Development of Federal Tax Credits to Support Community Investment in Canada

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Strengthening Canada's Communities

Des communautés plus fortes au Canada

Table of Contents

TABLE OF CONTENTS 2

EXECUTIVE SUMMARY 3

Tax Credit Recommendation 3

INTRODUCTION 6

National Policy Framework 6
Methodology 6
About this Document 7

THE CASE FOR CED IN CANADA 8

INCOME INEQUALITY 8
COMMUNITY INEQUALITY 9
INDICATOR 10
A CED APPROACH TO DECLINING COMMUNITIES 10

THE CASE FOR COMMUNITY INVESTMENT 13

Community Investment Potential 14

REVIEW OF EXISTING TAX CREDIT MODELS 16

1. EQUITY TAX CREDIT MODELS 16
Nova Scotia Community Economic Development Investment Funds 16
Manitoba Grow Bonds 18
Manitoba Community Enterprise Development Tax Credit 18
United States New Markets Tax Credits 19
United Kingdom Community Investment Tax Credit 21
2. CHARITABLE TAX CREDIT MODELS 23
New Hampshire Community Development Finance Authority 23
Crocus Fund 24
Proposed Alberta CED Investment Fund Tax Credit 24

LESSONS LEARNED: BALANCING COMMUNITY AND INVESTOR NEEDS 26

LOCAL RESPONSIVENESS 26
INVESTOR PROTECTION AND RISK PROFILES 27
ECONOMIES OF SCALE 28
SUMMARY 29

RECOMMENDED TAX CREDIT MODELS 30

GOVERNMENT PAYBACK MODELS 32
Nova Scotia 32
Alberta 34
INVESTOR PAYBACK MODEL 35

Executive Summary

This paper presents the Canadian CED Network's (CCEDNet) policy proposal for using tax credits and other mechanisms to increase the amount of financial capital available for CED in Canada. The recommendations in this paper grew out of CCEDNet's national Policy Forum, held in 2001, where Community Economic Development (CED) practitioners from across Canada came together to build a national policy framework.

Since that time, CCEDNet has been building on the work of the Policy Forum and actively working to document the evidence base for the Policy Framework's recommendations regarding human, social and financial capital. This paper presents the results of CCEDNet's research regarding tax credit and community investment models, and a cost-benefit analysis showing potential benefits to government from the proposed equity tax credit.

Our conclusions in this document complement and support our other policy efforts regarding improving support for human capital development, strengthening the supports available to CED organizations, and changing how these supports are delivered. Recommendations made in this document are to be taken in tandem with complementary and supporting recommendations in CCEDNet's other papers:

- *Human Capital Development in Canada: Closing the Gaps* (2003)
- *CED Funding and Delivery in Canada* (2003).

In particular, the tax credits recommended in this document must be implemented in concert with supporting funding for CED organizations, as recommended in CCEDNet's paper *CED Funding and Delivery in Canada (2003)*.

Tax Credit Recommendation

CCEDNet is recommending three main initiatives intended to encourage community investment by the private sector – that is, investment into community enterprises and/or investment funds by financial institutions, corporations, and individuals.

- First, CCEDNet recommends the development of a national seed fund to capitalize community investment funds in each Province. The rollout of this fund should be incremental and flexible, as CED organizations organize to identify local investment product needs and community needs. The federal government will see a substantial financial return on investment through increased economic activity, tax revenues and reduced social expenditures.
- Second, CCEDNet recommends a 30% tax credit and guarantee of capital attached to financial instruments (shares, bonds, etc.) to be defined by community investment funds in each province or territory. The specific financial instruments will vary with each province and territory, depending on the investment climate, securities regulations, and community needs. The tax credit should be available to

both retail and institutional investors, and not preclude RRSP eligibility for eligible community investment funds.

- Finally, charitable tax credits should also be extended to CED organizations focused on not-for profit activities. The model for this type of tax credit implementation would be very similar to that employed by the New Hampshire Community Development Finance Authority and Crocus Fund, and proposed by the Alberta CED Investment Fund Tax Credit, as described in this document.

By allowing both for-profit community investment funds and non-profit community development organizations to employ related but different tax credits, the government will ensure that the maximum amount of benefits are achieved by this policy. The intent is to provide vehicles through which equity can be raised for investment in social enterprises. In some cases, particularly with for-profit ventures, it will be most appropriate to use an equity tax credit. In other cases, a charitable tax credit will better enable community development organizations to raise the necessary funds for non-profit enterprises without having to deliver a return on investment to shareholders.

Implementation Strategy

The tax credits should be launched through select community economic development financial institutions (CDFI) or qualified organizations across the country. There are many institutions already well qualified to participate, including community development organizations, co-operatives, credit unions, labour funds, and ethical funds, to name a few. The Government of Canada should recognize, in each province, one or several organizations that could:

- Issue bonds or shares (or other appropriate financial instruments) through a Community Investment Fund and invest these funds in social economy enterprises using an equity tax credit on which investors will expect at least a marginal return on their investment, in addition to the credit; or

- Accept donations using a charitable tax credit, which will then be invested in non-profit community economic development organizations and ventures. In this case, investors would not expect a return on investment other than the tax credit and would not retain any equity in the Community Investment Fund (their funds are donated).

CDFIs should be focused on filling a gap in financing community-based enterprises (both non-profit and for-profit) in their region. These organizations should demonstrate proven success in community financing. Both retail and institutional investors should be able to invest in the community development funds

Canada-wide organisations such as CCEDNet could coordinate the implementation stage with regional partners that will take leadership roles in their respective provinces. Regional partners will be responsible for bringing together networks (much like what exists in Quebec) of loan funds, ethical equity funds, labour-sponsored funds, credit

unions, co-operatives and other relevant parties. These regional networks will identify:

- Whether an equity tax credit, charitable tax credit or both is most appropriate for their circumstances;
- What CDFI should take a leadership role in managing the Fund and marketing financial instruments to investors;
- What community organizations should be involved in disseminating investment raised;
- What type of financial instrument best fills the financing gap in their province (bonds, shares, etc.);
- What, if any, provincial legislative and regulatory requirements need to be amended;

This developmental phase should be funded through the community economic development supports referred to in CCEDNet's partner paper to this document: CED Funding and Delivery in Canada.

By the end of the first year, regional community development financial institutions should be ready to invest equity in the community enterprises and market shares, bonds or other appropriate financial instruments with the tax credit.

Return on Investment

A national cost-benefit model is still being developed by CCEDNet. Equity tax credits in Nova Scotia similar to those proposed in this document resulted in a cumulative net benefit to the provincial government of $180 million dollars after five years.

A proposed $5 million charitable tax credit expenditure in Alberta is predicted to product present value net benefits of $10,588,650.

Introduction

This paper presents the Canadian CED Network's (CCEDNet) policy proposal for using tax credits and other mechanisms to increase the amount of financial capital available for CED in Canada. The recommendations in this paper grew out of CCEDNet's national Policy Forum, held in 2001, where Community Economic Development (CED) practitioners from across Canada came together to build a national policy framework.

Since that time, CCEDNet has been building on the work of the Policy Forum and actively working to document the evidence base for the Policy Framework's recommendations regarding human, social and financial capital. This paper presents the results of CCEDNet's research regarding the development of financial capital for community investment in Canada. Our conclusions here complement and support our other policy efforts regarding improving support for human capital development, strengthening the supports available to CED organizations, and changing how these supports are delivered.

National Policy Framework

The recommendations contained in this document had their impetus in CCEDNet's 2001 Policy Forum, where participants called for a "*targeted tax credit that will allow advantages to private sector contributors of financial capital to a community group for any of a full range of CED projects*."

The Forum also recommended further research that would define a more exact nature and structure for this tax credit. This paper presents the results of this research.

Methodology

The purpose of this study was to provide an evidence base documenting the need for increased financial capital to support CED in Canada, an overview of potential tax credit models, and recommendations regarding the "best fit" model for Canada.

Our approach was to:

- Conduct a literature review of existing work on tax credits, social investment and CED financing;
- Conduct informal interviews with representatives of social investment organizations, community development organizations, labour funds and other relevant stakeholders;
- Develop a recommendation for a tax credit model that would provide: 1) an attractive return on investment to potential investors, 2) capital for community investment with appropriate conditions and requirements, 3) measures for appropriate liquidity and security requirements, and 4) positive net benefit to government over time.

Limitations

As this study solely used secondary research, it is limited by the extent of information currently available on tax credit initiatives and CED in Canada. The paper is not an exhaustive review of literature to date, but rather a selective review of tax credit models most relevant to the Forum's recommendations and related research.

The recommendations put forward in this paper are to be taken in tandem with CCEDNet's accompanying papers:

- *Human Capital Development in Canada: Closing the Gaps* (2003)
- *CED Funding and Delivery in Canada* (2003).

About this Document

The results of our research and recommendations are presented as follows:

- *The Case for CED*: A brief analysis of the need to capital available to CED organizations in Canada.
- *The Case for Community Investment*: A brief definition and description of the current state of community investment in Canada;
- *Review of Tax Credit Models*: A summary of relevant tax credit models;
- *Lessons Learned*: Highlights of issues pertinent to effective tax credit policy in Canada;
- *Recommended Model*: CCEDNet's recommended tax credit model.

The Case for CED in Canada

Canada is regularly rated as one of the best places in world to live by organizations such as the OECD. We are a country with abundant natural resources, economic opportunity and prosperity. However, we are also a society where these benefits are often limited to certain sectors and geographic areas. In the last 15 years, inequality has grown in Canada, creating a widening gap that is ever-more difficult for marginalized groups to cross. Innovation and productivity have suffered.

Community economic development (CED) offers a unique solution for stopping this decline and creating vibrant, healthy communities. Across Canada, communities have benefited greatly from existing programs that support CED – jobs have been created, new businesses started and community wealth enhanced. However, CED organizations continue to struggle with a lack of resources – particularly financial resources for investment in community enterprises. Greater integration with the private sector through increased investment and partnership provides will greatly enhance the resources available for CED activities in Canada. This section briefly outlines the ability of CED to address the persistent problems with growing inequality in Canada and the need to provide greater financial capital to CED organizations.

Income Inequality

Across Canada, we are seeing some disturbing trends in persistently high unemployment numbers and growing wealth inequality.[1] A recent study by Statistics Canada clearly demonstrated wealth inequality significantly increased from 1984 through 1999 – the median wealth in the bottom three decides of the wealth distribution fell, but rose by 27% or more in the top three deciles.[2]

The following table, based on the Canadian Centre for Policy Alternative' analysis of Statistics Canada's data, illustrates the breadth of this disparity.

[1] Andrew Sharpe and Myles Zyblock. Macroeconomic Performance and Income Distribution in Canada. Working Paper, Human Resources Development Canada, Applied Research Branch. June 1997.
[2] Rene Morissette, Xuelin Zhang and Marie Drolet. The Evolution of Wealth Inequality in Canada, 1984-1999. Statistics Canada, Business and Labour Market Analysis. No. 187. February 22, 2002.

Table1— Rising wealth inequality in Canada

Rags and Riches: Wealth Inequality in Canada Canadian Centre for Policy Alternatives, 2002. [3]	
In 1999, wealth inequality was rising in Canada:	
Control of wealth	
Income category	**Percentage of wealth**
▪ Wealthiest 10% of families	▪ 53% of wealth
▪ Wealthiest 50% of families	▪ 94.4% of wealth
▪ Poorest 50% of families	▪ 5.6% of wealth
Average wealth*	
Income category	**Growth in average wealth, 1970-1999**
▪ Wealthiest 10% of families	▪ 122% increase
▪ Poorest 10% of families	▪ -28% decrease
Average assets	
Income category	**Average assets, 1999**
▪ Wealthiest 20% of families	▪ $262,186
▪ Poorest 20% of families	▪ $1,974.00
Average income	
Income category	**Average income, 1998**
▪ Wealthiest 20% of families	▪ $62.518.00
▪ Poorest 10% of families	▪ $18, 698.00

* adjusted for inflation

What does this wealth disparity mean? For poorer Canadians, if their current income disappeared, their financial assets would only keep the family going for five weeks. Poor people are least able to withstand any kind of financial crisis because they have so few assets. [4]

Community Inequality[5]

Growing inequality is echoed at the community level, where we see cycles of reinforced poverty and decline putting some communities farther and farther behind. These economically challenged communities (whether urban neighbourhoods, rural villages, regions or impoverished segments of local populations), instead of contributing what they might to the strength of the country, exacerbate national social and economic problems of unemployment, business failure, family stress, crime, deteriorated housing, and poor

[3] Steven Kerstetter. Rags and Riches: Wealth Inequality in Canada. Canadian Centre for Policy Alternatives. December 4, 2002.
[4] Ibid.
[5] Canadian CED Network. Investing in Canda's Communities: Proposal to Create a National Economic Development Financing Initiative. March 2002.

health, among other ills. Thus, even in times of prosperity, Canada experiences a dual economy of mainstream growth but with continuing, even expanding pockets of poverty.

The table below illustrates one provincial example of the contrast in socio-economic conditions between a selection of communities in BC, facing major economic challenges, and the average for their province.

Table 2 – Coastal BC – Inequality in Community Conditions

Health Area / ***Indicator***	**Bella Coola Valley**	**North Island**	**BC**
Percentage of 18 years old not graduating (2000)	73.6%	41.4%	25%
Percentage of 25-54 years old without graduation (2000)	29.3%	30.4%	22.6%
Percentage of 25-54 years old without post secondary education (2000)	53.1%	53.6%	46%
Teen pregnancy per 1000 (1999)	75.1	64	26.6
Infant Mortality per 1000 (1999)	15.6	10.1	4.9
Suicide/Homicide per 1000 (1999)	9.1	9.9	5.3

Source: BC Stats, Local Health Area Profiles, 2001.

Communities like those on the coast of BC and Newfoundland are experiencing child mortality rates three times the average for their Province. Other communities in urban settings, like the Downtown Eastside of Vancouver and the North End of Winnipeg, have unemployment, addiction and mortality rates many times the national average and the story is even worse in aboriginal communities across the country – the differences between aboriginal communities (both reserve and non-reserve) and the rest of the population are also stark. For example, in 2001, 53% of Inuit in the Canadian arctic were living in crowded housing, compared with 7% of all Canadians. 34% of Inuit in northern Canada and an astonishing 73% of Inuit in northern Quebec have experienced contaminated water.[6]

A CED Approach to Declining Communities

There is increasing evidence around the world that community inequality and decline is a major factor in overall prosperity, well being and productivity – that a nation's status is an aggregate of its communities. A recent World Bank report on social development and community investment suggests that "the development community now recognizes that it needs greater understanding of community institutions, network, norms, and values to enable people to capture the benefits of development and build their capacity to help themselves."

[6] Vivial O'Donnell and Heather Tait. Aboriginal People survey 2001 – Initial Findings: Well-Being of the Non-reserve Aboriginal Population. Statistics Canada. September 2003.

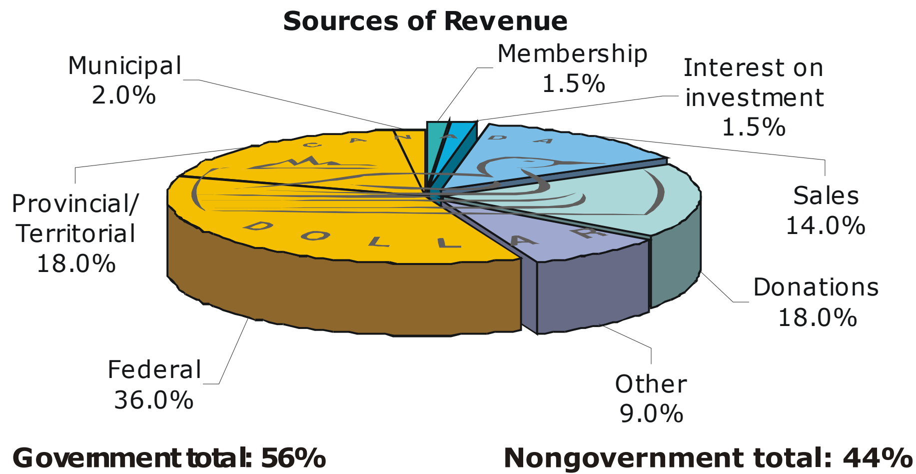
Communities and community investment are becoming central to our understanding of effective social and economic development in Canada, and around the world. Traditional public investment has not proven successful at decreasing community marginalization. Macroeconomic measures to enhance productivity and competitiveness have had little effect on the economics and status of lagging regions and disadvantaged populations.

At the same time, some communities have found a way to successfully combat decline and create vibrant, healthy communities. They have done so through a community economic development (CED) strategy — a multi-purpose social and economic strategy for systematic renewal, conceived and directed locally. By taking a CED approach to development, these communities are making Canada stronger as they transform themselves into attractive places to live and work that are full of opportunity.

Although no concise aggregate data on the impacts of all CED in Canada exists, numerous CED success stories are documented across the country, illustrating the how coordinated, integrated approaches that concurrently address human, social and financial capital development can succeed.[7] A 2002 evaluation of just one CED program, Community Futures (Western Canada) showed that as a result of receiving services provided by CFDCs, the businesses receiving support generated $1.4 billion in revenues from 1995 to 2001 and approximately 30,000 jobs. The return on investment to government is remarkable: from 1995 to 2001, CFDCs have received an average of $16.8 million in operating funding from Western Economic Diversification. Using this as a base, the revenues generated by a client in the first five years, which they attribute to the services of the CFDC, is estimated to be between $65 and $81 for every dollar in operating funding provided by WD to the CFDCs.[8]

Further, a 2003 CCEDNet survey of over 300 CED organizations shows CED to be a highly entrepreneurial sector, raising nearly $1 in investment for every $1 of government support, as illustrated in the following figure:

[7] Lilia Godfarb Initiatives. The Power of CED Throughout Canada: Thirteen Inspiring Stories. Canadian CED Network. March 2003.
[8] Ference Weiker and Company. Impact of Community Futures in Western Canada. 2002. www.communityfutures.ca/provincial/index.html



In the United States, a national census conducted by the National Congress for Community Economic Development estimated that the productivity of community development corporations has resulted in:

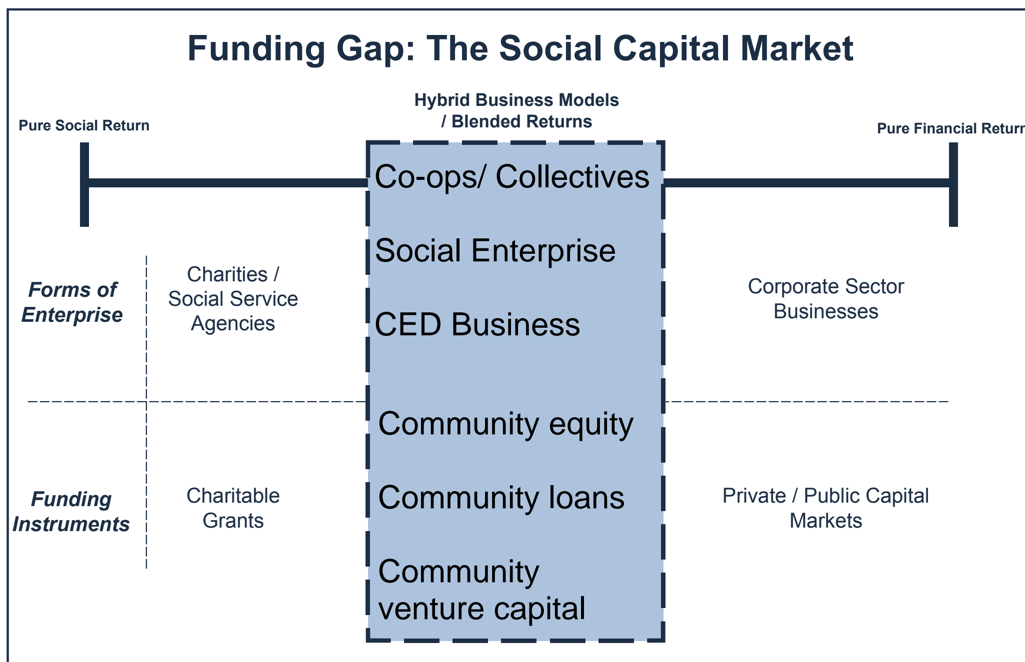
- 71 million square feet of commercial and industrial space developed
- $1.9 billion in loans outstanding (at the end of 1997) to 59,000 small and micro-businesses
- 247,000 private sector jobs created; and
- 550,000 units of affordable rental and ownership housing build or renovated, nearly 40% of which has been completed in the last four years."[9]

The case for CED is clear – what are needed now are appropriate and effective instruments to encourage community investment by local and institutional investors across the country.

[9] National Congress for Community Economic Development. Coming of Age: Trends and Achievements of Community-Based Development Organizations. 1998. www.ncced.org

The Case for Community Investment

Community enterprises in Canada are currently struggling to finance their activities. Community development corporations and social enterprises exist between two traditional silos: philanthropy and capital market equity - also between traditional private, not profit and public sector splits. Patient equity financing is often difficult if not impossible to obtain due to the hybrid nature of these ventures, which provide both financial and social returns. Typical private sector financing focuses primarily on financial returns, while non-profit financing focuses on social returns. This leaves a gap in financing for many community-based enterprises, as illustrated in the following figure:



Source: Social Capital Partners, 2003.

The financial products that are currently available (except for direct grants and member shares in cooperatives) are confined to loans that must be paid back within 3 to 10 years. This means that community economic development enterprises have almost no financial product that allows for the investment of permanent capital in the organization.

Researchers have also found persistent biases in the distribution of equity:

- There is a gender bias in equity distribution in that more men that women have access;

- Equity distribution is ethnocentric in that it is often not available to aboriginal businesses, even when they show strong growth potential;

- Equity concentrates in urban centres and large enterprises. [10]

As a result, the CED sector has typically relied on a patchwork of public funding and tried to morph programs to fit funding, both for the support of CED non-profit organizations and for-profit new ventures. This presents several problems that hinder the growth of new enterprises in disadvantaged communities:

- Government funding is short-term, and lacks the long-term, ownership focus of patient, equity capital;
- Governments often can not directly fund the development of for-profit enterprises;
- In cases where for-profit enterprise are funding through non-profit loan funds and other intermediaries, there is often a gap of technical expertise in developing successful private sector ventures;
- Local capital invested in banks and other institutions continues to flow out of communities instead being invested locally.

In Unites States, legislation such as the Community Reinvestment Act and Community Development Venture Capital Framework has promoted the creation of a more buoyant social capital market for community investment through targeted tax incentives and mandated corporate investment. However, in Canada, we have no broad framework of national legislation to encourage community investment activities. There are a number of provincial initiatives aimed at raising equity for certain business sectors, disadvantaged regions and small businesses, but to date a coordinated national program does not exist.

Community Investment Potential

In spite of structural limitations, there have been some interesting changes in equity markets that have direct implications for the community economic development sector. The social investment field is continuing to grow, raising capital across the country for ethically screened investments. The *Canadian Social Investment Review 2002* by the Social Investment Organization found that there are a total of $51.4 billion dollars in assets managed according to socially responsible guidelines. In addition, the combination of provincial tax credits and RRSP tax deductions are acting as incentives for growing investment in a number of Canadian labour funds with local business investment criteria due to good returns under most investment scenarios.[11] International financial markets are also showing that companies adhering to strict environmental standards in their global operations have individual value approximately $10.4 billion higher than those using less

[10] Brock Dickenson and Associates. Building Community Equity: The Practical Aspects of Tax Credits and Public Incentives and Mechanisms for Encouraging Private Investment in CED Initiatives. Canadian CED Network. September 2001
[11] Scotiabank. Labour Sponsored Investment Fund Evaluation. September 2003. www.scotiagroupplans.com

stringent standards.[12] That said, the community investment sector is currently lagging within the broader social investment aggregate – the SIO found a total of $69 million in community investment assets in 2002, a miniscule amount compared to the overall $51.4 billion in social investment assets. The SIO definition of community investment includes:

- Micro-enterprise lending: Community-based organizations providing capital for micro-entrepreneurs unable to obtain capital from conventional financial institutions.

- Community development venture capital: High-risk loans or equity placements in locally-based businesses meeting community or social needs.

- Non-profit lending: Lending to non-profit organizations pursuing a social mission that are unable to obtain capital from conventional financial institutions.

- Co-operative development: Funds making loans or equity placements in new co-operatives.

- Lending for social or affordable housing: Risk mortgages or construction loans for housing targeted at low-income markets.

- Economically-targeted investments: Community development investments made by pension funds or other institutions.

- Other forms of locally-based investment: Targeted to meet the needs of particular communities or groups.[13]

There appear to be three growing trends: 1) government interest in market-based incentives for venture capital investment in Canadian-born businesses, and 2) investor interest in supporting ethical ventures, and 3) market recognition of social and environmental value. This combination could be a catalyst for greater investment at the community level given adequate incentives.

The development of federal tax credits and other mechanisms to encourage equity investment in communities could have a dramatic impact on the financial assets available to this sector. The following section documents existing models of incentives for community investment in Canada and other jurisdictions.

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[12] Glen Dowell, Stuart Hart and Bernard Yeung. Do Corporate Global Environmental Standards Create or Destroy Market Value? Management Science. 2002. Vol 46: pp 1059-1074.
[13] Social Investment Organization. Canadian Social Investment Review 2002: A Comprehensive Survey of Socially Responsible Investment in Canada. March 2003. www.socialinvestment.ca.

Review of Existing Tax Credit Models

This section describes the highlights from a sampling of tax credit models for community investment in North America and the United Kingdom. This is not a comprehensive review tax credits in Canada, but rather a sampling of models that have relevance to a potential national community investment tax credit system.

1. Equity Tax Credit Models

Nova Scotia Community Economic Development Investment Funds[14]

Nova Scotia has two tax credit initiatives targeted at raised private investment in community initiatives: the Nova Scotia Equity Tax Credit (1994) and Community Economic Investment Funds Tax Credit (1999). Together, these programs have assisted 454 Nova Scotia businesses in raising $54,486,942 in equity capital from 5,011 investors who qualified for $15,658,376 in non-refundable provincial tax credits. The programs are targeted at retail, individual investors.

Nova Scotia Equity Tax Credit

The Nova Scotia Equity Tax Credit was legislated in 1994 in response to concerns over a lack of equity capital financing for small and medium-sized businesses and the amounts of funds leaving the province in RRSP contributions. Investors receive a non-refundable provincial tax credit of 30% of the amount invested to a maximum credit of $9,000 that can be carried back three years and forward seven years.

Eligible investments must be newly issued common voting shares of a corporation that are non-redeemable, non-convertible and not restricted in profit sharing or participation upon dissolution. The shares cannot be eligible for any other tax credit or deduction allowed under the Income Tax Act, except as a deduction for RRSP purposes. For co-operatives, eligible investments eligible investments are a share that would allow the investor to participate in the affairs of the co-operative as a member.

The tax credit is available to residents of Nova Scotia over 19 years of age. Each eligible issue of shares must have at least three eligible investors. Eligible businesses (for investment) include corporations, co-operatives and community economic development corporations. They must meet the following criteria:

- Involved in active business or investing in other eligible businesses;
- Less than $25 million in assets;
- At least 25% of salaries and wages paid in Nova Scotia;

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[14] Government of Nova Scotia. Equity Tax Credit Act and Community Economic Development Investment Funds Review. 2002.

- Corporations must have authorized capital consisting of shares without par value;
- Co-operatives must be marketing, producing or employee co-operative;
- Corporations must have at least three eligible investors taking part in the specified issue.

From 1994 to 2001, a total of $49.4 million was invested by 4,030 investors into 439 companies. These investors received personal tax credits of $14.1 million. The majority of the funds (56%) have been invested in the Halifax region. With an assumed survival rate (close to the actual) of 75% for businesses, the cumulative net benefit to government from the tax credit is $6,889,000. This includes employment benefits, household income, and provincial government revenue.

Community Economic Investment Funds

The Community Economic Investment Funds Tax Credit (CEDIF) has been active since 1999. This program expands on the Equity Tax Credit by offering a partial guarantee on the last 20% of an investment in areas outside of Halifax, Dartmouth, Bedford and Sackville for the first four years. Shares in Community Investment Funds are also pre-approved as holdings in self-directed RRSP accounts.

On the condition that investments are held for four years, investors receive several benefits for investing in a CEDIF:

- A provincial tax credit of 30% of the amount invested;
- The foreign property content of the investor's RRSPs is increased by the amount of the investment in the CEDIF;
- Investors receive an RRSP tax deduction for their marginal tax bracket;
- The last 20% of the investment is guaranteed by the provincial government.

The creation of CEDIF tax credits required a modification to the Nova Scotia Securities Act, requiring CEDIF offering documents before any issues of shares. This document is similar to, but less comprehensive than, a prospectus. The intent of this modification is to help CEDIFs avoid the costs associated with preparing a full prospectus.

CEDIFs can make public offerings for proceeds up to $3 million. These are limited-time offerings, where Nova Scotia residents can purchase shares in the CEDIF. The CEDIF can advertise as either a blind investment pool, where investors are not aware of the specific end use of the funds, or raise funds for specific community development projects. The same geographic and operation criteria apply under CEDIF legislation (regarding community development functions) as under the Equity Tax Credit. CEDIFs generally make equity investments, but a structure is in place to permit subordinated and unsecured lending.

By 2001 (the second full year of the program), the Nova Scotia government saw a cumulative cost benefit of $180,000. This includes employment benefits, household income, and provincial government revenue. As it is still very early in the program, the government expects this number to grow in the future.

Manitoba Grow Bonds[15]

Manitoba's Rural Development Bonds Program (Grow Bonds) was initiated in 1991 as a new approach to community development and economic diversification. It is a vehicle to assist rural entrepreneurs in attracting patient local investment al to their business while protecting the local investor with provincial guarantee for every dollar invested.

Eligible businesses include manufacturing, processing, tourism, export local goods, environmental value adds (protection), and commercial distribution of water and natural gas. Grow Bonds are available in denominations of $100, limited to individual purchases of $50,000 or 10% of an issue, whichever is less, for a five-year terms. The Government of Manitoba guarantees the bond principle. The process is as follows:

- The project company presents a business plan and project application to the Grow Bonds Office (government office).
- Analysts review and assess the viability of the project.
- Upon approval, a Grow Bond Corporation is formed and Grow Bonds are offered for sale.
- The Grow Bond money is invested in the approved business (investment is limited to 40% of total capital.)

Since 1991, there have been 24 Grow Bond issues worth a total of $12,360,000. All 24 issues sold out due to the attractiveness of the full guarantee. The total tax revenues from the results 22 funded projects (as of 1998) were $20.3 million – a positive return on investment to provincial treasury. 707 people have been employed by companies that receive grow bond financing

Note: investments cannot be used for businesses in start-up stage or for worker buy outs.

Manitoba Community Enterprise Development Tax Credit

Introduced in 2002, the Manitoba CED Tax Credit is a non-refundable, 30% personal income tax credit for resident investors in eligible community enterprise development projects. The maximum credit that an individual investor can earn in a year is $9,000, based on a maximum $30,000 eligible investment. Any credits and claim earned but unused in a given year are available to be carried forward for up to seven years and carried back up to three years. Investors are expected to maintain their investments in

[15] Centre for Community Enterprise. A Report to the Ministry of Community Development, Co-operatives and Volunteers. January 2000.

qualified community enterprises for a prescribed period of time in order to fully benefit from the tax credit. Investors claim the credit on their Manitoba personal income tax returns.

There are two types of qualified investments: specific community enterprises, and community development investment pools. The latter serves as a conduit for investments in qualifying Manitoba community enterprises. Eligible projects and pools are approved by the Manitoba government.

At the time of this report's writing, no detailed analysis of the community enterprise development tax credit has been done by the Manitoba government.

United States New Markets Tax Credits[16]

The New Market Tax Credit program was implemented in December of 2000 by the US Congress. At the time of implementation, it was a national program geared towards raising private capital for community investment. Investors into qualified community development entity receive tax credit spread equaling 39% of their investment, spread over seven years. The size of the tax credit is intended to make up for lower returns to institutional investors. Investors do need to pay any relevant capital gains tax when their investment is returned.

Eligible community development entities include organizations that:

- Have the primary mission of serving, or providing investment capital for, low-income communities and persons;
- Maintains accountability to residents of low-income communities through their representation on a governing or advisory board;
- Receives certification from the Department of Treasury.

Further, community development entities (CDE) must use 85% of capital generated from the sale of NMTC equity to fund loans to, or equity investment in, for-profit or non-profit businesses that are operating in low-income census tracts. A low-income community investment is defined as:

- Any capital or equity investment in, or loan to, any qualified active low-income community business;
- The purchase from another CDE of any loan made by a CDE that is a qualified low-income community investment;

[16] National Community Capital Association. How the New Market Tax CreditWorks. 2001. www.communitycapital.org

- Financial counseling and similar services to businesses located in, and residents of, low-income communities; and
- Any equity investment in, or load to, any CDE if the CDE uses the proceeds to invest in low-income community businesses for financial counseling.

Equity investment is considered to be stock, capital interest in a partnership.

Qualified active low-income community businesses are defined as:

- At least 50% of the total gross income of that business is derived from the active conduct of its business within any low-income community;
- A substantial portion (at least 40%) of the use of the tangible property of that business (whether owned or leased) is within any low-income community;
- At least 40% of services performed by businesses employees are performed in any low-income community;

The US treasury also placed limits on how much investment could be generated through tax credit - $ 1 billion in 2001 (rolled over if not filled), and $3.5 billion in 2006 and 2007. This seems to provide comfort for treasury regarding tax revenue directly lost.

Current Issues

The implementation of the New Markets Tax Credit did not go as smoothly as hoped, and the future of the program is currently in jeopardy due to the current US administration's changing focus.

Many of the problems encountered were rooted in legislation that was too ambiguous on some counts while being too prescriptive in other instances. For example, some community investment funds found that they had inadequate control (from an investment perspective) of enterprises in which they invested, resulting in problems with both community and financial performance. Subsequently, The New Market Tax Credit Coalition advocated increasing community control to 60% voting control from 33% to ensure accountability. On the other side, regulations that geographically limited where investee businesses were located caused problems in housing developments (where construction and other partnerships were needed) and limited the growth of successful enterprises.[17]

Community activists also had a number of concerns around the scoring system for becoming an approved CDE or community venture, which gave more preference to CDEs with the most profitable investments and did not adequately weight community returns. Some CDEs also had problems adequately conducting due diligence on their

[17] New Markets Tax Credit Coalition (NMTCC). Letter to Internal Revenue Service. May 16, 2003. www.newmarketstaxcreditcoalition.org

investment projects, and others faced lawsuits from organizations challenging unfavorable funding decisions.[18]

United Kingdom Community Investment Tax Credit[19]

The Community Investment Tax Credit (relief) was legislated in October 2001. It is intended to improve access to capital for small businesses, potential business start-ups and community projects in disadvantaged regions of the United Kingdom. It provides tax relief to corporations and individuals that invest in community development finance institutions that in turn invest in small and medium-sized enterprises and charitable projects in disadvantaged communities.

Under the program, Community Development Financial Institutions (CDFIs), defined as economically sustainable organisations specialised in providing business advice and finance, loans or equity investments, are empowered to grant tax credits to investors by UK government through an accreditation process. Providing finance and business advice for enterprises in disadvantaged areas must be the main feature of the CDFI's operations. The tax credit is available to both private and corporate investors. They receive 5% of the amount invested for tax year of the investment for five years, provided that the investment is held for five years from the date of investment (for a total of a 25% tax credit).

The UK program has also made a distinction between wholesale and retail CDFIs. Wholesale CDFIs are the equivalent of a national liquidity pool, which buys or holds assets of smaller CDFIs that sell deal directly with retail investors. Wholesale CDFIs are allowed to raise a total of £20 million during a single accreditation, where retail CDFIs can raise £10 million.

The CDFI must invest money raised – it cannot remain on deposit. Allowable investments include:

- Loans – SMEs: These must be in disadvantaged areas, must not exceed 100,000 pounds year.

- Loans – community projects: These include public sector projects or those benefiting charities and other non-profit bodies which are engaged entirely in public function, non-competitive and non-commercial activity OR projects which are commercial but are small scale and purely local in nature

- Equity – community projects: The criteria is the same as loans to community projects. The maximum investment is £250,000 pounds in any one project.

[18] Dr. Julia Sass Rubin and Gregory M. Stankiewiz. Evaluating the Impact of Federal Community Economic Development Policies on Targeted Populations: The Case of New Markets Initiatives of 2000. Taubman Center for Public Policy, Brown University and Woodrow Wilson School of Public and International Affairs, Princeton University. July 2003.

[19] Department of Trade and Industry, Small Business Service. The Phoenix Fund Vision for 2006. September 2003. www.sbs.gov.uk

United Kingdom: Phoenix Fund[20]

At the same time the UK legislated the community investment tax credit program, the national government set up a broad base of funding geared towards supporting Community Development Finance Institutions (CFDIs). Support is focused on:

- Gap filling, particularly among groups and in areas with low enterprise propensity, and through adding value to other social inclusion and related priorities such as the specific needs of social enterprise, ex-offenders, refugees and rural communities.
- Capacity building for business intermediaries, statutory providers of business support, economic regeneration organisations and the community development finance sector. This includes innovation in product development and service delivery methods, identification and dissemination of good practice, demonstration activity and sharing of lessons learned as well as developing common services such as wholesale funds.
- Piloting of "joined-up" local business support, including any necessary further support for projects that are contributing to mainstreaming of support for enterprise among disadvantaged communities and for social enterprises, thus "building on the best."

As of October 2003, almost £100 million of Phoenix Fund support has been committed to promote enterprise through a number of different channels:

- A Development Fund, which has supported almost 100 innovative projects supporting enterprise in disadvantaged areas or among under-represented groups;
- A Business Volunteer Mentoring Association, a national network of volunteer mentors to start-up businesses;
- A Challenge Fund, which has provided loan capital and revenue support to help over 40 CDFIs to provide loans to viable business propositions unable to access finance from conventional sources;
- Loan Guarantees to help encourage commercial and charitable lending to CDFIs, which has levered over £3 million of additional capital into participating CDFIs and thus ultimately to the businesses they finance;
- A matching investment of £20 million alongside private sector investors in the Bridges Community Development Venture Capital Fund, thus enabling growing businesses in the most disadvantaged parts of England to access venture capital.

[20] Community Development Finance Authority. Social Investment Task Force Report. Enterprising Communities: Wealth Beyond Welfare. CDFA Conference. July 2003.

The Phoenix Fund also supported the development of a national Community Development Finance Association (CDFA). This organization supports CFDIs with a number of capacity building and coordinating activities. The CDFA has future plans for a national wholesaler of funds that would function as a national liquidity pool for retail CDFIs across the United Kingdom.

2. Charitable Tax Credit Models

New Hampshire Community Development Finance Authority

The New Hampshire Community Development Finance Authority (CDFA) is the overseeing body of a broad-based program designed to raise capital for community-based initiatives, in particular social housing.

The New Hampshire CDFA provides financial and technical assistance to community development corporations, worker cooperatives, and certain municipal entities. They cannot assist a for-profit business directly. Features of their work include:

- tax credit program;
- capacity grant program;
- technical assistance for community development;
- training and education fund;
- economic development ventures fund;
- discretionary fund.

The New Hampshire CDFS has the authority to grant the ability to issue tax credits of 75% to community development projects. Once a project received this tax credit granting status, they can then solicit funds and/or land from potentials, and issue a tax credit in return. Accepted community development projects are restricted to those providing support to non-profit community development organizations – defined as an organization whose central purpose is housing, community, or economic development, cooperative housing or worker cooperatives.

In addition to granting tax credits, CDFA is also able to fund a variety of technical assistance and training projects related to community ventures the organization is supporting. The strength of the model lies in broad-based approach – CDFA is concurrently supporting human, social and financial capital development, and delivering CED services through an integrated, responsive model.

Over the last six years, CDFA has participated in over 125 projects in New Hampshire worth $74 million and CDFA returns $3 of community infrastructure value for every $1 of state tax credits. CDFA program have created affordable housing, assisted in area

revitalization, initiative local investments in the arts, sponsored job training and economic development services, and increased the capacity of not-for-profit housing, community developers, and of financial intermediaries. By legislative design, CDFA is flexible: it funds projects in communities to address their unique local economic problems.[21]

Crocus Fund

Crocus Investment Fund is the largest and most experienced labour-sponsored fund in Manitoba. They invest in Manitoba companies to create jobs, earn competitive long-term return for shareholders, and improve the overall quality of life for all Manitobans.[22]

Under their banner, the Crocus Fund has recently set up an Enterprise Development Corporation to better facilitate CED activities that do not fit within their overall Fund's requirements. The target beneficiaries of this fund are primarily worker co-operatives. To finance the Corporation, the Crocus Investment Fund has negotiated an expansion of charitable regulations to include donations that alleviate community deterioration. This will allow individuals and corporations to make cash and in kind donations to the Corporation. The Corporation in turn will invest grants and equity into non-profit and for-profit community enterprises, particularly worker co-operatives. Donors will get the same tax credit as currently granted to Manitoba charities.[23]

Proposed Alberta CED Investment Fund Tax Credit

This proposed tax credit has been put forward by The Alberta Community Economic Development Investment Fund Steering Committee. It is a detailed proposal calling for a provincial tax credit ranging from 30% - 50% for donations to community development organizations. Approved CED organizations will solicit funds from private sources such as individuals or corporations. These contributions will qualify for tax credits and, in turn, allow organizations to invest this capital in local ventures. Contributions can take the form of cash or assets (such as real estate at fair market value) to a maximum annual credit of $50,000. A tax credit rate of 50% is applied to the first $50,000, while a 30% rate is used for contributions over this amount. The credits are non-refundable (they only apply if taxes are owing) and can be carried forward seven years and back three years.

Designated organizations administer and disburse funds from the blind pools generated by these contributions. Funds are used to finance small businesses and housing projects. A micro-loan fund program, for example, could act as a designated organization and finance low-income, high-risk entrepreneurs who have bona fide business plans but cannot access capital elsewhere.

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[21] Dr. Richard England, Dr. Lisa Shapiro and Mr. Benjamin Ellis. The Economic Impacts of Community Development Finance Authority Programs. Center for Business and Economic Research, Whittemore School of Business and Economics, University of New Hampshire. January 1998.
[22] www.crocusfund.com
[23] Sherman Kreiner. Personal communication. September 2003.

The three-year pilot project will allocate a total of $5 million in tax credits across the province. During this initial period, 10 designated organizations deliver the program, receive contributions eligible for tax credits and provide technical assistance, when required. This approach results in a limited role for government and a maximized reliance on existing infrastructure.

A detailed benefit-cost analysis the proposed $5 million tax credit pilot program reveals a conservative estimate of Internal Rate of Return (IRR) at more than 18% with an expected cost-benefit ratio of 1.73.Upon full program release, it is estimated that 68 full-time positions and $952,388 in net after-tax revenue could be generated annually. Further, the annual net indirect and induced impact of the tax credit program is projected to include 14 employees and more than $332,000 in employment income.[24]

[24] Anna Bubel. A Community Economic Development Tax Credit for Alberta. Presentation, Alberta CED Conference. October 2003.

Lessons Learned: Balancing Community and Investor Needs

Developing an appropriate and effective tax credit model is a challenging task for government. Our review of tax credit models, combined with informal interviews with representatives of loan funds, social investment funds, labour funds, and community development organizations have brought a number of issues to light, which should be taken into consideration in the development of tax credit policy.

Local Responsiveness

First and foremost, any federal tax program must be flexible enough to adapt to differing economic and social environments throughout the country:

1. Differing securities regulations in each province;

2. Harmonizing with existing tax credit schemes are that are well developed in some provinces;

3. The limited capacity of community organizations and groups to prepare full prospectuses for initial offerings;

4. The lack of capacity among many of the start-up businesses, co-operatives and organizations that will be seeking funding from community investment funds;

5. The current lack of a single, national liquidity pool to back up smaller community investment funds;

6. Differing risk profiles among different investor segments (retail, institutional and more segmented);

7. The need for community accountability for how investment funds are utilised and delivered at the community level through the implementation of best practices in community economic development.

Earlier this year, CCEDNet completed a study *Financing Community-Based Rural Development*, which identified several best practices. These findings serve as a guideline for ensuring local direction and engagement:[25]

- Local strategic planning and control over implementation by individuals and organisations who will be affected by the outcomes, working in partnership and supported by competent technical assistance and adequate financing;

[25] William A. Ninacs. Financing Community-Based Rural Development. Canadian CED Network. February 2003.

- Competitive application processes involving some degree of local partnerships at the outset coupled with technical assistance during the application process;
- Medium and long-term commitment by funders for capacity-building programs in severely disenfranchised area;
- Multi-year or permanent core financing for community economic development organisations or their equivalent to ensure ongoing facilitation of partnerships and competent technical assistance to local projects and entrepreneurs;
- Multi-level government collaboration both in setting goals and program parameters and during the life of the supported projects;
- An expanded notion of development that includes social, cultural and environmental dimensions, including health and education issues;
- Publicly endowed development funds, managed by volunteer boards made up of stakeholders, appear to be a most cost-effective way of solving this issue;
- Flexibility regarding local implementation, firmness and clarity (provincial consistency) re establishing overall goals and accountability requirements.

Clearly, tax credits must be launched in concert with other supports to build the capacity of both community investment funds and community enterprises. In our previous analysis of different tax credit models around the world, the best example to date of an integrated, national strategy that meets these requirements is the Phoenix Fund and Community Development Financial Institution tax credit from the United Kingdom.

Investor Protection and Risk Profiles

In our discussions with fund managers, social investors and other across the country, it became apparent that effective tax credit schemes must also take into account the demands of capital markets and need for investor protection. Tax credits must:

- Be large enough such that they offset the lower financial returns of typical community (or social) investment funds and create an attractive investment product for the market. Brock Dickenson and Associates study *Building Community Equity* recommends a tax credit of 68.4%[26]. Other organizations, such as Social Capital Partners, suggest that a tax credit in the neighbourhood of 30% would be sufficient.
- Promote patient capital by requiring the investor to remain invested in the fund from four to seven years;

[26] Brock Dickenson and Associates. Building Community Equity: The Practical Aspects of Tax Credits and Public Incentives as Mechanisms for Encouraging Private Investment in CED Initiatives. Canadian Community Economic Development Network. September 2001. Unpublished.

- Offer a guarantee to attract institutional investors (such as pension funds) that operate under strict liquidity and security requirements;
- Ensure that investors have a clear and workable exit route;[27]
- Harmonize with existing tax credit schemes in other provinces and offer consistent reporting requirements across the country.

Economies of Scale

Currently, small, community-based loan funds (of which there are several) and community investment funds (of which there are very few) are operating independently across the country. Although this facilitates strong community ties and local control of how funds are invested in a community, it also causes several problems:

- Individual set up costs for each Fund are very high (especially if the Fund wishes to be approved for RRSP tax credits.) The experience of the labour funds is that it can take $150,000 to $200,000 in legal fees to set up a fund and get approved for the labour fund tax credits.
- Each Fund must support its own ongoing marketing and overhead costs. In some cases, this cost is so prohibitive that the organization cannot continue. For example, the Calmeodow Metrofund, a loan fund targeted at community financing, ended up closing operations because of determination that independently, it could never operate without ongoing subsidies.[28]
- There is no coordinated, retail brokerage at a provincial or national level for retail investors, which makes it difficult for some funds to build market share, particularly with regards to RRSP investors. Often, potential investors must hold a self-directed RRSP and direct their broker or financial institution to buy units in the Fund, or buy units on their own.[29]
- Many Funds are inadequately capitalized. As a result, they cannot invest in community enterprises to the degree they would like, and some small Funds have trouble qualifying for RRSP eligibility due to their relatively low liquidity.
- Funds struggle with training and upgrading staff skills. This could be better facilitated through better communication with like-minded organizations

In addition, many Funds have trouble independently measuring the social benefit they provide to illustrate 1) net benefit to government and 2) social return on investment to investors. The Social Investment Organization and others have been working to create consistent measurement tools such as the Social Return on Investment Framework

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[27] Ibid.
[28] Frankiewicz, Cheryl. Calmeadow Metrofund: A Canadian Experiment in Sustainable Microfinance. April 2001.
[29] Brock Dickenson and Associates, Ibid.

(SROI), which was developed by Roberts Enterprise Development Fund. This method attempts to quantify social returns by taking into account factors such as:

- Increased personal and business tax revenue;
- Reduced reliance on employment insurance or welfare;
- Reduced addiction and mental health issues;
- Reduced incidents of crime.

Summary

A national tax credit program must concurrently balance community and investor needs. From the community perspective, measures must be put in place to ensure that community investment funds are driven by and remain accountable to the communities in which they operate. Further, technical assistance and capacity building supports must be made available to community investment funds and community enterprises, such as what the Phoenix Fund provides in the United Kingdom. Finally, investor protection and risk profiles must be taken into account and mitigated by the size and nature of tax credit incentives and investment guarantees. Related to this, community investment funds will have to deal with economies of scale issues to truly scale up to the liquidity size needed by risk-adverse investors.

Recommended Tax Credit Models

CCEDNet is recommending three main initiatives intended to encourage community investment by the private sector – that is, investment into community enterprises and/or investment funds by financial institutions, corporations, and individuals.

- First, CCEDNet recommends the development of a national seed fund to capitalize community investment funds in each Province. The rollout of this fund should be incremental and flexible, as CED organizations organize to identify local investment product needs and community needs. The federal government will see a substantial financial return on investment through increased economic activity, tax revenues and reduced social expenditures.
- Second, CCEDNet recommends a 30% tax credit and guarantee of capital attached to financial instruments (shares, bonds, etc.) to be defined by community investment funds in each province or territory. The specific financial instruments will vary with each province and territory, depending on the investment climate, securities regulations, and community needs. The tax credit should be available to both retail and institutional investors, and not preclude RRSP eligibility for eligible community investment funds.
- Finally, charitable tax credits should also be extended to CED organizations focused on not-for profit activities. The model for this type of tax credit implementation would be very similar to that employed by the New Hampshire Community Development Finance Authority and Crocus Fund, and proposed by the Alberta CED Investment Fund Tax Credit, as described in this document.

By allowing both for-profit community investment funds and non-profit community development organizations to employ related but different tax credits, the government will ensure that the maximum amount of benefits are achieved by this policy. The intent is to provide vehicles through which equity can be raised for investment in social enterprises. In some cases, particularly with for-profit ventures, it will be most appropriate to use an equity tax credit. In other cases, a charitable tax credit will better enable community development organizations to raise the necessary funds for non-profit enterprises without having to deliver a return on investment to shareholders.

Implementation Strategy

The tax credits should be launched through select community economic development financial institutions (CDFI) or qualified organizations across the country. There are many institutions already well qualified to participate, including community development organizations, co-operatives, credit unions, labour funds, and ethical funds, to name a few. The Government of Canada should recognize, in each province, one or several organizations that could:

- Issue bonds or shares (or other appropriate financial instruments) through a Community Investment Fund and invest these funds in social economy enterprises using an equity tax credit on which investors will expect at least a marginal return on their investment, in addition to the credit; or

- Accept donations using a charitable tax credit, which will then be invested in non-profit community economic development organizations and ventures. In this case, investors would not expect a return on investment other than the tax credit and would not retain any equity in the Community Investment Fund (their funds are donated).

CDFIs should be focused on filling a gap in financing community-based enterprises (both non-profit and for-profit) in their region. These organizations should demonstrate proven success in community financing. Both retail and institutional investors should be able to invest in the community development funds

Canada-wide organisations such as CCEDNet could coordinate the implementation stage with regional partners that will take leadership roles in their respective provinces. Regional partners will be responsible for bringing together networks (much like what exists in Quebec) of loan funds, ethical equity funds, labour-sponsored funds, credit unions, co-operatives and other relevant parties. These regional networks will identify:

- Whether an equity tax credit, charitable tax credit or both is most appropriate for their circumstances;

- What CDFI should take a leadership role in managing the Fund and marketing financial instruments to investors;

- What community organizations should be involved in disseminating investment raised;

- What type of financial instrument best fills the financing gap in their province (bonds, shares, etc.);

- What, if any, provincial legislative and regulatory requirements need to be amended;

This developmental phase should be funded through the community economic development supports referred to in CCEDNet's partner paper to this document: CED Funding and Delivery in Canada. This will ensure adequate supports to both CDFIs and community enterprises during their development, such as is provided for by the U.K's Phoenix Fund.

By the end of the first year, regional community development financial institutions should be ready to invest equity in the community enterprises and market shares, bonds or other appropriate financial instruments with the tax credit.

Government Payback Models

Following are two provincially-based models that provide some idea of the return on investment government would see from a national tax credit. The Nova Scotia returns are proven and expected to improve in the coming years. The Alberta returns are proposed.

Nova Scotia[30]

The Nova Scotia CEDIF tax credit was launched in 1999. Since then it has raised a total of $5,131,791 from approximately 1000 investors. $1,538,128 in credits have been issued.

From 1999-2001, there was an actual survival rate of 100% for the companies that received investments through CEDIFs. Using Nova Scotia's Input/Output model and matching funds invested with the appropriate multipliers for each industry classification, the provincial department of finance calculated for the following aggregated economic impact and cost-benefit payback to the provincial government.

	1998	1999	2000	2001
Employment				
Annual	n/a	31	72	190
Cumulative	n/a	31	103	293
Household Income ($000)				
Annual	n/a	938	1960	4784
Cumulative	n/a	938	2898	7682
Provincial Government Revenues ($000)				
Annual	n/a	131	273	667
Cumulative	n/a	131	404	1071
Equity Tax Credit ($000)				
Annual	n/a	338	143	409
Cumulative	n/a	338	481	890
Cost Benefit to Provincial Government ($000)				
Annual	n/a	(207)	130	258
Cumulative	n/a	(207)	(77)	180

The cumulative cost-benefit to provincial government is aggregated in this analysis, that is, it is the sum of impacts of all existing eligible businesses in a particular year.

[30] Government of Nova Scotia. Equity Tax Credit Act and Community Economic Investment Funds Review 2002.

As a sensitivity test, if the actual rate of business survival was changed to a theoretical survival rate of one year, or a worst case scenario, the cumulative cost-benefit payback to government in 2001 would be ($196,000).

Assumptions

Data for the Nova Scotia Government's analysis of their CEDIF tax credit was supplied by their tax policy division. All data were assumed to be in current dollars. No adjustments were made for inflation.

The following assumptions were made in the calculations of employment, income, tax revenues and costs.

1. Total investment by companies and businesses is comprised of capital expenditures and working capital. Employment and payroll data are indicated separately in the data supplied on an annual program-aggregated basis. Aggregated payroll surpasses working capital for all CEDIF funded businesses under review.

2. Annual activities of CEDIFs are assumed to be fully incremental to the Nova Scotia economy; that is, they would not occur without the tax credit.

3. Data on the number of CEDIFs funded and their corresponding investment in various enterprises was supplied, which showed each CEDIF's capital expenditures, working capital, employment and payroll.

4. The data gathered on the CEDIFs was disaggregated into various industrial sectors and the Nova Scotia Input-Output Model was used to simulate impacts of capital and working capital expenditures incurred by businesses that participated in the program. This allowed an assessment of direct and indirect impacts. Direct impacts are those that result directly from the expenditures on, or purchases of, good and services in Nova Scotia. Indirect impacts are the result of inter-industry transactions and household spending and re-spending. Government revenues include provincial income tax revenue, Harmonized Sales Tax, and other indirect tax revenue.

5. The cost-benefit payback to the provincial government was assessed by comparing the periodic provincial government revenue generated by the CEDIF with the associated provincial CEDIF costs (administrative and lost tax revenue).

6. Further information is needed, but the Government of Nova Scotia does not appear to have discounted benefits using a present value analysis.

Alberta[31]

The Alberta Community Economic Development Investment Fund Steering Committee's proposal to the Alberta government includes a cost-benefit model for introducing the $5 million tax credit.

Their analysis showed that a $5 million tax credit of 50% on the first $50,000 donated and 30% on the remaining donation to a maximum of $75,000 would raise a total of $12,500,000. The investment of these funds in CED enterprises would result in the following direct benefits in five years (each of which are a net present value, discounted at 7%):

- $6,337,929 in direct employment income;
- $1,978,147 net after-tax revenues;
- $1,978,863 in net after-tax business revenue
- $293,711 in Supports for Independence (income assistance) savings

The total benefit/cost ratio on the $5,000,000 tax credit is 1.78, showing an IRR of 18.3%.

Assumptions

- The Alberta Steering Committee is seeking to raise funds to be used for lending. Hence, 18% of funds raised ($12.5 million) were reserved for loan loss contingencies in the calculations.
- 10% of the $12.5 million raised were reserved for program costs.
- 2% of the $12.5 million raised were reserved for administrative costs.
- After reserves, net funds available to program participants would be $8.8 million.
- Calculations of potential revenues, jobs, etc. generated through lending of the $8.8 million was based on how the funds are to be disbursed: 45% to micro-enterprise, 26% to small business and 29% to housing. Average loan size varied depending on the category. The cost-benefit model linked the average loan size and number of loans with small business classification reporting in order to estimate business and tax revenues. Employment numbers were based on data from the Federal government's Small Business Financing Act (broken down by industry classification). Success rates were applied based on the five-year success rates of small business in the Prairie Provinces for each industry (except housing, which was given a 100% success rate).

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[31] Alberta Community Economic Development Investment Fund Steering Committee. A Community Economic Development Investment Fund for Alberta. August 12, 2003.

Investor Payback Model

Social Capital Partners has provided the following net present value calculation for a 3-20 year equity investment of $1000 by a retail investor in a community investment fund (receiving an equity tax credit). Three scenarios are given: 30%, 40% and 50% tax credits. Three-five years scenarios show a rate of return close to 30%, a possible tax credit amount.

SCENARIO ONE

Principle Invested	1000	1000	1000	1000	1000
Tax Credit	30%	30%	30%	30%	30%
Tax Rate	NA	NA	NA	NA	NA
Net Principle	700	700	700	700	700
Natural Return	2%	2%	2%	2%	2%
Discount Rate	3%	3%	3%	3%	3%
Investment Periods	**3**	**5**	**7**	**10**	**20**
Present Value of Return	**$56.57**	**$91.59**	**$124.61**	**$170.60**	**$297.55**
Present Value of Principle	**$915.14**	**$862.61**	**$813.09**	**$744.09**	**$553.68**
Rate of Return	**46%**	**27%**	**19%**	**13%**	**6%**

SCENARIO TWO

Principle Invested	1000	1000	1000	1000	1000
Tax Credit	40%	40%	40%	40%	40%
Tax Rate	NA	NA	NA	NA	NA
Net Principle	600	600	600	600	600
Natural Return	2%	2%	2%	2%	2%
Discount Rate	3%	3%	3%	3%	3%
Investment Periods	**3**	**5**	**7**	**10**	**20**
Present Value of Return	**$56.57**	**$91.59**	**$124.61**	**$170.60**	**$297.55**
Present Value of Principle	**$915.14**	**$862.61**	**$813.09**	**$744.09**	**$553.68**
Rate of Return	**54%**	**32%**	**22%**	**15%**	**7%**

SCENARIO THREE

Principle Invested	1000	1000	1000	1000	1000
Tax Credit	50%	50%	50%	50%	50%
Tax Rate	NA	NA	NA	NA	NA
Net Principle	500	500	500	500	500
Natural Return	2%	2%	2%	2%	2%
Discount Rate	3%	3%	3%	3%	3%
Investment Periods	**3**	**5**	**7**	**10**	**20**
Present Value of Return	**$56.57**	**$91.59**	**$124.61**	**$170.60**	**$297.55**
Present Value of Principle	**$915.14**	**$862.61**	**$813.09**	**$744.09**	**$553.68**

Rate of Return	65%	38%	27%	18%	9%

Assumptions

- The discount rate of 3% is set at the rate of inflation;
- The natural return of 2% is already discounted for risk;
- Individual funds have the option of paying dividends to investors if they so wish. This would be a decision at the fund level.
- The ROR is based on the present value of the principle + the present value of the return, divided by the discounted net principle.