

ORAL AGREEMENTS WORTH MORE THAN THE PAPER THEY'RE WRITTEN ON

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The Federal Court recently ruled that taxpayers may be required to disclose descriptions of records that should have been kept by the taxpayer, including oral contracts and invoices, when audited by the Canada Revenue Agency (the “**CRA**”).

In *Canada (Minister of National Revenue) v Miller*, the Federal Court held that the CRA can compel a taxpayer to provide an account of the terms and conditions of a business relationship, the services rendered and the amounts invoiced when such items have not been committed to writing by the taxpayer.^[1] The Court further held that taxpayers are required to put forth reasonable efforts to obtain copies of certain documents that are not in their possession in response to requests made during a CRA audit.

Background

The taxpayer, Miller, was a consultant for foreign companies entering the Canadian public market. Miller received payments from one particular client, Casala Limited (“**Casala**”), through accounts maintained in Luxembourg.

The CRA began auditing Miller in 2018. In 2020, the CRA requested the Court issue a compliance order under subsection 231.7(1) of the *Income Tax Act* (the “**Tax Act**”) to compel Miller to reveal information and documents that were not provided at the CRA’s request. The information requested included contracts and invoices between Miller and Casala that, as alleged by Miller, were made orally. In addition, the CRA requested a series of documents, including trust ledgers and bank statements, that were in the possession of Miller’s Luxembourg bank and his counsel.

The Federal Court’s decision

Miller argued that he could not be compelled to disclose the details of oral contracts made with Casala, primarily relying on the Federal Court of Appeal’s reasoning in *Canada (Minister of National Revenue) v Cameco Corporation*.^[2] In *Cameco*, the Court held that the ability of the CRA to inspect books and records during an audit did not extend to an ability to compel employees to attend oral interviews. In Miller’s view, this

suggested that information not contained in his actual books and records did not fall within the ambit of the CRA's initial audit inquiry powers.

The Federal Court rejected this interpretation. Referring to the language used in subsection 231.1(1) of the Tax Act, which captures information that "should be" in the taxpayer's books and records, the Court found that *Cameco* does not protect a taxpayer from providing an account of information that *ought to have been documented*. The oral contracts and invoices, in the Court's view, fell firmly into this category. As a result, Miller was obligated to disclose the information upon request.

On the other hand, the Court found that Miller was not obligated to provide a narrative of how he developed his business with Casala. Unlike the oral contracts and invoices, the narrative was not the type of information that ought to have been documented in Miller's books and records.

Miller further argued that documentation related to his Luxembourg bank account, and information from trust ledgers held by Miller's counsel, could not be provided. For the Luxembourg accounts, Miller claimed that the COVID-19 pandemic prevented him from travelling to receive the documents. For the trust ledgers, Miller argued that he could not be forced to obtain documents that were not in his possession.

The Court disagreed that Miller was excused from seeking out the documents. While Miller could not be required to travel to Luxembourg, he was still expected to make reasonable efforts to obtain the documents by contacting the party in possession of the documents, such as the bank in Luxembourg or his counsel. Only if Miller was unable to obtain the documents after attempting to do so would he then be in a position to explain the deficiency to the CRA.

Miller has appealed the Court's decision to the Federal Court of Appeal. For now, however, this decision represents the current state of the law.

Takeaway

The Federal Court's decision in *Miller* is an important alert to taxpayers that the CRA can compel the production of the terms of an oral agreement, even where no written records exist.

Where a taxpayer *ought to have documented* information pertaining to a commercial transaction in its books and records, the CRA is permitted, in the course of an audit, to compel the taxpayer to provide a description of the terms and conditions of the transaction sufficient to establish the parameters of the taxpayer's business relationship.

Ultimately, taxpayers should not assume that an agreement that has not been committed to writing is immune from production in the course of a CRA audit.

[1] 2021 FC 851 (“Miller”).

[2] 2019 FCA 67 (“Cameco”).

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A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

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