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REVENUE TAX

GUIDE

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TEMPORARY RECAPTURE OF CERTAIN PROVINCIAL INPUT TAX CREDITS

This Guide provides general descriptions of the temporary recapture of input tax credits (RITC) requirement that will apply as a result of the introduction of the Harmonized Sales Tax (HST) in Prince Edward Island (PEI). The RITC requirement will be proposed to be implemented by way of regulations made under the federal *Excise Tax Act* (ETA).

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OVERVIEW

Effective April 1, 2013, PEI's Revenue Tax (PST) will be replaced with the HST. The HST would have a combined tax rate of 14 per cent - combining the existing five per cent federal Goods and Services Tax (GST) with a nine per cent PEI component. The HST would be administered by the Canada Revenue Agency (CRA).

During the initial period of the HST in PEI, it is proposed that large businesses - generally those making taxable supplies worth more than \$10 million annually, and certain financial institutions - be required to repay or 'recapture' ITCs attributable to the provincial component of HST payable in respect of specified property and services acquired, or brought into PEI, by a large business for use by that business in the province.

- Persons subject to the RITC requirement would separately identify recaptured ITCs in their GST/HST NETFILE returns and would not simply forego claiming these ITCs in their calculation of net tax (as explained in the section of this Guide on Accounting for Recaptured ITCs).

The rate of ITC recapture would be 100 per cent for the first five years that the HST is in effect in PEI. The RITC requirement would then be phased-out by reducing the rate of recapture in equal increments over the following three years. Thus, the ITC recapture rates for PEI would be:

- 100 per cent for the period from April 1, 2013 to March 31, 2018,
- 75 per cent for the period from April 1, 2018 to March 31, 2019,
- 50 per cent for the period from April 1, 2019 to March 31, 2020,
- 25 per cent for the period from April 1, 2020 to March 31, 2021,
- 0 per cent on or after April 1, 2021.

Interpretation

The terms and concepts used in this Guide generally have the same meaning as they do for the purposes of Part IX of the ETA. In addition, the following terms have the following meanings:

"recapture period" means a one-year period that (a) begins immediately after June 30th of a particular calendar year and ends immediately before July 1st of the following calendar year, and (b) occurs during the period that the RITC requirement is in effect (please note that the recapture period (July to June) is different than the period during which an ITC recapture rate for PEI applies (April to March)); and

"specified property or service" generally means a road vehicle, fuel used in a road vehicle, energy, a telecommunication service, or a meal or entertainment that is acquired, or brought into PEI, by a large business for use by that business in the province. The particular circumstances in which the RITC requirement would (or would not) apply to specified property and services are described elsewhere in this Guide.

LARGE BUSINESSES

In general, only large businesses would be subject to the RITC requirement. For the purposes of the RITC requirement, a person would be considered to be a large business during a particular recapture period if the person is a GST/HST registrant and:

- a. the person's RITC threshold amount (which is described in the section of this Guide entitled The RITC Threshold Amount) for that recapture period is greater than \$10 million, or
- b. the person is one of the following financial institutions or a person that is related (for purposes of the ETA) to one of the following financial institutions (hereafter "specified financial institutions"): a bank; a corporation that is licensed or otherwise authorized under the laws of Canada or a province to carry on in Canada the business of offering to the public its services as a trustee; a credit union; an insurer or any other person whose principal business is providing insurance under insurance policies; a segregated fund of an insurer; or an investment plan.¹

A person would be considered to be a large business even if the person does not have a permanent establishment in PEI.

A public service body would not be considered to be a large business. Similarly, a person whose chief source of income is farming, as defined in the federal *Income Tax Act*, would not be considered to be a large business to the extent that the person is acquiring, or bringing into PEI, a specified property or service for use in farming activities.

A government entity would not be considered to be a large business if it is an entity of the government of Canada that is not listed in Schedule I of the federal *Federal Provincial Fiscal Arrangements Act*, a department (as defined in section 2 of the federal *Financial Administration*

¹ Special RITC rules apply to financial institutions that are selected listed financial institutions. These rules are described in the section of this Guide entitled "RITC Rules for Selected Listed Financial Institutions (SLFIs)".

Act), or an entity of the government of a province that is eligible, pursuant to a provision of a sales tax harmonization agreement with the province, for a rebate of the GST/HST.

If a partnership is a large business and a member of the partnership (other than an individual) acquires, or brings into PEI, a specified property or service for use in the province, and that use is in respect of the activities of the partnership (but not on account of the partnership), the member would generally be considered to be a large business in respect of that acquisition or bringing in.

If a participant in a joint venture is a large business that has made a joint venture election with the operator of the joint venture, and the operator acquires, or brings into PEI, a specified property or service on behalf of that participant for use in the province, the operator would generally be considered to be a large business in respect of that acquisition or bringing in.

If a large business pays an allowance or a reimbursement to an employee or a partner in circumstances where ITCs would be available to the large business in respect of that allowance or reimbursement, the large business would generally be required to recapture the PEI component of those ITCs to the extent that the allowance or reimbursement is attributable to specified property and services.

The RITC Threshold Amount

In determining whether a particular person is a large business for a particular recapture period, the RITC threshold amount of that person for that recapture period would include:

- a. the total of all consideration for taxable supplies made in Canada, or outside Canada through a permanent establishment in Canada, by the particular person that became due, or was paid without having become due, in the last fiscal year of the particular person that ended before the recapture period; and
- b. the total of all consideration for taxable supplies made in Canada, or outside Canada through a permanent establishment in Canada, by a GST/HST registrant that is associated (for purposes of the ETA) with the particular person, that became due, or was paid without having become due, in the last fiscal year of the associated person that ended before the recapture period.

In calculating the amount of consideration described in (a) and (b) above, the following amounts would be included:

- any amount by which consideration for a supply is reduced because of a trade-in of tangible personal property by the recipient of the supply,
- consideration that is attributable to a supply made by a specified member of a qualifying group to another specified member of the same qualifying group, to the extent that the supply is deemed under the ETA to have been made for no consideration, and
- the fair market value of a supply made between persons not dealing at arm's length, to the extent that the consideration for the supply is less than fair market value.

However, in calculating the amount of consideration described in (a) and (b) above, the following amounts would not be included:

- an amount attributable to the GST/HST, or to a provincial levy that is prescribed for the purposes of the ETA (e.g., a provincial retail sales tax);
- an amount attributable to a supply by way of sale of real property that is capital property of the supplier;
- an amount attributable to a supply of a financial service; and
- an amount attributable to goodwill supplied as part of the supply of a business.

In calculating the amount of consideration described in (b) above, a person would include consideration attributable to taxable supplies made by an associated person that is not itself considered to be a large business.

If a person has a fiscal year that is shorter or longer than 365 days, the \$10 million RITC threshold amount would be adjusted to reflect the length of that fiscal year.

Changes during a Recapture Period

If a person that is not a large business at the beginning of a recapture period has a fiscal year end during that recapture period and its RITC threshold amount exceeds \$10 million at that point, the person would generally not become a large business until the beginning of the next recapture period. Conversely, if a person that is a large business at the beginning of a recapture period has a fiscal year end during that recapture period and its RITC threshold amount is below \$10 million at that point, the person would generally continue to be a large business until the end of that recapture period.

***Example 1:** Business A has a fiscal year that ends on December 31, 2013 and its RITC threshold amount for that fiscal year is \$8 million. Therefore, Business A would not be a large business during the recapture period of July 1, 2014 to June 30, 2015. At the end of its 2014 fiscal year (December 31, 2014), Business A's RITC threshold amount is \$11 million. Business A would (a) not be a large business until July 1, 2015, and (b) would be a large business during the recapture period of July 1, 2015 to June 30, 2016.*

***Example 2:** Business B has a fiscal year that ends on December 31, 2013 and its RITC threshold amount for that year is \$12 million. Therefore, Business B would be a large business during the recapture period of July 1, 2014 to June 30, 2015. At the end of its 2014 fiscal year (December 31, 2014), Business B's RITC threshold amount is \$9 million. Business B would (a) continue to be a large business until June 30, 2015, and (b) would not be a large business during the recapture period of July 1, 2015 to June 30, 2016.*

If the threshold amount of a person is greater than \$10 million at the time it becomes a GST/HST registrant, that person (and any associated person) would generally be considered to be a large business, and would be required to begin recapturing ITCs, at that time.

If a particular corporation that is a large business acquires control of another corporation that is not a large business, the other corporation (and any associated persons) would generally be considered to be a large business when that control is acquired and would be required to begin recapturing ITCs at that time.

If two or more corporations amalgamate and the combined RITC threshold amounts of those corporations is greater than \$10 million at that time, the amalgamated corporation would generally be considered to be a large business upon amalgamation and would be required to begin recapturing ITCs at that time.

If a particular person that is not a large business acquires all or substantially all of the assets of another person that is a large business and continues to carry on the business of that other person, the particular person would generally be considered to be a large business at the earlier of (a) the time that it begins to carry on the business, and (b) the time that it acquires substantially all of the assets, and would be required to begin recapturing ITCs at that earlier time.

If a person becomes a specified financial institution or becomes related to one, at a particular time, the person would generally be considered to become a large business at that time (and continue to be one until it ceases to be a specified financial institution or ceases to be related to one), and would be required to begin recapturing ITCs at that time.

SPECIFIED PROPERTY AND SERVICES

The RITC requirement would generally apply to specified property and services that are acquired, or brought into PEI, by a large business for consumption or use by that business in the province. Property and services that are acquired in PEI for consumption or use outside PEI would generally not be subject to the RITC requirement.

In general, specified property and services would include:

- specified road vehicles, including certain vehicle parts and services, and motive fuel (other than diesel fuel) for use in specified road vehicles;
- specified energy;
- specified telecommunication services; and
- specified meals and entertainment that are currently subject to an ITC repayment requirement under the ETA (generally at a 50 per cent repayment rate).

However, the RITC requirement would generally not apply to:

- specified property acquired by a large business for the sole purpose of being re-supplied by that business (i.e., by way of sale, or by way of lease, licence or similar arrangement);
- specified property that is acquired by a large business for the sole purpose of it becoming a component part of tangible personal property that is to be supplied by that business; or
- a specified service acquired by a large business for the sole purpose of being resupplied by that business.

Specified Road Vehicles

A specified road vehicle would generally mean a vehicle that:

- a. is a motor vehicle;
- b. is licensed, or required to be licensed, under applicable provincial laws for use on a public highway (a vehicle that is licensed, or required to be licensed exclusively for use elsewhere than on a public highway would generally not be considered to be a specified road vehicle); and
- c. weighs less than 3,000 kg at the time that the vehicle is first licensed or required to be licensed in PEI under paragraph (b).

A trailer, semi-trailer or detachable axle would not be considered a specified road vehicle.

Specified road vehicles would include vehicles that are acquired by way of sale, or by way of lease, licence or similar arrangement. However, a person entrusted with the custody and operation of a taxi by a taxi permit-holder would generally not be considered to be acquiring a specified road vehicle for purposes of the RITC requirement.

Parts and Services

The RITC requirement would generally apply to vehicle parts and services that are acquired, or brought into PEI, by a large business in respect of a specified road vehicle if those parts and services are acquired, or brought into PEI, within 12 months of the acquisition, or bringing into PEI, of the vehicle itself (even if that vehicle was acquired, or brought into PEI, prior to April 1, 2013): e.g. the acquisition and installation of a vehicle anti-theft system. However, the RITC requirement would generally not apply to vehicle parts and services that are acquired, or brought into PEI, by a large business for the routine repair or maintenance of a specified road vehicle of that business.

Use of Specified Road Vehicles before Resupply

If a large business acquires, or brings into PEI, a specified road vehicle for the purpose of resupplying it but uses that vehicle before resupplying it, the large business would generally be required to recapture a portion of the ITCs that it claimed in respect of the acquisition or bringing in. Specifically, the large business would be required, for each month or part thereof it uses the vehicle, to recapture the portion of the provincial component of the ITCs claimed that is attributable to 2 per cent of the cost of the vehicle.

Example 3: In April 2014, a car dealership that is a large business acquires in PEI, for the purpose of resale, a vehicle that costs \$20,000 and claims full ITCs in respect of that acquisition (i.e., with no recapture). The dealership subsequently uses the car as a demo vehicle for two months before selling it. The dealership would recapture \$72 of the ITCs claimed in respect of the acquisition of that vehicle: $\$20,000 \text{ (cost)} \times 2 \text{ per cent} \times 9 \text{ per cent (PEI component of HST)} \times 2 \text{ months} = \72 .

Fuel for use in Specified Road Vehicles

The RITC requirement would generally apply to fuel (other than diesel fuel) that is acquired, or brought into PEI, by a large business, to the extent that the fuel is for use by that business in the engine of a specified road vehicle (even if that vehicle was acquired, or brought into PEI, prior to April 1, 2013).

Specified Energy

Specified energy would generally include electricity; gas; fuel (other than fuel used in a propulsion engine)²; and steam that is acquired, or brought into PEI, for use in the province by a large business.

For purposes of the RITC requirement, consideration for a single supply of specified energy would include consideration attributable to transportation services and fees (e.g., delivery charges or regulatory fees) that are incidental to the supply of energy. However, consideration for a supply of specified energy would generally not include consideration for transportation services that are not incidental to the supply of energy itself.

The RITC requirement would generally not apply to specified energy acquired by a sponsor or organizer of a convention for use exclusively at that convention. In addition, the RITC requirement would generally not apply to specified energy used to heat asphalt that is for use in the construction of an eligible road.

Specified energy acquired by a lessee as part of a single supply of a real property lease would not be subject to the RITC requirement (as the lessee would not, for purposes of the GST/HST, be acquiring a supply of energy). Conversely, a lessor that provides energy to a lessee as part of a single supply of a real property lease would not be able to claim relief from the RITC requirement on the basis of the manner in which the lessee uses that energy: e.g., if the lessee uses the energy directly in the production of tangible personal property for sale.

Production for Sale

The RITC requirement would generally not apply to specified energy used by a large business directly in the production of:

- tangible personal property for sale, or
- production equipment used by the large business in the production of tangible personal property for sale.

The RITC requirement would, however, generally apply to specified energy used by the large business to facilitate such production (i.e., not directly in the production process), including specified energy that is used to light, heat, air condition or ventilate a production facility.

² However, fuel for use in the engine of a specified road vehicle may be subject to the RITC requirement: please see the section of this Guide on Specified Road Vehicles.

Example 4: Large Business A, which sells widgets, acquires electricity for use in one of its production facilities in PEI. The electricity is used to operate the widget producing machines, to provide light, heat and ventilation in the building, to operate a building security system, and to run appliances in a dining area in the building.

The RITC requirement would not apply to the portion of the electricity used in the production facility to operate the widget producing machines (because that electricity is used directly in the production process) but would apply to the portion of the electricity used otherwise (because that electricity is not used directly in the production process).

The RITC requirement would generally apply to specified energy used by a large business to produce tangible personal property that is used:

- otherwise than for sale: e.g. energy used by the large business to produce furniture that is used as capital personal property by the large business;
- in the construction of real property (which includes mobile homes and floating homes) of the large business, including real property that is (a) capital property of the large business or (b) for sale by the large business; or
- in the course of supplying services or intangible personal property.

The RITC requirement would generally not apply to specified energy used by a large business to produce another form of energy that is used in a manner whereby the RITC requirement would not apply if the specified energy were used directly: e.g. if diesel fuel were used in a generator to produce electricity used directly in the production of tangible personal property for sale, the RITC requirement would generally not apply to the portion of the diesel fuel attributable to the electricity subsequently used directly in the production of tangible personal property for sale.

Production and Production Equipment

For purposes of the RITC requirement, 'production' would generally mean the assembling, processing or manufacturing of tangible personal property to make other tangible personal property that is different from the first property by its nature or characteristics, and would include:

- the restoring of tangible personal property by its owner,
- the recording of images or sounds on media,
- the generation of energy,
- the cutting, transformation and handling of timber in a forest, including the building and maintenance of forest access roads in the course of carrying on a timber business,
- the extraction and processing of minerals to the first stage of concentration, and
- the transformation of toxic industrial waste into a non-toxic material or substance.

Production would also generally include the following activities when performed in conjunction with one of the production activities described above:

- the cleaning, screening, sifting, wrapping, packing or putting into containers of tangible personal property; and

- the transportation to the first point of depot of refuse or waste derived from the production of tangible personal property.

However, 'production' would generally not include (a) the storage of finished products or (b) the assembly, processing or manufacturing of tangible personal property in a retail establishment.

For purposes of the RITC requirement, 'production equipment' would generally mean machinery, tools, equipment and accessories used directly in the production of tangible personal property, and would include:

- moulds and dies,
- media for recording images or sounds,
- plans, drawings, models and prototypes, and
- materials used to produce or repair production equipment.

However, 'production equipment' would generally not include (a) containers used for the delivery or transportation of property and (b) vehicles, other than vehicles for use elsewhere than on a public roadway.

For purposes of the RITC requirement, specified energy used by the following kinds of businesses would generally not be considered to be used in the production of tangible personal property for sale:

- financial institutions,
- hotels, bars, coffee shops and restaurants,
- auto repair shops, and
- scrap metal dealers.

Production Proxy

To simplify compliance with the RITC requirement, a large business producing tangible personal property for sale (and carrying on such production activities primarily in PEI) would generally be able to elect to use a production proxy to determine what portion of the specified energy that it acquires for use in PEI would be considered to be used directly in the production of tangible personal property for sale (and hence not subject to the RITC requirement).

This production proxy would be based on the Canadian detail of the North American Industry Classification System for 2007 ("NAICS Canada 2007"), which is a statistical tool that classifies particular sectors, subsectors and industries into categories based on production-oriented principles.

Specifically, if the most significant business activity of a large business during its last fiscal year falls into one of the 24 categories described below (which are based on NAICS Canada 2007 categories), it would be eligible to use one of three fixed percentages to determine the portion of the total amount of specified energy that it acquires for use in PEI that would be considered to be used directly in the production of tangible personal property for sale. These percentages reflect the

average proportion of energy used directly in such production activities in a particular industrial sector.

- For a large business whose most significant business activity during its last fiscal year falls within one of the following categories (the corresponding three-digit NAICS Canada 2007 codes are also provided), the production proxy would be 96 per cent:
 - 113 - forestry and logging;
 - 211 - oil and gas extraction;
 - 212 - mining and quarrying (except oil and gas);
 - 322 - paper manufacturing;
 - 324 - petroleum and coal product manufacturing;
 - 325 - chemical manufacturing;
 - 327 - non-metallic mineral product manufacturing; and
 - 331 - primary metal manufacturing.

- For a large business whose most significant business activity during its last fiscal year falls within one of the following categories, the production proxy would be 87 per cent.
 - 311 - food manufacturing;
 - 312 - beverage and tobacco manufacturing;
 - 313 - textile mills;
 - 314 - textile product mills;
 - 321 - wood product manufacturing;
 - 326 - plastics and rubber products manufacturing; and
 - 332 - fabricated metal product manufacturing.

- For a large business whose most significant business activity during its last fiscal year falls within one of the following categories, the production proxy would be 70 per cent.
 - 315 - clothing manufacturing;
 - 316 - leather and allied product manufacturing;
 - 323 - printing and related support activities;
 - 333 - machinery manufacturing;
 - 334 - computer and electronic product manufacturing;
 - 335 - electrical equipment, appliance and component manufacturing;
 - 336 - transportation equipment manufacturing;
 - 337 - furniture and related product manufacturing; and
 - 339 - miscellaneous manufacturing.

A large business whose most significant business activity during its last fiscal year does not fall within any of the foregoing categories (or that does not carry on its production activities primarily in PEI) would not be entitled to use this proxy.

The election to use the proxy would have to be filed with the CRA before the beginning of a particular recapture period and would generally apply for that entire recapture period. For example,

a large business whose most significant business activity falls within the category of wood product manufacturing (NAICS Canada 2007 category # 321) could, instead of tracking the amount of specified energy that it uses in production, file an election with the CRA before the beginning of a recapture period and, for each reporting period during that recapture period, the business would be deemed to use 87 per cent of the specified energy that it acquires for use in PEI directly in the production of tangible personal property for sale.

Note that a large business that acquires specified energy that is later re-supplied by that business (in addition to specified energy used by that business in producing tangible personal property for sale) would first have to deduct the proportion of its specified energy that is re-supplied from the total specified energy it acquired before applying the proxy.

Specified Telecommunication Services

Specified telecommunication services would generally include:

- a. the service of emitting, transmitting or receiving signs, signals, writing, images or sounds or intelligence of any nature by wire, cable, radio, optical or other electromagnetic system, or by any similar technical system; and
- b. the making available for such emission, transmission or reception a telecommunications channel, such as a telecommunications circuit, line, frequency, channel, partial channel or other similar means of transmitting a telecommunication (but not a satellite channel).

Thus, the RITC requirement would generally apply to services such as local and long-distance telephone, cable and pay television, satellite television, facsimile and electronic mail, video, audio and computer link-ups and data transmission acquired by a large business for use in PEI by that large business.

However, the RITC requirement would generally not apply to:

- internet access services;
- web-hosting services;
- toll-free telephone services (e.g., 1-800, 1-888 or 1-877 telephone services); and
- telecommunication services acquired by a sponsor or organizer of a convention for use exclusively at that convention.

Supplies that are provided by means of telecommunication, but are not themselves telecommunication services, would generally not be subject to the RITC requirement. Examples of supplies that are provided by means of telecommunication include building surveillance services, news services offered by press agencies, a right to access a data bank, and services provided by means of a 1-900 telephone service.

Proxies for Specified Telecommunication Services

If a large business receives an invoice for a single supply that includes both specified telecommunication services and other services and/or goods (i.e., that are not subject to the RITC

requirement), and the large business cannot readily ascertain which portion of the provincial component of the HST applicable to the supply is attributable to these other services and/or goods, the large business would be allowed to use the following proxies to make that determination.

1. If the supply covered by the invoice includes specified telecommunication services, other services, and goods (e.g., telecom equipment rental), then 14 per cent of the consideration for the supply would be deemed to be attributable to the other services and goods.
2. If the supply covered by the invoice includes specified telecommunication services and other services (but no goods), then 4 per cent of the consideration for the supply would be deemed to be attributable to the other services.
3. If the supply covered by the invoice includes specified telecommunication services and goods (but no other services), then 11 per cent of the consideration for the supply would be deemed to be attributable to the goods.

Specified Meals and Entertainment

Specified property and services would generally include food and beverages for human consumption (meals) and entertainment that are acquired by a large business in PEI, to the extent that the meals or entertainment are subject to the existing (generally 50 per cent) ITC repayment requirement in the ETA (specified meals and entertainment).

Thus, meals and entertainment subject to the RITC requirement would include:

- business dinners;
- tickets for a theatre, concert, athletic event or other performance;
- private boxes at sports facilities; and
- admissions to nightclubs, athletic, social and sporting clubs.

Conversely, meals and entertainment not subject to the RITC requirement would generally include:

- meals or entertainment acquired solely for the purpose of resupply (e.g., by a restaurant or airline);
- meals or entertainment acquired for certain events where all employees from a particular location are invited (e.g., an office Christmas party); and
- meals or entertainment for an employee in situations where the expenses are required to be included in the employee's income as a taxable benefit under the federal *Income Tax Act*.

ACCOUNTING FOR RECAPTURED ITCs

When to Account for Recaptured ITCs

A large business would generally be required to account for recaptured ITCs in its GST/HST return for the reporting period in which the ITCs first become available: i.e., in the first reporting period

in which the provincial component of the HST to which the ITCs relate becomes payable, or is paid without having become payable.

However, if a large business is currently required under the ETA to repay ITCs in respect of a particular specified property or service in a reporting period other than the reporting period in which the ITCs first become available, the large business would generally be required, under the RITC requirement, to recapture ITCs in respect of that same specified property or service in that same reporting period.

***Example 6:** A large business is currently required to repay 50 per cent of the ITCs that it claims for certain meal and entertainment expenses in the reporting period immediately following the end of its fiscal year. To the extent that the meals and entertainment are specified property or services, the large business would generally be required to recapture the remaining portion of the provincial component of those ITCs in that same reporting period.*

Transitional Measure

If a large business is the recipient of a supply of a specified property or service, and the consideration for the supply first becomes due, or is paid without having become due, after November 8, 2012 and before February 2013, then to the extent that

- the specified property is delivered, and ownership of the property is transferred, to the large business on or after April 1, 2013, or
- part of the specified service (at least 10 per cent) is performed on or after April 1, 2013,

the large business would generally be required to self-assess the provincial component of the HST in respect of that property or part of the service either: (i) in the GST/HST return for the reporting period of the large business that includes April 1, 2013, if the due date for that return is before August 2013, or (ii) in any other case, in prescribed form and before August 2013. The large business would generally recapture any ITCs available in respect of that provincial component of the HST for the reporting period in which the ITCs first become available.

How to Account for Recaptured ITCs

Similar to the filing requirement for GST/HST registrants subject to the RITC requirement in Ontario, which was outlined in the [CRA News Release and Backgrounder of January 4, 2010 entitled "Government of Canada announces new electronic filing requirements for GST/HST registrants"](#), GST/HST registrants who are subject to the RITC requirement (large businesses) in PEI would be required to calculate and report their ITCs in the GST/HST NETFILE return (GST/HST NETFILE is a free internet-based service that allows persons to file their returns with the CRA on-line). A large business would complete the GST/HST NETFILE return in the following manner:

- The amount of the "gross" ITCs would be reported in a separate information field on a schedule to the GST/HST NETFILE return. "Gross" ITCs are the ITCs and adjustments that a GST/HST registrant is entitled to claim before taking into account any ITC recapture.

- The amount of ITCs that is recaptured would be reported in separate information fields on the schedule: one field for recaptured ITCs in respect of the provincial portion of the HST in PEI and one for each other province with an RITC requirement.
- The net amount of ITCs, which is the gross ITCs less the recaptured ITCs, would then be calculated and reported in an information field on the schedule. This net amount would be eligible to be claimed as an ITC in the GST/HST NETFILE return in the field "Total ITCs and adjustments."

Generally, if a registrant fails to report recaptured ITCs in an appropriate reporting period, any subsequent reporting of the recaptured ITCs would be done through an amended return.

***Example 7:** In its September 2013 reporting period, a large business that is a monthly filer pays \$2,000 in HST in the course of acquiring property, all of which is for use (and not resupply) in its commercial activities in PEI. Of this amount, \$1,400 is attributable to the acquisition of specified property by the large business (this \$1,400 of HST is made up of a 5 per cent federal portion of \$500 and a 9 per cent provincial portion of \$900). The business does not acquire any specified property or services subject to ITC recapture in another province.*

In its GST/HST NETFILE return for the September reporting period, the large business indicates that it is required to recapture ITCs and:

- reports gross ITCs (before recapture) of \$2,000;
- reports \$900 in the field for recaptured ITCs in PEI. This \$900 would be multiplied by the applicable recapture rate in PEI (which would be 100 per cent in September 2013); and
- this \$900 amount would be subtracted from gross ITCs ($\$2,000 - \$900 = \$1,100$), and the difference reported in the field for Total ITCs and Adjustments. The large business uses this \$1,100 amount to calculate net tax in the main part of its return.

It is important to note that large businesses would not be allowed to simply forego claiming ITCs in order to fulfill the RITC requirement (even if the effect on net tax would be the same). In this way, the RITC requirement differs from the restriction on input tax refunds in Québec. Failing to recapture ITCs as and when required could result in penalties.

***Example 8:** Large Business A (LBA), which is a quarterly filer, routinely acquires specified property in PEI. Rather than claim the ITCs for this property in the GST/HST return for the reporting period in which the ITCs first become available, LBA waits until the end of its fiscal year and claims the ITCs at that point. It also recaptures the provincial portion of those ITCs at that point. LBA may be subject to penalties in this situation, as it would generally be required to recapture the provincial portion of the ITCs in the reporting period when the ITCs first became available.*

This approach to reporting and accounting for recaptured ITCs is necessary in order to allow administrators to properly allocate GST/HST revenues.

Option to Use an Estimation/Instalment Approach

In order to help simplify compliance with the RITC requirement, a large business would generally be allowed to make an election to use an estimation, instalment and reconciliation approach to

accounting for recaptured ITCs (Estimation/Instalment Approach). The election would be filed with CRA after the end of a large business's fiscal year and would apply for at least one year.

- Large businesses would, before the introduction of the HST in PEI on April 1, 2013, generally be able to elect to use the Estimation/Instalment Approach.

Under the Estimation/Instalment Approach, for each province that has an RITC requirement, a large business would:

- estimate the amount of ITCs it would be required to recapture during a fiscal year;
- based on this estimate, make equal instalment payments of recaptured ITCs in each reporting period during a one-year period; and
- at the end of the fiscal year, determine the actual amount of ITCs it should have recaptured during that year and reconcile any differences between the actual amount and the amounts reported during the fiscal year.

Thus, under the Estimation/Instalment Approach, a large business would still have to identify the specified property and services that it acquires or brings into a province in such a way that it could determine the actual amount of available ITCs that are subject to the RITC requirement. However, this Approach would allow the large business to account for these recaptured ITCs on an annual basis and on the basis of aggregate financial information.

Large businesses would still be able to use any proxies otherwise available to them when using the Estimation/Instalment Approach (e.g. the proxy for specified energy used directly in the production of tangible personal property for sale).

Step 1: Estimation

At the beginning of a fiscal year, a large business that has filed the appropriate election with the CRA would estimate the amount of ITCs it would be required to recapture, for each province with an RITC requirement, during that fiscal year (Estimated RITCs). This estimate would be based on:

- ITCs that it would have been required to recapture during its most recently completed fiscal year, if the RITC requirement had been in place throughout that year; and
- any additional ITCs that it would be required to recapture in its current fiscal year because of anticipated changes in circumstances vis-à-vis its previous fiscal year.

A large business would not be allowed to use an Estimated RITCs amount that is less than the actual amount of ITCs that the large business was (or would have been) required to recapture in its previous fiscal year. However, it could use a greater amount.

***Example 9:** Large Business A (LBA), which is a monthly filer and has a fiscal year that ends December 31, 2013, elects in January 2014 to use the Estimation/Instalment Approach. In the period from January to March 2014, it reviews its financial records for its 2013 fiscal year, as well as its business plans for its 2014 fiscal year, and determines that:*

- *its recaptured ITCs for its 2013 fiscal year for PEI would have been \$6,000, if the RITC requirement had been in effect during that entire fiscal year; and*
- *an additional \$2,400 of recaptured ITCs is expected in its 2014 fiscal year as a result of the anticipated acquisition of a new company car for use in PEI.*

Therefore, LBA's Estimated RITCs for PEI for its 2014 fiscal year would be \$8,400 (\$6,000 + \$2,400).

Step 2: Instalment

A large business using the Estimation/Instalment Approach would generally be required to report its Estimated RITCs, for each province with an RITC requirement, over the course of a year-long period that begins three months after the beginning of its fiscal year and ends three months after the end of that fiscal year (the Instalment Period).

To determine the amount of recaptured ITCs that must be reported in each reporting period during the Instalment Period, a large business would generally divide the relevant Estimated RITC amount by the number of GST/HST reporting periods in the Instalment Period (e.g., a monthly filer would divide the amount by 12). The equal instalment amounts would be reported in the GST/HST NETFILE return of the large business as recaptured ITCs for each reporting period in the particular Instalment Period.

Example 10: *LBA (from the previous example) has \$8,400 of Estimated RITCs for PEI for its 2014 fiscal year. LBA would divide this Estimated RITC amount by the 12 monthly reporting periods that occur in the Instalment Period starting April 1, 2014 and ending March 31, 2015.*

LBA would report \$700 (\$8,400/12) in the recaptured ITCs field for PEI in the GST/HST NETFILE return for each monthly reporting period that occurs in the Instalment Period from April 2014 through March 2015.

Step 3: Reconciliation

After the end of its fiscal year, a large business using the Estimation/Instalment Approach would review its financial records and determine the actual amount of ITCs it would have been required to recapture, for each province with an RITC requirement, during that year, if the RITC requirement had been in effect throughout that year (Actual RITCs).

The Actual RITCs amount would be compared to the amount of recaptured ITCs that the large business reported in its GST/HST returns for the same fiscal year³. The large business would report any differences between these two amounts in its GST/HST return for a reporting period that includes a date that occurs within three months after the end of its fiscal year (e.g., if a fiscal year ends on December 31st of a particular calendar year, the reconciliation should take place in a reporting period that includes a date before April 1 of the next calendar year).

³ If this reconciliation is made in respect of a particular fiscal year, and the HST was only in effect in PEI for part of that year (e.g. a fiscal year ending December 31, 2013), the Actual RITC amount for that fiscal year should be adjusted to reflect the portion of the fiscal year during which the HST was in effect.

Example 11: In March 2015, LBA (from the previous two examples) determines that, for its fiscal year ending December 31, 2014, its Actual RITCs were \$9,000. It then compares this amount to the amount of recaptured ITCs that it reported during that same fiscal year, which is the sum of:

- \$1,800 that it recaptured in its GST/HST returns for the reporting periods of January, February, and March 2014 (i.e., before it began using the Estimation/Instalment Approach); and
- \$6,300 that it recaptured in its GST/HST returns for the reporting periods from April through December 2014 (i.e., under the Estimation/Instalment Approach).

The difference between the two amounts would be \$900 (\$9,000 - \$8,100) and LBA reports this additional \$900 in its GST/HST NETFILE return for the March 2015 reporting period (i.e., in addition to the \$700 instalment payment for that same reporting period).

As it does not anticipate any material differences in its recaptured ITCs for its 2015 fiscal year (vis-à-vis its 2014 fiscal year), LBA would use \$9,000 as its Estimated RITCs amount for its 2015 fiscal year. LBA would therefore report \$750 of recaptured ITCs (i.e., \$9,000/12 reporting periods = \$750) for PEI in each monthly reporting period in the Instalment Period from April 1, 2015 to March 31, 2016.

Some Special Cases

Specified Property and Services Brought into PEI

If a large business:

- brings a specified property into PEI from another province or country; or
- acquires a specified service in another province or country,

and the specified property or service is for use in PEI (in whole or in part) by the large business, then that large business would, under the RITC requirement, generally be required to account for the provincial portion of ITCs that are available (or would be available if the provincial component of the HST were payable) in respect of that acquisition, or bringing into PEI, of the specified property or service (i.e., even if the property or service was acquired, or brought into the province, for consumption or use exclusively in commercial activities of the large business).

Specified Members of a Qualifying Group

If a large business is a specified member of a qualifying group that has made an election for closely-related persons under the ETA, and that large business acquires a specified property or service from another specified member of the same qualifying group, the large business would, under the RITC requirement, generally be required to account for the provincial portion of ITCs that are available (or would be available if the supply were not deemed to have been made for no consideration) in respect of that acquisition of the specified property or service.

Non-Arm's Length Transactions

If a supply of a specified property or service is made for no consideration, or for consideration that is less than fair market value, between persons who are not dealing with each other at arm's length for purposes of the ETA, the recipient of the supply (if it is a large business) would generally be

required to recapture ITCs as if the supply had been made at fair market value (i.e., even if the property or service was acquired, or brought into the province, for consumption or use exclusively in commercial activities of the large business).

RITC Rules for Selected Listed Financial Institutions (SLFIs)

SLFIs operating in PEI which are both “large businesses” (as discussed above) and GST registrants would be subject to PEI RITC rules. However, as is the case for Ontario, these SLFIs would generally not be subject to the general RITC rules and would instead “recapture” ITCs, in respect of the PEI component of the HST payable on specified property and services, through modifications to the Special Attribution Method that SLFIs use to calculate their liability for the provincial component of the HST.⁴

These modifications would generally require an SLFI subject to these rules to make an adjustment to its net tax for a reporting period of the SLFI equal to the total of all amounts, each of which is an amount in respect of a specified class of specified property or services determined by the formula:

$$A \times B \times C \times D/E \times F \times G$$

where

A is the total GST paid or payable across Canada by the SLFI in the reporting period in respect of supplies of specified property and services of that class;

B is the tax recovery rate of the SLFI for the reporting period, which is,

- in the case where the SLFI makes an election in respect of the reporting period, the amount (expressed as a percentage) determined by dividing (1) all ITCs of the SLFI, in respect of GST paid or payable across Canada by the SLFI, for the reporting period; by (2) all GST paid or payable across Canada by the SLFI for the reporting period; or
- in any other case, the amount (expressed as a percentage) determined by dividing (1) all ITCs of the SLFI for the reporting period, in respect of GST paid or payable across Canada by the SLFI in respect of the class of the specified property or service; by (2) all GST paid or payable across Canada by the SLFI for the reporting period in respect of that class of specified property or services.

C is the SLFI’s provincial attribution percentage for PEI for the reporting period;

D is the tax rate for PEI (9 per cent);

E is the tax rate for the GST (5 per cent);

F is the average recapture rate that applies during the reporting period; and

G equals

- where the class of the specified property or service is specified meals and entertainment, 50 per cent;

⁴ Exceptions, where an SLFI would be required to comply with the general rules in respect of specific property or services, would be in respect of the PEI component of the HST where (1) the PEI component is paid on specified property and services that relate exclusively to the investigation, settlement or defence of a claim in relation to property and casualty insurance; (2) the PEI component is payable or required to be self-assessed under the general transitional rules and GST in respect of the supply is payable before the transitional reporting period of the SLFI (i.e., its reporting period that begins before April 1, 2013 and ends after March 31, 2013); or (3) the PEI component is payable, or is paid without having become payable, by an investment plan or a segregated fund of an insurer in respect of property or a service, to the extent that the property or service is acquired, imported or brought into PEI for consumption, use or supply in the course of activities of a provincial series of the investment plan or segregated fund.

- where the class of the specified property or service is specified telecommunication services and the service is supplied with other property or services which is not specified property or service (each of which is referred to as an “element”) and the consideration for the telecommunication service and the element is not separately identified, if telecommunication is provided to the SLFI together with
 - o an element that is a service, 96 per cent;
 - o an element that is property, 89 per cent; and
 - o an element that is a service and an element that is property; 86 per cent; and
- in any other case, 100 per cent.

In addition, for the transitional reporting period of the SLFI that begins before April 1, 2013 and ends after March 31, 2013, the amount determined by the above formula would be further apportioned based upon the ratio of the number of days in the reporting period that are after March 31, 2013 to the total number of days in the reporting period.

ANTI-AVOIDANCE

Large businesses that fail to account for recaptured ITCs in the proper manner would generally be subject to penalties.

Existing anti-avoidance rules in the ETA would generally apply to transactions to which the RITC requirement applies. Additional anti-avoidance rules may be implemented in order to maintain the integrity of the GST/HST and the RITC requirement.

ADDITIONAL INFORMATION

The Canada Revenue Agency administers the HST. Visit their website at www.cra.gc.ca/gsthst or call 1 800 959-5525 for more information.

Any particular questions concerning this Guide should be addressed to:

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