EMPLOYEE SHARE OWNERSHIP PROGRAM

GUIDELINES

CREATING BUSINESS INVESTMENT, INNOVATION AND OPPORTUNITY

Accelerate your access to capital

BRITISH COLUMBIA
Ministry of Competition, Science and Enterprise
Investment Capital Branch

EMPLOYEE SHARE OWNERSHIP PROGRAM GUIDELINES

These guidelines are provided for information purposes only and do not replace or negate any requirements of the *Employee Investment Act*, R.S.B.C. 1996, c. 112 and its amendments or the accompanying regulations and program policy statements. The material in these guidelines is condensed from the *Employee Investment Act*.

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BACKGROUND

To compete effectively in today's global marketplace, business leaders must constantly search for new and innovative ways to improve productivity and to attract and retain skilled employees. In many cases, businesses must be prepared for the dramatic change in leadership they will face as owners and managers retire.

Employee ownership is a tool that can help businesses meet these challenges. It's a proven strategy for increasing profits and productivity and lowering staff turnover. It's also a valuable mechanism for helping retiring owners sell their businesses to their employees. This way, jobs are protected and local economies strengthened.

BC's Employee Share Ownership Program (ESOP) provides employees with a 20 percent tax credit for making investments in their employers' businesses. In most cases, investments can be made from or transferred to self-directed RRSPs which can result in further tax benefits. The program also shares the costs of setting up a plan. The program is available to both privately held and publicly traded companies. Ministry staff are available to help along the way.

Objective

The Employee Share Ownership Program (ESOP) is the operating name of the employee investment incentive program set out in the *Employee Investment Act*. The program is designed to encourage employees to make equity investments in British Columbia companies for the purposes of job creation, job protection, participation in business ownership and the establishment of a business succession plan.

Program Rationale

The Government of British Columbia recognizes that the formation of new businesses and the diversification or expansion of existing businesses will both balance and strengthen the overall provincial economy while also creating more jobs.

There are a number of strong reasons for encouraging employee share ownership in British Columbia:

Employee buy-outs/retirement succession planning

An ESOP can be used by a retiring business owner to sell all or a portion of their business to interested employees, either outright or over time.

Human resources development

Whether an employer wants stronger employee commitment, or wants to attract and keep the very best people in the field, an ESOP can provide an extra incentive and encourage a long-term commitment to the firm.

Improved business performance

An ESOP implemented in conjunction with increased employee involvement can provide the competitive edge a company needs to be successful. ESOPs are ideal for companies in knowledge based industries where the assets are skilled employees or where the employee has direct contact with customers and his or her efforts can directly affect the profitability of the organization.

Financing growth

Companies need large amounts of capital to finance growth. Using existing cash flow to fund growth-oriented projects, including new product development and market expansion, is often difficult. ESOPs can provide a source of new equity capital to assist with expansion, diversification or new capital investment.

OVERVIEW

The Employee Share Ownership Program provides four specific types of employee investment with some variation permitted in their implementation:

- **Employee Share Ownership Plan (ESOP) The Standard Incentive ESOP** – provides employees with an opportunity to invest directly by purchasing shares of the company that employs them.

- **The Succession ESOP** – a variation of the Standard ESOP which provides employees with the opportunity to invest by purchasing shares of the company from the retiring/departing owner.

- **The Cooperative ESOP** – a variation of the Standard ESOP which provides employee members with the opportunity to invest by purchasing shares in the worker cooperative association that employs them.

- **Employee Venture Capital Corporation (EVCC)** – The EVCC provides employees with the opportunity to purchase shares in their own holding company, an employee group sponsored Employee Venture Capital Corporation, and the EVCC in turn invests in the company that employs them.

Standard documents

Each of these employee investment models requires a documented plan or contract that has been adopted by the company. The program provides a complete set of standardized or model documents to reduce the time required for preparation and implementation. These documents are available in hard copy, via e-mail, or on the web. (See Contact Information).

Tax credits

Tax credits are available to eligible employees/investors, providing they hold the shares for a minimum period of time: three years for the ESOP types and five years for the EVCC. Note that retention of the federal tax credit provided in the case of EVCC investment requires that the investor hold the EVCC shares for eight years.

Cost-sharing assistance

Small- to medium-sized businesses and all employee groups are each eligible to apply for government cost sharing of eligible expenses related to the development, evaluation and implementation of any of the types of ESOPs. Employers setting up plans and employees seeking to invest are encouraged to obtain independent professional advice.

Use of funds

Funds raised under a Plan may be used for most business purposes including business start-up or expansion, debt reduction or, in approved registrations, owner retirement.

Employee investment success factors

Studies of employee investment have shown that these factors are vital to achieving the full benefits of employee investment. The Employee Share Ownership Program supports ESOPs that incorporate the following success factors:

a) Employee involvement.

b) Broad based employee investment.

c) Longer term investment.

d) Fully participating and voting shares.

e) Equal opportunity for participation. Plans must provide an equal opportunity for all employees to acquire shares after two years of employment. The company has the option of setting a qualifying period of less than two years employment.

f) Investment at risk.

g) Exercise of voting rights.

h) Liquidity. Plans must provide reasonable terms for share liquidity.

i) Changes to plans. Plan amendments require the consent of a majority of the employee shareholders and of the Administrator of the *Employee Investment Act*.

j) Objective valuations. Plans must provide an objective valuation method to determine the fair value of a share. This can be done by an opinion from an independent qualified person, a formula referencing financial information of the corporation, or a formula referencing the trading value of a class of shares of the corporation trading on a public stock exchange. Examples of share valuation formulas used by other companies are available in hard copy, via e-mail or on the web.

k) Employee/employer communication.

INCENTIVES

Employee tax credits

The Government of British Columbia provides employee investors with a provincial tax credit equal to 20 percent of the amount they invest under a registered ESOP or 15 percent of the amount they invest through an EVCC. The provincial tax credit is subject to a maximum of $2,000 in credits per person in any one taxation year and no lifetime maximum. EVCC investors are also eligible to receive a 15 percent federal tax credit on their investment, to a maximum of $750 in any one year.

Each year, employers apply to the Administrator of the *Employee Investment Act* for provincial tax credit certificates on behalf of employees who have purchased new shares under their registered plan during that period. Employee investors then attach their certificate to their income tax return filed with Canada Customs and Revenue Agency. If shares are purchased in the first 60 days of the calendar year, employees have the choice of claiming the provincial tax credit for that year or the previous taxation year or of allocating a portion of the tax credit to each of the two years.

Provincial tax credits can only be claimed by British Columbia residents to the extent that they have provincial taxes payable. Any excess credit is non-refundable. There are no carry forward or carry back provisions with regard to the provincial tax credit.

If the employee investor sells his or her shares prior to the end of the three-year holding period for ESOPs and five-year period for EVCCs, he or she will be required to repay all or part of the tax credits received on the shares, depending on the selling price.

Employer/employee cost sharing

To help establish and maintain ESOPs and EVCCs, the province will provide cost-sharing assistance of 50 percent (up to $2,500) of eligible costs for each calendar year for companies with less than 150 employees and for employee groups.

Eligible costs include professional fees incurred in establishing a plan, providing appropriate advisors are used. To be eligible for government cost sharing, the professional advisors utilized must be a member of a self-governing professional association. Only one employee group from a company can be certified for cost-sharing purposes. If more than one application for employee group certification is received, the groups will be informed and encouraged to make one application. If this is not possible, the application representing the majority of employees will be accepted for cost-sharing assistance.

THE STANDARD ESOP

Employee Share Ownership Plans are designed to facilitate direct investment by employees in their employer's company. The Standard ESOP encourages the employee and the employer to work together to achieve the long-term success of the business. It provides employees with an opportunity to receive dividend income and benefit from capital appreciation. It provides the employer with a new source of equity capital for business uses.

Eligible employees

Employees wishing to invest under a Standard ESOP on a tax-credit-eligible basis must be BC residents, work an average of 20 or more hours per week for the company and not already be major shareholders of the company. Plans may require employees to work for the company for a qualifying period not to exceed two years.

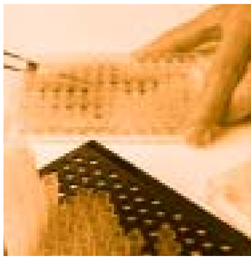
In some cases, employees who do not meet the above criteria may purchase shares under the Plan, but will not receive a BC tax credit.

Eligible companies

Any Canadian company which, together with its affiliates, has less than $500 million in total assets and pays at least 25 percent of its wages to employees resident in BC is eligible to register a Plan under the program.

Form of investment

The shares that employees may purchase under the Plan must be 'equity shares' out of the company's treasury. Equity shares are fully participating, voting shares which are not limited as to risk. The common shares of most companies will meet these requirements.



Other requirements

The shares of the company need an objective method of share valuation at least annually. Private companies generally use a formula based on their annual financial statements, while public companies use a market-based formula for share valuation.

The Plan must allow for share liquidity. The company may ensure a market for their shares by arranging for shares to be bought by other employees or a third party. If a market does not exist for the shares, the company is required to provide liquidity by redeeming shares at the current value established under the Plan. Such redemptions are subject to the company's financial state and ability to pay.

Share certificates representing the ESOP shares must be sent to an authorized depository to be held in escrow for three years. Once the share certificates have been issued, an Investment Confirmation confirming the purchase must be sent by the Company to the employee/investor within 30 days.

THE SUCCESSION ESOP

The Succession ESOP is a special application of the Standard ESOP which facilitates a transfer of control of the business from the current and retiring/departing owner(s) by involving the employees over a period of time.

Eligible employees
[same as standard ESOP]

Employees wishing to invest under a Succession ESOP on a tax-credit-eligible basis must be BC residents, work an average of 20 or more hours per week for the company and not already be major shareholders of the company. Plans may require employees to work for the company for a qualifying period not to exceed two years.

In some cases, employees who do not meet the above criteria may purchase shares under the Plan, but will not receive a BC tax credit.

Eligible companies
[same as standard ESOP]

Any Canadian company which, together with its affiliates, has less than $500 million in total assets and pays at least 25 percent of its wages to employees resident in BC is eligible to register a Plan under the program.

Form of investment

The voting shares of the company held by the selling owners are the shares to be purchased by the employees. At the outset of the Plan the intention must be to transfer control of the company (i.e. more than 50 percent of the voting shares) over a reasonable period of time, which will result in widely dispersed ownership by persons resident in Canada.

Other requirements
[same as standard ESOP]

The shares of the company need an objective method of share valuation at least annually. Private companies generally use a formula based on their annual financial statements, while public companies use a market-based formula for share valuation.

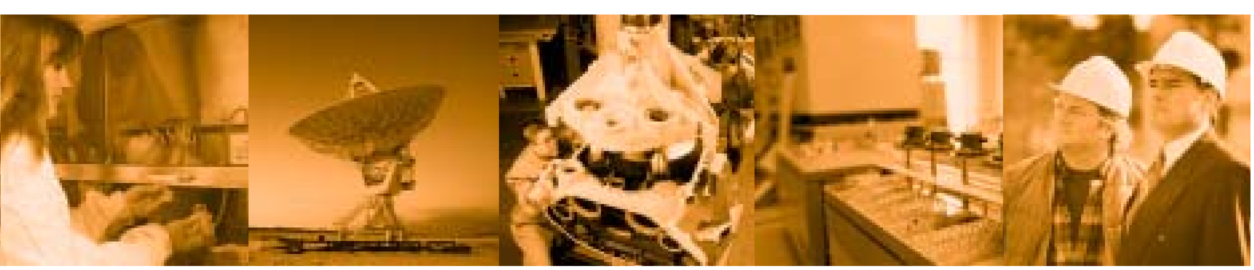
The Plan must allow for share liquidity. The company may ensure a market for their shares by arranging for shares to be bought by other employees or a third party. If a market does not exist for the shares, the company is required to provide liquidity by redeeming shares at the current value established under the Plan. Such redemptions are subject to the company's financial state and ability to pay.

Share certificates representing the ESOP shares must be sent to an authorized depository to be held in escrow for three years. Once the share certificates have been issued, an Investment Confirmation confirming the purchase is to be sent by the Company to the employee/investor within 30 days.

Other considerations for a Succession ESOP

The retiring owner must do a great deal of planning to realize a smooth and effective transfer of control of the company. For example, the owner should consider:

- the length of time it will take to transfer control of the company, including both share transfers and the owner's directorship role;
- the price to be paid: will it be fixed initially with payment terms, or will the owner have a share offering once each year, where the share value may change each year;
- any company benefits, such as a company car that the owner enjoys, and how they will be phased out as the company's ownership transfers;
- the amount of continued support and guidance, on a day-to-day basis, the owner will provide as the ownership transfers;
- any and all of the tax aspects involved in the purchase and sale of a business.



THE EVCC

An Employee Venture Capital Corporation (EVCC) must be sponsored by an employee organization or an employee group. An EVCC is registered, raises capital through share offerings, and invests in an eligible business. The employee/investor receives a 15 percent provincial tax credit, to a maximum of $2,000 per year, and an additional federal tax credit of 15 percent, to a maximum of $750 per year.

An EVCC provides the employee/investor with an opportunity for dividend income and capital appreciation. All funds raised by this single-purpose EVCC must be invested in equity shares of the employer company.

There are some additional costs (time and money) related to setting up a single-purpose EVCC versus simply implementing a Standard ESOP. The benefit of an additional federal tax credit must be weighed against the additional costs. In addition, successful implementation usually requires a larger number of employees (i.e. over 50).

Eligible investors

In addition to the requirements under a Standard ESOP, the employees must have a work-related affiliation.

Eligible companies

Except as noted below, any BC company that has less than $50 million in total consolidated assets and pays at least 50 percent of its wages to employees resident in BC is eligible to register an EVCC Plan under the program. A maximum of $5 million can be invested in a company over a two-year period. Businesses involved in retail sales or service, primary resource exploration or extraction, the provision of financial services, property management, real estate development or traditional agriculture are not eligible.

Form of investment

The shares that employees may purchase under the Plan must be 'equity shares' out of the newly formed EVCC's treasury. Equity shares are fully participating, voting common shares which are not limited as to risk.

Other requirements

The shares of the company need an objective method of share valuation at least annually. Private companies generally use a formula based on their annual financial statements, while public companies use a market-based formula for share valuation.

The Plan must allow for share liquidity. The company may ensure a market for their shares by arranging for shares to be bought by other employees or a third party. If a market does not exist for the shares, the company is required to provide liquidity by redeeming shares at the current value established under the Plan. Such redemptions are subject to the company's financial state and ability to pay.

Share certificates representing the EVCC shares must be sent to an authorized depository to be held in escrow for five years. Once the share certificates have been issued, an Investment Confirmation confirming the purchase must be sent to the employee/investor within 30 days by the EVCC.

In addition to the requirements of a Standard ESOP, an EVCC must have at least $25,000 in equity capital at the time of registration and must invest at least 80 percent of the equity capital raised in the eligible business within 12 months of the fiscal year in which it was raised. An EVCC must deposit an amount equal to the tax credits to be issued into an investment protection account. These funds are released upon the EVCC making eligible investments.

KEY DECISIONS

The process of registering a Plan involves making the following key decisions. Talk to your program analyst for clarification, examples, and other details.

- How many equity shares do you wish to sell and how many do the employees wish to buy? If you have a percentage in mind, will you sell it all at once or over time?
- Determine who is to be an eligible employee/investor. Choose a qualifying period of between zero months and two years.
- Will the funds raised be used for general working capital purposes or specific purposes such as debt reduction, employee training, market expansion, new product development or purchasing equipment?
- How much is your company worth? By what method will you value the shares? If yours is a private company, shares must be valued at least annually through either a formula (examples available) or the use of a Chartered Business Valuator.
- When will the annual redemption period occur? Company cash flow patterns should be considered to ensure you meet minimum liquidity requirements.
- When will you hold the first share offering? What are the capital requirements of the company? Consider when it is most appropriate for employees with regard to tax credit timing.
- How will share purchases be paid for? Lump sum or payroll deduction, or perhaps some combination of the two?
- Should future share offerings be set out now, or will they be determined later?

ESOP IMPLEMENTATION PROCESS

Step 1: Investigation

- Determine employee interest.
- Contact program analyst (See Contact Information).
- Review boilerplate documents.
- A presentation to employees by your program analyst is available.
- Consult your professional advisors.

Step 2: Implementation

- Work with ministry staff to register your Plan. They will provide model documents and concrete examples of successful Plan terms, and guide you through the process.
- Review Plan with your professional advisors.

Step 3: Share Offering

- Prepare the Share Offering document to offer shares to employees.
- Receive the purchase funds (cash and/or payroll deductions) and issue shares when payments are complete.
- Place shares in escrow.
- Complete and deliver tax credit applications and documents to the ministry.

Step 4: Annual Reporting

- Prepare and deliver annual financial statements to the employee/shareholders.
- Complete the Plan Annual Report and forward to the ministry.
- Hold an annual shareholder meeting and distribute a report to shareholders.

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The *Employee Investment Act* and regulations and general information on the Employee Share Ownership Program may be viewed at the branch's web site at www.equitycapital.gov.bc.ca

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