

Eligible Small Business and Business Corporations

Policy Statement
Small Business Venture Capital Act (SBVCA)
s. 10 of the Act;
s. 11 of the Regulation

INTRODUCTION

This policy statement is intended to help investors and businesses seeking investment to determine whether or not a particular business is eligible for the purposes of the Small Business Venture Capital Act (the “Act”).

Venture capital corporations (“VCCs”) registered under Part 1 of the Act must invest in an “eligible small business”. A company seeking registration as an eligible business corporation (“EBC”) under Part 2 of the Act must also meet these requirements and have equity capital of at least \$25,000.

To qualify as an eligible small business (“ESB”), a business must meet the following four basic requirements:

1. A business must show upon application for registration that it is either: incorporated in B.C.; incorporated extra-provincially in B.C.; or incorporated federally.
2. The business, together with its corporate “affiliates” must have no more than 100 employees at the time of an initial investment by a VCC or EBC investors, as calculated using the formula set out in part 1 of Appendix A to this policy statement. Note that the business may receive additional investment capital from a VCC or EBC investors if its employment level is beyond 100.
3. The business must pay at least 75% of its wages and salaries to B.C. employees, as calculated using the formula set out in Appendix A. Note that this percentage may be reduced to 50% if the business is engaged in the export of goods (or services that are directly related to the export of goods) to customers located inside or outside B.C.
4. The business must be “substantially engaged” in one or more of the prescribed business activities outlined in section 11(1) of the Small Business Venture Capital Regulation (the “Regulation”).

The fourth requirement concerning prescribed business activities allows the Province to target the investment capital to business sectors that diversify the B.C. economy.

The remainder of this policy statement discusses how to determine whether or not a particular business is “substantially engaged” in the eligible business activities prescribed under section 11(1) of the Regulation.

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THE DETERMINATION PROCESS

The process for determining whether or not a business is substantially engaged in the prescribed business activities involves answering the following four questions:

1. Do any of the business's activities fit within one or more of the general categories of prescribed activities set out in sections 11(1)(a), (b), (c), (e), (f), (g) and (h) of the Regulation?
2. If the business is located outside the Metro Vancouver Regional District ("MVRD") or Capital Regional District ("CRD"), do any of its activities fit within sections 11(1)(a), (b), (c), (e), (f), (g) and (h), or 11(2)(e) "non-traditional agriculture", or 11(2)(f)(iii) "retail and commercial services", **AND** contributes to Community Diversification in the regional district where it has its place of business.
3. Are any of the business's activities specifically identified as not being prescribed activities in section 11(2) of the Regulation?
4. Is the business "substantially engaged" in any of the business activities prescribed under section 11(1) of the Regulation?

The business's activities must be examined and divided into those that are prescribed activities and those that are not, and the prescribed activities must represent the majority of the business's total activity as calculated in section 11(3) of the Regulation.

GENERAL CATEGORIES OF PERSCRIBED ACTIVITIES

1. Manufacturing and Processing - Regulation 11(1)(a)

This category covers business activities involving the manufacturing and processing of goods produced in B.C. and the services that are directly associated with the exporting of the goods to customers located inside or outside of the Province.

For clarification, manufacturing and processing are considered to be activities that consist of producing, or putting goods or materials into marketable form by employees of the small business, from raw, unfinished or prepared goods or materials, by changing the form or content of those goods or materials into a finished product.

Goods not wholly produced in B.C. will be deemed to be goods produced in B.C. if the Administrator of the Act is satisfied that substantial value has been added by the business's operations in the Province.

Section 11(1)(a) of the Act allows certain export related service costs directly associated with the exporting of goods to customers located outside of the Province to be considered permitted "activity expenses" as outlined in section 11(3) of the Regulation. The permitted "activity expenses" are applicable to finished goods only and may include:

- Shipping and forwarding expenses;
- Warehousing and distribution expenses;
- Installation and maintenance expenses to install equipment in a non-B.C. location; and
- Inspection and permitting expenses for installation of equipment in a non-B.C. location.

2. Tourism - Regulation 11(1)(b)

This category covers business activities that support the growth of tourism in the Province. To qualify under this activity, a business must demonstrate that it does or will earn 50% or more of its gross revenues from tourists. A "tourist" is defined as an individual who resides more than 40 kilometres from the destination resort or attraction.

1. The development and operation of a destination tourist resort that means:
 - a. a resort where there are during at least 120 consecutive days a year, operating concurrently, an accommodation facility, and a facility providing recreational activity. Examples of a destination resort include a fishing lodge, ski resort lodge or a guest ranch; and
 - b. the resort is located outside of the MVRD, the CRD and the Municipality of Whistler. These areas are excluded because they already have a significant resort base and inclusion would not result in economic diversification.
2. The development and operation of a tourist attraction that means:

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- i. a facility that is intended to attract and provide recreation to tourists on a fee for service basis;
 - ii. does not include the operation of:
 - motion picture or drive in theatre;
 - video or electronic game parlour;
 - bowling alley, ice rink, health club, racquet club or playing field;
 - night club; or
 - a facility that is restricted to members; and
 - iii. the tourist attraction is located outside of the MVRD, the CRD and, the Municipality of Whistler.
3. The development and operation of a tourist service means:
- a. a charter service that is not licensed as a common carrier for scheduled passenger services and provides for tourists the service of hiring of vehicles, boats or aircraft; or,
 - b. a tour operator that provides, for one price, vacation packages consisting of accommodation and recreation with the province of B.C.

3. Research and Development of Proprietary Technology – Regulation 11(1)(c)

This category covers business activities involving the research and development of proprietary technologies produced in B.C., including services directly associated with exporting the technologies that are provided inside or outside the Province.

Some industry sectors included under this activity are:

- Life sciences;
- Information & communication technology; and
- Environmental technology.

A proprietary or “ownership” right to the technology is critical for qualification under this category because it enables the business to commercially exploit the technology and direct its research and development.

Section 11(1)(c) of the Act allows certain service related expenses that are directly associated with the exporting of the proprietary technologies developed in B.C. to customers located outside of the Province to be considered permitted “activity expenses” as outlined in section 11(3) of the Regulation.

Permitted “activity expenses” may include:

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- Operating and demonstrating a prototype;
- Attendance at a trade show to demonstrate the technology;
- Developing a specifications monograph or other technical materials; and
- Demonstrating the technology to equipment manufacturers.

4. Community Diversification – Regulation 11(1)(d)

A business located outside the MVRD and the CRD may be engaged in a prescribed activity if the business activity promotes economic community diversification within the region.

In assessing community diversification, consideration will be given to:

1. The impact of the business activity on existing businesses in the region; and
2. How the business activity supports or will support existing businesses in the community.

It should be noted that a business that involves retail and commercial services located outside the MVRD and CRD may be an eligible small business, if it can demonstrate that the activity is unique and supports the economic diversification and development of a community.

5. Development of Interactive Digital Media Product – Regulation 11(1)(e)

This category covers activities involved with the development of interactive digital media product intended for commercial exploitation in B.C. Regulation 11 (1) (e) prescribes the following eligibility criteria for the product to be developed:

1. Educates, informs or entertains the user;
2. Presents information using at least two of the mediums of text, sound or visual images;
3. Will not be developed for internal use to promote the qualifying business, including its products or services;
4. Will not be used mainly for interpersonal communication; and
5. Will not be a product for which public financial support would, in the opinion of the program Administrator, be contrary to public policy.

A company may still qualify under this category if it is developing a product under contract for a third-party client. However, the product must be developed in B.C. and the business developing the product under contract must still meet the remaining eligibility criteria.

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An activity will not be considered eligible if it involves the development of a product that is “contrary to public policy” in the opinion of the program Administrator. Examples of content that would be considered “contrary to public policy” include product that:

1. Incites hatred against an identifiable group, or
2. Has a dominant characteristic which is the undue exploitation of
 - Sex,
 - Violence involving one or more crime,
 - Horror, or
 - Cruelty.

6. Development of Clean Technologies – Regulation 11(1)(f)

A business substantially engaged in the research and development, and/or manufacturing and processing of clean technologies for commercial exploitation may qualify if the technologies do one of the following:

- Increase energy efficiency and conservation;
- Reduce greenhouse gas emissions, or
- Reduce the environmental impact of energy production, generation, storage, transmission, delivery, provision or conversion

Research and development are activities where the business has a proprietary or ‘ownership’ right to the clean technology that enables the business to commercially exploit the technology and direct its research and development.

7. Advanced Commercialization – Regulation 11(1)(g)

A business located outside the MVRD and the CRD that is substantially engaged in a business activity that involves the use of advanced digital technology tools to assist other businesses with scale-up activities.

This category does not require the registering company to be developing or manufacturing the technologies that are being utilized, instead the focus is on how a business can use digital technologies in innovative ways that represent a value-add to other businesses scaling-up

This qualifying category excludes businesses providing traditional marketing, public relations, branding, direct sales and other similar services. Advanced commercialization does not include:

- Direct sales;
- Traditional advertising services such as print, radio, television, mail, email, telephone and outdoor advertising;
- Multi-level marketing, pyramid selling, network marketing or other forms of referral marketing;

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- Public relations;
- Business strategy, advisory or consulting services; or
- The operation of a call centre.

Advanced commercialization involves the use of digital technology tools to assist other businesses with acquiring customers or retaining customers through technologies such as:

1. Data analytics, including analysing internet searching, viewing and purchasing habits;
2. Optimizing web searches by increasing the prominence of a website or web page;
3. Increasing the volume of internet traffic to a website;
4. Financially rewarding an internet host or digital content provider based on the number of visits to a website or the volume of sales from a website;
5. Attracting new customers and retain existing customers through on-line referral and reward programs; and
6. Informing or educating potential customers about products or services based on the customers' internet search habits; and
7. Posting product advertisements to websites based on viewers' internet searches, purchasing habits, or viewing habits.

8. Scale-up Activities– Regulation 11(1)(h)

The qualifying activity of scale-up allows qualifying EBCs and ESBs to raise tax credit supported investment for customer acquisition and other marketing activities.

Scale-up activities are those related to the expansion of an EBC's or ESB's business and include the acquisition of customers, building the business's brand, and developing sales brochures, website content, and other marketing collateral to promote the business's products and services.

An EBC must be, or have been, substantially engaged in a prescribed business activity referred to in the Regulation (11)(1)(a-g) for at least two years after first raising tax credit supported funds under the program.

An ESB must be, or have been, substantially engaged in a prescribed business activity referred to in the Regulation (11)(1)(a-g) for at least two years after a VCC has made an eligible investment in the ESB.

ACTIVITIES THAT ARE NOT PRESCRIBED ACTIVITIES

The following business activities are specifically identified in section 11(2) of the Regulations as not being prescribed eligible activities. They represent business activities that are already very well developed in B.C.

- Primary resource exploration or extraction;
- Financial services, such as providing loans, selling insurance or real estate, or trading in securities;
- Property management or the rental or leasing of land or improvements;
- The development of or improvement of land;
- Traditional agricultural activities;
- Retail and commercial services other than services that are:
 - Involved in exporting manufactured or processed goods,
 - Support an R&D company showcasing its technology outside the Province,
 - Provided by a business which derives more than 50% of its revenues from the provision of services to tourists, or
 - Provided by a regional business and promote community diversification within the region.
- Restaurant or food services; and
- The sale or lease of tangible or intangible personal property for a person's personal consumption or use.

The Administrator may exercise their discretion to the extent required in reaching a conclusion that a business is substantially engaged in one or more of the prescribed business activities described above.

“Substantially Engaged” In

A business may be engaged in a number of activities. Some may be prescribed eligible activities and others may not. The business only needs to be substantially engaged, not completely engaged, in prescribed activities. See the example in Appendix B to this policy statement for a practical illustration of this concept.

A business is substantially engaged in prescribed business activities if:

1. More than 50% of the business’s total assets and expenses are applied to prescribed activities, as calculated using the formula in Appendix B, or (if qualified under the prescribed activity of Tourism) more than 50% of the business’s total revenues are generated from prescribed activities;
2. Not more than 20% of the business’s assets are located outside B.C.; and
3. The business has its “permanent establishment” (as determined under the federal *Income Tax Act*) in B.C. This means it must have a permanent place of business in B.C. staffed by senior management personnel who can direct the operations of the company and have the authority to bind it contractually.

APPENDIX A

Part 1 – Number of Employees Formula

The number of employees may be calculated using either of the following formulas:

Option A: Number of Employees = $\frac{\text{Total Hours}}{40 \times w}$

Where:

Total Hours = the total hours worked by all employees each of whom worked for at least 20 hours (counting all time worked by each employee whether for the small business, any of its affiliates or both) during any week of the calculation period,

and

w = the number of weeks in the calculation period; or

Option B: Number of Employees = $\frac{\text{Employee Costs} \times 52}{w}$ divided by \$45,000

Where:

Employee Costs = all amounts paid or payable by the small business to or on behalf of employees for work performed or services provided by them during the calculation period,

and

w = the number of weeks in the calculation period.

Note: If the small business has any corporate “affiliates” (as defined in the Act), the number of employees of the small business together with its affiliates, is the sum of the number of employees of the small business and each of its affiliates, calculated using the above formulas.

APPENDIX A (Continued)

Part 2 – Wages and Salaries Formula

$$\text{Percentage of wages and salaries} = \frac{\text{Wages (B.C.)}}{\text{Total Wages}} \times 100$$

Where:

Wages (B.C.) = the total remuneration paid, payable or to be paid in respect of the calculation period to employees of the corporation who regularly reported to work during the calculation period at operations located in British Columbia,

and

Total Wages = the total remuneration that was paid, payable or to be paid in respect of the calculation period to all employees of the corporation during the calculation period.

“calculation period” means

- (a) where, at the date of the calculation, a corporation has been in business for a period of less than 12 consecutive months, that entire period.
- (b) where, at the date of the calculation, a corporation has been in business for a period of 12 or more consecutive months, the 52 weeks just ended at the date of the calculation

APPENDIX B

Substantially Engaged Calculations

Formula:
$$\frac{\text{Activity Assets} + \text{Activity Expenses}}{\text{Total Assets} + \text{Total Expenses}} > 0.5$$

Where:

- Activity Assets = the value of assets of the small business used in B.C. in the prescribed activity,
- Total Assets = the total value of all assets of the small business,
- Activity Expenses = the expenses of the small business incurred during the calculation period with respect to the portion of the prescribed business activity carried on in B.C.,
and
- Total Expenses = the total of all expenses of the small business incurred during the calculation period with respect to all operations of the small business.

Note: The value of assets and expenses must be determined in accordance with generally accepted accounting principles.

Example:

XYZ Co. is a family business that grows and harvests specialty timber from its private lands (40% of assets/ expenses), mills and processes the lumber into furniture (51% of assets/expenses) and has a small factory direct retail outlet (9% of assets/expenses). Even though the business is engaged in “manufacturing and processing” which is a prescribed activity, the primary resource extraction and retailing portions of its operations are specifically not prescribed activities. Therefore, the harvesting and retailing assets and expenses could not be included in the numerator of the above formula. Even so, the business would still be “substantially engaged” in prescribed business activities because 51% of its assets and expenses are applied to manufacturing and processing activities.