

# GOVERNMENT CAN IMPOSE PENALTIES ON LARGE BUSINESSES FOR DEFICIENTLY REPORTING RECAPTURE OF INPUT TAX CREDITS ("ITCS")

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Generally, "large businesses"<sup>[1]</sup> are subject to the recapture of their ITCs relating to the Ontario and Prince Edward Island ("PEI") portion of the HST ("PVAT") payable in respect of certain categories of property and services acquired or imported (the "**Prescribed Property**" and "**Services**").<sup>[2]</sup> However, many businesses are not aware that they can be subject to potentially significant penalties for failing to report such recapture, even when no ITCs were claimed!

## Timing of PVAT ITC Recapture

Excluding financial institutions, large businesses are generally monthly GST/HST filers. A monthly filer is generally required to report its PVAT ITC recapture either:

- i. on the GST/HST return for the month in which the HST becomes payable, or
- ii. on its next monthly return.

There are exceptions to the above. Of note, special timing rules apply to food, beverages and/or entertainment expenses that are subject to 50% income tax deductibility and ITC eligibility restrictions (one of the categories of Prescribed Property and Services). Where a large business chooses to defer the 50% limitation on such ITC claims to the first monthly GST/HST return following the fiscal year in which the ITCs were claimed, then the PVAT ITC recapture (relating to the 50% of the ITCs allowed) should occur on this same return.

## Penalties for Failing to Accurately Report PVAT ITC Recapture

If a large business fails to report PVAT ITC recapture (or to do so correctly), then CRA can impose penalties. The penalty is calculated as 5% of the unreported or under-reported amount of the PVAT ITC recapture, plus 1% of such amount for each complete month, not exceeding 5 months, that the appropriate PVAT ITC recapture goes unreported. A delinquency of 5 or more months would result in the maximum penalty of 10% of the unreported or under-reported amount.

Even if a large business did not actually claim the ITCs available for Prescribed Property or Services acquired or imported, such that the business did not receive any financial benefit from its failure to recapture the appropriate portion of the ITCs (and the government suffered no financial disadvantage), these penalties could still be imposed. To add insult to injury, the business would generally be restricted from deducting the penalties from its income for Canadian income tax purposes.

### **Traps for the Unwary**

Where no HST was actually payable on an acquisition or importation of Prescribed Property or Services, PVAT ITC recapture may arise. For example, the import of Prescribed Property or Services into Ontario or PEI by a GST/HST-registered large business, exclusively for consumption, use or supply in the importer's taxable commercial activity, may not give rise to HST, but could nevertheless trigger PVAT ITC recapture. For this reason, large businesses need to be alert to the possibility of PVAT ITC recapture relating to Prescribed Property or Services entering Ontario (or PEI) on a HST-free basis.

### **Correcting Deficient Reporting of ITC Recapture**

If a GST/HST registrant fails to report, or incorrectly reports, recaptured ITCs and wishes to correct any such error, then the registrant generally has two options to do so:

- a. send a letter to the registrant's local Canada Revenue Agency ("**CRA**") tax services office explaining the nature of the error(s) and requesting that the appropriate adjustment(s) be made to correct the error(s);  
or
- b. adjust the registrant's GST/HST return(s) electronically under the "Adjust a return" option of the My Business Account portal (assuming that the registrant is enrolled or enrolls to use that portal).

In certain cases, where the penalty amount is significant, a delinquent large business should consider making a GST/HST voluntary disclosure to CRA to seek a waiver of the penalties.

### **The Bottom-Line**

Regardless of whether the government suffers any revenue loss from the filing deficiencies, the government can impose penalties for the errors (that are non-deductible for Canadian income tax purposes). In the government's view, the maxim "no harm, no foul" has no application to revenue neutral GST/HST filing errors made by large businesses, so large businesses need to be diligent in their compliance relating to the recapture of PVAT ITCs. Changes to the rules should be monitored. Of note, as we explained in our [July 2015 Bulletin](#), the PVAT ITC recapture rate is being incrementally phased-out between July 1, 2015 and July 1, 2018 in Ontario.<sup>[3]</sup>

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[1] Generally, a person whose annual taxable supplies made in Canada (or made outside Canada through a permanent establishment in Canada) exceed \$10 million is a "large business". This threshold is calculated with reference to taxable supplies made by any associated persons. Irrespective of whether this \$10 million threshold is exceeded, certain financial institutions are large businesses, if they are registrants. Public service bodies, as defined, and certain government entities are not considered large businesses.

[2] Prescribed Property and Services include motor vehicles for use on public roads (excluding for re-sale or lease), motor fuel for such vehicles, specified energy, certain telecommunication services, and food, beverages and entertainment that, on acquisition, are restricted to 50% income tax deductibility and ITCs.

[3] In this regard, refer to our Bulletin, [Reduction of ITC Recapture Rate for Ontario Portion of HST \("OHST"\) Starting July 1, 2015](#).

#### **A Cautionary Note**

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

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