TAX TALK

Meal expenses as a tax strategy for incorporated O/Os

Tax Talk

Scott Taylor

We all watched over the past four years as a British Columbia lawyer marched a class action lawsuit over meal allowance claims through the courts. Tom Johnston of Summerland, B.C., rallied nearly 2,200 people to join the suit (for a fee) based on an argument that truck drivers should be entitled to deduct a daily meal expense equal to the per diem allowance given to federal government employees: roughly $73.50 a day.

The suit is now dead after being dismissed by the Supreme Court of British Columbia, by a provincial appeals court, and, last December, by the Supreme Court of Canada. The courts said the argument is flawed because it tries to compare a tax deduction with an employment benefit. They just aren't the same thing.

Truck drivers get a tax deduction on a portion of the meals they consume while they're on the road (50% or 60% of $51 a day, or $17 per meal, in 2006). Federal civil servants get an expense allowance. The Canada Revenue Agency field auditor who's poring over your tax returns doesn't have to calculate a meal-expenses deduction on his tax return. He simply turns in a travel expense form and his employer pays him back.

If you want the same sort of treatment, you don't need a class action lawsuit. You need to be employed by a company that provides a reasonable per diem as part of your overall compensation.

You can always apply for a job with the federal government. Or, if you're an owner/operator, you can incorporate your business and go to work for it.

When you incorporate, your company is separate from your personal finances. It becomes a distinct entity with you as the primary shareholder. As the main shareholder, you can appoint yourself director. As director, you can appoint yourself president. As president, you can hire yourself as an employee and include a per diem for meals and travel as part of your overall compensation.

There can be big tax advantages:

1. A per diem paid to you by your corporation is a tax-free benefit. You don't report it as income on your personal income tax return. As a truck driver on the road 50 weeks a year, it can really add up. Let's say your company policy on meal and travel expense reimbursement is $70 a day. That could put as much as $350 a week – $17,500 a year – into your pocket tax-free.

2. You can reduce your taxable income. You'd have to earn approximately $24,000 in gross salary to net $17,500 take-home pay. If your household budget requires you to bring $40,000 or more into the home, you can lower your taxable income from salary or dividends and make up the difference with the travel and meal allowance.

3. Your corporation would save payroll-related expenses because it would pay you less taxable income even though the net amount you take home – the salary plus per diem – would be the same.

4. By incorporating, your meal claim is safely and legitimately calculated either on the TL2 form or through the travel per diem based on your away-from-home time recorded in your logbook. Sole proprietors need to document their claims with receipts – a logbook no longer can be used to substantiate a meal claim.

Like any other strategy designed to reduce your tax obligation, you need to take steps to ensure that your actions will stand up in case of an audit. For example:

• The per diem amount must be reasonable. Is $70 reasonable? That's up to you to judge, but it is the standard our own federal government uses to compensate civil service employees for travel expenses. A CRA auditor or a scientist with Environment Canada may not be away from home 250 days a year like you are, but the same principle applies.

• Establish policies and procedures for expenses. Your company should require you to complete travel expense forms and submit them in order for the allowance to be paid. You need to be diligent about following these procedures and not just write cheques to yourself or take cash for the allowance. A proper paper trail will prevent CRA from poking a hole in this strategy.

• If you have employees other than yourself, you must pay the same allowance to all who qualify. It can't be just for you.

Finally, talk to your tax advisor about whether incorporation is the best choice for you, and then whether it's a good idea for your compensation to include an allowance for meals and travel. Cutting your taxable income may save you $3,000 or $4,000 in tax, but there can be a big downside to earning less – everything from lower Canada Pension Plan contributions to a weaker financial position when you apply for a loan. You rarely hear about the pitfalls of using a per diem as a tax strategy. I'll cover these next month. □

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