Equity Tax Credit Act and
Community Economic Development Investment Funds
Review 2002

Executive Summary

Nova Scotia Equity Tax Credit

The Equity Tax Credit ("ETC") programme since 1994, and the Community Economic Development Investment Funds ("CEDIF") programme since 1999, together have assisted 454 Nova Scotia businesses in raising $54,486,942 in equity capital from 5,011 investors who qualified for $15,658,376 in non-refundable provincial tax credits.

The ETC and CEDIF programmes provide that on eligible capital investments, eligible individual Nova Scotia residents can receive a non-refundable provincial tax credit of 30% of the amount invested to a maximum credit of $9,000 that can be carried back three years and forward seven years.

In compliance with the Securities Act, businesses using the general ETC are limited to selling shares as exempt issues (non-public), while CEDIF offerings can be sold to the public. Therefore, a CEDIF issue is offered to a greater number of potential investors and typically raises more equity for the business.

Positive features of the programmes are:

1. They provide an economic incentive that is geographically distributed throughout the province
2. High dollar value CEDIF's have encouraged regional development as they have been used exclusively outside of the Halifax Regional Municipality area.
3. They promote economic diversification, many types of businesses have used the programmes
4. A past survey shows 86% of participant businesses believe the ETC programme has had a positive effect on their business
5. The Nova Scotia Input Output model indicates that after a brief lag time there is a positive tax payback to the province as a result of the programmes.
6. CEDIF's encourage community investment and involvement.
7. CEDIF's create a direct Nova Scotia Registered Retirement Savings Plan investment option for Nova Scotians and increase the allowable foreign property content limit.

Recommendation

It is recommended that the programmes be extended to December 31, 2006, but there should be modifications and clarifications to the legislation as suggested in the section titled Proposed Changes to the Act and Regulations.

History and Purpose

Introduced in 1994, the Equity Tax Credit ("ETC") programme was implemented in response to concerns raised in public consultations in the early 1990's. In the consultations a primary concern brought forward was the lack of equity capital financing for small and medium sized businesses. The lack of equity capital hindered business start-ups and expansions; therefore potential economic growth and employment were not being realized. At that time it was also noted that in excess of $600 million in funds were leaving the Province each year in RRSP investments of which only 2% was being re-invested in the Nova Scotia economy.

To encourage Nova Scotians to invest in Nova Scotia and supply needed equity capital the ETC programme was introduced. This approach was thought to have several advantages over that of the traditional direct government investment in businesses. First, businesses would actively pursue equity capital and reliance on debt and traditional government financing would be lowered. Second, equity partners would provide personal contact and guidance to businesses that government could not. Third, investment decisions would now rest with investors and business people who would aim to optimize returns through efficient use of their capital.

The ETC provides that on eligible capital investments eligible individual Nova Scotia residents can receive a non-refundable provincial tax credit of 30% of the amount invested to a maximum credit of $9,000 that can be carried back three years and forward seven years.

The summarized eligibility criteria for investments, individuals and businesses, which can be found at www.gov.ns.ca/finance/taxpolicy/etc.html are:

Eligible Investments

In the case of corporations, eligible investments must be newly issued common voting shares of the corporation that are non-redeemable, non-convertible and are not restricted in profit sharing or participation upon dissolution. The shares cannot be eligible for any other tax credit or deduction allowed under the Income Tax Act, except as a deduction for RRSP purposes. In the case of co-operatives, eligible investments must be a share that would, if it were the only share issued to the investor, allow the investor to be a member in the co-operative and allow the member to participate in the affairs of the co-operative. In addition, shares are not eligible if the investor disposed of any shares of the eligible business at any time after September 30, 1993 and before the specified issue of shares. The specified issue of shares means the shares that are specified in the application of the eligible business to which a Certificate of Registration applies.

Eligible Investors

The credit is available to residents of Nova Scotia who are over 19 year of age and who have bona fide reasons for making the investment, other than simply obtaining the tax credit. Each eligible issue of shares must have at least three eligible investors.

It should be noted that any approval of shares issued under the program does not constitute an

endorsement by government of the corporation or co-operative issuing the shares. The Province does not guaranty any investment. The investor is at risk for his or her investment.

Eligible Businesses

Eligible businesses include corporations and co-operatives incorporated pursuant to the laws of Canada, including CED corporations and co-operatives. CED corporations and co-operatives are those organizations created to assist or develop local businesses within the community. The CED corporation or co-operative raises capital by issuing shares to individuals and in turn invests that capital in local businesses. In addition, eligible businesses must meet the following criteria:

- involved in active business or investing in other eligible businesses,
- less than $25 million in assets,
- at least 25% of salaries and wages paid in Nova Scotia,
- Corporations must have authorized capital consisting of shares without par value,
- Co-operatives must be marketing, producing or employee co-operatives,
- Corporations must have at least three eligible investors taking part in the specified issue.

Programme Review

Activity

In total $49.4 million has been invested by 4,030 investors in 439 companies receiving personal tax credits of $14.1 million from 1994 to 2001. In the last five years, from 1997 to 2001, the amount invested has ranged from a low of $6.7 million in 1998 to a high of $9.7 million in 2000 with an average of $8.3 million being invested in businesses in each of those years.

Summary of Equity Tax Credit Activity, 1994/2001

Tax Year	# of Investors	# of Companies	Investments ($)	Credits ($)
1994	73	9	414,723	104,181
1995	173	26	1,633,567	484,616
1996	454	34	5,544,458	1,671,987
1997	892	63	8,116,342	2,369,653
1998	558	77	6,712,492	1,939,492
1999	563	88	7,900,632	2,152,505
2000	655	69	9,728,830	2,606,581
2001	662	73	9,304,107	2,791,233
Totals	4,030	439	49,355,151	14,120,248

Each investment by an individual is counted as one. Each offering by a company is counted as one.

NAICS Distribution

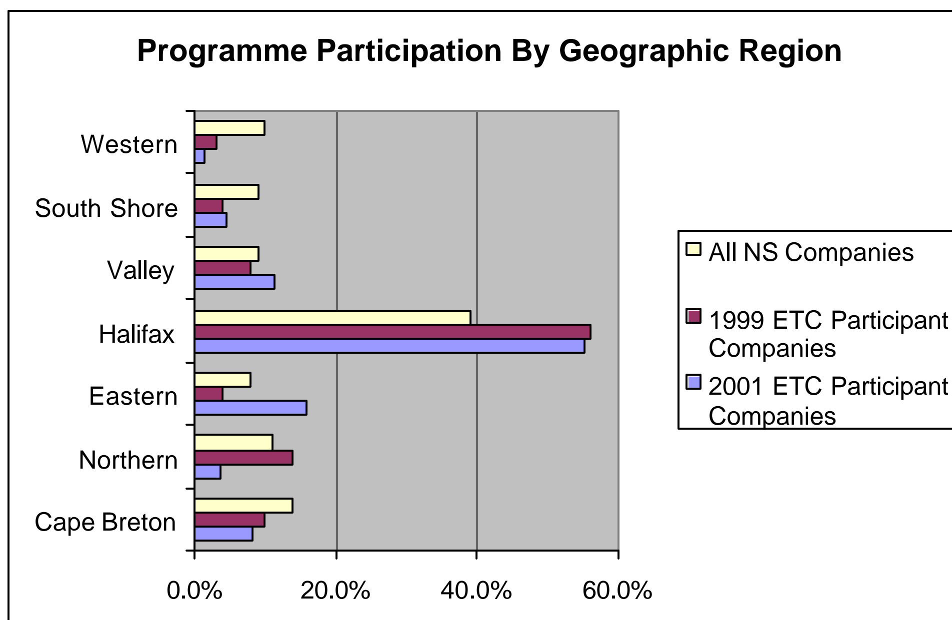
Based on the North American Industry Classification System ("NAICS") the usage of the ETC programme by type of business varies slightly from the overall distribution for all Nova Scotia companies with the largest differences being in the manufacturing, construction and information & cultural industry classifications.

NAICS Code Distribution for ETC and NS Companies

NAICS Code	NAICS Description	% of ETC Participants	% of all NS Companies
11	Agriculture, Forestry, Fishing and Hunting	11.7	11.7
21	Mining and Oil and Gas Extraction	2.7	0.3
23	Construction	2.9	11.8
31	Manufacturing	17.3	5.5
41	Wholesale Trade	4.3	6.2
44	Retail Trade	15.7	13.8
48	Transportation and Warehousing	0.9	5.2
51	Information & Cultural Industries	8.7	1.2
52	Finance & Insurance	1.3	4.5
53	Real Estate & rental & leasing	0.7	6.2
54	Professional, Scientific, and Technical Services	10.1	8.0
55	Management of Companies	2.0	3.2
56	Waste Management & Remediation services	2.5	3.9
61	Educational Services	1.6	0.9
71	Arts, entertainment and recreation	7.4	1.9
72	Accommodation and food services	8.7	6.2
81	Other Services	1.6	9.4

Geographic Breakdown

Geographically, the distribution of ETC participant businesses has changed very little from that reported in the Tax Credit Review Phase II Report. Up to 1999, as reported in the Phase II Report, 56% of investments were in the Halifax Regional Municipality ("HRM") area, while in 2001, 55.3% of businesses were in the HRM area. Outside the HRM area the percentages for each area have changed basically as a consequence of small numerical changes resulting in large percentage changes.



Phase I and Phase II Report Studies

Past studies (Phase I April 2000, and Phase II March 2001) indicate that companies using the ETC programme when compared to Nova Scotia companies in general have improved survival rates. Several years after certification they also have increased revenues, greater payroll expenditures and improved liquidity ratios. For further information these studies are available at http://www.gov.ns.ca/finance/taxpolicy/

Economic Impact Analysis

An economic impact analysis using the Nova Scotia Input/Output ("NSIO") model was completed for the investment expenditures of companies certified from 1998-2001 and their ongoing annual operations associated with the ETC investment. In the scenario presented in Table S1 the survival rates of the operations of the businesses using the tax credit is assumed to be only one year and present a worst-case outcome. Based on the actual survival rates in 2002, the scenario presented in Table S2 assumes survival rates decline over time to 75% by year 4.

Table S2
Aggregated Economic Impact, Cost-Benefit/Payback to Provincial Government-With Survival Rate at 75% -1998-2001

	1998	1999	2000	2001
Employment (Pys)				
Annual	399	888	1,436	2,071
Cumulative	399	1,287	2,723	4,794
Household Income ($'000)				
Annual	10,294	22,459	35,516	52,140
Cumulative	10,294	32,753	69,270	121,410
Provincial Government Revenue ($'000)				
Annual	1,435	3,126	5,085	7,262
Cumulative	1,435	4,560	9,645	16,907
Equity Tax Credit ($'000)				
Annual	1,939	2,370	2,918	2,791
Cumulative	1,939	4,309	7,227	10,018
Cost-Benefit to Provincial Government ($'000)				
Annual	(504)	756	2,167	4,471
Cumulative	(504)	251	2,418	6,889

Table S1
Economic Impact, Cost-Benefit/Payback to Provincial Government-Without Survival Rate, 1998-2001

	1998	1999	2000	2001
Employment (Pys)	399	520	615	744
Household Income ($'000)	10,294	13,061	15,883	18,681
Provincial Government Revenue ($'000)				
Annual	1,435	1,816	2,213	2,604
Cumulative	1,435	3,251	5,464	8,067
Equity Tax Credit ($'000)				
Annual	1,939	2,370	2,918	2,791
Cumulative	1,939	4,309	7,227	10,018
Cost-Benefit to Provincial Government ($'000)				
Annual	(504)	(554)	(705)	(188)
Cumulative	(504)	(1,055)	(1,763)	(1,951)

Note: Figures may not add due to rounding.
For a summary of the key NSIO model assumptions please see the appendix.

NSIO Review

Given the assumption of zero survivability in S1 the results are not surprising. In effect this scenario disregards any future impact of business expenditures on the economy. It is more realistic therefore to examine the results provided by S2 for an indication of the likely impact of the ETC. Under this scenario a positive payback to the province takes place sometime in year 2 assuming all investments are made at the beginning of year 1. Even under S1 the net cost to the government of employment per person year is only $856 ($1,951,000 cumulative cost/2278 total Pys).

Other Jurisdictions

Currently, Newfoundland & Labrador, New Brunswick and British Columbia have legislated similar tax credit programmes.

The Newfoundland & Labrador Direct Equity Tax Credit Act became effective Oct 30, 2000. There is a 5 year investment holding period for investments, there are restrictions on the type of businesses eligible; they exclude investments in; 1) wholesale 2) retail 3) food and beverage services 4) real estate marketing & development 5) oil & gas development 6) mineral resource exploration and extraction 7) financial services and 8) fish harvesting and primary fish processing. This approach is meant to target growth sectors facing the greatest equity capital challenges in Newfoundland. Additionally, $25,000 must be in the business before an application

is made and there are two investor tax credit rates; 20% for investments inside the North East Avalon area and 35% for investments outside the North East Avalon area.

The New Brunswick legislation, which has not been proclaimed, the Equity Tax Credit Act, like the Newfoundland Direct Equity Tax Credit Act, restricts investments to certain businesses, they achieve this by including eligible businesses in their Act; 1) manufacturing or processing industries 2) information technology related businesses 3) commercial service sector businesses engaged in an export-oriented or import replacement activity 4) businesses in the tourism sector that meet prescribed criteria and 5) any other prescribed business activity or industry.

The British Columbia Small Business Venture Capital Act requires registered Venture Capital Corporations ("VCC") to raise $50,000 for investment in eligible small businesses involved in (i) manufacturing and processing;(ii) research and development;(iii) tourism;(iv) aquaculture, with a maximum of 75 employees; with at least 75% of the wages being paid in British Columbia. Additional funds beyond the $50,000 can be raised with administrator approval. If eligible investments are not made the VCC must pay an amount equal to 30% of the money raised into an investor protection fund. Individuals investing in the VCC are entitled to a provincial tax credit of 30%.

Policy Support

The rationale for continuing the ETC programme with its current focus can be found in the programmes many positive features.

The programme is popular with businesses and investors having grown from 9 companies and 73 investors in 1994 to 73 companies and 662 investors in 2001.

This study along with the ETC studies conducted in the Phase I and Phase II program reviews indicate that the ETC program has had a positive impact on participating companies and has generated net revenues for the province.

The ETC programme has assisted businesses throughout the province in raising equity capital.

Businesses obtaining investment equity under the ETC programme are widely distributed in their types of business, more or less mimicking the overall Nova Scotia economy.

Surveys done in past reviews indicate that 93 percent of respondents agreed the ETC encouraged them to seek equity financing as opposed to debt; and 89 percent indicated it allowed them to obtain equity financing that was otherwise unavailable. Additionally, three quarters of respondents to the survey indicated that they would not have started or expanded their business without the ETC.

Three jurisdictions have somewhat comparable programmes. The major differences are in the business eligibility criteria; in one way or another each is more restrictive than the Nova Scotia Act. They focus on a narrower base of businesses therefore any incremental activity in excluded business sectors is sacrificed. Granted, a tax credit for an investment in an individual business or

even a business sector may not lead to the government realizing future tax benefits resulting from investment in that business or business sector but the diversification through all business sectors increases the probability of overall positive tax results for the programme. By not excluding industries from the programme the government avoids the impossible task of picking winners and losers based solely on the industry. This decision is complicated by: 1) Over time the industries picked by the government as winners may become losers and vice versa and 2) An excellent management team in any industry may be successful and create employment and tax payback to the Province while an inferior one in a thriving industry may fail. So to provide special status based on industry or other simple criteria as a means of promoting successful business development without regard for other factors is an unrewarding pursuit. The marketplace will decide on a level playing field where the winners and losers are based on merit not government assistance. By not restricting industries the Province also avoids accusations of favouritism and requests for compensatory measures by the excluded industries.

Another feature of the Newfoundland and Labrador Act is a higher tax credit rate for investors based on the location of the business. Pursuit of this policy would create economic inefficiencies by misallocating resources to areas for no other reason than a tax credit, which does not ensure one location is actually preferable to another.

Policy Decision

The current programme is designed to be a broad based initiative to enable small and medium sized businesses to raise equity capital. Based on the above review the programme has delivered the desired results. Therefore, the ETC should be extended to December 31, 2006.

Community Economic Investment Funds

History and Purpose

The Community Economic Development Fund ("CEDIF") programme was another outcome of the consultations with the public in the early 1990's. Due to requirements of the Securities Act (Nova Scotia) the first CEDIF was not registered until 1999.

The role and advantages of the CEDIF programme duplicate those of the general ETC programme as mentioned above and offer these additional benefits for investors, a partial guarantee on the last 20% of the original investment in areas outside of Halifax, Dartmouth, Bedford and Sackville from the provincial government for the first four years and the shares are pre-approved as holdings in self directed RRSP accounts. Where the programmes differ is in the approach made to potential investors to obtain their funds and the amount of funding typically raised.

Businesses offering ETC shares are restricted by the Securities Act (Nova Scotia) Sections 58 and 67, which require in Section 58 that the seller of the shares be registered to sell under the Act unless an exemption is available, and in Section 67 that a prospectus be prepared and delivered to each purchaser unless there is an exemption in the Act. These restrictions exclude the general public and limit the pool of potential investors; therefore the amount of funds raised by an ETC certified business is typically quite low ($10,000-$200,000).

A CEDIF offering is permitted under the Community Economic-Development Corporations Regulations made under Section 150 of the Securities Act. A disclosure document referred to as the CEDIF Offering Document (Form 1) is prepared by the business and once granted non-objection status by staff of the Nova Scotia Securities Commission allows the company to sell up to a maximum of $3 million of their shares per offering to the public and use approved advertising. The format and requirements of the document are much less stringent than a prospectus which is required for public offerings by the Securities Commission and is prepared by lawyers and accountants and scrutinized by underwriters, costs $75,000 or more to prepare and file and is unlimited as to the amount of proceeds raised. The purpose of the CEDIF document is to allow the business at a low cost to provide a basic level of knowledge of all material facts to potential investors concerning the business they are considering investing in.

Therefore, a business can use either a CEDIF disclosure document or prospectus to make a public offering for proceeds of up to $3 million, with the CEDIF option being much quicker and less costly to prepare. What distinguishes between the two is that to be CEDIF eligible, a CEDIF is to be an investment in a defined community, which means it must have a community purpose distinguished by common geographic, cultural or economic characteristic. This is a fundamental difference from a business offering made by prospectus where the goal is usually totally commercial and financial.

CEDIF's are investments therefore they have a commercial and financial element, which increases the difficulty in distinguishing eligible CEDIF proposals from non-eligible CEDIF proposals. This is especially difficult based on the information available at the time of

application. Actual community support by number of community investors and dollar amount invested by community members is not known until the offering has closed and the effect on the community cannot be assessed until the project is underway or completed. At the time of application one way to determine community support for a CEDIF is the contribution to the project by unpaid volunteers and expected community impact.

Programme Review

Activity

Indications are that activity may not have reached its peak in the CEDIF programme. From 1999 to 2001 the number of investors has increased by 41%, the number of companies by 166% and the dollar amount of investment and tax credits have both increased by 134%.

Summary of CEDIF Activity, 1999/2001

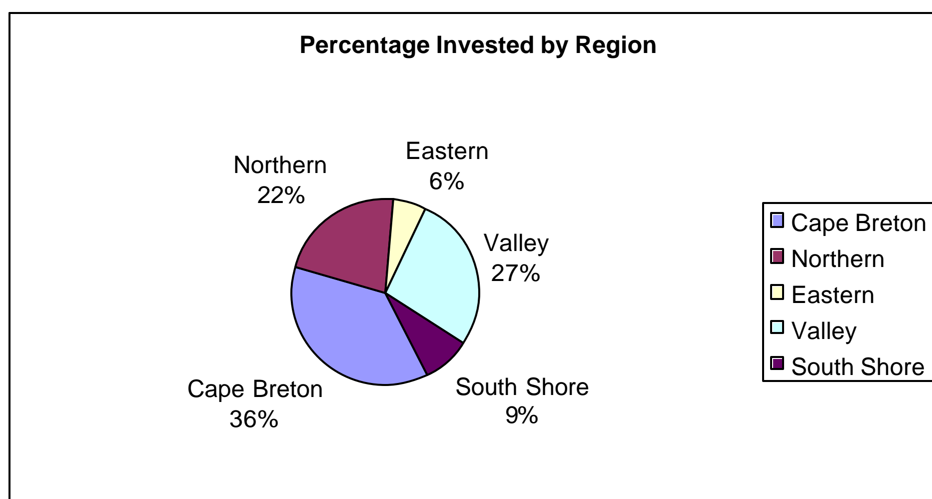
Tax Year	# of Investors	# of Companies	Investments ($)	Credits ($)
1999	260	3	1,128,250	335,475
2000	353	4	1,380,482	415,735
2001	368	8	2,623,059	786,918
Totals	981	15	5,131,791	1,538,128

Each investment by an individual is counted as one. Each offering by a company is counted as one.

In the offering documents of the fifteen closed offerings, seven were disclosed as being for specific projects, eight were for projects to be decided in the future, i.e. blind pools. There have been concerns that some blind pools have not met the investment timing objectives required in Section 16 of the Regulations. Blind pools have been popular with investors; the eight blind pools have raised $3,055,973; which is 59.5% of the funds raised. Therefore there is merit in continuing them as a source of equity capital, but changes are needed to ensure regulatory requirements are being met. Possibly, the investment timing requirements could be relaxed, but by delaying investments the future tax revenue payback to the province would be delayed and reduced and it is not certain that the new objectives would be met. Blind pools could be required to have at least one investment of 40% disclosed in their offering document, this would ensure they reach the 12 month investment objective but they could still fail to meet the 24 and 36 month requirements. Currently, for blind pools the inaction of the investment management process results in the investors realizing the benefits of a 30% tax credit, a 20% guarantee on the last portion of the investment for four years and a low four year hold period, while economic activity does not increase and the government does not recoup any payback in tax revenues. A measure to establish a relationship between investor risk and reward can be a useful tool to improve regulatory compliance.

Geographic Breakdown

Geographically, the CEDIF programme has had no successful closings in HRM. Outside of HRM there have been four closed offerings in Cape Breton raising $1.9 million, six closed offerings in the Valley raising $1.4 million, three closed offerings in Northern Nova Scotia raising $1.1 million, and one closed offering in each of the South Shore Region and the Eastern Region raising $.4 million and $.3 million respectively.



Economic Impact Analysis

As with the ETC an economic impact analysis using the NSIO model was completed for the investment expenditures of companies certified from 1998-2001 and their ongoing annual operations associated with the CEDIF investment. In the scenario presented in Table S3 the survival rates of the operations of the businesses using the tax credit is assumed to be only one year and present a worst-case outcome. The scenario presented in Table S4 assumes the actual survival rate of 100% from 1999 to 2001.

Table S4Aggregated Economic Impact, Cost-Benefit/Payback to Provincial Government-With Survival Rate 100% -1998-2001

	1998	1999	2000	2001
Employment (Pys) Annual Cumulative	N/A N/A	31 31	72 103	190 293
Household Income($000) Annual Cumulative	N/A N/A	938 938	1,960 2,898	4,784 7,682
Provincial Government Revenue ($'000)				
Annual	N/A	131	273	667
Cumulative	N/A	131	404	1,071
Equity Tax Credit ($'000)				
Annual	N/A	338	143	409
Cumulative	N/A	338	481	890
Cost-Benefit to Provincial Government ($'000)				
Annual	N/A	(207)	130	258
Cumulative	N/A	(207)	(77)	180

Table S3
Economic Impact, Cost-Benefit/Payback to Provincial Government-Without Survival Rate, 1998-2001

	1998	1999	2000	2001
Employment (Pys)	N/A	31	47	118
Household Income ($'000)	N/A	938	1,216	2,824
Provincial Government Revenue ($'000)				
Annual	N/A	131	169	394
Cumulative	N/A	131	300	694
Equity Tax Credit ($'000)				
Annual	N/A	338	143	409
Cumulative	N/A	338	481	890
Cost-Benefit to Provincial Government ($'000)				
Annual	N/A	(207)	26	(15)
Cumulative	N/A	(207)	(181)	(196)

Note: Totals may not add due to rounding
For a summary of the key NSIO model assumptions please see the appendix.

NSIO Review

Under the assumption of zero survivability a worst-case scenario is presented which indicates a cost to the province of $196,000. This translates to a net cost per person year of employment of $1,000 ($196,000/Pys total of 196). Under the S4 scenario, which presents results at the actual 100% survivability, the payback to the province takes place in year 3. The payback is slower than with ETC and may be more variable in the future as CEDIF blind pools have until year three to invest 80% of the proceeds they raise.

Other Jurisdictions

Currently, Ontario, Manitoba, and the North West Territories have legislated similar tax credit programmes.

In 1997 Ontario started the "Community Small Business Investment Funds" programme that is scheduled to wind up on December 31, 2003. The programme requires a community sponsor, only new companies are eligible and the minimum is $25,000 per investor. Ontario also has the "Small Business Investment Tax Credit for Financial Institutions" which provides financial institutions with a 75% corporate tax credit on investments up to $50,000.

The Manitoba programme is capped at $20 million of equity investment per year with a maximum of $5 million being invested in any one business in a year. The companies must be listed on the CDNX, which requires a prospectus be prepared and cleared. The credit on shares

purchased between April 30, 1999, and June 30, 2008, is 15%, which is claimed at 5% per year for a period of three years to a maximum of $1,500 per year.

The North West Territories Risk Capital Investment Tax Credit of 1999 is available to three types of businesses. Labour Sponsored Venture Capital Corporations, Employee Venture Capital Corporations and Community Endorsed Venture Capital Corporations. Each allow a maximum investment of $100,000 per resident of the NWT and a 30% non–refundable tax credit which can be carried back three years and forward seven years.

Policy Support

The reasons for continuing the CEDIF programme are:

The programme assists small and medium sized businesses in raising capital beyond what is typically possible under the Securities Act and Rules.

While the general ETC programme has been more heavily utilized in HRM, the CEDIF programme offsets this imbalance by its use in regions outside HRM.

There is a positive impact on tax revenues as indicated by the NSIO model.

The programme encourages community investment and participation.

Nova Scotia residents are given a Nova Scotia RRSP option as shares are recognized by the Canadian Customs and Revenue Agency as RRSP eligible and increase the allowable RRSP foreign property content limit above the usual 30%.

Policy Decision

The CEDIF programme was created to enable individuals to participate in, and invest financially in their communities and to make available capital for small and medium sized businesses in those communities. Based on the above review the programme, which is relatively new, is starting to fill that role and continuing to expand. Therefore the CEDIF programme should be extended to December 31, 2006.

Proposed Changes to the Act and Regulations

While the programmes should be extended to December 31, 2006, the following proposed changes to the Act and Regulations should be made:

1. Due to the economic payback to the Province and other benefits of the programmes the annual credit limit in section 37 of the Income Tax Act (Nova Scotia) should be increased to $15,000. This will raise the annual investment limit to $50,000 and facilitate capital raising activities for businesses.

2. The definition of "active business" in subsection 2(a) of the Act includes investment businesses employing directly or indirectly 5 or more employees; this should be changed to require all investments to truly be in active businesses.

3. In the Act subsection 2(j) the time period contained in the definition of replacement share must be extended to December 31, 2006, to prevent rollovers of existing investments for additional tax credits.

4. The Act in subsection 4(b) and 12(b) states no par value shares which restricts even nominally valued common shares (i.e. .01, $1.) as some businesses may have. To increase the fairness of the programme to all businesses this should be changed. Suggested change to "consisting of one class of voting equity shares" which are the shares being issued under the ETC. The corporation should also be restricted to taxable Canadian corporations, not societies or not for profit corporations therefore add "taxable" to subsection 2(f).

5. The Act in subsections 4(d) and 12(d) states assets less than $25 million for ETC while the Regulations clause 2(b)(i) states less than $50 million in assets. This discrepancy should be rectified and limit set at $25 million as alternatives to ETC and CEDIF exist for larger entities to raise capital.

6. The company size test used for general ETC businesses in Subsection 4(d) of the Act is $25 million in net assets while the test of company size for CEDIF's in Subsection 12(d) of the Act is $25 million in net assets or revenues. The tests to limit business size should be identical as both the ETC and CEDIF programmes are available to the same sized businesses. The limits on both assets and revenues should be used, with the limit on assets of $25 million as proposed in change number 3 and revenues of $25 million.

7. An eligibility criteria setting the maximum number of employees at 500 should be in Section 4 of the Act. Currently it is in the Regulations 2(b)(ii) as a result of the adoption of regulations for LSVCC's, but the Act does not refer to eligibility criteria for other ETC applicants being in the Regulations.

8. Another criteria to add to Section 4 of the Act is that no officers and directors of the corporation or association are officers or directors of any other corporation or association

that has not in the opinion of the Minister complied with the requirements of the Equity Tax Credit Act or Regulations. This would improve compliance by preventing individuals from going to the market again to raise equity if they have not complied with the Act and Regulations in other businesses.

9. Currently, the Act and Regulations do not specifically prevent a business from relocating to another province after raising funds through the ETC programme. A clause in subsection 6(1) should be added stating that if a business relocates out of the province the certification will be revoked unless they otherwise would still be eligible for the ETC and undertake to comply with the Nova Scotia Equity Tax Credit Act requirements. This change prevents a registered business from leaving the province and then neglecting to comply with the Act and Regulations. A further clause added to subsection 6(1) should allow the Minister to revoke certification if an eligible business sells assets whose original book value when deducted from the total assets impinges on the ETC capital raised by the business.

10. To clearly prevent affiliates from using funds for prohibited uses, Section 7 of the Act should insert the clause "or affiliate" between the words "business" and "shall". The introductory phrase should read as: *An eligible business or affiliate shall not use the funds raised by a specified issue to which tax credits have been or are entitled to be claimed pursuant to Section 37 of* the *Income Tax Act*. This will clarify to businesses that they cannot use subsidiaries or partners to perform transactions they themselves are not permitted to do.

11. Added to Section 9(2) of the Act should be a statement making it the responsibility of the business to withhold the full tax credit amount if shares are repurchased by the business in a disposition not permitted under the Act or Regulations and to remit the held funds to the Minister of Finance along with details of the transaction.

12. To encourage CEDIF's to promptly file their required annual reports the provincial guarantee in Section 13A of the Act should be conditional on the CEDIF filing their annual reports as required in Section 20 of the Act in a timely manner and otherwise being in compliance with the Act and Regulations. This would improve businesses awareness of the requirements and provide an intermediate measure to manage those not meeting the requirements. Disclosure of the conditional nature of the guarantee would be a required risk factor disclosed in the offering document and any advertising mentioning the guarantee. The Minister would continue to have the power to revoke certification for failure to file information.

13. To encourage CEDIF's to invest their funds and to more closely link risk and return two measures should be taken.

    a) Annually at 12 months, 24 months and 36 months, 1/6 of any shortfall (required eligible investment amount less actual eligible investment amount) in meeting the pacing requirements of Regulation 16(a) should be remitted to the Minister by the business unless the payment will result in the bankruptcy of the business. To encourage the pursuit of the investment objective; if subsequently

the business achieves the pacing requirements they can request a refund without interest of the repayment in writing.
b) The guarantee should be structured to match the time funds are at risk. For any month in which the pacing requirements of Regulation 16(a) are not met the guarantee should decrease by 1%. The lost guarantee can be recovered if the business subsequently achieves the pacing requirement. The Minister should also have discretion to base pacing and guarantee requirements on the equity capital raised net of any redemptions.

The Minister would have the right to waive or vary these conditions on application of the business or to revoke the certification. Disclosure of the conditions and the structure of the guarantee and possible payback would be a required risk factors disclosed in the offering document and any advertising.

14. Upon meeting any conditions and requirements of the Minister and the Securities Commission a CEDIF should have the option to voluntarily surrender its certification. This will allow CEDIF's who are no longer moving towards their intended goals to dissolve instead of continuing in business only to meet legislative requirements.

15. Section 19 of the Act requires that a register be kept containing the information prescribed by Regulation, but the Regulations contain no guidelines on the information to be kept in the register. A section should be added to the Regulations requiring the register to contain the name of the business, the address of the business and the ETC number, for the purpose of potential investors checking on the ETC certification of businesses.

16. Section 20 of the Act imposes continuous in perpetuity annual reporting obligations on all companies that use the ETC programme. To relieve the administrative burden on businesses this can be eliminated, with the provision that if the Minister requests information it must be provided. For CEDIF's and LSVCC's the requirement to file the required annual report should lapse with the report for the end of the business' taxation year in which the hold period on the shares expires additionally they should be required at any time to provide information at the request of the Minister. After that for both types of issues the reports should be provided at the Minister's request. CEDIFs at the request of the Minister should have to provide financial statements and information for any businesses in which they have invested.

17. Any public offerings under NSSC, MI 45-103 will not be eligible for ETC. Offering to the public prior to review by the NSSC would place tax dollars at risk if subsequent to the offering the NSSC objected to the offering. Depending on volume it is beyond the current resources of the NSSC to provide pre clearance for these offerings. Therefore an addition to clause 2(k)(iv) of the Act should be made.

18. Added to the Regulations subsection 10(a), a permitted disposition of a share in a share exchange take over bid where there is no dilution of the shares and the business for which shares are exchanged undertakes to comply with the ETC Act and Regulations should be allowed. Also a provision for the disposition in the case of personal bankruptcy should be

added. A subsection 10(c) should be added which would give the Minister the power to waive or prorate the repayment of the tax credit on application of the individual.

19. Finally, added to section 9 of the Act; if circumstances require that upon conversion to a RRIF or annuity that CEDIF shares held in a RRSP be disposed of in a non-permitted transaction then a repayment to the Minister of an amount determined by multiplying the total amount of the tax credits received in respect of the shares by 48 minus the number of months the shares have been held, divided by 48 months should be required and withheld by the business.

Appendix

Summary of Key NSIO Assumptions

The data supplied, disaggregated into various industrial sectors, conform to the industrial classification of the 1990 Nova Scotia Input-Output Model (Model), whose industrial classification somewhat varies from the latest version of the 1996 Model. Therefore, the data supplied were re-classified to conform to the industrial classification of the 1996 Model.

The Model was used to simulate impacts of capital and working capital (operating) expenditures incurred by businesses that participated in the ETC program in assessing the economic impacts on Nova Scotia of the activities of these ETC-eligible businesses from 1988 to 2001.

All data were assumed to be in current dollar terms in the year that the credit and the investment were made. As with the case of the previous study, no adjustment was made for inflation.

There was no time lag between receiving the credit and the application of the investment made by the businesses. In other words, if the company received the credit in a specific year, the investment was assumed to be undertaken in that year.

Capital Expenditures

- All capital equipment was assumed to be imported and was placed in the Import sector of the Model (capital investment is a "leakage" to the Nova Scotia economy). No allowances were made for wholesale/retail margins, or for installation costs, both of which were small in any case.

- Even though the data supplied indicated plant construction expenditures on an industry basis by year, the annual aggregate of these expenditures was used, and allocated to the Construction sector of the Model.

- In the absence of further information, and for modeling purposes, the construction expenditures were simulated at producers= price for the reason that these items are assumed to have been procured directly from suppliers without the involvement of intermediary agents. All impacts indicated in the results are Model-generated.

Operations

- The data supplied provided information on the working capital of the businesses. No specific data were provided on the operating expenses (income statement) of the companies. Working capital (balance sheet) is not the same as operating expenses, and the former, in all likelihood, will be less than the latter. In recognition of this, an attempt was made to relate the working capital information supplied in the data set to the operating expenses of the businesses on an industry basis. This effort was, however, thwarted by lack of sufficient information.

- The Small Business Profiles (SBP): *Statistics Canada Cat. No. 61f0015xdb,* was reviewed alongside the cost profile contained in the Model Tables with the view to

finding out whether there is a match between the two cost profiles. The ensuing evidence is inconclusive.

- In the absence of detailed information on annual operating expenses, working capital was assumed to be equivalent to operating expenses, but not without reservations. Apart from the fact working capital and operating expenses are different as noted above, the fact that payroll is indicated to be higher than working capital in the data set also conflicts with the assumption of equating working capital to operating expenses. Hence, this is likely to lead to an understatement of the economic impact on Nova Scotia, and hence on the provincial coffers, of the operations of the businesses that participated in the ETC program during the period under preview.

- For modeling purposes, all input vectors for each year are developed from the data supplied on an industry-allocated working capital data, and the employment and corresponding payroll indicated on an annual program-aggregated basis. In other words, in each year, the dollar value of the input vector comprises both working capital and payroll expenditures.

- In the absence of further information, all operations data are simulated at purchasers= price, based on the premise that the ETC-eligible businesses procured goods and services through local distributors.

- As in the case of the previous study, and based on the previous survey conducted by the Department of Finance, the annual activities of the ETC-eligible businesses are assumed to be fully incremental to the Nova Scotia economy.

For a full description of all assumptions please see the "Economic Impact on Nova Scotia of Equity Tax Credit (Updated), January 2003.