

Per diem pitfalls: Meal expense strategy has drawbacks

There are good reasons why government agencies and many corporations offer a per diem instead of reimbursing employees for travel expenses. A daily allowance simplifies expense reporting (generally, no receipts required), makes the company's travel and entertainment budget a lot more predictable, and gives employees some latitude about their spending choices while they're on the road.

And what the employee doesn't use, he pockets tax-free.

For the past few months, we've been talking about how incorporated owner/operators can include a reasonable allowance for meals and travel as part of their overall compensation package. (See the April and May issues or visit www.trucknews.com.)

The potential tax savings are significant. Let's say your corporation

Tax Talk

Scott Taylor



pays you an annual salary of \$40,000. If you took a \$70 per diem, it would amount to \$17,500 a year, tax-free (five days a week away from home, working 50 weeks a year). Because you'd have to earn \$24,000 in salary in order to bring home \$17,500 after taxes, you could pay yourself \$16,000 a year, take \$17,500 in compensation for meals, and net the same amount as your \$40,000 salary today.

As a tax strategy, you're reducing taxable income without cutting your overall net take-home compensation. But you rarely hear

about the potential drawbacks of replacing income with a tax-free per diem.

Before you order up a travel allowance from your corporation, you should have a serious discussion with your accountant or business advisors about these issues:

Canada Pension Plan: The amount you pay into the Canada Pension Plan is based on your employment earnings (if you're self-employed, it's based on net business income after expenses). The less you earn, the less you're obligated to pay into the plan. At \$40,000 a year, your total CPP contribution is \$3,613.50. At \$16,000, it's \$1,237.50. That's a savings of \$2,376 a year.

The CPP uses your contributions to determine whether you or your family is eligible for monthly benefits when you retire. Normally, the

more you earn and contribute to the CPP over the years, the higher the retirement benefit will be. How far away are you from retirement? How much are you counting on CPP for your retirement income? What about survivor benefits for your family? CPP not only supplies retirement income but also pays pension income to your spouse and kids should you die.

So while a lower annual salary may reduce your CPP obligation, the less you put in, the less you'll get out of it.

Registered Retirement Savings Plan: An RRSP is not just a retirement plan, it's an important part of tax planning. Annual RRSP contributions are limited to 18% of your income. At \$16,000, your annual contribution limit is \$2,880 each year versus \$7,200 with a \$40,000 income. Once again, are you close to retirement? If you are five to 10 years away, curtailing your ability to contribute to your RRSP may not be a good option.

Borrowing power: "Debt servicing" is the term financial institutions use to define the ratio of how much money you pay to lenders versus the total income you have. Most financial institutions will not recognize and include allowances as part of your income. When a loan officer reviews your application, all he's going to see is \$16,000 in annual income. It's going to be a lot tougher getting approved for a line of credit, mortgage, or personal loan at this salary versus \$40,000.

Income replacement: You probably have insurance through your corporation or carrier for workers' compensation or some other form of disability insurance. Once again, benefits are based on your annual salary. At a reduced income of \$16,000, you would be paid much less should you make a claim. Your lost income calculation would not include the per diem.

If your goal is to save as much tax as possible on the money you earn today, then the per diem strategy is a definite winner. But you need to make informed decisions. Given the potential tax savings a lower annual salary can bring, it's easy to look past how it affects tax planning, saving for retirement, financing personal or business investments, and even your exposure to audit by the Canada Revenue Agency.

Your accountant should be able to clarify how this strategy would apply to your specific situation. If you get blanket statements or general pronouncements instead, find yourself a different advisor. There's more than meal money at stake.

Finally, if you're headed to the Atlantic Truck Show (June 8-9 at the Moncton Coliseum), stop and see us at Booth 510. I'd love to hear what you think of the column and answer any questions you have. □

— Scott Taylor is vice-president of TFS Group, a Waterloo, Ont., company that provides accounting, fuel tax reporting, and other business services for truck fleets and owner/operators. For information, visit www.tfsgroup.com or call 800-461-5970.