Opportunities for industry and business in Canada

Government of Canada
Regional Economic Expansion

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Expansion Économique Régionale

Regional development incentives

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Introduction

The primary objective of the Department of Regional Economic Expansion (DREE) is to encourage slow-growth regions of Canada to realize their potential. Through programs under the Regional Development Incentives Act (RDIA) and the Department of Regional Economic Expansion Act, the department is able to provide incentives to industry and business to invest in these slow-growth areas and thus create improved opportunities for productive employment.

These programs can assist you in two ways – development incentives and loan guarantees. Both are available for manufacturing or processing facilities. Commercial facilities are eligible for loan guarantees only.

During its first eight years of operation, the department received over 14 000 applications for grants and loan guarantees. RDIA has helped to stimulate projects expected to involve total investments of approximately $3 billion and almost 128 000 direct new jobs.

This booklet is designed to answer frequently asked questions concerning RDIA and special areas under the DREE Act, and is directed to the individual who is interested in doing business with us.

Any Canadian or foreign firm or person may be considered for a grant or loan guarantee under these programs. The procedures are not difficult. We will make every effort to assist you, no matter what your requirements, provided that your project will be located in one of the designated DREE regions or areas.

The nearest DREE office in your province is the place to start. However, if you are considering a project in another province, you will save time by dealing with the DREE people there. If you are outside Canada, call the nearest Canadian consulate for further information.

General information

You asked us . . .

What type of financial assistance is available?

There are two basic types of incentives available: development incentives and loan guarantees.

1. Development incentives include the following:
   - non-repayable development grants;
   - specifically repayable development incentives; and
   - provisionally repayable development incentives (repayable if the project achieves a certain level of profitability or other objectives specified in the offer and accepted by the applicant).
2. Loan guarantees are available for manufacturing and processing and for certain commercial undertakings.

These incentives are available individually or in combination.

What regions of Canada are eligible?

Under the regional development incentives program, a wide choice of locations is available. Please refer to the appendices for further information.

What industries are eligible?

Most manufacturing and processing industries are eligible for development incentives and loan guarantees. The major exceptions are initial processing operations such as petroleum refining and certain parts of the pulp and paper industry. The processing of natural products in operations such as sawmills, fish plants or food processing plants is eligible.

Commercial facilities are not eligible for grants but loan guarantees may be provided for business offices, warehousing and freight-handling facilities, shopping centres, convention facilities, hotel and motel accommodations, recreational facilities and research facilities.

Who may apply for an incentive?

Any type of Canadian or foreign entity may apply, e.g. incorporated companies, partnerships, cooperatives or sole proprietorships.

What are the requirements with respect to Canadian ownership?

Canadian ownership is not a prerequisite for the authorization of an incentive. However, applicants subject to the provisions of the Foreign Investment Review Act must satisfy the requirements of that Act before they can qualify for an incentive.

Application to DREE can be made before approaching the Foreign Investment Review Agency.

What size of project is determined eligible?

The approved capital costs for new facilities, new product expansions, volume expansions and modernizations must be at least $25 000. However, if a new facility or new product expansion creates at least five direct jobs in the operation, the capital costs can be as little as $5 000. In the case of a loan guarantee, projects with total capital costs of $100 000 or more may qualify for assistance.

Development incentives
A. Eligibility

In addition to eligibility considerations under General Information, the following are applicable.

Does prior commitment render a project ineligible?

A development incentive cannot be offered if a contractual commitment was made for buildings, machinery or equipment – whether or not the commitment remains in force – before the day on which the application is officially received by the department. The purchase of land or the undertaking of research and development are not normally considered prior commitments.

Must eligible assets be new?

No. Used buildings, machinery and equipment may be included in eligible assets, provided they are in suitable working condition. Assets purchased in a non-arm's length transaction may be eligible in some circumstances, but only to the extent of the direct costs to the non-arm's length party, e.g. from an affiliate who is an equipment dealer. Existing assets owned by an applicant or an associated firm which are moved to the facility are ineligible, but certain rebuilding, transporting and installation costs may be eligible.

Are mobile operations eligible?

Normally they are not. However, certain mobile operations may be eligible provided they remain in a specified section of a designated region for a period of at least five years. Examples of such projects may include mobile sawmills, feedmills and pelletizers.

How much equity must the applicant invest in a project?

Normally the applicant must provide equity equal to at least 20 per cent of the total capital employed (including working capital) in the eligible operation. For applicants with existing operations, the equity must be equal to at least 20 per cent of the new capital employed plus 20 per cent of the book value of existing assets and working capital.

The amount of equity includes share capital, surplus accounts and subordinated shareholders' loans, adjusted for such items as intangibles, appraisal increases, amounts due from shareholders, or similar items which may inflate the equity figure unreasonably. However, the equity requirement may be increased for high risk or sensitive projects. In certain unusual circumstances, the Minister may approve a project where the applicant's equity is less than that specified above but never below 20 per cent of the approved capital costs.

When must equity be provided?

Unless special authorization is given, the equity should be provided at the latest by the start of commercial production. No incentive payment can be made until the equity is provided.

What are the requirements with respect to insurance coverage?

The facility must be insured to the satisfaction of the Minister against loss by fire, flood and other acts beyond the control of the applicant.

Is pollution abatement equipment eligible?

Capital costs incurred to prevent air, water and other types of pollution may be included in the approved capital costs of a project that is otherwise eligible for an incentive. However, a project involving only the purchase and installation of pollution abatement equipment is not eligible.

Are leased assets eligible?

The costs of leased machinery and equipment, which fall into classes 8 and 29 of Schedule "B" to Part XI of the Regulations to the Federal Income Tax Act, may be included (under certain conditions) in the approved capital costs of a project.

Can the assets be leased from any leasing company?

No. The lessor must be a company incorporated in Canada and subject to Canadian income tax legislation.

Are leasehold improvements eligible?

Costs of leasehold improvements may be included in approved capital costs provided they reflect improvements essential to the proposed project.

Are takeovers eligible?

No, although the takeover of a firm which has qualified for a grant may not disqualify the grant commitment. Further, an application for an incentive to purchase the assets of an existing facility may be considered eligible if the facility has ceased operations and the applicant proposes to make the purchase from non-related interests.

Are phased projects eligible?

Phased projects can be considered eligible provided they are well-defined when the application is submitted to the department and they meet certain specified requirements. However, all phases of the project must be completed within a fixed period starting from the date of commercial production for the first phase of the project.

Are feasibility studies eligible?

No. However, capitalized engineering and designing costs which are directly related to the facility may be included in the approved capital costs.

Are prototype development or research and development costs eligible?

Development incentives are not available for research and development projects. Assistance on such projects may be available from other sources such as the federal Department of Industry, Trade and Commerce and the National Research Council.

Is the expansion or modernization of a facility previously supported by DREE eligible?

The expansion of a facility which has previously been supported by the department is considered eligible. However, a development incentive cannot be authorized for the modernization of any facility for which a development incentive has previously been authorized under the regional development incentives program.

B. General

How is the amount of development incentive determined?

Most category A and B incentives (see below) are determined according to a standard formula, although exceptions are made in cases of merit. Large projects (category C) are analysed differently and a specific amount is determined according to the benefits and needs of the individual project.

An example of a development incentives calculation may be found on page 16.

What are the categories of projects?

The three current categories are:

Category A — projects with approved capital costs (ACC) of less than $300 000 and fewer than 40 direct jobs;

Category B — projects other than A cases, but with less than $2 million ACC and fewer than 100 direct jobs;

Category C — projects with at least $2 million ACC or 100 direct jobs.

What are the standard formulae for categories A and B?

The standard formulae are based on percentages of the approved capital costs (ACC) and for certain projects the average of the approved annual wages and salaries (W & S) paid during the second and third years after the commencement of commercial production.

The standard formulae for projects falling under categories A and B are as follows:

I) New Facility or New Product Expansion
   - a) Atlantic Region–25 per cent ACC plus 30 per cent W & S
   - b) Other Regions –25 per cent ACC plus 15 per cent W & S

II) Modernization or Volume Expansion
   - All Regions –20 per cent ACC

Are there any limitations to the level of grant?

Yes. The ceilings for development incentives are:

I) For new facility and new product expansion, the lowest of the following:
   a) 25 per cent of approved capital costs and $5 000 for each direct job created in the facility (the initial 20 per cent of capital costs may not exceed $6 million);
   b) $30 000 for each direct job created;
   c) 50 per cent of the capital employed in the operation; or
   d) 80 per cent of the approved capital costs for most incentives determined by standard formulae. (In the case of the garment industry, the maximum is 40 per cent.)

II) For modernization and volume expansion, the lesser of the following:
   a) 20 per cent of the approved capital costs; or
   b) $6 million.

Are there any exceptions to the standard formulae?

Standard formulae were introduced to accelerate the decision-making process and to make approvals more systematic. They help the applicant to estimate the amount of incentive that he may receive under the program. However, in exceptional circumstances, a deviation from the standard formula may be made.

Can additional financial support be obtained from other government sources?

Yes. However, assistance offered by the other federal departments and provincial or municipal governments will be taken into consideration in determining the amount of the development incentive. Changes in the amount of the assistance from other government sources identified at the time of an offer may be taken into account in determining the final amount of the incentive paid.

How does the development incentive affect income taxes?

Development incentives are exempt from income tax. However, for capital cost allowance purposes, in the case of a non-repayable grant the value of the assets of the facility must be decreased by an amount equal to the development incentive paid.

If the incentive is specifically repayable, it does not affect the capital cost allowance which may be claimed on assets purchased with this incentive. A provisionally repayable incentive is regarded by the Department of National Revenue to be a grant for tax purposes and, therefore, the capital cost allowance is reduced accordingly. If and when repayment of the incentive commences, capital cost allowance privileges are reinstated in the amount of the repayment in the year in which the repayment is made.

What are the income tax implications relating to the portion of a grant based on the eligible leased assets?

The applicant does not have his capital cost allowances reduced by the part of the grant that is based on the eligible leased assets. The leasing company which receives the payment from the applicant must take it into taxable income in the year received. However, for taxation purposes the lessor can charge to income a reserve equal to the unamortized value of the leased assets. Each subsequent year during the life of the lease, the lessor amortizes the reserve with a credit to taxable income.

What are the usual terms of the letter of offer?

The letter of offer specifies the estimated amount of the incentive and also sets the date by which construction must begin and the date by which the facility must achieve commercial production. These dates are usually determined by the applicant at the time of submitting his application. The letter also specifies that the eligible assets must be acquired, installed and utilized not later than 24 months from the date the facility was brought into commercial production in the case of an expansion/modernization project, or 36 months in the case of a new facility or a new product expansion. The offer remains open for a period not exceeding 90 days.

Is the information provided to the department held in confidence?

All information is held in confidence until an offer is accepted. If the offer is accepted, the Minister reports to Parliament the name of the applicant, the location of the facility, the product or process involved, the estimated capital costs, the number of direct jobs to be created, the rate of offer, and the amount of the incentive. All other commercial information is held in confidence.

What are the normal conditions respecting development incentives?

The applicant should review the conditions outlined in the Regional Development Incentives Act and Regulations or the DREE Act, before submitting an application. A few of the more important ones are:

- Applications for incentives must be received before any contractual commitments are made for buildings, machinery or equipment.
- The applicant must cooperate with Canada Manpower Centres in his recruitment and training of manpower. He must undertake to employ as many residents of the region in which the facility is located as practicable.
- Pollution control systems must meet standards of appropriate regulatory bodies.
- The applicant must give Canadian manufacturers a reasonable opportunity to produce the machinery and equipment for the project.

Are there any special conditions respecting development incentives?

The letter of offer may stipulate special provisions resulting from the evaluation that has been made. Where such special provisions are included, they are normally designed to provide additional assurance of viability or enhance the expected net economic and social benefits.

What happens when the letter of offer is accepted?

If the offer is accepted within 90 days, construction must start within the time limits specified. However, if the offer is not accepted within 90 days, it automatically lapses. As the project proceeds, attention should be given to any possible problems – especially any involving changes of plans. Contact should be made with the incentives officer to comply with requirements respecting significant changes and to clarify any concerns which the applicant may have.

As the commercial production period approaches, the applicant should consult with the incentives officer concerning documentation required to facilitate the inspection of the plant. Early arrangements are well worthwhile to ensure early payment – as well as to avoid any conflict with the regulations.

On occasion, the letter of offer of a development incentive may include a reference to the applicant's eligibility for loan guarantee consideration if such support is required. Should the applicant anticipate any difficulty in confirming the availability of a suitable loan, it would be worthwhile to contact an incentives officer in order to discuss loan guarantee support.

C. Payment

When is the incentive normally paid?

The first payment, of up to 80 per cent of the approved total incentive, can be made after the plant has been in commercial production for 30 days and after an inspection has revealed that the project is operating in accordance with terms of the offer. The remainder of the approved incentive will be paid within 30 months after the start of commercial production of an expansion or modernization, or within 42 months for a new plant or new product expansion; but no sooner than 24 or 36 months respectively.

What procedures are followed at the time of incentive payment?

The initial payment of an incentive is contingent upon the verification made by an incentives officer of the department through a physical inspection of the facility and a review of the firm's financial and other records. A similar verification is made prior to the final payment being made.

Are there any provisions for interim payment?

Yes. Interim payments are permitted in order to reduce financial strains on an entrepreneur who must install assets over a period of time following commencement of commercial production. However, payments must exceed 25 per cent of the initial payment.

Are there any provisions for capital cost and job overruns?

Yes, there is an allowance for overruns of up to 25 per cent of the originally authorized capital cost and new jobs (or authorized new wages and salaries). Some higher amounts may be authorized provided that special authorization is sought before excess costs are incurred.

May the applicant make significant changes to the project after having accepted the letter of offer?

If a significant change – of ownership, management, financing, location, plant size or timing – is contemplated after the acceptance of the letter of offer, a formal request must be submitted to the department for reconsideration. The offer may then be amended or withdrawn. Under no circumstances will these changes be included in approved capital costs already committed.

How is the incentive paid if assets are leased?

Although the incentive is paid to the applicant, he must transfer the amount directly related to the eligible leased assets to the leasing company upon receipt of such funds.

D. Calculation

Case Data

Approved capital costs	\$100 000
Approved wage and salary bill–year 2	70 000
–year 3	93 000
Estimated working capital at full capacity	85 000
Incentive formula – Atlantic – 25% ACC + 30% W & S	
– Other – 25% ACC + 15% W & S	
Actual number of jobs in year 3, tabulated on basis of man-days divided by number of days plant operated	10 jobs

Incentive Calculation

Atlantic Region

$$25\% \times \$100\,000 \text{ ACC} = \$\ 25\,000$$

30% × salary & wage bill

$$\frac{.3\ (\$70\,000+93\,000)}{2} = 24\,450$$

$$\$\ 49\,450$$

Other Region

$$25\% \times \$100\,000 = \$\ 25\,000$$

$$\frac{.15\ (\$70\,000+93\,000)}{2} = 12\,255$$

$$\$\ 37\,225$$

Cross-check to ensure that incentive is within the maxima established by legislation and guidelines.

1. One half of capital employed .5 ($100 000+85 000)	=	$ 92 500
2. 25% of $100 000 ACC	=	$ 25 000
$5 000×10 jobs	=	50 000
		$ 75 000
3. $30 000 per job $30 000×10 jobs	=	$300 000
4. 80% of $100 000 ACC	=	$ 80 000

Since the incentive does not exceed any of the four ceilings, the Atlantic offer is $49 450 and the non-Atlantic offer is $37 225.

Loan guarantees

Why was the loan guarantee program included in the RDIA program?

The loan guarantee program was included in the RDIA program in order to help entrepreneurs obtain adequate term debt financing for projects located within the designated regions.

What are some of the significant features of a loan guarantee from the point of view of a lender?

A loan guarantee ensures the lender of repayment of up to 90 per cent of the original amount of any loan. It is not a guarantee of prompt payment but a guarantee against loss. The percentage of a loan to be guaranteed and the type of guarantee extended are matters for negotiation by the lender, the applicant and the department.

What are the basic types of loan guarantee?

There are two types of loan guarantee agreements used by the department. Each type guarantees the repayment of a certain pre-negotiated percentage of the loan but differs in its manner of application. The two types of guarantee are:

1. Shared Risk:
   Under a shared risk guarantee the lender is protected for a specified percentage (up to 90 per cent) of any loss sustained on a loan after liquidation of all security.
2. Incremental:
   Under this type of guarantee, the department and the lender do not necessarily share all losses. The department will pay 100 per cent of any loss sustained up to a pre-negotiated maximum dollar amount. These maximum amounts are subject to the following ceilings:
   - 33⅓ per cent of the loan balance where the term is five years or less.
   - 25 per cent of the loan balance where the term is more than five years.

Any losses beyond the guaranteed portion are absorbed 100 per cent by the lender.

Are there any legislative limitations regarding repayment terms of guaranteed loans?

No. Terms are a matter for mutual agreement between the applicant, the lender and the department.

Can total financing of a project consist of a loan guarantee and grants from government agencies?

No. Loan guarantees are not intended to cover the entire cost of the project. They are provided to help the applicant secure the debt financing he requires from private lenders on normal terms and conditions to finance the project over and above what he provides through his own equity, unguaranteed loans and grants from government agencies.

Who may qualify for a loan guarantee?

Manufacturing or processing firms which could be, are, or have been eligible for a development incentive are eligible provided their project is not fully established. In some cases, a project may be ruled ineligible for a development incentive because the facility could be established, expanded or modernized without the assistance of a development incentive. Such projects remain eligible for loan guarantee support. Firms planning certain new commercial facilities may also qualify.

Does the rule concerning prior commitments apply for loan guarantees?

Manufacturing or processing projects that have been ruled ineligible for development incentive support due to a prior commitment, are also ineligible for loan guarantee assistance. However, for commercial facilities a prior commitment in the development stage of the project would not prevent the department from offering a loan guarantee.

What is the maximum guarantee?

By regulation, the guarantee cannot exceed 90 per cent of the total amount of the advances made by the lender. The Act precludes a loan guarantee if the loan exceeds 80 per cent of the estimated total capital costs, after deducting the DREE development incentive or assistance from other government agencies.

Is any lender acceptable to the department?

Any lending institution which is active in the Canadian financial community and has a demonstrated capacity to service the loan would be acceptable. Exceptions are lenders who are directly related to the applicant, and government bodies or agencies. Guarantees are made to specific lenders regarding a specific loan. The guarantee is not transferable or negotiable without prior approval from DREE.

Who is responsible for selecting the lender?

It is the applicant's responsibility to find an appropriate lender, although guidance may be approved by the relevant DREE office in each province.

Are there any fees attached to a guarantee?

Lenders are required to pay the department a fee of one per cent per annum calculated on the declining monthly balance of the portion of the loan which is guaranteed.

Hints for applicants

At the time of applying for regional development incentive inducements, the applicant should, if possible, meet with a provincially located DREE incentives officer in the province where the project will be located. This will avoid delays and clarify any points on eligibility and type of information that should be submitted with the application.

Each application is assigned to an officer, who will be responsible for that case until the evaluation is completed. His task is to ensure that all necessary information is obtained and analysed, and that there is a liaison with other government departments as may be required. Once all pertinent information is submitted, the application is promptly reviewed. Each evaluation decision results in a letter of offer or rejection.

At any time during the progress of the project, the applicant may contact his incentives officer for assistance and advice. This can save problems later. As the time of commercial production nears, the applicant should consult his incentives officer to ensure that the latter schedules the time for inspection well in advance.

Glossary

The terms outlined here are explanatory only and are not meant to be legal definitions.

Approved Capital Costs (ACC)

Means the capital costs of assets approved by the Minister as forming the whole or part of a facility or commercial facility, but does not include land and a few other types of assets which are described in article 2(1) of the Regulations.

Capital Employed

Capital to be employed in the operation means, in relation to the establishment or expansion of a facility, the aggregate of:

(i) the approved capital costs;
(ii) the value, as accepted by the Minister, of the fixed assets that are to be employed in the operation and that are not included in the approved capital costs; and
(iii) such amount in respect of the working capital required for the purposes of the operation at full capacity, as is approved by the Minister.

Commercial Production

The Minister may determine that a new expanded or modernized facility has been brought into commercial production when the facility has been utilized in the continuous production of marketable goods in commercial quantities for a period of not less than 30 days. In addition, that more than 50 per cent of the eligible assets, as forecast for the purposes of the authorization of the development incentive, are being and will continue to be used in the manufacturing or processing of those goods.

Control Period

This term refers to the general period within which specific requirements of the Act and Regulations must be met. In general, the control period is 24 months after the facility is brought into commercial production, in the case of a facility in respect of which a development incentive is based only on the approved capital costs, or 36 months in the case of a facility in respect of which a development incentive is based in part on the number of jobs created in the operation.

In the case of an eligible mobile operation, the control period is extended to 60 months. For leased assets on which a grant is paid, the control period is the economic life of the project.

Direct Jobs — Total of Eligible and Ineligible Direct Jobs

Direct jobs include only those involving employment that relates to the manufacturing or processing of products for the production of which the facility is established or expanded. The total number of direct jobs is the sum of eligible and ineligible jobs created directly in the operation.

a) Eligible Direct Jobs
   For a development incentive which is based in part on the number of jobs created directly in the operation, the department establishes an estimate of the number of eligible jobs to be created, on the basis of information supplied by the applicant. This number will be declared in the offer, and is the departmental estimate of the number of jobs on which payment will be based, whether as a percentage of the wages and salaries relating to those jobs, or as an amount per job.
b) Ineligible Direct Jobs
   These are the direct jobs which do not enter into the specific calculation of the incentive.

Equity

Equity means—

(i) the aggregate of:
   a) the share capital;
   b) the earned surplus;
   c) contributed surplus;
   d) other surplus or deficit accounts;
   e) shareholders' loans that are subordinated to all other liabilities; and
   f) the proprietor's or partners' capital accounts,

(ii) less such accounts that, in the opinion of the Minister, unreasonably inflate the net worth of the applicant.

Modernization

A project involving capital expenditures for the modernization of an existing facility, without significantly increasing its capacity.

New Facility

To qualify as a new facility, the proposed operation must use independent services and plant management separate from any existing facility. It must be a self-supporting operation, capable of existence independent of any existing facility.

New Product Expansion

The determination of a new product expansion is related to the following key points:

a) the product is one that is significantly different from any product that on the date of application is, or within the three years immediately preceding that date was, being manufactured or processed in the operation of which the facility constitutes the necessary components; and
b) the product cannot be economically manufactured or processed in that operation without the acquisition of additional assets.

Volume Expansion

An expansion of an existing facility to produce more products which are the same or similar to those previously produced in the facility.