ITC recapture: Phase-out update in Ontario and Prince Edward Island

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Online Tax Strategies

It is finally happening! The ongoing compliance and recapture restrictions that large business have had to contend with since 2010 in Ontario are finally going away. While the changes are very welcome, ensuring your organization is prepared and correctly accounting for the change is almost as important as the initial reporting was to ensure that your organization is no longer absorbing the tax, or a portion of the tax, as a cost—a concept that effectively is contrary to the basics of a value-added tax regime.

The specific provisions previously applied to large businesses—organizations that exceeded $10 million in taxable and zero-rated revenues during their last fiscal year (including all sales made by associated entities). These organizations were required to recapture a portion of their input tax credits (ITCs) claimed in respect of the provincial part of the HST paid or payable on specified property and services in Ontario and Prince Edward Island[1].

Specified property and services

Generally speaking, the specified property and services to which the recaptured input tax credit (RITC) requirement and the ITR restriction applies include:

- specified road vehicles;
- fuel (other than diesel) for use in specified road vehicles;
- energy (not directly used for manufacturing purposes);
- most telecommunication services; and
- certain meals, beverages and entertainment (generally those subject to the 50 percent income tax limitation).

Failure to recapture ITCs at the time and in the manner required can result in the imposition of penalties. Penalties can be assessed for both under- or over-reported RITCs or restricted ITRs.

Rate of ITC recapture and phase-out

RITCs are administered by the federal government on behalf of the governments of Ontario and Prince Edward Island under the terms of their respective HST agreements. In both cases, the agreements provided that the rate of ITC recapture will be 100 percent for the first five years in which the agreement is in place and will then be gradually phased out as the recapture rate is reduced by 25 percent per year. The ITC recapture for Ontario was to be phased out as shown in the following table:

Table A

ITC recapture – Ontario

(8% provincial component of HST)

Period	**Recapture rate**
July 1, 2010 to June 30, 2015	100%
July 1, 2015 to June 30, 2016	75%
July 1, 2016 to June 30, 2017	50%
July 1, 2017 to June 30, 2018	25%
On or after July 1, 2018	0%

Prince Edward Island began its three-year phase-out period of the province's HST RITC rules on April 1, 2018. The ITC recapture for Prince Edward Island will be phased out as follows:

Table B

ITC recapture – Prince Edward Island

(10%provincial component of HST)

Period	**Recapture rate**
April 1, 2013 to March 31, 2018	100%
April 1, 2018 to March 31, 2019	75%
April 1, 2019 to March 31, 2020	50%
April 1, 2020 to March 31, 2021	25%
On a after April 1, 2021	0%

How to prepare

With the phase-out of the recaptured ITCs in Ontario and Prince Edward Island always evolving, large businesses must ensure that their systems are updated to correctly account for the ITC recapture for specified property and services.

Because large businesses are required to account for RITCs in the GST/HST return for the first period in which the ITC becomes available, the change in rate will have to be reflected in the first return due following the change in the recapture rate.

If the adjustment is not made in the return as required and the ITC continues to be recaptured at a higher rate (instead of the reduced rate), it will not be possible to recover the tax in question by simply adjusting a subsequent return. Instead, the business will be required to amend the return for the period in question.

The changes affect not only purchases made directly by the organization but also, to a significant extent, employee reimbursements and allowances which generally have a significant amount of restricted or recaptured expenses included.

Thus, managing the change in recapture and restrictions rates often involves multiple changes within an organization's accounting system.

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[1] For these purposes, the threshold amount for large business will include taxable and zero-rated revenues in respect of supplies made in Canada or outside Canada through a permanent establishment in Canada by the organization and its associates. Certain financial institutions also qualify as large businesses for these purposes, regardless of their threshold amount.

Do not hesitate to contact your Raymond Chabot Grant Thornton advisor who can help you determine which measures apply to your situation and assist you with the steps needed to benefit from these measures.

For further information, visit our website at rcgt.com.