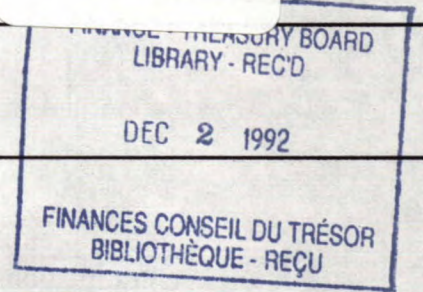


news release



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MEASURES TO ASSIST SMALL BUSINESS FINANCING ANNOUNCED

(OTTAWA) Finance Minister Don Mazankowski today proposed a number of measures to assist small business financing. Announced as part of the December 2 Economic and Fiscal Statement, the measures involve changes to the rules governing investments by RRSPs and activities of labour-sponsored venture capital corporations (LSVCCs).

The measures will expand opportunities to invest in small businesses and simplify the rules which direct such investments.

Expanded Opportunities: These initiatives will provide additional opportunities for LSVCCs and RRSPs to provide funds to small businesses.

- The 50-per-cent limit on an RRSP investment in small business shares will be eliminated.
- Employees will have increased flexibility in using their RRSPs to invest in their employer's business.
- Preferred shares, which are attractive to both venture capital funds and small businesses, will be added to the list of eligible small businesses investments for LSVCCs.

Simpler Procedures: The new rules will be simpler to understand and comply with, raising the appeal of small business investments.

- Procedures for placing LSVCC shares in RRSPs will be streamlined.
- RRSP trustees will be better able to certify compliance with the simplified rules and more willing to oversee small business investments.
- Individuals will feel more comfortable investing under a regime they can readily understand.

"These initiatives will help small and medium-sized businesses to acquire the financing they need to grow and provide jobs for Canadians," Mr. Mazankowski said.

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**DRAFT LEGISLATION AND REGULATIONS ON
INVESTMENTS IN SMALL AND MEDIUM-SIZED BUSINESS**

(a) Income Tax Act

1.(1) Subsection 127.4(1) of the *Income Tax Act* is amended by adding thereto, in alphabetical order therein, the following definition:

"qualifying trust"
«fiducie admissible»

"qualifying trust" for an individual in respect of a share means a trust governed by a registered retirement savings plan where

(a) the individual makes contributions to the trust and those contributions (and no other funds) can reasonably be considered to have been used by the trust to acquire or subscribe for the share, and

(b) the annuitant under the plan is the individual or a spouse of the individual;

(2) Subsections 127.4(3) and (4) of the said Act are repealed and the following substituted therefor:

Computation of tax credit

(3) The labour-sponsored funds tax credit of an individual for a taxation year is the total of all amounts, in respect of an approved share acquired or irrevocably subscribed and paid for by the individual (or by a qualifying trust for the individual in respect of the share) in the year or within 60 days after the end of the year (to the extent that it was not deducted in computing the individual's tax payable under this Part for the preceding taxation year), each of which is

(a) where a tax credit is provided under the law of a province in respect of the acquisition of, or subscription for, the share by the individual or the trust, and the share is not a share of a registered labour-sponsored venture capital corporation (within the meaning assigned by section 204.8), the amount, if any, by which

(i) 40% of the net cost to the individual or the trust of the share
exceeds

(ii) the amount of the tax credit so provided; and

(b) in any other case, where the individual has filed with the individual's return of income under this Part for the year (other than a return of income filed under subsection 70(2), paragraph 104(23)(d) or 128(2)(e) or subsection 150(4)), the information return described in paragraph 204.81(6)(c) in respect of the share, 20% of the net cost to the individual or the trust of the share.

Idem

(4) Notwithstanding subsection (3), where paragraph (3)(a) applies in computing an individual's labour-sponsored funds tax credit for a taxation year in respect of an approved share and the amount of the tax credit referred to in that paragraph is less than 20% of the consideration for which the share was issued, the amount determined under that paragraph for the year in respect of the share shall be deemed to be nil.

(3) Subsections (1) and (2) apply to the 1992 and subsequent taxation years.

2.(1) Paragraph (a) of the definition "eligible investment" in section 204.8 of the said Act is repealed and the following substituted therefor:

(a) a share that was issued to the particular corporation and that is a share of the capital stock of a corporation that was an eligible business entity at the time the share was issued,

(2) Section 204.8 of the said Act is further amended by adding thereto, in alphabetical order therein, the following definition:

"specified individual"
«particulier déterminé»

"specified individual" in respect of a share means an individual (other than a trust) whose labour-sponsored funds tax credit for a taxation year would take into account the amount of consideration paid to acquire, or subscribe for, the share if the information return described in paragraph 204.81(6)(c) in respect of the share were filed as required under paragraph 127.4(3)(b).

(3) Subsections (1) and (2) apply after December 2, 1992.

3.(1) All that portion of paragraph 204.81(1)(c) of the English version of the said Act preceding subparagraph (i) thereof is repealed and the following substituted therefor:

(c) the articles of the corporation provide that

(2) All that portion of clause 204.81(1)(c)(ii)(A) of English version of the said Act preceding subclause (I) thereof is repealed and the following substituted therefor:

(A) Class A shares that are issuable only to individuals (other than trusts) and trusts governed by registered retirement savings plans, that entitle the holders thereof

(3) All that portion of subparagraph 204.81(1)(c)(ii) of the said Act following subclause (A)(III) thereof is repealed.

(4) Subparagraphs 204.81(1)(c)(v) to (vii) of the said Act are repealed and the following substituted therefor:

(v) subject to the provision described in subparagraph (vi), the corporation may redeem a Class A share in respect of which an information return described in paragraph (6)(c) has been issued only if

(A) where the share is held by the specified individual in respect of the share, a spouse or former spouse of that individual or a trust governed a registered retirement savings plan or registered retirement income fund under which that individual or spouse is the annuitant,

(I) a request in writing to redeem the share is made by the holder to the corporation within 60 days after the day on which the share was issued to the original purchaser and the information return referred to in paragraph (6)(c) has been returned to the corporation,

(II) the corporation is notified in writing that the specified individual in respect of the share has retired from the workforce or ceased to be resident in Canada, or

(III) the corporation is notified in writing that the specified individual in respect of the share became disabled and permanently unfit for work or terminally ill after the share was issued,

(B) there is no specified individual in respect of the share,

(C) the time of redemption is on or after the day on which the specified individual in respect of the share attained, or would, but for death, have attained the age of 65 years,

(D) the corporation is notified in writing that the share is held by a person on whom the share has devolved as a consequence of the death of

(I) a holder of the share, or

(II) an annuitant under a trust governed by a registered retirement savings plan or registered retirement income fund that was a holder of the share,

(E) the redemption occurs more than 5 years after the day on which the share was issued, or

(F) the holder of the share has satisfied such other conditions as may be prescribed,

(vi) unless a Class A share has been issued and outstanding for at least 2 years, the corporation shall not be permitted to redeem the share solely because the specified individual in respect of the share attains 65 years of age or the corporation is notified that the specified individual

(A) has retired from the workforce, or

(B) has ceased to be resident in Canada,

(vii) the corporation shall not register a transfer of a Class A share by the specified individual in respect of the share, a spouse of the specified individual or a trust governed by a registered retirement savings plan or registered retirement income fund under which the specified individual or spouse is the annuitant, unless

(A) no information return has been issued under paragraph (6)(c) in respect of the share,

(B) the transfer occurs more than 5 years after the day on which the share was issued,

(C) the transfer is to the specified individual, a spouse or former spouse of the specified individual or a trust governed by a registered retirement savings plan or registered retirement income fund under which the specified individual or the spouse or former spouse of the specified individual is the annuitant,

(D) the corporation is notified in writing that the transfer occurs as a consequence of the death of the specified individual or a spouse of the specified individual,

(E) the corporation is notified in writing that the transfer occurs after the specified individual dies, retires from the workforce or ceases to be resident in Canada,

(F) the specified individual attains 65 years of age,

(G) the corporation is notified in writing that the specified individual became disabled and permanently unfit for work or terminally ill after the share was issued and before the transfer, or

(H) such other conditions as may be prescribed are satisfied.

(5) Paragraph 204.81(6)(a) of the said Act is repealed and the following substituted therefor:

(a) the articles of the corporation do not comply with paragraph (1)(c);

(a.1) the corporation has failed to comply with any of the provisions of its articles described in paragraph (1)(c);

(6) Subsections (1) and (5) apply after 1988.

(7) Subsections (2) to (4) apply after December 2, 1992 except that, where a corporation was registered under subsection 204.81(1) of the said Act before December 3, 1992, those subsections apply to the corporation on and after the earlier of

(a) the last day of the sixth month after the month in which this Act is assented to, and

(b) the first day after December 2, 1992 on which the articles of the corporation are amended.

4.(1) Subsection 207.1(5) of the said Act is repealed.

(2) Subsection (1) applies to property held after October 31, 1985.

(b) Income Tax Regulations

1. Section 4900 of the *Income Tax Regulations* is amended by adding thereto the following subsections:

"(12) For the purposes of subparagraph (iv) of the definition "qualified investment" in paragraph 146(1)(g) of the Act and subparagraph (iii) of the definition of the same expression in paragraph 146.3(1)(d) of the Act, a property is a qualified investment for a trust governed by a registered retirement savings plan or a registered retirement income fund at any time if, at the time it was acquired by the trust, the property was

(a) a share of the capital stock of a corporation (other than a cooperative corporation) that would be a small business corporation if the expression "Canadian-controlled private corporation" in the definition "small business corporation" in subsection 248(1) of the Act were read as "Canadian corporation (other than a corporation controlled at that time, directly or indirectly in any manner whatever, by one or more non-resident persons)",

(b) a share of the capital stock of a prescribed venture capital corporation described in section 6700, or

(c) a share of the capital of a specified cooperative corporation established pursuant to the laws of Canada or a province that is not required to be purchased as a condition of membership in that corporation,

and, immediately after the time it was acquired by the trust, the annuitant under the plan or fund at that time was not a connected shareholder of the corporation.

(13) Notwithstanding subsection (12), where

(a) a share that is otherwise a qualified investment for the purposes of subparagraph (iv) of the definition "qualified investment" in paragraph 146(1)(g) of the Act or subparagraph (iv) of the definition of the same expression in paragraph 146.3(1)(d) of the Act solely because of subsection (12) is held by a trust governed by a registered retirement savings plan or registered retirement income fund,

(b) an individual

(i) provides services to or for,

(ii) acquires goods from, or

(iii) is provided services by

the issuer of the share or a person related to that issuer,

(c) an amount is received in respect of the share by the trust, and

(d) the amount can reasonably be considered, having regard to all the circumstances, including the terms and conditions of the share, or any agreement relating thereto and any dividend provided on the share to be

(i) on account of, in lieu or in satisfaction of, payment for the services to or for the issuer or the person related to the issuer, or

(ii) in respect of the acquisition of the goods from, or the services provided by, the issuer or the person related to the issuer,

the share shall, immediately before the amount is received, cease to be and shall not thereafter be a qualified investment for the trust."

2.(1) Subsection 4901(1.1) of the said Regulations is revoked.

(2) Subsection 4901(2) of the said Regulations is further amended by adding thereto, in alphabetical order therein, the following definitions:

""connected shareholder" of a corporation is a trust that would be a specified shareholder of the corporation if

(a) a share in the capital of a specified cooperative corporation and all other shares in the capital of the corporation that have identical attributes to that share were shares of a class of the capital stock of the corporation, and

(b) each person or partnership that has a right under a contract, in equity or otherwise, either immediately or in the future and either absolutely or contingently, to acquire a share of a class of the capital stock of the corporation owned the share; (*actionnaire rattaché*)

"specified cooperative corporation" means

(a) a cooperative corporation within the meaning assigned by subsection 136(2) of the Act, or

(b) a corporation that would be a cooperative corporation within the meaning assigned by subsection 136(2) of the Act if the purpose described in that subsection were the purpose of providing employment to the corporation's members or customers. (*coopérative déterminée*)

3.(1) The definition "qualifying Class A share" in subsection 6706(1) of the said Regulations is revoked and the following substituted therefor:

""qualifying Class A share" in the capital stock of a corporation means a share

(a) in respect of which an information return described in paragraph 204.81(6)(c) of the Act was provided by the corporation, where the information return was not returned pursuant to subclause 204.81(1)(c)(v)(A)(I) of the Act, and

(b) the consideration for which would not be taken into account in determining the labour-sponsored funds tax credit (within the meaning assigned by subsection 127.4(1) of the Act) for any taxation year of any individual (other than a trust) if the information return described in paragraph 204.81(6)(c) of the Act were filed as required under paragraph 127.4(3)(b) of the Act;" (*action admissible de catégorie «A»*)

(2) Subsection 6706(2) of the said Regulations is amended by deleting the word "and" at the end of paragraph (a) thereof, by adding the word "and" at the end of paragraph (b) thereof and by adding thereto the following paragraph:

"(c) where a share was originally acquired by a qualifying trust (within the meaning assigned by subsection 127.4(1) of the Act) for an individual in respect of the share for any taxation year, the trust shall be deemed in respect of the acquisition to have been an agent for that individual."

(3) Subsection 6706(3) of the said Regulations is amended by deleting the reference to "clause 204.81(1)(c)(v)(G)" therein and substituting "subparagraph 204.81(1)(c)(v)" therefor.

4.(1) Section 1, subsection 2(2) and section 3 apply after December 2, 1992.

(2) Subsection 2(1) applies after October 31, 1985.

**EXPLANATORY NOTES ON DRAFT LEGISLATION AND REGULATIONS
ON INVESTMENTS IN SMALL AND MEDIUM-SIZED BUSINESS**

ITA
127.4

Section 127.4 of the *Income Tax Act* provides a tax credit for individuals equal to 20% of the cost of "approved shares" of a prescribed labour-sponsored venture capital corporation. The credit cannot exceed \$1,000 and is available to an individual only where that individual is the first purchaser of such shares.

Subsections 127.4(3) and (4) are amended so that the tax credit is provided to an individual where a trust governed by an RRSP (under which the individual or the individual's spouse is the annuitant) is the first purchaser of such shares and uses contributions made to the trust by the individual for the purchase. Such a trust is defined in subsection 127.4(1) as a "qualifying trust".

This amendment applies to the 1992 and subsequent taxation years.

ITA
204.8

"eligible investment"
"specified individual"

Section 204.8 of the Act sets out a number of definitions which apply for the purposes of Part X.3, relating to national labour-sponsored venture capital corporations (LSVCCs). A tax credit in respect of the acquisition of shares of LSVCCs registered under Part X.3 is provided under section 127.4.

An "eligible investment" for a national LSVCC includes common shares issued by qualifying small and medium-sized businesses and certain subordinated debt. A national LSVCC is ultimately required to invest at least 60% of its shareholder's equity in "eligible investments", pursuant to subsection 204.82(2).

The definition of "eligible investment" is amended so that preferred shares issued by qualifying small and medium-sized businesses are included therein.

Section 204.8 is also amended to introduce the definition "specified individual". A "specified individual" in respect of a share in the capital stock of a national LSVCC is the individual whose labour-sponsored funds tax credit (as defined in subsection 127.4(3)) takes into account the consideration paid for the share, assuming the individual files the required form to claim the credit. This definition is consequential to the changes to sections 127.4 and 204.81 permitting the original purchaser of a share issued by LSVCCs to be made by a trust governed by an RRSP.

These amendments apply after December 2, 1992.

ITA

204.81(1)(c) and (6)

Subsection 204.81(1) of the Act permits the Minister of National Revenue to register a corporation as an LSVCC under Part X.3 if the corporation's articles of incorporation satisfy specified conditions and other requirements are met. Under paragraph 204.81(6)(a), the Minister may revoke the registration if the corporation fails to comply with such provisions.

The preamble to paragraph 204.81(1)(c) is amended so that the articles of a corporation, rather than its articles of incorporation are relevant for the purposes above. As defined in the *Canada Business Corporation Act*, the articles of a corporation include the original or restated articles of a corporation.

Subsection 204.81(6) is amended as a consequence of the above amendment. Amended paragraph 204.81(6)(a) allows for the revocation of the registration of a corporation where the articles of the corporation do not comply with the specified conditions. New paragraph 204.81(6)(a.1) allows for the revocation of the registration of a corporation where, at any time, it fails to comply with the specified conditions set out in its articles at that time.

These amendments apply after 1988.

ITA

204.81(1)(c)(ii) and (v) to (vii)

Paragraph 204.81(1)(c) of the Act sets out the specified conditions that must be provided by the articles of a corporation, in order for the corporation to be registered as an LSVCC under Part X.3.

Subparagraph 204.81(1)(c)(ii) is amended to permit a trust governed by an RRSP to be the original purchaser of shares issued by a registered LSVCC. The restrictions on the redemption and transfer of LSVCC shares that currently apply where the original purchaser was an individual will apply in a substantially similar manner where the original purchaser is a trust governed by an RRSP.

Subparagraph 204.81(1)(c)(ii) is also amended to eliminate a reference to the restrictions on redemption and transfer of shares contained in subparagraphs 204.81(1)(c)(v) to (vii). This reference is no longer necessary because of amendments to subparagraphs 204.81(1)(c)(v) and (vii).

Subparagraphs 204.81(1)(c)(v) and (vii) are amended so that a share can be transferred or redeemed if consideration for the share would not be taken into account in computing any individual's labour-sponsored funds tax credit (within the meaning assigned by subsection 127.4(1)) if the required form to claim the credit were filed. These circumstances are anticipated to arise in very unusual situations. For example, a

share could be issued to a trust governed by an RRSP that did not use contributions to the trust by any one individual to acquire the share.

Subparagraph 204.81(1)(c)(vii) is also amended to permit transfers of LSVCC shares to trusts governed by RRIFs to be made on the same basis as transfers to trusts governed by RRSPs.

Subparagraph 204.81(1)(c)(vii) is also amended to allow for the registration of a transfer of a Class A share, from (or to) an individual whose labour-sponsored funds tax credit takes into account the cost of the share, to (or from) that individual's spouse. This extends the existing provision in subparagraph 204.81(1)(c)(vii) which allows transfers to spousal RRSPs, but not to the annuitant of such an RRSP directly.

These amendments apply after December 2, 1992. However, where a corporation was registered under Part X.3 prior to December 3, 1992 the amendments apply on the earlier of

- the last day of the sixth month after the month in which Royal Assent occurs, and
- the first day after December 2, 1992 on which the articles of the corporation were amended.

ITA
207.1(5)

Subsection 207.1(5) of the Act imposes a 1% penalty tax on a trust governed by an RRSP or a RRIF with respect to "excessive" holdings in small business properties.

This subsection is repealed, retroactive to the date of its introduction.

(b) Income Tax Regulations

ITR
4900(12) and (13)

Subsection 4900(6) of the Regulations allows a share in the capital stock of an "eligible corporation" to be held as an investment for a property governed by an RRSP or RRIF, unless the annuitant under the RRSP or RRIF is a "designated shareholder" under the RRSP or RRIF. This is an ongoing test that has proved to be difficult to administer in many cases. In addition, the "designated shareholder" definition generally does not facilitate the control of a corporation by groups of unrelated employees.

New subsection 4900(12) of the Regulations is introduced to allow a share of the capital stock of a "small business corporation" (other than a cooperative corporation) to be a qualified investment for an RRSP or RRIF, provided that the RRSP or RRIF

annuitant is not a "connected shareholder" of the corporation immediately after the acquisition of the share. For this purpose, a "small business corporation" is a corporation described in the existing definition of that expression in subsection 248(1) of the Act, except that the corporation is required only to be a Canadian corporation (other than a corporation controlled, directly or indirectly by one or more non-resident persons) rather than a Canadian-controlled private corporation. The expressions "Canadian corporation" and "Canadian-controlled private corporation" are defined in subsections 89(1) and 125(7) of the Act, respectively). Under amended subsection 4901(2), a "connected shareholder" of a corporation is a person who owns or has options to acquire, or who is a member of a related group which owns or has options to acquire, directly or indirectly 10% or more of the issued shares of any class of the corporation.

New subsection 4900(12) also allows shares of the capital stock of a prescribed venture capital corporation described in section 6700 to be a qualified investment for an RRSP or a RRIF, provided that the RRSP or RRIF annuitant is not a "connected shareholder" (as described above).

New subsection 4900(12) also allows shares of the capital stock of a specified cooperative corporation to be a qualified investment, provided that such shares are not required to be purchased as a condition of membership in one or more of the cooperatives operated by the corporation. The "connected shareholder" restriction described above also applies and, for this purpose, shares in the capital of a specified cooperative corporation are treated as shares in the class of a capital stock of the corporation. As defined in subsection 4901(2), a "specified cooperative corporation" is a cooperative corporation described in subsection 136(2) of the Act, as well as similar corporations established for the purpose of providing employment to the corporation's members or customers.

Subsection 4900(13) is introduced to ensure that amounts received in respect of any such shares by a trust governed by an RRSP or RRIF must be in the nature of a return from an investment. It applies where a share held by such a trust is a qualified investment by virtue of subsection 4900(12). Where it may reasonably be considered that an amount is received by the trust in respect of such a share

- on account of, in lieu or in satisfaction of, payment for services rendered to the issuer of the share or a person related to the issuer, or
- in respect of the acquisition of goods from, or the provision of services by, the issuer or a person related to the issuer

the share ceases to be a qualified investment for the trust.

These amendments apply with respect to property acquired after December 2, 1992.

ITR
4901(1.1)

Subsection 207.1(5) of the Act imposes a penalty tax on the excessive holding of prescribed property. Subsection 4901(1.1) of the Regulations prescribes property for this purpose.

Subsection 4901(1.1) is revoked, effective as of the date of the introduction of the penalty tax. This amendment is strictly consequential to the proposed repeal of subsection 207.1(5) of the Act.

ITR
6706

Subparagraph 204.81(1)(c)(v) of the Act contains restrictions on the redemption of shares issued by a national labour-sponsored venture capital corporation (national LSVCC). Existing clause (G) of that subparagraph provides that the holder of the share may redeem such shares if prescribed conditions are satisfied. For this purpose, section 6706 of the Regulations prescribes a number of conditions.

Section 6706 essentially provides that a national LSVCC may redeem a share if the maximum tax credit associated with that share is repaid by the holder.

The definition of "qualifying Class A share" in subsection 6706(1) is amended to take into account that, in some circumstances, it would be possible for a qualifying Class A share to be acquired without the consideration for such share being taken into account in determining an individual's labour-sponsored funds tax credit under section 127.4. The amended definition disregards such share for the purposes of computing the repayment obligation under section 6706. This amendment is consequential to changes to the Act which allow trusts governed by RRSPs to be issued shares of LSVCCs. It would apply only in unusual situations, such as when an LSVCC share is issued to a trust that is not a "qualifying trust", as described in the commentary to the amendments to section 127.4 of the Act.

Subsection 6706(2) is amended to take into account that the original acquisition of a share may be by a "qualifying trust" governed by an RRSP. New paragraph 6706(2)(c) provides that, for the purposes of section 6706, a qualifying trust for an individual is deemed to have been an agent of that individual in respect of the acquisition.

These amendments apply after December 2, 1992.