal Court.

[40] The appellant neither knowingly, nor due to gross negligence, made false statements or omissions in its GST/HST returns for the Periods or in its documents used to support the claimed ITCs. For these reasons, the appellant is not liable for the penalties assessed under section 285 of the ETA.

F. Conclusion

³³ *Venne v. Canada (Minister of National Revenue – M.N.R.)*, [1984] F.C.J. No. 314, at para. 28.

[41] The appellant is not entitled to the ITCs totaling \$89,886.06 that were disallowed by the Minister, but the appeals in respect of the Periods are allowed, without costs, on the basis that the appellant is not liable for the penalties totaling \$22,471.48, assessed under section 285 of the ETA.

Signed this 30th day of June 2026.

“Andrew Miller”

Miller A.J.

CITATION: 2026 TCC 124

COURT FILE NO.: 2022-2614(GST)I

STYLE OF CAUSE: ZHEN ZHEN FASHION COMPANY LTD. AND HIS MAJESTY THE KING

PLACE OF HEARING: Toronto, Ontario

DATE OF HEARING: February 19, April 7 and 8, 2026

REASONS FOR JUDGMENT BY: Associate Judge Andrew Miller

DATE OF JUDGMENT: June 30, 2026

APPEARANCES:

Agent for the Appellant: Quan Fa Yang
Counsel for the Respondent: George Lin

COUNSEL OF RECORD:

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Name: N/A

Firm: N/A

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