BUDGET 2016: LABOUR-SPONSORED VENTURE CAPITAL CORPORATIONS TAX CREDIT RE-INTRODUCED

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Budget 2016 confirmed the Government's intention to re-establish the federal tax credit for investments in certain "labour-sponsored venture capital corporations" ("**LSVCCs**").

Background

LSVCCs have been fixtures on the Canadian investment fund landscape for over 30 years. LSVCCs were originally conceived of as domestically-focused investment funds, guided by sponsoring labour organizations that would be drawn to opportunities that created local jobs.

The Québec provincial government created the first LSVCC following the economic recession of the early 1980s. In 1983, the Fonds de solidarité des travailleurs de Québec (the "**Solidarity Fund**") was established by the Québec government as a mutual fund sponsored by the Fédération des travailleurs et travailleuses du Québec. Initially, Québec taxpayers that invested in the Solidarity Fund were entitled to claim a 35% provincial tax credit on a maximum share investment of $3,500 per year.

In 1985, the federal government introduced a federal tax credit for individuals who invested in "prescribed" LSVCCs. New regulations to the *Income Tax Act* (the "**Tax Act**") were introduced that set out the circumstances under which a corporation established or registered under provincial LSVCC legislation would be a "prescribed" LSVCC. The establishment of the federal LSVCC tax credit motivated provinces other than Québec to establish LSVCC legislation. In 1988, the federal government ultimately permitted the formation of federally registered LSVCCs that were "prescribed" for the purposes of the Tax Act.

In recent years, both the federal government and the governments of certain provinces have sought to eliminate the tax credits previously granted to investors in LSVCCs. The Province of Ontario phased out its provincial LSVCC tax credit in 2011. In Budget 2013, the federal Government announced that it would gradually reduce the federal LSVCC tax credit, and that no federal tax credits would be granted in respect of investments in LSVCCs made after 2016. Budget 2013 also proposed to end new federal registrations of LSVCCs, as well as the eligibility of taxpayers to claim tax credits in respect of investments in LSVCCs that were registered or established under provincial legislation after March 20, 2013.

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Budget 2016 Proposals

Budget 2016 proposes to once again permit individual taxpayers to claim a 15% federal tax credit in respect of the "net cost" of an "approved share" of an LSVCC.

The "net cost" to an individual of an approved share is defined as the amount of consideration paid by an individual (or a "qualifying trust" for an individual, such as the individual's RRSP or TSFA) to acquire or subscribe for the share *minus* the amount of any assistance provided or to be provided by any government, municipality or public authority in respect of, or for the acquisition of, the share.

An "approved share" is defined as a share of the capital stock of a "prescribed" LSVCC, but does not include (a) a share issued by a federally registered LSVCC where the venture capital business of the LSVCC was discontinued before the share was issued, and (b) a share issued by a "prescribed" LSVCC (that is not federally registered) if, at the time the share was issued, no province under the laws of which the corporation is registered or established provides assistance in respect to the acquisition of the share (e.g., a provincial tax credit).

The circumstances under which an LSVCC qualifies as a "prescribed" LSVCC are set out in Part LXVII of the *Income Tax Regulations* (the "**Regulations**"). Regulations 6701 and 6701.1 currently provide that corporations registered or established under the provincial statutes listed in Regulation 6701 will be "prescribed" LSVCCs so long as the corporation did not apply for registration after March 20, 2013. (The list of statutes currently contained in Regulation 6701 can be accessed through the following link.)

Budget 2016 proposes to amend the Tax Act and the Regulations to provide that a 15% federal tax credit, up to a maximum annual credit of $750, may be claimed in respect of the acquisition cost of shares of most prescribed LSVCCs, regardless of when they become registered. One notable exception is that investments in LSVCCs that are prescribed LSVCCs solely by virtue of having been registered federally will not be eligible for the federal tax credit. According to the Government, "while significant funding to small and medium-sized businesses has been provided in a number of provinces through provincial LSVCC programs, the national LSVCC program has not had a similar impact". On this basis, the Government has proposed that the federal tax credit for investments in solely federally registered LSVCCs will continue to be phased out (5% for investments in 2016 and 0% thereafter), and the prohibition on new federal LSVCC registrations will remain.

The Government has indicated that for provinces that have not enacted LSVCC legislation, the Government will be open to amending the Regulations to provide that corporations established or registered under new statutes will be prescribed LSVCCs, provided the new provincial statute "is patterned on currently prescribed provincial legislation". In this regard, the Government has indicated that any new provincial legislation will need to:

- provide a provincial tax credit of at least 15% of an individual's net cost of shares purchased in an LSVCC;
- require that the LSVCC be sponsored by an eligible labour body; and
- mandate that the LSVCC invest and maintain a minimum of 60% of its shareholder equity in eligible investments (which will generally need to be comprised of certain defined investments in small and medium-sized enterprises).

It is interesting to note that the Budget does not appear to require provincial LSVCC statutes that are currently listed in Regulation 6701 to provide a minimum level of provincial tax credits (so long as some level of credit or other assistance is provided to satisfy the current definition of an "approved share"). This stands in stark contrast to the qualifying requirements that will be imposed on newly enacted statutes in provinces that have not historically facilitated the formation and registration of LSVCCs.

Budget 2016 estimates that the fiscal cost of reintroducing the federal LSVCC tax credit will amount to $300 million over the next 3 years. Thus, the Government is implicitly projecting that more than $2 billion will be invested in LSVCC shares over that period.

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A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.