

Stock Savings Plan II

INTRODUCTION

Over the past few months, the Minister of Finance of Québec consulted the business and financial communities with respect to the SME Growth Stock Plan. In her March 19, 2009 budget, she announced that the plan would be updated and improved, including a change in its name. The changes announced were well received by the main players involved.

The principal rules applicable to the SME Growth Stock Plan originated with the Stock Savings Plan which was introduced in 1979. At that time, the percentage of Quebecers holding public corporate equity securities was one of the lowest in North America. The SSP sought to change this situation while fostering the capitalization of Québec companies. In order to take advantage of the notoriety of the SSP, the plan will now be known as the "Stock Savings Plan II". For ease of reference, we will refer to it as the Stock Savings Plan (SSP).

The plan is directed to the segment of the public markets comprising small- and medium-sized Québec public companies (SMEs), given that many "Québec Inc." companies that listed their shares on a stock exchange did so with initial public offerings (IPOs) of less than \$10 million.

The tax deduction provided by the plan to individuals residing in Québec reduces the cost of the shares acquired and, consequently, the financial risk of such an investment. Concurrently, this should increase the amount of capital channelled to such corporations.

Claude Désy, M. Fisc., FCA, is a taxation and financing specialist. He advises companies in connection with mergers and acquisitions as well as public and private financings. Mr. Désy is member of the Quebec Advisory Committee of the TSX Venture Exchange and has assisted the Toronto Stock Exchange and the TSX Venture Exchange in making representations to the Government of Québec regarding the SME Growth Stock Plan and the Stock Savings Plan II.



PUBLIC SMES

Findings and Objectives — The SSP's aim is to stimulate and facilitate the public financing of our SMEs, helping them grow and position themselves more effectively within their market niches.

The modifications to the plan were introduced in response to the following findings of the Government of Québec:

"However, the economic crisis has thrown the environment in which public companies of all sizes operate into turmoil. Investors are gripped by fear and loath to commit to the financing of public companies, even sound ones with a promising profit outlook.

As is the case with all exchange-listed companies, the situation of Québec public companies has deteriorated in recent months.

- The number of Québec corporations listed on a Canadian stock exchange has fallen from 351 in 2007 to 335 in 2008.
- The number of public financing transactions carried out by these companies dropped by 41% between 2007 and 2008.

- Overall public financing obtained by these companies fell by 46% between 2007 and 2008. Québec public companies must not only be able to offset the negative effects of the credit crisis, but also improve their positioning on public capital markets compared to other Canadian companies.
- In 2008, while Ontario's GDP was roughly twice the size of Québec's, the number of Ontario corporations listed

on a Canadian stock exchange was almost 3.5 times the number of Québec public companies.

- The share of financing obtained by Québec corporations on Canadian public markets is only 5% of total financing raised on these markets in 2008 and has been falling since 2006.
- The average public financing obtained by Québec corporations is substantially less than what is raised by Ontario corporations.¹

Number of companies listed on a Canadian stock exchange and financing obtained

	2006				2008			
	Québec companies	Ontario companies	Other companies	Total	Québec companies	Ontario companies	Other companies	Total
Listed corporations	347	1 128	2 160	3 635	335	1 162	2 338	3 835
<i>As a % of the total</i>	10	31	59	100	9	30	61	100
Financing obtained (\$ billion) ¹	4.2	19.9	26.5	50.7	1.9	23.5	15.6	40.9
<i>As a % of the total</i>	8	39	52	100	5	57	38	100
Average financing (\$ million)	10.7	23.7	10.0	13.1	7.5	43.2	8.5	15.6

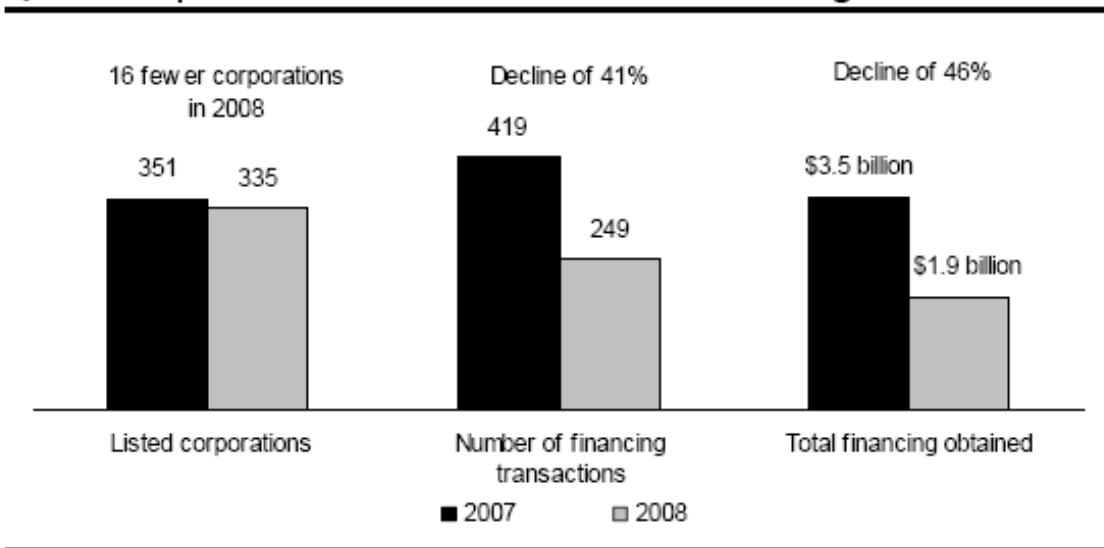
Note: Because of rounding, the figures may not add up to the totals shown.

1 The large amount of financing obtained by Ontario public companies in 2008 is attributable in particular to major financings raised by a few companies in the financial services sector.

Source: TMX Group.

Source: 2009-2010 Budget, page F. 22

Québec corporations listed on a Canadian stock exchange



Source: TMX Group.

Source: 2009-2010 Budget, page F. 21

Importance of Public Financing — In its 2005-2006 Budget, the Government of Québec stated that public financing is an essential tool for the development and growth of businesses.

“Though not the only available source of capital, the public capital market is an essential tool for the development and growth of companies:

- It provides access to more capital and liquidity for securities.
- It helps growing companies to maintain a balance between debt and capital.
- Lastly, it provides an important exit mechanism for investors who contributed to the capitalization and growth of the company before its listing on the stock market.”²

The plan's measures complement other significant contributions by the Government of Québec in support our companies, including the venture capital sector. The following comments relate to the complementarity between the public markets and venture capital: “[A] well developed stock market that permits venture capitalists to exit through an initial public offering (IPO) is critical to the existence of a vibrant venture capital market.”³

THE AMENDMENTS

In summary, the following are the principal amendments to the plan:

Extension — The plan has been extended by five years and will end on December 31, 2014.

Increase in the Deduction — For eligible shares and eligible securities acquired after March 19, 2009 and before the January 1, 2011, the adjusted cost for purposes of computing the SSP deduction has been raised from 100% to 150% of their cost of acquisition. The 150% rate will decrease to 100% for acquisitions made as of January 1, 2011.

Holding Period — One of the features of the SSP is designed to ensure that capital invested in Québec public SMEs stays invested for 2 years.

In order to respect this requirement, an investor will not have to continue holding the eligible shares or eligible securities that gave rise to his SSP deduction. However, in order not to lose the right to the SSP deduction claimed, the investor will have to hold, on December 31 of the year of

acquisition of the securities having given rise to the SSP deduction, as well as on December 31 of the two subsequent years, eligible shares, valid shares or eligible securities for which the total adjusted cost is at least equivalent to the amount of SSP deductions granted over the preceding two taxation years. For this purpose, the adjusted cost of an eligible share or a valid share purchased before January 1, 2011 by an individual or an investment fund will be equal to 150% of the cost of acquisition thereof.

A valid share is a share acquired in a transaction carried out on a stock exchange. These are shares that appear on the list of valid shares drawn up by the Autorité des marchés financiers (AMF). It should be noted that valid shares do not include treasury shares subscribed under a new public offering.

Size of Companies — Henceforth, the SSP will be available to medium-sized companies whose assets do not exceed \$200 million. As a result, the shares of approximately 225 Québec public companies could be valid shares.

Québec Corporations Currently Listed on an Exchange and Targeted by the Stock Savings Plan II ⁴

	Companies targeted
Number of companies targeted	225
Total assets (\$ billion)	5.6
Market capitalization * (\$ billion)	4.0

Source: Investment Industry Regulatory Organization of Canada (IIROC).

* As of February 13, 2009

Simplified Registration — In order for shares of an eligible issuing corporation to be valid shares, they must appear on the list of valid shares published by the AMF. The procedure for registering valid shares on the AMF list has been simplified. To do so, it will be sufficient to file a prescribed form with Revenu Québec. This form should be available as of July 1, 2009, although it is our understanding that Revenu Québec will try to make the form available before then. In the meantime, a corporation can register on the AMF list by applying for an advance ruling from Revenu Québec.

Main Parameters of the Stock Savings Plan II

	Parameters
Eligible corporations	<ul style="list-style-type: none"> • Québec corporations with assets of less than \$200 million • Start-up capital corporations (designated eligible issuing corporations)⁵ • Investment funds
Eligible securities	<ul style="list-style-type: none"> • Newly issued common shares with voting rights • Securities issued by eligible investment funds
Tax incentive	<ul style="list-style-type: none"> • Deduction for individuals: - 150% until December 31, 2010 - 100% after December 31, 2010
Minimum holding period	<ul style="list-style-type: none"> • 2 years
Eligible securities for coverage purposes	<ul style="list-style-type: none"> • Common shares of Québec corporations with assets of less than \$200 million • Securities issued by eligible investment funds
Coverage deadline	<ul style="list-style-type: none"> • Coverage required within 3 months
Application period	<ul style="list-style-type: none"> • Until December 31, 2014

Source: 2009-2010 Budget, Table F.8, p. F. 23.

STOCK SAVINGS PLAN II

The SSP is an arrangement entered into between an individual and a securities broker under the terms of which the individual entrusts the broker with custody of his *eligible shares*, his *eligible securities*, or his *valid shares*. The SSP can also be an arrangement between an individual and a qualified mutual fund (the "SSP Fund") under which the individual entrusts the SSP Fund with custody of his *eligible securities* of the SSP Fund.

SSP DEDUCTION

Québec Investors — Only individuals residing in Québec on December 31 of a given year and having acquired eligible shares or securities during that year can claim the tax deduction available under the SSP. The benefit is obtained in the form of a deduction from the calculation of an individual's taxable income for purposes of Québec income tax.

Annual Cap — The SSP deduction for the year is limited to 150% or 100% of the cost of the eligible shares or securities acquired, with an annual cap of 10% of the individual's total income for the year, within the meaning of the *Taxation Act*. Unused SSP deductions may not be carried forward to other years.

Capital Gain or Loss — The capital gain or loss resulting from the sale of an eligible share or security that is a fixed asset for an individual is the difference between the proceeds of its disposition and its adjusted cost base. To that end, the amount of the SSP deduction will not reduce the adjusted cost base of the eligible share or security acquired for federal or provincial income tax purposes.

TRANSFER TO AN RRSP

The shares that form part of an individual's SSP cannot be included in another plan. Consequently, a share cannot be both an investment in an SSP and in a registered retirement savings plan (RRSP). However, an individual can withdraw from his SSP a share acquired by him during the preceding year and, within the first sixty days of the current year, transfer it into his RRSP as a contribution to his RRSP for the preceding year. It is assumed that the share does not exceed the annual RRSP contribution limit. Under the SSP coverage rule, the individual will have to acquire, within 3 months of the sale of the share having entitled him to the SSP deduction, a sufficient amount of eligible shares, valid shares or eligible securities. Thus, the individual will be entitled to two deductions for the same acquisition.

After-tax Cost of a Share Acquired by an SSP and Transferred to an RRSP

	2008
Cost	\$100.00
SSP deduction ⁽¹⁾ (\$100 x 150% x 24%)	(36.00)
RRSP deduction ⁽²⁾ (\$100 x 48.2%)	(48.20)
After-tax cost – 2008 ^{(1) (3)}	15.80

(1) Based on the maximum marginal Québec and federal income tax rates for 2008.

(2) Assumes that on the transfer date, the market value of the share is equal to its cost.

(3) When an amount is withdrawn from an RRSP, it is fully taxable in the hands of the beneficiary at his combined federal-provincial marginal tax rate applicable at that time.

The transfer by an individual to his RRSP constitutes a disposition for purposes of computing his capital gain or

loss. To this end, the proceeds of disposition of the share will be equal to its market value at the time of the transfer. The taxable capital gain resulting from the transfer will have to be included in the income of the RRSP beneficiary. However, a capital loss resulting from such a transfer is not deductible. The transfer could therefore result in a taxable capital gain. Moreover, in such a case, the RRSP contribution will be equal to the market value of the share at that time.

ELIGIBLE SHARES AND SECURITIES

Two types of securities give rise to the SSP deduction. The first is an *eligible share* issued by an eligible issuing corporation. The second is an *eligible security* issued by an SSP Fund. In the second case, it is the amount invested by the SSP Fund in eligible shares of eligible issuing corporations that gives rise to the deduction.

Eligible Shares – Only a common share, acquired for money and issued by an eligible issuing corporation in connection with a public offering, will give rise to the tax deduction under the SSP. The share must have an unrestricted voting right, must be issued directly by the corporation and cannot be redeemable or retractable or have a fixed dividend. The holder of a common share must not be prevented from participating in the assets of the corporation beyond the amount paid for such share, in the event of a reduction or redemption of the capital stock.

ELIGIBLE ISSUING CORPORATION

The following companies are eligible issuing corporations whose common shares give rise to an SSP deduction when an investor subscribes for their shares. First and foremost, the corporation must have carried out a public offering of shares eligible under the SSP. The shares must be listed on a Canadian stock exchange.

Eligible Issuing Corporation

The following conditions must be met by a company in order to qualify as an eligible issuing corporation. These conditions are cumulative, not alternative.

- *Time of qualification* — The conditions must be met by the corporation on the date of the final prospectus receipt for its public offering or, if applicable, on the date of the prospectus exemption (the “Offering Date”).
- *Status of the corporation* — The corporation must be a Canadian corporation, namely, a corporation resident in Canada for income tax purposes.
- *Asset requirement* — It must have assets under \$200 million. The assets are those shown in the financial statements of the corporation for the taxation year ended prior to the Offering Date. Two items must be deducted in computing a corporation's assets, namely, the amount representing its intangible assets, insofar as the amount exceeds the expenses incurred with respect to such assets. Moreover, when the consideration for the acquisition of an intangible asset is comprised of a share of the share capital of the corporation, the consideration is deemed to be nil.

In order to ensure that the measure does not arbitrarily favour corporations from the same group, computation of the maximum assets includes the assets of any other corporation with which the corporation is associated, for income tax purposes, at any time during the twelve months preceding the Offering Date.
- *Québec attachment criterion* — Senior management of the corporation must be in Québec and, during the 12 months preceding the Offering Date, more than half of the salaries paid to its employees must have been paid to employees of an establishment located in Québec. Revenu Québec's position regarding the notion of senior management being in Québec is that management will be considered to be carried out in Québec if the corporation's principal policies originate from Québec or if decisions regarding the corporation are made in Québec.
- *Five employees/twelve months criterion* — This criterion is designed to ensure that the corporation has a commercial history that demonstrates a degree of stability indicative of longevity. The corporation must have carried on a business throughout the twelve months preceding the Offering Date. Furthermore, during that period, it should have had at least five full-time employees who are not insiders within the meaning of the Securities Act or persons related to them.
- *50% of the value of property criterion* — This criterion is designed to make certain holding companies ineligible under the SSP so as to ensure that the SSP benefits only active commercial corporations. No more than 50% of the value of the corporation's property may consist of investments, other than eligible investments. This value is determined on the basis of the corporation's annual financial statements for the most recent taxation year ended before the Offering Date.

The types of investments contemplated are shares, debentures, debt instruments, certificates of deposit and other investments of a similar nature. Moreover, eligible investments include cash on hand or on deposit and the shares and securities of another corporation in which the

corporation holds an interest representing at least 20% of the voting shares of that other corporation's capital stock.

- *Prohibited purchase and buy-back* — A corporation will not be eligible if, during the five calendar years preceding the SSP Offering Date, it has carried out, directly or indirectly, a purchase or buy-back of shares of its capital stock. However, a corporation may remedy this situation. To do so, it will first have to make an offering outside the SSP for an amount at least equal to the amount of the prior purchase or buy-back.

Certain purchases and buy-backs will not result in a refusal of SSP eligibility for a corporation, namely, where the percentage of the purchase or buy-back does not exceed certain thresholds or where the rules of the corporation's industry segment require such a purchase or buy-back.

Holding Company

A corporation will also be an eligible issuing corporation if, on the Offering Date, almost all of its property consists of shares of the capital stock of one or more subsidiaries it controls or of loans or advances made to such subsidiaries. One of these subsidiaries must satisfy the requirements under the definition of eligible issuing corporation. The holding company must be a Canadian corporation whose head office or principal place of business is located in Québec. No more than 50% of the value of its property, as shown in the most recent consolidated financial statements for the taxation year ended prior to the Offering Date, may consist of investments, other than eligible investments.

Designated Eligible Issuing Corporation

Specific measures have been included in order to link the SSP with the TSX Venture Exchange's Capital Pool Company (CPC) Program.⁶ These measures are designed to render eligible, under the SSP, eligible shares issued within the scope of financing concurrent with the qualifying transaction of a CPC. It should be noted, however, that the shares issued within the scope of the IPO of a CPC will not give rise to the SSP deduction.

Briefly, a CPC is a shell which has carried out an IPO in order to raise funds, not exceeding \$2,000,000, which it will use to identify, evaluate and acquire assets, including another corporation, for the purpose of completing its *qualifying transaction*. The qualifying transaction must result in a corporation that satisfies the usual listing requirements of the TSX Venture Exchange or the Toronto Stock

Exchange. The transaction must take place within 24 months of the CPC's IPO. The TSX Venture Exchange refers to such a transaction as a *qualifying transaction*.

The CPC program is a listing method based on sponsorship by shareholder-directors who acquire common shares issued at a discount to the price of shares issued to the public under the CPC's IPO. In order to obtain a listing, the CPC must have the support of at least 200 public investors within the scope of its IPO. The second step of the program is the qualifying transaction, namely, the consolidation of the CPC with an operating corporation or the acquisition of assets. Generally, the shareholders of the operating corporation or the persons who own the assets acquire control of the CPC by means of the transaction. Such a transaction is referred to as a reverse takeover. The transaction may take place in a number of ways, including a purchase of assets or shares, a business combination or an arrangement with another corporation. Once the qualifying transaction has been completed, the corporation is no longer a CPC.

A CPC does not meet all the requirements of an eligible issuing corporation. This is due to the fact that before the qualifying transaction has been completed, the CPC program limits the activities of the CPC to identifying, evaluating and completing a qualifying transaction. The rules set out below are designed to render eligible, under the SSP, shares issued within the scope of its qualifying transaction.

Financing Concurrent with the Qualifying Transaction – The status of designated eligible issuing corporation will be granted to a CPC if, on the date of the final prospectus for financing concurrent with its qualifying transaction:

- it is a Canadian corporation;
- it has assets under \$200 million (asset requirement);
- no more than 50% of the value of its property, as shown on its financial statements submitted to shareholders for its most recent fiscal year ended before the date of the receipt for the final prospectus for the concurrent financing may consist of property other than eligible investments. In computing this percentage, the liquid assets to be used in carrying out the qualifying transaction will not be included (50% of the value of property criterion);

- the majority of the proceeds of the offering will be used to carry out the qualifying transaction whose objective consists in continuing an existing business which met the following conditions throughout the 12 months preceding the qualifying transaction:
 - senior management of the business was in Québec and more than half of the salaries paid to its employees was paid to employees of an establishment located in Québec (Québec attachment criterion);
 - it had five full-time employees who are not insiders within the meaning of the Securities Act or persons related to them (five employees/twelve months criterion).
- Revenu Québec is of the view that the offering satisfies the objectives of the SSP.

SSP INVESTMENT FUND

An SSP Fund refers to a qualified mutual fund. When such a fund carries out a public offering of securities, it undertakes, in the final prospectus, to acquire eligible shares with the proceeds of the issuance of its eligible securities, namely, eligible shares issued by an eligible issuing corporation. The SSP Fund must be established in

Québec, its trustee or manager must reside in Canada and it must maintain an establishment in Québec.

SPECIAL PURPOSE ACQUISITION CORPORATIONS

On December 19, 2008, the Toronto Stock Exchange announced the introduction of the Special Purpose Acquisition Corporation program. This program is similar to the CPC program.⁷ It differs from the latter primarily due to the fact that the initial public offering must equal at least \$30 million. To date, no public offering within the scope of this program has been carried out in Canada. The Government of Québec has not yet aligned this program with the SSP.

NOTE: This text was prepared before legislation regarding the "Stock Savings Plan II" was available. Once published, the legislative text should clarify the rules for its application.

¹ Government of Québec, 2009-2010 Budget Plan (2009-2010 Budget), Page F. 20.

² Government of Québec, 2005-2006 Budget Plan, section 6, page 38.

³ Bernard S. Black, Ronald J. Gilson, "Venture capital and the structure of capital markets: banks versus stock markets", (1998) 47, Journal of Financial Economics, p. 243-277.

⁴ Source: 2009-2010 Budget, Table F.9, p. F. 23.

⁵ More specifically, eligible shares issued in the course of a financing concurrent with the qualifying transaction of a capital pool company (see below).

⁶ For more information on the Capital Pool Company Program, please consult our publication: Claude Désy, "Public Financing for SMEs", August 2008, www.degrandpre.com and "Certaines opérations sur la Bourse de croissance TSX", Congrès 2004, APFF, p. 22:1-152.

⁷ For more information on this program, please consult our publication: Claude Désy, "SPACs: Special Purpose Acquisition Corporations", January 2009, www.degrandpre.com

DE GRANDPRÉ CHAÏT S.E.N.C.R.L.
AVOCATS
1000, RUE DE LA GAUCHETIÈRE OUEST, BUREAU 2900
MONTRÉAL (QUÉBEC) CANADA H3B 4W5
T 514 878-4311 F 514 878-4333 WWW.DEGRANDPRE.COM

Corporate Financing Group

Michel G. Beaudin
Jean-Didier Bussièrès
Daniel Courteau
Claude Désy, FCA

Yves Hébert
Jacques Lemay
Martin Raymond
George Stougiannos

CE BULLETIN EST DESTINÉ À FOURNIR DES COMMENTAIRES GÉNÉRAUX SUR LES DÉVELOPPEMENTS RÉCENTS DU DROIT. IL NE CONSTITUE PAS UN AVIS JURIDIQUE ET AUCUN GESTE DE NATURE JURIDIQUE NE DEVRAIT ÊTRE POSÉ SUR LA BASE DE CE BULLETIN. © DE GRANDPRÉ CHAÏT