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Small Business

Ministre d'État
Petite entreprise

Government
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IMPROVING THE EQUITY FINANCING ENVIRONMENT

FOR SMALL BUSINESS IN CANADA

Presented for Public Discussion

By

The Honourable A.C. Abbott

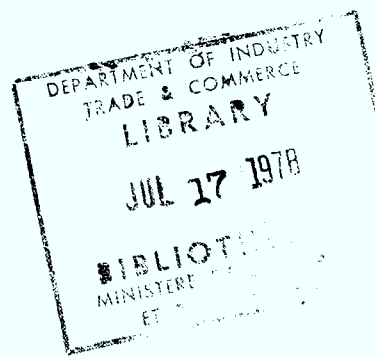
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I. INTRODUCTION

For some years now, a growing number of Canadians have become aware of the importance of small business and the unique facets and potential of this sector of the Canadian economy. Concerns that this sector is experiencing various difficulties have been reflected in public statements, in the media and in studies, briefs and submissions by informed commentators, professional associations and by government authorities at both the federal and provincial levels.

Many have made proposals for changes in federal government policies to alleviate problems faced by this sector and to promote and ensure its continued health. The federal government, conscious of these problems, and acknowledging that small business plays a vital role in Canada's economic development, has responded to several of these concerns. For example, the Federal Business Development Bank (previously the Industrial Development Bank) has loaned some \$3.5 billion since 1944 to some 50,000 small and medium-sized businesses. Currently there are over \$1.5 billion in loans out to over 33,000 firms.

In September 1977, the Minister of State for Small Business, the Honourable A.C. Abbott, announced the federal government's strategy for small business, an outline of which was presented in a public document entitled "Small Business in Canada: Perspectives". This report included considerable discussion on the financing concerns of small businesses. It noted, in particular, the government's commitment to examine ways to improve the equity financing environment for small business.



This paper responds to that commitment. It raises for public discussion the complexity of the issues associated with the availability of venture capital, or as it is sometimes referred to, risk capital. Several approaches for further support in the area of small business equity financing are suggested, in full recognition that any identified or perceived problems are interrelated with other issues.

One of the approaches suggested concerns the establishment of a small business investment company mechanism. Conceptually, such a mechanism would consist of a number of privately owned and operated companies, licensed by the government for the purpose of providing equity and equity-related financing to small businesses. These companies would also be supported by the government through, for example, tax incentives and guaranteed leverage, without undue interference by the government in their day-to-day decision making process.

The United States' experience with their Small Business Investment Company (SBIC) program dates from 1958. While the U.S. program has not been an unqualified success, it has channeled over \$3 billion in equity capital and long-term debt to over 50,000 small firms. Since 1976 studies have been conducted by the Small Business Administration, Congress and the Executive Branch in an effort to further improve the SBIC mechanism. Final decisions concerning changes to the program have not yet been made. Nevertheless, the commitment to the success of the program is strongly present in both the private and public sectors.

Public debate has been an integral part of the development and improvement of the SBIC program in the U.S. This discussion has involved the small business community, the investment community, government agencies, political parties and industry spokesmen. Similar public involvement is considered essential to the determination of the need for such a mechanism in Canada.

Québec and Ontario have introduced programs designed to foster the establishment of private investment companies whose purpose is to provide selected kinds of small and medium-sized companies with risk capital, and several other provinces are examining similar proposals. Many small business people and financial commentators have pointed to the need for a federal program.

Other courses of action for further government support for small business equity financing are raised in this paper, including increasing the equity investment activities of the Federal Business Development Bank and introducing additional tax measures. These are presented in order to solicit opinion and comment from the financial community, from other governments, and particularly from entrepreneurs and small business people. This process will ensure that the ongoing development of federal government policies will accurately respond to small business needs in this area.

II. GOVERNMENT RECOGNITION OF THE NEED TO SUPPORT
SMALL BUSINESS FINANCING

Private sources of capital have traditionally provided the bulk of the external financing needs of Canadian small businesses. Governments or their agencies at both the federal and provincial levels have complemented the efforts of the private sector by making capital available to small businesses through various loan and loan guarantee programs and occasionally by making equity investments directly in these businesses. Moreover, fiscal measures have a significant impact on the availability of financing for small businesses — both from external sources and those generated from a firm's day-to-day operations.

The federal tax structure, for example, has for many years provided substantial measures to benefit small businesses. Measures relating to capital cost allowances, the treatment of R&D expenditures, investment tax credits, inventory adjustment allowances, and many others, have had a direct and positive impact on the cash flow of all companies, including small firms. The lower tax rate for small Canadian controlled private corporations contributes substantially to the cash flow of these businesses. This lower tax rate on the first \$150,000 of annual income is some 20 to 21 percentage points lower than that of larger businesses. It is not widely known that the federal revenue foregone as a result of this rate of tax for small businesses is estimated to be \$900 million in 1978.

There is no doubt these measures increase the return to owners on the capital they have invested in small businesses. In addition, the owners benefit from the tax treatment of dividends and capital gains. The favourable treatment of stock options for employees of Canadian controlled private corporations should also be noted.

It obviously is not possible to assess the Canadian tax system in a vacuum, without reference to some standard. Comparisons with the tax structures of other countries is one way of looking at the overall adequacy of the Canadian system. A review of the tax treatment of small businesses in Canada and in the United States does not reveal any wide disparities. In fact, there are several aspects of the Canadian structure that make it more generous.

In addition to tax initiatives, the federal government has several programs which support the financing needs of small businesses. The Federal Business Development Bank, as previously noted, provides term loans to small and medium-sized businesses. In addition, the FBDB is rapidly becoming the largest institutional supplier of equity financing to small and medium-sized firms — its investments in its portfolio companies total close to \$45 million.

Under the Small Businesses Loans Act (SBLA) the federal government guarantees loans up to \$75,000 to businesses with gross revenues of less than \$1.5 million. From the inception of the SBLA program in January 1961 to December 1977, 48,858 loans have been made for a total amount of \$577 million. At the present time there is some \$233 million in outstanding loans under this Act.

In 1976, several of the programs of the Department of Industry, Trade and Commerce in support of innovation and industrial adjustment were merged into one — the Enterprise Development Program (EDP). This program has a primary focus on the support of smaller and medium-sized companies. Under the EDP, the federal government provides direct grants for innovation and insures loans by private lenders, such as chartered banks, to eligible firms undertaking major restructuring projects designed to achieve international competitiveness. In the current fiscal year, expenditures under this program for innovation projects are estimated to be \$25 million, and the loan guarantee side of the program has recently been expanded from \$250 million to \$350 million.

III. SMALL BUSINESS EQUITY FINANCING: THE DEBATE TODAY

Few other small business issues have received more attention recently than that concerning the availability of risk capital for small firms in their early stages of development or in the process of expansion. On the one hand, some studies conclude that there is a severe shortage of risk capital for small business, while, on the other hand, many claim that the best ideas are usually successful in obtaining financing. Both are simplistic responses to a very complex problem.

There is a general consensus that it is extremely difficult to predict which ventures will be successful or to what extent the various levels of risk will result in commensurate levels of reward. More fundamentally, it is difficult to predict the potential of unproven innovations. However, there seems to be little doubt that there are sound business ideas and projects which for one reason or another do not obtain adequate equity financing. This does not in itself suggest that there is a shortage of risk capital as there are many reasons why these ventures might not be successful in obtaining the required financing.

Although it is not possible to accurately measure the demand for, or the supply of, risk capital, a number of observations concerning the issue have been made. From the viewpoint of many investors, investments in small venture activities: (i) generally offer low returns relative to high risks; (ii) require relatively greater investments in investigation and research costs; (iii) require relatively greater need for supervision; and (iv) are relatively more difficult to divest. In addition, existing tax measures may be viewed as offering an attractive alternative to direct savings to other channels such as Registered Retirement Savings Plans (RRSPs), Registered Home Ownership Savings Plans (RHOSPs), and the Multiple Unit Residential Buildings (MURBs) measure.

Moreover, for the prospective investor, an assessment of an entrepreneur's potential may be complex because:

(i) it may be difficult for the investor to assess the entrepreneur's skills and the viability of his or her ideas; (ii) the entrepreneur may lack the skills and resources to prepare comprehensive business plans and financial package proposals; (iii) he or she may demand too high a price for equity ownership in the business; and (iv) he or she may wish to maintain complete control over the venture and may not be interested in the participation and advice of "outsiders".

Conversely, from the viewpoint of some entrepreneurs:

(i) capital is not available or is available at too high a price and under unreasonable conditions; (ii) the search for capital is extremely frustrating and time consuming because of the lack of information concerning the availability of capital, the lack of concern for urgency on the part of investors, and their overwhelming need for detailed business plans before they ever will consider investigating a venture; (iii) a high level of investment by outsiders may result in loss of control over a venture by the founding entrepreneur; and (iv) wide dispersal of shares of a small business may result in the need for it to qualify as a public company and so forfeit the small business tax rate.

Essentially, private individuals constitute the most frequently used source of capital in the early stages of a small business' development. However, a number of serious barriers exist which impede the flow of funds from individuals into such enterprises (e.g. their inability to provide secondary financings).

Apart from private individuals, the banking system is a major source of financing for small businesses. However, banks cannot meet all of the financing needs of small businesses. Bank loans, usually secured by the assets of a business and the personal guarantees of its owners, can satisfy only the relatively low-risk needs.

Venture capital companies would appear to be the most appropriate vehicle for providing risk capital to small businesses. In reality, for a number of reasons their activities have been declining in recent years. Finally, it is no longer possible to bring the securities of a small young company onto the public market.

IV. POSSIBLE COURSES OF ACTION

There is no doubt that the problem of the availability of risk capital for small businesses is extremely complex. It is, moreover, a problem whose solution embodies many components: the respective viewpoints of the investors and seekers of risk capital, liquidity problems, the overall state of the economy and the state of capital markets, and fiscal and monetary environments, e.g. regulations and taxation policies to mention a few.

It follows that any comprehensive approach adopted by the government to encourage small business equity financing must involve the private sector to the greatest degree possible and, at the same time, recognize the need for government support aimed at either leveraging private sources of capital or directly complementing the role of the private sector, or both. Such an

approach should also acknowledge the need to build upon experience in the light of various existing uncertainties and the fact that no one measure can solve all the risk financing problems encountered by small businesses. Finally, prior to the introduction by the federal government of any additional initiatives, the adequacy or inadequacy of existing measures, including provincial initiatives, taxation policy, and other federal programs, such as the FBDB, must be considered.

Accordingly, it would appear that one or more of a number of possible courses of action can form the basis of an adopted approach, should it be accepted that additional government measures are clearly required to enhance the availability of risk capital for small business. The following questions suggest themselves for public discussion:

- (a) Should the equity investment activities of the Federal Business Development Bank be substantially increased?
- (b) Should further tax measures be introduced, or existing tax measures be adjusted, in order to enhance the availability of risk capital to small business?
- (c) Should a new federal mechanism be enacted to provide for the creation of pools of risk capital? (An outline of a possible small business investment company mechanism, termed a Venture Enterprise Investment Company (VEIC) Program, follows in this document.)

THE VENTURE ENTERPRISE INVESTMENT

COMPANY (VEIC) PROGRAM

- AN OUTLINE FOR DISCUSSION -

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INTRODUCTORY COMMENTS

The outline of a Venture Enterprise Investment Company (VEIC) Program as presented in this paper is by no means to be considered as a complete or in any way a final proposal. Rather it is intended to raise, for discussion purposes, many of the complex issues associated with a small business investment company mechanism. For example, the suggestion that a company would be required to have a combined paid-in capital and contributed surplus of at least \$2,000,000 in order to qualify for licensing as a VEIC is intended to raise the issue relating to the minimum size of VEICs: should there be a required minimum size and, if so, what should be the criteria for size and what level should be established as a minimum?

All the statements made relating to the various aspects of the outlined program do not necessarily have to be directly reflected in an eventual VEIC Act -- some could form the basis for VEIC Regulations.

Finally, in some sections of the outline, such as those concerning taxation, two alternatives (A and B) are presented. Any final proposal would include only one of the alternatives or a variation of those presented.

A. PURPOSE OF THE VEIC PROGRAM

To stimulate the flow of equity and equity-related capital, which is not normally available to small businesses (venture enterprises) for their growth, expansion, and modernization -- ensuring, at all times, maximum participation of private financing sources.

(Note: The phrase "not normally available" is not intended to imply "last resort". Instead, it is a policy statement regarding an objective of the program concerning the general lack of availability of risk capital for small business.)

B. HIGHLIGHTS OF THE VEIC PROGRAM

- 1. VEICs would be privately owned and operated "Venture Enterprise Investment Companies" which have been licensed by the Federal Government to provide equity and equity-related financing to eligible venture enterprises and which would operate in accordance with a VEIC Act and Regulations.*
- 2. VEICs would be profit-seeking entities.*
- 3. Debt securities issued by VEICs to approved lenders could be guaranteed (up to 90%) by the Federal Government.*
- 4. VEICs would be required to invest at least as much in equity financings as in non-equity (equity-related) financings.*
- 5. VEICs would be required to be Canadian owned and operated businesses and their portfolio investments would be required to be in eligible Canadian controlled private companies.*

6. *Each VEIC would require an initial capitalization of at least \$2 MILLION.*
7. *VEICs, their shareholders, and key employees would be eligible for special tax incentives.*

C. LICENSING REQUIREMENTS FOR VEICs

1. *VEICs would be required to be incorporated under federal law solely for performing the functions and conducting the activities contemplated under the VEIC Act.*
2. *A company could not qualify to be licensed as a VEIC if it is licensed or registered under a provincial program aimed at encouraging the availability of risk capital.*
3. *A company could not qualify to be licensed as a VEIC if it is wholly or partly owned by any federal or provincial government organization prescribed as ineligible under VEIC regulations.*
4. *Only companies owned by private sector financing sources (e.g. financial and non-financial corporations, pension funds, insurance companies and private individuals) could qualify to be licensed as VEICs.*
5. *A company that has previously carried on business could not qualify to be licensed as a VEIC. (This does not preclude existing organizations such as venture capital companies from establishing VEICs as subsidiaries).*
6. *A company would be required to be 75% owned and controlled by residents of Canada in order to qualify to be licensed as a VEIC -- and would be required to maintain this status in order to remain licensed.*

7. *In determining whether to approve a company's articles of incorporation and permit it to operate under the provisions of the VEIC Act, the Federal Government would give due regard, among other things, to: the general business record and character of the proposed owners and management of the company; and, the ability of the company to search for and analyze investment opportunities, negotiate investments, and provide assistance to portfolio companies. (However, a VEIC would not be precluded from complementing its in-house resources through the use of outside consultants or investment managers.)*
8. *Each company, in order to be licensed to operate under the VEIC Act, would be required to have a combined private paid-in capital and contributed surplus of not less than \$2,000,000.*

D. LIMITATION OF LICENSES AND VEIC EXPENSES

1. *A license could be recalled or suspended by the Federal Government for cause as stipulated under the VEIC Act and Regulations.*
2. *Under the VEIC Act the Federal Government would have the right to suspend further licensing if the number and size of VEICs would be sufficient to meet the objectives of the legislation or where it would be in the public interest to do so.*
3. *Under the VEIC Act the Federal Government would have the right to limit the capitalization of a VEIC.*
4. *The Federal Government could prescribe the kinds of expenses that a VEIC could claim in the organization, promotion and operation of its business and affairs and could impose limits thereon.*

E. OWNERSHIP AND DIRECTION OF VEICS

- 1. A VEIC would be required to maintain a permanent full-time staff qualified to manage and administer the VEIC.*
- 2. The Board of Directors of a VEIC would be required to consist of at least three "unrelated" Canadian residents and the majority of Directors must be Canadian residents.*
- 3. No person or group of associated persons could own more than FORTY (40%) PERCENT of the voting shares of any one VEIC.*

F. POWERS OF VEICs

- 1. A VEIC would have the authority to borrow money, pledge assets as security, guarantee the obligations of portfolio companies, and issue its debentures, bonds, promissory notes or other obligations under such general conditions and subject to such limitations and regulations as the Federal Government may prescribe under the VEIC Act and Regulations.*
- 2. A VEIC would have the authority to accept direct loans, loan guarantees, grants and other subsidies from sources such as federal and provincial departments, agencies, and Crown Corporations, PROVIDED such support could in no way be construed as ownership or control of the VEIC and would not be contrary to the VEIC Act and Regulations.*
- 3. A VEIC would have the authority to make only those investments allowed in the VEIC Act and Regulations as being eligible investments in eligible venture enterprises and to maintain a certain proportion of its assets in liquid reserves.*

4. A VEIC could provide management advisory services including the performance of any service relating to the financial, management, administrative, or operating activities of a business operation. Such services may be provided, for a fee, to portfolio companies only.
5. A VEIC's total annual revenues from the provision of management advisory services could not exceed twice the salaries paid to the VEIC's permanent full-time management employees.
6. Where a VEIC directly or indirectly provides management advisory services, for a fee, to one of its portfolio companies, such services would be required to be performed pursuant to a written contract with the portfolio company and the contract would be required to be approved, in advance, by the Board of Directors of the portfolio company.

G. ELIGIBLE INVESTMENTS BY VEICs

1. Eligible investments by VEICs would be any debt or equity, or debt or equity-related, investments in eligible venture enterprises, PROVIDED they are in accordance with the laws and regulations pertaining to the individual investments and overall portfolio of VEICs.
2. The maturity date of any debt investment in an eligible venture enterprise by a VEIC could not be less than FIVE (5) YEARS. However, short-term loans with a maturity date of less than TWELVE (12) MONTHS could be extended by VEICs to eligible venture enterprises if these loans are for purposes relating to "bridge financing", as defined under VEIC Regulations.

3. *The maximum allowable rate of interest charged by VEICs on straight debt investments in eligible venture enterprises would be stipulated under VEIC Regulations. This rate of interest would not apply to any "participating aspects" of debt securities but would apply to the fixed income portion of participating debt securities.*
4. *Neither equity nor debt investments made by a VEIC in an eligible venture could be secured by any assets of the eligible venture or of its principals.*
5. *At least ONE (\$1.00) DOLLAR in the form of equity (common or preferred shares) would be required to be invested by a VEIC in an eligible venture enterprise for each dollar of debt (participating or non-participating) extended by the VEIC to the eligible venture enterprise.*
6. *A VEIC could guarantee short-term loans by "outside" lenders to a VEIC's portfolio companies only when such funds would be used for purposes of "bridge financing". However, such guarantees would not be considered as investments by the VEIC, unless the guarantee materialized.*
7. *The investment agreements between VEICs and eligible venture enterprises would be required to clearly demonstrate a willingness on the part of the VEIC to reduce its percentage of ownership in an eligible venture as the latter matures. Such agreements would also be encouraged to provide a portfolio company and its shareholders with the "right of first refusal" on the VEIC's offer to sell its holdings in the company.*

H. ELIGIBLE PORTFOLIOS OF VEICs

1. Within *THREE (3) YEARS* after being licensed, a VEIC would be required to have at least *SIXTY (60%) PERCENT* of its assets invested in eligible venture enterprises. Thereafter, *SIXTY (60%) PERCENT* or more of a VEIC's assets must be invested in eligible venture enterprises.
2. A VEIC could have less than *SIXTY (60%) PERCENT* of its assets invested in eligible venture enterprises during the first *THREE (3) YEARS* following issuance of its license and for any period not exceeding *TWELVE (12) CONSECUTIVE MONTHS* thereafter.
3. Not more than *TWENTY (20%) PERCENT* of the assets of a VEIC could be invested in any one eligible venture enterprise or group of "associated" eligible venture enterprises.
4. The balance between a VEIC's investments in eligible venture enterprises and the total assets of the VEIC would be required to be maintained in the form of liquid reserves as stipulated under VEIC Regulations.
5. A VEIC could take appropriate steps or make an appropriate investment in a portfolio company for purposes of "salvaging" the portfolio company and protecting its investment in the event of difficulties.
6. Under specific conditions as prescribed in the VEIC Act and Regulations a VEIC would be allowed to own more than *FORTY (40%) PERCENT* of the voting shares of a portfolio company.

I. ELIGIBLE VENTURE ENTERPRISES

1. An eligible venture enterprise would be a business:

- i) that is not excluded under VEIC Regulations.
- ii) that is principally not in the business of relending or financing or investing in real estate, or in the business of being a holding company.
- iii) which is not seeking support from VEICs for the purpose of reinvestment outside of Canada.
- iv) which is not "associated" with the shareholders, managers or debtors of any VEIC.
- v) in which NINETY (90%) PERCENT of its assets are situated or invested in Canada and NINETY (90%) PERCENT of its wages and salaries are paid to residents of Canada - prior to and following investment by a VEIC.
- vi) in which the number of voting shares taken by any VEIC or group of VEICs in the business, or group of affiliated businesses, does not exceed FORTY (40%) PERCENT of all the issued and outstanding voting shares of the business.
- vii) which is a private Canadian-controlled corporation as defined in the Income Tax Act of Canada.
- viii) which is a company incorporated in Canada:

Alternative A: whose total assets are less than \$1,000,000 and whose sales are less than \$2,000,000 as evidenced by its most recent audited annual financial statements.

Alternative B: that has not earned an average of more than \$150,000 in annual pre-tax earnings in its last three fiscal years, and whose total shareholders' equity is less than \$750,000 as evidenced by its most recent audited annual financial statements.

- 2. Additional financings by a VEIC in a portfolio company would be allowed even though the portfolio company may have exceeded the size limitation of an eligible venture enterprise following the first financing by the VEIC.*

J. GOVERNMENT GUARANTEED LEVERAGING OF VEICs

- 1. A VEIC would be eligible for government guaranteed loans not exceeding the amount of its paid-in capital and contributed surplus.*
- 2. The Federal Government could guarantee the principal and interest of eligible leverage funds to the extent of NINETY PERCENT (90%).*
- 3. The leverage by lenders, designated as eligible under VEIC Regulations, would be required to be in the form of straight debt (i.e. non-participating) at a specified rate of interest which does not exceed a maximum rate as determined under VEIC Regulations, and with a specified date of maturity of not less than TEN (10) YEARS, and not more than FIFTEEN (15) YEARS.*
- 4. The annual rate of interest on a government guaranteed loan could be specified on the basis of a clearly defined "floating formula" but the actual annual rate of interest must not exceed that specified under VEIC Regulations.*

5. *The leverage funds could be provided by approved lenders in the form of a loan with periodic interest payments and/or principal repayments, or in the form of deferred interest debentures, or in the form of discounted debentures, or in such form as may be prescribed under VEIC Regulations.*
6. *The provider of government guaranteed leverage funds to a VEIC could not be a shareholder of any VEIC prior to the extension of such funds or subsequently while such funds are still subject to a guarantee by the government. Furthermore, the provider of government guaranteed leverage would be required to deal with the borrowing VEIC on an "arm's-length" basis (e.g. a VEIC's portfolio company would not be eligible as a lender of government guaranteed funds to the VEIC).*
7. *The amount of leverage funds eligible for government guarantee would not normally exceed an amount equal to the VEIC's paid-in capital and contributed surplus.*
8. *The amount of government guaranteed leverage outstanding to any VEIC could not exceed TEN MILLION DOLLARS.*
9. *A VEIC would be charged an annual insurance fee of ONE (1%) PERCENT on the outstanding debt (principal and interest) guaranteed by the government.*
10. *The contract between the lender and VEIC covering government guaranteed leverage would be required to include the privilege for a VEIC to prepay the outstanding debt, subject to negotiated terms and conditions.*
11. *A VEIC whose license is surrendered or revoked would be immediately liable for all outstanding government guaranteed loans.*

12. A VEIC could not make any distributions to its shareholders if it has arrears with respect to government guaranteed financing.
13. A VEIC would be eligible for government guaranteed leverage only if, at the time leverage is extended, it has invested at least SIXTY (60%) PERCENT of its assets in eligible venture enterprises.
14. Government guaranteed leverage would be included in the assets of a VEIC for purposes of calculating whether a VEIC has attained and is maintaining an eligible portfolio (i.e at least SIXTY (60%) PERCENT of assets invested in eligible venture enterprises, etc.).

K. TAXATION OF VEICs

Alternative 1:

- VEICs would be exempt from income taxes.
- A VEIC would be subject to taxes following the surrender of its license or from the time an event occurred which led to the revocation of its license.

Alternative 2:

- VEICs would be taxable at full corporate rates.
- VEICs would be allowed to deduct reserves for losses from taxable income at an annual rate of FIVE (5%) PERCENT of the portfolio investments in eligible venture enterprises for the first EIGHT (8) YEARS; thereafter reserves for losses would be based on estimated net losses incurred.

- *VEICs would be allowed tax credits on the realized net taxable capital gains reinvested in eligible venture enterprises within ONE (1) YEAR after the realization of the gains.*
- *Non-capital losses incurred by VEICs could be carried forward for up to FIFTEEN (15) YEARS.*
- *One-half of capital losses realized by VEICs could be deducted from other income on an unlimited basis.*

L. TAXATION OF VEIC SHAREHOLDERS

Alternative 1: *(coincides with Alternative 1 re Taxation of VEICs)*

- *All VEIC distributions to shareholders (individuals and corporations) would be deemed to be dividends.*
- *One-half of the capital losses realized by VEIC shareholders (both individuals and corporations) may be deducted from other income on an unlimited basis.*
- *Investors realizing taxable capital gains on their investments in VEICs would receive a tax credit if these gains are reinvested in VEICs within ONE (1) YEAR from the date the capital gain is realized.*

Alternative 2: *(coincides with Alternative 2 re Taxation of VEICs)*

- *VEIC shareholders (individuals and corporations) would be taxed in accordance with existing tax legislation with the following exceptions:*
 - i) *One-half of the realized capital losses may be deducted from other income on an unlimited basis.*

- ii) *VEIC shareholders realizing taxable capital gains would receive a tax credit if these gains are reinvested in VEICs within ONE (1) YEAR from the date of realization.*

M. TAXATION OF KEY VEIC EMPLOYEES

- 1. *Key employees of VEICs would receive a special tax treatment for VEIC stock option plans. The difference between the option price paid for the shares and their sale proceeds would be taxed as a capital gain and then only when the shares are disposed of.*

N. INFORMATION REQUIREMENTS

- 1. *VEICs would be required to make reports to a designated body of the Federal Government, at such time and in such form as the Federal Government may require, and be subject to examination by examiners as selected or approved by the Federal Government.*

O. OFFENSES

- 1. *The VEIC Act would prescribe penalties for any individual or corporate body, including a VEIC, for offenses as defined under the VEIC Act or Regulations.*

P. MINISTERIAL POWERS

- 1. *Where a designated Minister of the Crown is of the opinion that a VEIC or its security holders are conducting their business and affairs primarily so as to avoid payment of taxes, in a manner that is contrary to the spirit and intent of the VEIC Act, the Minister could revoke the registration of the VEIC.*

[illegible]

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48069



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