NOVA SCOTIA
INNOVATION EQUITY TAX CREDIT
GUIDELINES

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

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Nova Scotia Innovation Equity Tax Credit Guidelines

General Information

The Innovation Equity Tax Credit (Innovation ETC) is meant to encourage investors to make equity capital investments in eligible Nova Scotia small and medium corporations, who are engaged in innovative activities that contribute to inclusive economic growth and increase investment in innovation. The investments incented by this program are meant to provide capital required for research, development or commercialization of new technology, new products or new processes.

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

Approved corporations must ensure that each specified issue under this program complies with the *Securities Act* (Nova Scotia). More information on this can be found here. Innovation 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.

Approval to complete a specified issue under the program does not constitute an endorsement by government of the corporation completing the specified issue. 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 Innovation Equity Tax Credit will take precedence over the Guidelines, application forms, advance rulings or any other published information.

Tax Credit

Eligible investors can qualify for a non-refundable personal or corporate income tax credit calculated in the following way:

Investment Amount **x** Tax Credit Rate

where

Investment Amount = amount paid in cash for an eligible investment during a specified issue.

Tax Credit Rate =

- For Investments made by Individuals:
  - **35%** for eligible investments made in an approved corporation whose *primary business* does not fall within the sectors and NAICS industry groups below;

    - **45%** for eligible investments made in an approved corporation whose *primary business* fall within
        - the ***oceans technology sector*** comprising one of the following NAICS[1] industry groups
            - 3341 (Computer and peripheral equipment manufacturing),
            - 3342 (Communications equipment manufacturing),
            - 3343 (Audio and video equipment manufacturing),
            - 3344 (Semiconductor and other electronic component manufacturing),
            - 3345 (Navigational, measuring, medical and control instruments manufacturing),
            - 3346 (Manufacturing and reproducing magnetic and optical media),
            - 3351 (Electric lighting equipment manufacturing),
            - 3353 (Electrical equipment manufacturing), and
            - 3359 (Other electrical equipment and component manufacturing), or
        - the ***life sciences sector*** comprising the following NAICS industry groups:
            - 3254 (Pharmaceutical and medicine manufacturing),
            - 3391 (Medical equipment & supplies manufacturing),
            - 5417 (Scientific research and development services); and

- For Investments made by Corporations:
    - **15%** for eligible investments made in an approved corporation.

The maximum annual eligible investment is

- $250,000 for individuals and
- $500,000 for corporations.

The maximum annual personal tax credit is $87,500 for the 35% tax credit rate and $112,500 for the 45% tax credit rate.

The maximum annual corporate tax credit is $75,000.

Eligible corporations must apply for approval under the program before each specified issue.

For the 2019 and subsequent taxation years, eligible investors who are individuals, can make an eligible investment within the calendar year or within 60 days of the calendar year end, as long as the approved corporation has a valid certificate of registration at the time the investment is made.

To avoid being required to repay the tax credit, eligible investors are required to hold their investment in the approved corporation for a minimum of 4 years from the date the share certificate or convertible denture is issued.

Tax credit certificates are issued by the Department after a specified issue is complete. After the tax credit certificate has been issued to the eligible investor, the tax credit may be claimed via the

[1] North American Industry Classification System Canada 2017 Version 1.0 published by Statistics Canada

individual's personal income tax return or the corporation's corporate income tax return for the taxation year in which the investment was made.

The Innovation ETC is a non-refundable credit, however

- unused portions of the *personal* tax credit may be carried forward for 7 years or carried back 3 years for any taxation year after December 31, 2018.
- unused portions of the *corporate* tax credit may be carried forward for 7 years or carried back 3 years for any taxation year after April 1, 2019.

Eligible Corporations

A corporation is an **eligible corporation** provided that it

- is a taxable Canadian corporation;
- carries on a business in Nova Scotia (and is registered in Nova Scotia);
- was incorporated less than 10 years ago;
- has its head office in Nova Scotia (*see page 5*);
- uses all or substantially all of its assets in an active business (*see page 5*);
- has less than $15 million in assets (including assets of associated corporations);
- has fewer than 100 employees (including employees of associated corporations);
- pays at least 50% of its remuneration to employees or full-time contractors (*see page 5*) who are residents of Nova Scotia and report to or deal with a permanent establishment of the corporation in Nova Scotia;
- has authorized capital consisting of at least 1 class of common voting shares;
- is developing or implementing new technologies or applying existing technologies in a new way to create new products, services or processes; and
- does not fall under any of the restrictions below.

A corporation is not eligible if

- its principal business includes any of the following:
    - construction,
    - developing, leasing or selling real property,
    - hotel ownership or management,
    - retail, including food and beverage services,
    - oil or gas exploration, development and production,
    - film, digital animation, or digital media,
    - membership based recreational activities (e.g. golf courses, fitness clubs, sports centers, etc.),
    - financial or insurance services;
- it is incorporated for a self-regulated professional practice (*see page 5*);
- it is a business for which public financial support would be contrary to public policy;
- it has been issued a Film Industry Tax Credit, Digital Media Tax Credit, Digital Animation Tax Credit, or Capital Investment Tax Credit;
- it has been approved for or received a payroll rebate or an innovation rebate from Nova Scotia Business Incorporated; or
- it has raised (along with all associated corporations) more than $5 million through previous specified issues.

A corporation's **head office** is considered to be either

- the corporation's registered office as listed with the Nova Scotia Registry of Joint Stock Companies, or
- the place where the majority of the corporation's employees report to work (if a law office is listed as the corporation's registered office).

All businesses are considered **active businesses** except for

- personal services businesses as defined in the *Income Tax Act* (Canada), and
- businesses with a principal purpose of deriving their income (including dividends, interest, and rent) from property and that don't employ more than 5 full-time employees throughout the year.

NOTE: 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.

A corporation is considered **associated** with another corporation if it falls under the definition of 'associated corporation' in Section 256 of the *Income Tax Act* (Canada), except that the association is determined at the time of the corporation's application for approval rather than in a taxation year of the corporation.

A **full-time contractor** is considered to be a contractor/consultant of a corporation whose only client is the corporation or who provides services to the corporation for more than 20 hours a week.

Self-regulated professional practices include, but are not limited to, accountants, lawyers, dentists, medical doctors, veterinarians, and chiropractors.

If it is determined that a reason for the existence of multiple separate eligible corporations is to increase the amount of funds raised above the maximum permitted amount of $5 million, those corporations may be considered as 1 eligible corporation and approval refused.

If it is determined that a corporation's business was in existence for more than 10 years before the date of its application for approval, and the business was acquired by another corporation or incorporated as a new corporation, the corporation may be considered to have been incorporated more than 10 years before the application date and approval refused.

Eligible Investors

For an investment in an approved corporation to be eligible for the Innovation ETC, it must be made by an eligible investor.

An **eligible investor** is

- an individual who is a resident of Nova Scotia and at least 19 years of age, or
- a taxable Canadian corporation which
    - is registered to carry on business in Nova Scotia,

- has its head office in Nova Scotia, and
- is not a qualifying venture capital fund under section 27B of the Income Tax Act (Nova Scotia).

NOTE: An "individual" does not include a trust, unless it is governed by a Registered Retirement Savings Plan (RRSP) where

- the individual makes contributions to the fund and those contributions were used to make an eligible investment, and
- the annuitant under the RRSP is the eligible investor or their spouse.

For individual eligible investors: if the investor invests in a convertible debenture of an approved corporation, the eligible investor cannot be

- a director of the approved corporation, or
- an individual, or part of a group of related individuals, owning 25% or more of the approved corporation or any corporation related to the approved corporation.

For corporate eligible investors: if the investor invests in a convertible debenture of an approved corporation, the eligible investor cannot be

- an associated corporation of the approved corporation, or
- a specified shareholder of the approved corporation, owning 25% or more of the approved corporation or any corporation related to the approved corporation.

Corporate investors must also not make or hold an investment in an approved corporation if the corporate investor, either alone or with 1 or more of the following persons, will own (directly or indirectly) shares carrying 50% or more of the votes for the election of directors of the approved corporation or will control the approved corporation in any manner:

- affiliates or associated corporations of the corporate investor,
- shareholders of the corporate investor or their affiliates or associated corporations,
- directors of the corporate investor or their affiliates, or
- officers of the corporate investor or their affiliates.

Eligible Investments within a Specified Issue

Provided that the corporation is approved and receives a certificate of registration, eligibility for the Innovation ETC begins the day the application was received by the Department. This allows the corporation to raise the funds (as stated in their application) through a specified issue. Any investments made in the corporation *before* the application is received by the Department are *not eligible* for the Innovation ETC.

An eligible investment is comprised of an investment made in an approved corporation by an eligible investor in exchange for newly issued

(a) common voting shares,
(b) preferred shares that are not redeemable during the 4 year holding period,
(c) convertible debentures (may be converted to shares that fall within (a) or (b) above during the 4 year holding period).

Each eligible investment must be fully paid in cash by the eligible investor and be a minimum of

- $1,000 for individual investors, and
- $50,000 for corporate investors.

The investments may <u>not</u> be any of the following:

- a replacement investment,
  i.e. A share/debenture purchased as a replacement for another share/debenture of an approved corporation that was previously disposed of by the investor,
- eligible for another tax credit/deduction (other than one in respect of an individual's RRSP),
- made mainly for the purpose of obtaining the tax credit.

In order for an eligible investment to be considered as part of a specified issue, it must be made before the expiry date on the approved corporation's certificate of registration. A specified issue must

- comply with the *Securities Act* (Nova Scotia),
- have at least 3 eligible investors, at least 1 of which is investing in common or preferred shares,
- have a total of *at least* $10,000 in eligible investments,
- comply with the spirit and intent of the Act and Regulations, and
- not increase the total amount of funds raised, by an approved corporation (and associated corporations), across all specified issues above $5 million.

All eligible investments must be held by the eligible investor in the approved corporation for a minimum of 4 years from the date the share certificate or convertible debenture is issued.

Use of Funds Raised

Funds raised through the Innovation ETC program must be used for business activities of the approved corporation in Nova Scotia and can be used for a variety of purposes. Corporations must state what they will be using the funds raised for at the time of application for a certificate of registration and are limited to using the funds raised only for that purpose.

The funds raised must be used by the approved corporation within 4 years after the expiry of the corporation's certificate of registration.

The funds raised under the program by the approved corporation <u>are prohibited</u> from being used for matters such as

- lending;
- acquiring securities;
- purchasing land (other than land that is required for the active business that the approved corporation is primarily engaged in);
- paying dividends;
- repaying a debt to a director, officer or shareholder of the approved corporation (or one of their associates – *see below*).

- redeeming or purchasing previously issued shares of the approved corporation (or associated corporation);
- retiring a liability of a shareholder of the approved corporation (or an associated corporation);
- funding the purchase of all, or substantially all, of the assets of an existing proprietorship, partnership, joint venture, trust or company;
- funding the purchase of any services or assets at a price that is greater than the fair market value.

An **associate of a person** is considered any of the following:

- a corporation of which the person owns, directly or indirectly, shares carrying 10% or more of its voting rights,
- a partner of the person,
- a participant in a joint venture with the person,
- a trust or estate in which the person has a substantial beneficial interest or serves as trustee,
- a person's spouse along with the person (and their spouse's) parent, grandparent, child, grandchild, brother or sister who reside in the same residence as the person.

Application Processes and Reporting

There are multiple steps that corporations must take in order to ensure that their eligible investors are able to claim the tax credit and retain the tax credit:

1. Apply for approval under the Innovation ETC program.
2. Issue eligible investments to eligible investors through a specified issue.
3. Apply for tax credit certificates for the eligible investors (after a specified issue is complete).
4. Submit an annual return for each of the 4 years after the expiry date on the certificate of registration.

Instructions for each step can be found below.

1. Application for Approval (Certificate of Registration)

Eligible corporations must first apply to the Department to obtain a certificate of registration *prior to* accepting investments.

Application packages consisting of the following must be sent via email to the Innovation 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 corporation. 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 previous tax year), together with a review engagement report or auditor's report, for the applicant corporation.
  Note: interim financials may also be requested by the administrator.
  The financial statements must be audited/reviewed by a person who is licensed as a public accountant under an Act of the Province. If the corporation was recently incorporated, financials are not required.

- Financial statements (for the previous tax year), together with a review engagement report or auditor's report, for all corporations associated with the applicant corporation.
  Note: interim financials may also be requested by the administrator.
  The financial statements must be audited/reviewed by a person who is licensed as a public accountant under an Act of the Province. If the corporation was recently incorporated, financials are not required.

- T2 Corporate Income Tax Return (for the previous tax year) of the applicant corporation (including all forms and schedules).
  This is not required if the corporation is in its first tax year.

- T2 Corporate Income Tax Returns (for the previous tax year) of all corporations associated with the applicant corporation (including all forms and schedules).
  This is not required if the corporation 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 corporation 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).

- Debenture agreements (if any).

- Proposed investor forms completed by all proposed eligible investors.
  The form can be found on the Department's website.

- A <u>brief</u> business plan (2-3 pages maximum) including:
  - a description of the corporation's major business activities (current and future) and major revenue sources;
  - a description on how the corporation is developing or implementing new technologies or existing technologies in a new way to create new products, services or processes;
  - the amount of funds to be raised through the specified issue and a description of how and when the funds raised will be used;
  - a list of directors (including names, addresses & brief background information); and
  - the total amount raised across all specified issues by the applicant corporation and all associated corporations.

- Certificate of incorporation, constitution/articles of incorporation and memorandum of association.
  These are not required if they have been previously provided to the administrator during a past application (unless subsequent changes have been made).

At times, the corporation may be required to submit additional information beyond what is listed above.

If the application is approved, the approved corporation will receive a certificate of registration signifying the approval. The certificate will state the time period that the corporation is eligible to complete a specified issue under the program. Only eligible investments that that are fully paid and issued within this timeframe are eligible for the tax credit.

Extensions may be granted if the approved corporation needs more time to raise funds than the timeframe allotted on the certificate of registration. Extension requests must be made via email to the Innovation ETC administrator, preferably 3-4 weeks before the current certificate lapses to allow enough time for the request to be processed.

The amount of funds raised within a specified issue may be increased at the written request of an approved corporation. Requests for an increase in funds to be raised must be made via email to the Innovation ETC administrator **before** completing any transaction(s) that will make the approved corporation go above the amount stated in their original application for approval.

If a corporation has not been approved (and a certificate of registration has not been issued), or if an extension request has not been approved within 6 months from the application date, the application may be considered lapsed.

2. Application for Tax Credit Certificates

After a specified issue is complete, approved corporations must apply for tax credit certificates for their eligible investors. This application should be submitted as soon as possible after a specified issue and must be made no later than 6 months after the expiry date on its certificate of registration.

Applications for tax credit certificates consist of the following and must be sent via email to the Innovation ETC administrator (paper copies are not accepted):

- Up-to-date and notarized shareholder's register.
  *The shareholder register must contain information on **all** share transactions (from the time when the corporation 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.*

- Investor Data Report (in Excel).
  The form can be found on the Department's website. It must list all eligible investors that made eligible investments during the timeframe the corporation's certificate of registration.

- A copy of each share certificate or convertible debenture issued to each eligible investor showing the terms of the share/debenture.

- Signed statements from each eligible investor.
  The form can be found on the Department's website.

- Proof of payment from each eligible investor displaying the amount invested and date of investment.

- A signed statement from an authorized officer of the corporation.
  The form can be found on the Department's website.

At times, the corporation may be required to submit additional information beyond what is listed above.

Once approved, tax credit certificates are issued directly to the investors and may then be claimed via the individual's personal income tax return or corporation's corporate income tax return for the tax year stated on the certificate.

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

Tax credit certificates will be issued if all of the following conditions are satisfied:

- The approved corporation and its eligible investors are complying with the Act and Regulations.
- The approved corporation or its directors, officers or shareholders are not conducting the corporation's business in a manner that is contrary to the spirit and intent of the Act or the Regulations.
- The shares do not constitute a type of security that entitles the holder to claim/receive any of the following:
    - a tax credit under the Act or the *Income Tax Act* (Canada), other than the Innovation ETC,
    - a deduction from income under the Act or the *Income Tax Act* (Canada), other than one in respect of an individual's RRSP,
    - any other financial assistance from any government, municipality or public authority.
- No tax credit has previously been allowed for the shares under the Act or the *Income Tax Act* (Canada).
- All other conditions imposed on the approved corporation have been met.

Tax credit certificates will not be issued if

- a corporation's approval is cancelled and certificate of registration is revoked after a specified issue is completed but before the tax credit certificates are issued, or
- the specified issue or eligible investment to which the tax credit certificate relates in an avoidance transaction as defined in Section 80A of the Act.

3. Annual Return

Approved corporations, which have completed a specified issue, must submit an annual return to the Innovation ETC administrator. The annual returns are necessary to confirm that the approved corporation is complying with the Act and Regulations.

Each annual return must be submitted within 90 days of the approved corporation's tax year end for each of the 4 years after the expiry date on its certificate of registration.

Annual returns consist of the following and must be sent via email to the Innovation ETC administrator (paper copies are not accepted):

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

- Up-to-date and notarized shareholder's register.
  *The shareholder register must contain information on **all** share transactions (from the time when the corporation 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.*

- Financial statements (for the previous tax year), together with a review engagement report or auditor's report, for the approved corporation.
  The financial statements must be audited/reviewed by a person who is licensed as a public accountant under an Act of the Province.

- T2 Corporate Income Tax Return (for the previous tax year) of the approved corporation (including all forms and schedules).

At times, the corporation may be required to submit additional information beyond what is listed above.

Tax Credit Repayment

Eligible investors are required to hold their investment in the approved corporation for a minimum of 4 years from the date the share certificate or convertible debenture is issued. If investments are not held for this 4-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 investment is disposed due to the eligible investor's death,
- the investment is transferred to the shareholder's RRSP or Registered Retirement Income Fund (RRIF),
- the eligible business ceases to conduct business due to financial failure, or
- a 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.

If the disposal of an eligible investment is a result of the wind-up or dissolution of the corporation for reasons other than financial failure, a prorated credit amount must be repaid to the Province. The amount is calculated as follows:

$$TC \times ((48 - MH) / 48)$$

where

TC = the total Innovation ETC received for the eligible investment
MH = the number of months the eligible investment has been held

If an approved corporation repurchases, redeems or repays an eligible investment in a transaction not permitted under the Act or Regulations, the approved corporation must withhold the amount of the credit from the eligible investor. The credit amount must be remitted, along with the details of the transaction, to the Department within 30 days of the transaction.

The approved corporation is jointly and severally liable for all tax credit repayments that any of its eligible investors are required to repay.

The approved corporation is jointly and severally liable for the repayment of <u>all</u> issued tax credits in all of the following scenarios:

- The corporation's approval is cancelled and certificate of registration is revoked.
- The corporation surrenders its approval and certificate of registration.
- The corporation is issued a tax credit certificate through the Film Industry Tax Credit, Digital Media Tax Credit, Digital Animation Tax Credit, or Capital Investment Tax Credit within 4 years after the expiry date on its certificate of registration.
- The corporation is approved for a payroll rebate or an innovation rebate from Nova Scotia Business Incorporated within 4 years after the expiry date on its certificate of registration.

NOTE: Any amount required to be repaid is a debt due to the Crown and may be recovered in a court.

Approval Cancellation / Revocation of Certificate of Registration

A corporation's **approval is automatically cancelled**, and its certificate of registration is **<u>automatically revoked</u>**, if any of the following occurs:

- The corporation uses the funds raised through a specified issue for a prohibited purpose.
- For each of the 4 years immediately after the expiry date of its certificate of registration,
    - the corporation does not pay at least 50% of its remuneration to employees or full-time contractors who are residents of Nova Scotia and report to or deal with a permanent establishment of the corporation in Nova Scotia;
    - the corporation's head office relocates out of Nova Scotia; or
    - the corporation ceases to use all, or substantially all, of its property in an active business.
- The corporation 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 an eligible investor is unable to exercise any real influence in the management of the corporation.
- The corporation misrepresented any information to the Minister either knowingly or negligently.

- The corporation sells assets with a book value that, when deducted from the total book value of the assets of the corporation, impinges on the funds raised through a specified issue.

A corporation's approval may be cancelled, and its certificate of registration may be revoked, if any of the following occurs:

- The corporation has not complied with the Act or Regulations, or the spirit and intent of the Act or these Regulations.
- The corporation is no longer conforming to the business plan submitted with their application for approval
- The corporation has not used the funds raised through the specified issue within 4 years after the expiry date on the certificate of registration.
- It is determined that a reason for the corporation's existence is to increase the amount of funds raised above the maximum permitted amount of $5 million.
- It is determined that the corporation was in existence for more than 10 years before its application for approval.

Penalties

A penalty may be imposed on the corporation if a corporation's approval has been cancelled and its certificate of registration revoked. If a corporation's approval has been cancelled, the corporation may apply to the Department for reinstatement of the approval and certificate of registration.

In cases where the approval was not *automatically* cancelled (see the previous section), a penalty may also be imposed on a corporation in lieu of cancelling a corporation's approval and revoking its certificate of registration,

The penalty can be any amount up to the total of all tax credits that were issued to all eligible investors of the corporation across all of the corporation's specified issues.

Amalgamation

If 2 or more corporations amalgamate/merge and at least 1 of the corporations completed a specified issue less than 4 years before the amalgamation the following must be observed:

- Eligible investors in the original corporation(s) must continue to hold their investment(s) in the amalgamated corporation for the holding period. The amount of time the investment is required to be held will be based on the date the eligible investment was made in the original corporation (i.e. the date the share certificate or convertible debenture was issued).
  If the investment is not held for the 4 year holding period, the investor must pay back a prorated amount of the tax credit as calculated in the Tax Credit Repayment section of these Guidelines.
- The amalgamated corporation must file the required annual returns and comply with the Regulations for the duration of the holding period.

If the amalgamated corporation applies for a certificate of registration to have another specified issue:

- The capital raised by each of the original corporations will be added together when determining whether the corporation has reached it's $5 million maximum raise.
- The 10 year limit on incorporation will be based on when the original corporations were incorporated.

All documentation or information received from an applicant will be maintained in strictest confidence by the Department.