ITC recapture: Second stage of phase-out for Ontario HST

June 2016

Large businesses that exceeded $10 million in taxable and zero-rated revenues during their last fiscal year are required to recapture a portion of their input tax credits (ITCs) claimed in respect of the provincial part of the Ontario HST paid or payable on specified property and services.[1] The first stage of the phase out of the recapture rate began on July 1, 2015. Starting July 1, 2016, the second stage of this recapture rate phase out will commence.

Specified property and services

Generally speaking, the specified property and services to which the recaptured input tax credit (RITC) requirement applies include specified road vehicles, energy, 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.

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 provide 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. As a result, unless the federal and provincial governments concerned announce changes to this schedule, the ITC recapture for Ontario continues 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%

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

How to prepare

With the second rate reduction of the RITC in Ontario quickly approaching, large businesses in Ontario must ensure that their systems are prepared to correctly account for the adjusted recapture rate 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 for periods starting July 1, 2016. If the adjustment is not made in this return as required and the ITC continues to be recaptured at the rate of 75 or 100 percent (instead of the reduced rate of 50 percent), it will not be possible to recover the tax in question by simply adjusting a subsequent return. Instead, the business will be required to write to its assigned CRA tax centre and request that the return for the period in question be amended.

Similarly, as an organization may be assessed a penalty for over- or under-reported RITCs, businesses will need to consider additional measures to ensure invoices for RITC type expenses that are dated prior to July 1, 2016 are recaptured appropriately at 75 or 100 percent and not 50 percent.

Prince Edward Island and Quebec

The first reduction of the Prince Edward Island RITC is scheduled to take place April 1, 2018. Quebec has similar restrictions for its input tax refunds (ITRs). However, unlike Ontario and Prince Edward Island, where the ITC is claimed and then separately recaptured, in Quebec the ITR itself is restricted. The first phase-out for the Quebec restrictions is scheduled to take place in 2018.

Please contact one of our firm's sales tax specialists if you have any questions about the application of these rules.