NOVA SCOTIA
EQUITY TAX CREDIT
GUIDELINES

PRIVATE CORPORATIONS & CO-OPERATIVES

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

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Nova Scotia Equity Tax Credit Guidelines
Private Corporations & Co-operatives

General Information

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

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).

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 an ETC-registered organization. The maximum tax credit an individual can receive is $17,500 per year (35% of a $50,000 investment). Organizations 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 organization is ETC-registered at the time the investment is made. Eligible investors are required to hold their investment in the particular ETC-registered organization for a minimum of 5 years to avoid being required to repay 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.

Eligible Business

Eligible businesses include corporations and co-operatives but not sole proprietorships and partnerships. Most small and medium sized Nova Scotia businesses are eligible provided that the organization:

- is taxable,
- is headquartered in Nova Scotia,
- carries on a business in Canada,

- has less than $25 million in assets (including affiliated organizations),
- has less than $25 million in revenues (including affiliated organizations),
- has fewer than 500 employees (including employees of affiliated organizations),
- pays at least 25% of salaries and wages in Nova Scotia,
- is an active business (see below) or will be investing all or substantially all of the funds raised in a business that would otherwise qualify under the ETC program,
- has at least 3 eligible investors taking part in the specified issue (for corporations),
- has authorized capital consisting of at least 1 class of common voting shares (for corporations),
- is a marketing, producer or employee co-operative (for co-operatives),
- is not incorporated for the professional practice of an accountant, dentist, lawyer, medical doctor, veterinarian, or chiropractor, and
- none of the officers and directors of the eligible business are officers or directors of any other corporation or co-operative that is currently not in compliance with the Act or Regulations.

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.

Use of Funds Raised

Funds raised through the ETC 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/director debt).

The funds raised under the program by the eligible business must be used in an active business and <u>cannot</u> be used for matters described in Section 7 of the Act such as

- lending;
- 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 eligible business or an associate of a director, officer or shareholder of the eligible business;
- 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 eligible business 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 eligible business or its affiliates,
  - the retirement of a liability of a shareholder of the eligible business 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 eligible business of any services or assets at a price that is greater than the fair market value.

Eligible Investors

For an investment in an ETC-registered organization to be eligible for the ETC, it must be made by an individual who is a resident of Nova Scotia and at least 19 years of age.

There is no minimum investment amount.

For private corporations, each specified issue (i.e. share offering) must have at least 3 eligible investors in order for the investors of a registered corporation to qualify for the ETC.

Eligible Investments

Provided that the business is approved, eligibility will begin the day the application was received by the Department. Shares purchased before the application is received by the Department are not eligible for the ETC.

In the case of a 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 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 eligible business any time after September 13, 1993.
- 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.
- The main purpose of the investment cannot be to obtain the tax credit.

Tax Credit Repayment

Investors are required to hold their investment in the ETC-registered organization 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.

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 sale is due to the involuntary loss of employment of the shareholder and the share was purchased as part of a specified issue by a corporation only to its employees,

- the share is transferred to the shareholder's RRSP or Registered Retirement Income Fund (RRIF),
- the eligible business ceases to conduct business due to financial failure (in the opinion of the Minister), or
- the share was 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 organization for reasons other than financial failure, a prorated credit amount must be repaid to the Province.

When the organization repurchases shares in a transaction not permitted under the Act or Regulations, the organization (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 organization 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 organization must withhold a monthly prorated amount of the credit and remit it to the Department.

In all cases, organizations 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

Eligible businesses must first apply to the Department to obtain a Certificate of Registration *prior to* issuing shares to investors.

Application packages consisting of the following must be sent <u>via email</u> 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 applicant business. 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 organization'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 organization was recently incorporated, financials are not required.

- T2 Corporate Income Tax Return (including all forms and schedules) for the preceding tax year.
  This is not required if the organization 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 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, sold and transferred.*

- Corporate chart/structure (if applicable).

- Shareholder agreements (if any).

- Proposed investor forms completed by 3 proposed investors (for corporations).

The form can be found on the Department's website.

- A <u>brief</u> business plan (1-2 pages maximum) including:
    - a description of the business including major revenue sources,
    - how the funds raised under the ETC program will be used, and
    - a list of directors (names, addresses & brief background)

- 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).

If the application is approved, the eligible business will receive a Certificate of Registration registering the organization for the ETC program. The Certificate will state the period that the organization is eligible for the program. Only shares that that are fully paid and issued within this timeframe are eligible for the tax credit.

Extensions may be granted if the ETC-registered organization 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, preferably 3-4 weeks before the current Certificate lapses to allow enough time for the request to be processed.

If an organization has not been registered, or if an extension request has not been approved within 90 days from the date of application it is deemed to have been denied.

Approved businesses are limited to selling shares as an exempt issue under the *Securities Act* (Nova Scotia) (e.g. to family and friends, accredited investors, etc.). ETC approval from the Department does not constitute any approval that may be required from the Nova Scotia Securities Commission under the *Securities Act* (Nova Scotia). Due diligence is required from all applicants on this matter.

There are different requirements relating to the Nova Scotia Securities Commission if the eligible business is registering as a Community Economic Development Investment Fund (CEDIF). More information on CEDIFs can be found on the Department's website.

Issuance of Tax Credit Receipts

In order for tax credit receipts to be issued to eligible investors after the specified issue is complete, ETC-registered organizations 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 ETC 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.

Tax credit receipts are then issued 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.

Revocation of Certificate of Registration

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

- 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 a prohibited use as set out in Section 7 of the Act,
- relocates out of the Province unless it would otherwise continue to qualify for registration, or
- sells assets whose original book value when deducted from the total book value of the assets of the eligible business impinges on the capital raised under the Act.

If the registration is revoked after the specified issue, the organization (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 a corporation or a member of a group/shareholder that controls the corporation 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 organization and its shareholders.