# NOVA SCOTIA
# EQUITY TAX CREDIT
# GUIDELINES

## *COMMUNITY ECONOMIC DEVELOPMENT INVESTMENT FUND (CEDIF)*

**Nova Scotia Department of Finance and Treasury Board**
**Taxation and Federal Fiscal Relations Division**

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NOVA SCOTIA

# Nova Scotia Equity Tax Credit Guidelines
# Community Economic Development Investment Fund (CEDIF)

## General Information

The Equity Tax Credit (ETC) program was designed to assist Nova Scotia small businesses, co-operatives and community economic development initiatives in obtaining equity financing by offering a non-refundable personal income tax credit to individuals that invest in eligible businesses.

Community Economic Development Investment Funds (CEDIFs) assist Nova Scotia community-run small businesses and co-operatives in obtaining local financing. In particular, CEDIFs are formed in order to provide capital to businesses within a defined community distinguishable by common geographic, economic or cultural characteristics. The funds raised under the program must be used within that community. The Province supports these community initiatives by providing an Equity Tax Credit (ETC) for eligible investments made in CEDIFs.

The ETC is administered by the Taxation and Federal Fiscal Relations Division of the Nova Scotia Department of Finance and Treasury Board (the Department).

The legislative authority for this tax credit is contained in

- Section 37 of the *Income Tax Act* (Nova Scotia),
- *Equity Tax Credit Act* (the Act), and
- *Equity Tax Credit Regulations* (the Regulations).

CEDIF specified issues (i.e. share offerings) are permitted under the *Community Economic-Development Corporations Regulations* of the *Securities Act* (Nova Scotia). If a business wishes to be registered as a CEDIF and have a specified issue, it must to apply to both the Department and the Nova Scotia Securities Commission prior *to* issuing shares to investors.

Approval of the issuance of shares under the program does not constitute an endorsement by government of the corporation or association issuing the shares. The Province does not guarantee any investment. The investor is at risk for his or her investment.

*Where there is a conflict between the information contained in these Guidelines and the Legislation and Regulations, the Legislation and Regulations governing the ETC will take precedence over the Guidelines, application forms, advance rulings or any other published information.*

## Tax Credit

Eligible investors qualify for a non-refundable tax credit of 35% of the eligible investments made in a CEDIF. The maximum tax credit an individual can receive is $17,500 per year (35% of a $50,000 investment). CEDIFs must register under the ETC program for each specified issue.

Eligible investors can make an eligible investment within the calendar year or within 60 days of the calendar year end (as long as the CEDIF is ETC-registered at the time the investment is made). Eligible investors are required to hold their investment in the CEDIF for a minimum of 5 years to avoid being required to pay the tax credit.

Tax credit receipts are issued by the Department. After the receipt is issued, the tax credit can be claimed via the individual's personal income tax return (using form T1285) for the taxation year in which the investment was made. The ETC is a non-refundable credit but unused portions may be carried forward for 7 years or carried back 3 years.

Provided that the CEDIF meets certain requirements, subsequent/rollover tax credits of 20% and 10% are available to investors who agree to keep their investments in the CEDIF for an additional 5 and 10 years, for a total of 10 or 15 years respectively. If the investment is not held in the CEDIF for the additional time, the subsequent tax credit must be repaid to the Province.

A detailed list of historical CEDIF specified issues can be found on the Department's website.

## CEDIF Eligibility & Structures

A CEDIF may be set up as a corporation or co-operative but not a sole proprietorship or partnership and must:

- be taxable, for-profit and non-charitable,
- be headquartered in Nova Scotia,
- carry on a business in Canada,
- have less than $25 million in assets (including affiliated organizations),
- have less than $25 million in revenues (including affiliated organizations),
- have fewer than 500 employees (including employees of affiliated organizations),
- pay at least 25% of its salaries and wages in Nova Scotia,
- have a minimum of 6 directors who are residents of Nova Scotia,
- have authorized capital consisting of at least 1 class of common voting shares (for corporations),
- in the case of a corporation:
    - be an active business (see below), or
    - invest all or substantially all of the funds raised in an active business, or
    - have a constitution that restricts the CEDIF to making specified investments in eligible businesses entities,
- in the case of a co-operative:
    - be a marketing, producer or employee co-operative, or
    - have a constitution that restricts the company to making eligible investments in other co-operatives.

All businesses carried on in Canada are considered active businesses except for those that are personal services businesses or specified investment businesses as defined in the federal Income Tax Act.

- Personal services businesses are those where an individual who would reasonably be regarded as an employee of an organization provides their services to that organization through a corporation (such that the individual is essentially an "incorporated employee"), where the individual or a related person owns at least 10% of the corporation.
- Specified investment businesses are those whose principal purpose is to derive their income from property, typically in the form of interest, dividends, rentals from real estate, or royalties.
  Note: The exception contained in the federal Income Tax Act for businesses having more than 5 full-time employees is not applicable by virtue of the definition of "active business" contained in the Equity Tax Credit Act.

CEDIFs are typically structured as one of the following:

- <u>A corporation set up as a holding company.</u>
  In this case, the CEDIF is limited to making specified investments (i.e. buying common voting shares and/or issuing subordinate loans) in eligible business entities that

  - are taxable Canadian corporations,
  - have less than $25 million in assets (including assets of associated corporations),
  - have fewer than 500 employees,
  - pay at least 75% of salaries and wages in Nova Scotia, and
  - are active businesses or invest all or substantially all of its property in one or more corporations that follow the criteria above.

- A co-operative set up as a holding company.

  In this case, the CEDIF co-operative that invests funds raised under the program must use the funds to make eligible investments (i.e. buy shares in other co-operatives which allow the CEDIF to be a voting member of the co-operative).

- A corporation/co-operative that runs an active business itself

  In this case, the CEDIF has revenue, employees, etc. and the funds raised from shareholders are used to run the actual business.

A company will not be registered as a CEDIF if the specified issue does not comply with the provisions of the *Securities Act* (Nova Scotia).

## Use of Funds Raised

If the CEDIF runs an active business (and is not a holding company), the funds raised under the program can be used for a wide variety of purposes including, but not limited to: start-up costs, working capital, research, equipment purchases, salaries, general expansion, repaying debt (other than shareholder debt).

If the CEDIF is a holding company, it can use the funds raised under the program to loan money (corporations) to or invest in corporations/co-operatives that meet the criteria stated above.

Funds raised by CEDIFs cannot be used for matters described in Section 7 of the Act such as

- acquiring securities, other than eligible investments in an eligible business;
- paying dividends or repaying a debt owed to a director, officer or shareholder of the CEDIF or an associate of a director, officer or shareholder;
- purchasing services or assets provided by the Province or its agencies or corporations, where
  - those services or assets are to be used in a business or activity that is the same or similar to the activity previously carried on by the Province or its agencies or corporations, and
  - the CEDIF has received, either directly or indirectly, any financial assistance from any government, municipality or public authority with respect to the acquisition of those services or assets;
- part of a transaction or series or transactions directly or indirectly involving
  - the redemption or purchase of previously issued shares of the CEDIF or its affiliates,
  - the retirement of a liability of a shareholder of the CEDIF or its affiliates,
  - the payment of dividends, or
  - the funding of the purchase of all or substantially all of the assets of an existing business, except a business in receivership or in bankruptcy where an eligible investor or group of investors did not own at any time more than 10% of the voting shares of the business in receivership or in bankruptcy;
- funding of the purchase by the CEDIF of any services or assets at a price that is greater than the fair market value.

## Pacing Requirements

If the CEDIF is a holding company, it must use the funds raised under the program within a specified timeframe:

- At least 40% of the equity capital raised must be invested within 12 months after the closing date of a specified issue.
- At least 60% of the equity capital raised must be invested within 24 months after the closing date of a specified issue.
- At least 80% of the equity capital raised must be invested within 36 months after the closing date of a specified issue.

If the funds raised under the program are not being used as required, the CEDIF becomes non-compliant with the Act and Regulations. This means that the Minister may revoke the Certificate of Registration of the CEDIF (and all previously issued tax credits). Also, while the CEDIF is non-compliant, it is not eligible for rollover/subsequent tax credits.

## Eligible Investors

For an investment in a CEDIF to be eligible for the tax credit, it must be made by an individual who is a resident of Nova Scotia who is at least 19 years of age.

There is no minimum investment amount.

No individual or group of related individuals can own, at any given time, 20% or more of the CEDIF or any organization related to the CEDIF.

## Eligible Investments

In the case of a CEDIF corporation, an eligible investment comprises of fully paid, newly issued common voting shares of the corporation that are non-redeemable, non-retractable, non-convertible and are not restricted in profit sharing or participation upon dissolution.

In the case of a CEDIF co-operative, an eligible investment must allow the investor to vote in the affairs of the co-operative.

In both cases:

- Shares must be issued on or before February 28, 2022.
- Replacement shares are not eligible.
  *A replacement share is one that is issued as part of a specified issue where the purchaser has disposed of a share of any class of the CEDIF.*
- Shares cannot entitle the shareholder, by virtue of their acquisition, to:
  - any other tax credit or deduction allowed under the *Income Tax Act* (Nova Scotia) or federal *Income Tax Act*, except as a deduction for Registered Retirement Savings Plan (RRSP) purposes or
  - to receive any other financial assistance from any government, municipality, or public authority.
- Shares purchased before the application is approved are not eligible for the ETC.
- The main purpose of the investment cannot be to obtain the tax credit.

CEDIF investments can be held in self-directed RRSPs but cannot be held in any other type of trust (including Tax Free Savings Accounts).

## Tax Credit Repayment

Investors are required to hold their investment in the CEDIF for a minimum of 5 years. If investments are not held for this 5-year period the tax credit(s) must be repaid back to the Province. Also, investors who receive a subsequent/rollover tax credit must keep their investment in the CEDIF for an additional 5-year period.

There are several exceptions to this rule. The credit is not required to be repaid if:

- the sale is due to the death of the shareholder,
- the share is transferred to the shareholder’s RRSP or Registered Retirement Income Fund (RRIF),
- the CEDIF ceases to conduct business due to its financial failure (in the opinion of the Minister), or
- the shares were exchanged for a share of a different series in the same class of shares, if each series of shares within the class meets the eligibility requirements of the Act.

If the share sale is a result of the wind-up or dissolution of the CEDIF for reasons other than financial failure, a prorated credit amount must be repaid to the Province.

When the CEDIF repurchases shares in a transaction not permitted under the Act or Regulations, the CEDIF (not the shareholder) must withhold the amount of the credit and remit it, along with the details of the transaction, to the Department.

Where the CEDIF has repurchased shares in a transaction not permitted under the Act or Regulations in the event of a conversion of a RRSP to a RRIF or annuity, the CEDIF must withhold a monthly prorated amount of the credit and remit it to the Department.

In all cases, CEDIFs should notify the Department of all transactions before they occur so that the necessary actions can be taken and an accurate repayment amount can be calculated.

## Application Process

The CEDIF application process normally takes 2-3 months.

CEDIF specified issues are permitted under the *Community Economic-Development Corporations Regulations* of the *Securities Act* (Nova Scotia). If a business wishes to be registered as a CEDIF and have a specified issue, it must to apply to both the Department and the Nova Scotia Securities Commission prior *to* issuing shares to investors.

1. The Department is responsible for ensuring that the CEDIF and the specified issue comply with the Act and Regulations. Generally speaking, this means assessing the types of organizations eligible for the program, how funds raised can be used, and issuing tax credit receipts to eligible investors.

   Application packages consisting of the following must be sent via email to the ETC administrator (paper copies are not accepted):

   - An application form (found on the Department’s website).
     *The application form must be signed by an authorized officer of the CEDIF. Electronic signatures like Adobe’s EchoSign are acceptable as well as forms that have been signed by hand and then scanned.*

   - Financial statements for the CEDIF’s previous tax year.
     Note: interim financials may also be requested by the administrator.
     *The financial statements do not have to be audited or reviewed. Also, if the CEDIF was recently incorporated, financials are not required.*

- T2 Corporate Tax Return (including all forms and schedules) for the preceding tax year.
  *This is not required if the CEDIF is in its first tax year.*

- Up-to-date and <u>notarized</u> shareholder's register.
  *The shareholder register must contain information on* ***<u>all</u>*** *share transactions (from the time when the CEDIF was incorporated) including, but not limited to, the name of the investor and the date, type and number of shares that have been bought, sold and transferred.*

- Offering Document Draft
  *The purpose of the CEDIF Offering Document is to provide a basic level of knowledge of all material facts to potential investors concerning the business they are considering investing in. Subsequent drafts and the final version of the Offering Document must also be submitted to the Department when available.*

- Constitution/Articles of incorporation and memorandum of association.
  *These are not required if they have been previously provided to the ETC administrator during a past application (unless subsequent changes have been made).*

2. <u>The Nova Scotia Securities Commission</u> is responsible for ensuring that the CEDIF and the specified issue are in compliance with the *Securities Ac*t (Nova Scotia) and *Community Economic-Development Corporations Regulations*. Generally speaking, this means protecting investors through ensuring proper disclosure. More information on applying with the Nova Scotia Securities Commission can be found on their website.

Once an application is approved by the Department and the specified issue receives a non-objection letter from the Nova Scotia Securities Commission, the applicant will receive a Certificate of Registration. This Certificate registers the organization as a CEDIF and specifies the period of time during which the CEDIF is permitted to issue shares under the program. During this timeframe, the CEDIF is permitted to sell shares to the public and use advertising as approved by the Nova Scotia Securities Commission. Only eligible shares that that are fully paid and issued within this timeframe are eligible for the tax credit.

Extensions may be granted if the CEDIF needs more time to raise funds than the timeframe allotted on the Certificate of Registration. Extension requests must be made <u>via email</u> to the ETC administrator and the Nova Scotia Securities Commission preferably 3-4 weeks before the existing certificate lapses to allow enough time for the request to be processed. Extensions must be approved by both the Department and the Nova Scotia Securities Commission.

## Issuance of Tax Credit Receipts

In order for tax credit receipts to be issued to eligible investors after the specified issue is complete, CEDIFs must submit the following to the Department:

- an up-to-date <u>notarized</u> shareholder register, and
- the Investor Data Report (in Excel).

The Investor Data Report can be found on the Department's website. It must list all eligible investors that made eligible investments during the timeframe the organization was registered under the program.

Both documents must be submitted <u>via email</u> to the ETC administrator as soon as possible after the lapse date on the Certificate of Registration. By submitting this, the submitter is certifying to the Department that the information contained in the email and files provided is true and correct. The Nova Scotia Securities Commission has additional reporting requirements – contact them for more information.

Tax credit receipts are then issued by the Department directly to the investors and can then be claimed via the individual's personal income tax return (using form T1285) for the tax year stated on the receipt.

If duplicate or replacement tax credit receipts are needed, please contact the ETC administrator.

## Rollover Tax Credits (Subsequent Tax Credits)

Rollover tax credits were introduced in the program as a way of encouraging investors to keep their money invested in the CEDIF. CEDIF investors that receive the initial 35% tax credit at the time of the investment may qualify for 2 rollover (subsequent) tax credits.

- A 20% rollover tax credit is available after the initial 5-year holding period to CEDIF investors that agree to keep their investments for an additional 5 years (for a total of 10 years).
- A 10% rollover tax credit is available after the 10-year holding period to CEDIF investors that agree to keep their investments for an additional 5 years (for a total of 15 years).

In order to qualify for each of the rollover tax credits, the CEDIF must apply to the Department and meet certain criteria. Applications for rollover credits take approximately 5-6 weeks.

Application for the 20% rollover tax credit may be made on the 5$^{th}$ anniversary of the original specified issue. At this time,

- the market value of the CEDIF must be greater than 65% of the original book value of invested capital raised,
- the CEDIF must be up-to-date with pacing requirements, and
- the CEDIF must have raised additional funds through at least 1 other specified issue (i.e. the CEDIF must have had at least 1 other successful specified issue above and beyond the offering that has become eligible for the subsequent tax credit).

Application for the 10% rollover tax credit may be made on the 10$^{th}$ anniversary of the original specified issue. At this time,

- the market value of the CEDIF must be greater than 50% of the original book value of invested capital raised,
- the CEDIF must be up-to-date with pacing requirements, and
- the CEDIF must have raised additional funds through at least 1 other specified issue (i.e. the CEDIF must have had at least 1 other successful specified issue above and beyond the offering that has become eligible for the subsequent tax credit).

In both cases, investors must agree to keep their investments in the CEDIF for the additional 5 years.
Only the investors listed on the Rollover Investor Data Report will receive the rollover tax credits. Before applying for rollover credits, CEDIFs should confirm with each individual investor whether they would like the rollover tax credit and will keep their investment for an additional 5 years. CEDIFs should also confirm with investors who are turning 65 during the 5-year holding period and holding their investments in an RRSP, if they are able to continue holding their investment for the required time.

Rollover applications consisting of the following must be submitted to the ETC administrator via email (paper copies are not accepted):

- An application form (found on the Department's website).

*The application form must be signed by an authorized officer of the applicant business. Electronic signatures like Adobe's EchoSign are acceptable as well as forms that have been signed by hand and then scanned.*

- Up-to-date and notarized shareholder's register.
  *The shareholder register must contain information on **all** share transactions (from the time when the organization was incorporated) including, but not limited to, the name of the investor and the date, type and number of shares that have been bought and sold.*

- Most recent financial statements

- 20% or 10% Investor Data Report (in Excel), depending on which rollover credit is being applied for.
  *These can be found on the Department's website. The report must list all eligible investors that want the rollover credit and have agreed to keep their investment in the CEDIF for an additional 5 years*.

## Annual Filings

CEDIFs are required to make annual filings (to the Department and the Nova Scotia Securities Commission) after their first successful specified issue. The annual filings to the Department are to be made within 180 days of their corporation tax year end and must include the following documents:

- Full corporate tax return for the preceding year (including all forms and schedules).
- Financial statements for the preceding year.
- Details of any investments made by the CEDIF and any potential investments being considered for the following year.
- A notarized shareholder register showing details of all share transactions.

CEDIFs must continue to file annual reports with the Department for five years from the last issuance of tax credit receipts (including rollover tax credits). Failure to submit filings could result in future applications being turned down and/or the CEDIF's registration being revoked and issued tax credits clawed back.

## Revocation of Certificate of Registration

An ETC Certificate of Registration can be revoked at any time after being issued if the CEDIF:

- does not meet the pacing requirements,
- has not complied with any provision of the Act and Regulations, or the spirit and intent of the Act and Regulations,
- has issued shares of the same or substantially the same class as the shares issued as part of the specified issue to an individual for an unreasonably low cost per right to vote, such that the eligible Investor is unable to exercise any real influence in the management of the corporation,
- has misrepresented any information to the Minister either knowingly or through circumstances amounting to gross negligence,
- has used the proceeds raised by the specified issue for any prohibited use,
- relocates out of the Province unless it would otherwise continue to qualify for registration,
- sells assets whose original book value when deducted from the total book value of the assets of the CEDIF impinges on the capital raised under the Act, or
- has purchased, redeemed or acquired shares issued by it if, without the prior written approval of the Minister, the cost of the purchase, redemption or acquisition exceeds 20% of the CEDIF's retained earnings, or the purchase, redemption or acquisition results in the CEDIF being unable to pay its liabilities as they become due.

If the registration is revoked after the specified issue, the CEDIF (not the shareholders) must repay the aggregate value of all the tax credits issued. If the registration is revoked before the specified issue, tax credit receipts will not be issued.

Where a director or officer of the CEDIF or a member of a group/shareholder that controls the CEDIF permits or agrees to a transaction/event or a series of transactions/events that the person knew or ought to have known at that time would cause the Certificate of Registration to be revoked, that person is jointly and severally liable for the repayment of tax credits.

## Penalties and Inspection of Records

The Act and Regulations list various offences and resulting penalties. Offences include, but are not limited to, making false or misleading information and impeding an investigation. The legislation also gives the Department the right to inspect records and conduct an investigation on the company and its shareholders.