Tax Talk

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The underground economy and trucks

In April, Statistics Canada released its latest report on Canada's underground economy.

Typically this is where, with a wink and a nod, the contractor building the deck on your house agrees to take less if you pay cash, or the waitress pockets your tip and fails to report it for tax purposes.

There are examples not related to employment – guys who sell used vehicles for cash on Craigslist or Autotrader, for instance.

The underground economy adds up. In 2012, the total value was estimated at $42.4 billion, which is equivalent to 2.3% of Canada's GDP.

Some of this economy moves by truck.

In 2013, Canada Revenue Agency concluded a two-year crackdown that focused on individuals and businesses in the oil and gas sector, particularly pilot car drivers and hot shots. CRA reviewed more than 4,000 tax accounts in northern British Columbia and the Yukon and produced nearly $3 million in federal tax and penalties.

It shows that for all of CRA's talk about going after the high-net-worth tax cheat sunning himself offshore, they're flushing out guys living off the grid and keeping their cash under a mattress.

Here's the deal:

So let's look at cash transactions strictly from the point of view of you as an owner/operator.

You're a shrewd person. You're on the lookout for ways to save money. After all, it's not what you earn that counts, it's what you keep.

A cash deal means you pay less, right?

That's the idea. Typically someone offering a cash price will mention that you'll save money by not paying GST/HST. Well, you're a business and can claim 100% of all GST/HST that you pay on expenses. You're getting the GST/HST back anyway. Therefore, this "benefit" has zero value to you.

Second, consider the effect on your income tax bill.

You pay income tax and CPP based on the bottom line of your business statement. By paying cash you're giving up the ability to deduct this expense and reduce your income.

After all, you have no proof of payment, no cancelled cheque, no debit from your account, no credit card receipt, and no invoice from the business you dealt with.

You may have a cash withdrawal from your bank account but that's not good enough to support an expense claim.

A $1,000 business expense properly documented will save you about $240

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on your tax return so your net out-of-pocket is $760. If you pay cash, you're not entitled to an income tax deduction and reduction in income.

You're out of pocket whatever amount you paid. If that cash price is not lower than 75% of the normal receipted price, there's literally nothing in it for you.

Another take on the math:

Here's another way to do the math.

Say you have $10,000. You spend $1,000 on a legitimate business expense leaving $9,000 in your pocket. You owe $2,160 in income tax ($9,000 times 24%). After paying CRA, you have $6,840 remaining.

If you paid the $1,000 as cash and have no receipt, CRA thinks you still have $10,000 in taxable income. You owe $2,400 in tax ($10,000 times 24%). So what's left in your pocket? $10,000 less $1,000 less $2,400 equals $6,600.

The cash purchase cost you $240 more than the above-board transaction where you could declare the $1,000 expense.

There are other moral and business reasons not to do cash deals. No receipt means no warranty, support, or guarantee of workmanship. And if your buddy isn't paying income tax then somehow, some way, you and I will have to pay more to make up for him. I don't know about you, but I hate paying taxes. Often, though, you're better off when you do.

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