



CWCF
FCCT

CANADIAN
WORKER
CO-OP
FEDERATION

FÉDÉRATION
CANADIENNE DES
COOPÉRATIVES
DE TRAVAIL

DELIVERED BY EMAIL to QI-consultation-PA@fin.gc.ca

15 July 2024

Qualified Investment Consultation
c/o Director General, Tax Legislation Division
Department of Finance Canada
90 Elgin Street
Ottawa ON K1A 0G5

Dear Sir or Madam,

Re: Worker Co-ops and Registered Plans

We are writing in response to the first question in your consultation on Qualified Investments for Tax-Advantaged Savings Plans, i.e.:

- 1) *Should the rules relating to investments in small businesses be harmonized to apply consistently to all registered savings plans, and if so, how?*

We are responding primarily to this first question, although we note that facilitating investments by Canadians in co-operatives would promote more Canadian-based investments (Question 4). That is because the vast majority of co-operatives in Canada are locally focused, or at least not operating outside the country. We believe that worker co-operatives should have distinct treatment from other businesses, in the following ways. Our comments are equally applicable to multi-stakeholder co-operatives that include workers as one of their stakeholder groups, and in some cases to all types of co-operatives.

The Canadian Worker Co-op Federation (CWCF) is the national, bilingual federation of worker-owned co-operatives and related types of organizations. Our vision is to support the development of healthy, just and sustainable local economies, based on co-operative values and principles.

SOLIDARITY WORKS / LA SOLIDARITÉ NOUS RÉUSSIT

One of our services is the administration of registered plans in co-operatives of all types, CED Funds, and non-profit organizations, under the name *Common Good Capital Registered Plans Program*. CWCF's Program is one of the few which administers registered plans for such organizations. There are currently 63 members using this Program, with nearly \$70 million under administration in local communities. The fact that investors can invest locally in such community-based enterprises using self-directed registered plans is very positive and should not change.

First, we will provide some background on the issues related to registered plans that have had an adverse impact on the ability of co-operatives, and, in particular, worker co-operatives, to find the capital they need to be successful.

A great deal of capital is held in registered plans, and easier access to that capital for co-operatives would be immensely helpful.

And expanding Canadians' opportunities to invest in a co-operative through their registered plan without undue restrictions offers them expanded choices that may better fit their values, and investment priorities than many conventional investment opportunities. Lastly, we will explain what makes co-operatives different.

1. Improving Co-operatives' Ability to Raise Capital and Expanding Investors' Choice

There are provisions in the Income Tax Act (**ITA**) and its Regulation that should be revised to enhance co-operatives' ability to access the capital they need to be successful, and to provide community-minded investors with investment opportunities that better fit their values and priorities.

"Qualifying shares" in "specified co-operative corporations" are "eligible investments" for registered plans unless they are a "prohibited investment".

Co-operatives, and worker co-operatives in particular, encounter these issues in qualifying their shares for registered plans:

1.1 Definition of "Specified Co-operative Corporation"

A "specified co-operative corporation" as defined in ITA Regulation 4901(2), is either a "co-operative corporation" as defined in subsection 136(2) of the ITA or a corporation that would be a "cooperative corporation" "if the purpose described in that subsection [136(2)] were the purpose of providing employment to the corporation's members or customers".

This expanded definition, inserted in 1992, permits worker co-operatives, as well as other co-operatives to issue “qualifying shares”.

Most co-operatives, but not all, fit within the definition of “co-operative corporation” in s. 136(2) of the ITA.

It is the last of the four conditions in that definition that is problematic:

- (d) At least 90% of the shares of the corporation are held by members described in c) *or* by RRSPs, RRIFs, TFSAs, RESPs, the annuitants, holders or subscribers of which are the members described in c).

Co-operatives need to be able to reach out to their non-member supporters for the capital they need - particularly at their initial start-up stage, when capital is hardest to attract, and should they require additional capital at any time. Limiting the proportion of non-member shares held to 10% of all issued shares is a severe constraint.

This is particularly so in new worker co-ops, where the amount of capital available from member-employees is usually quite limited, and one can readily anticipate non-member non-voting shares to significantly out-number voting members’ shares in the early stages of their business development. Nonetheless, these preferred or investment shares are not controlling shares.

Co-operatives need to be much freer to obtain their capital where they can find it. Section 136 (2)(d) of the ITA negatively impacts potential financing received from outside investors, at a time when the Government is encouraging more impact investing through its Social Innovation and Social Finance Strategy.

Recommendation: that section 136(2)(d) be removed.

Alternatively, if this recommendation is not accepted, as a fall-back position we would seek to have the percentage of shares required to be held by members be significantly reduced.

1.2 “Qualifying share”

ITA Regulation 4900(14)(a)(iii) provides that a “qualifying share” of a “specified cooperative corporation” is a qualified investment for a registered plan provided that at the time the share was acquired, it was not a “prohibited investment” of the trust.

This regulation applies to investments acquired on or after March 23, 2011.

The definition of prohibited investment (ITA section 207.01(1)) is this:

Prohibited investment, at any time for a trust governed by a registered plan, means property (other than excluded property for the trust) that is at that time ... a share of the capital stock ... which the [holder of the registered plan] (or those who do not deal at arm's length with the holder) has a significant interest.

An individual is considered to have a significant interest in a corporation at any time if the individual owns at least 10% of the issued shares of any class of the capital stock of the corporation.

Shares will therefore be a prohibited investment for an RRSP if the annuitant, together with his or her spouse and RRSP (and certain other persons) holds 10% or more of the issued shares of any class.

In a worker co-operative's early days, the number of employee-members is most unlikely to be as many as ten, meaning none of the members would be eligible to place their shares in a registered plan.

And, if, due to the fortunes of the co-operative's business, the number of member/shareholders falls below ten, and each remaining shareholder therefore holds >10% of the shares, shares held in a registered plan become a prohibited investment and are immediately subject to a 50% tax applied on the fair market value of the investment.

Recommendation: For worker co-operatives, that the prohibited investment rule not apply.

1.3 Designated Shareholder

A "designated shareholder" is defined, to include a person (and those not at arm's length) owning not less than 10% of the issued shares of any class of the corporation, or if >10%, the shares cost <\$25,000.

As noted above, the number of employee-shareholders in a worker co-operative can be less than 10, prohibiting their ability to invest in the co-operative through a registered plan, and placing each member in jeopardy of becoming a designated shareholder.

A "designated shareholder" also includes a person who is part of any group of employees who control their employer, and who does not deal at arm's length with the corporation, as a "designated shareholder".

Since members of a co-operative each hold one vote in the affairs of their co-operative, it is possible that they could collectively be considered to control their employer.

We recognize that [the courts](#) have required a “common connection” for control to be established by a group of shareholders. However, the Canada Revenue Agency has taken the opposite position, including in a number of technical interpretations on the meaning of the term “designated shareholder” (see, for example, AC59554, dated February 22, 1990, and 9228791, dated November 25, 1992) where it has concluded that where shares held by the employees of the corporation are sufficient in number to have control, those employees represent a group of employees that controls the corporation.

Recommendation: That the designated shareholder provision be clearly stated to not apply to members of worker co-operatives.

2. **What makes co-operatives different?**

Key characteristics of all co-operatives are:

- Each member has one vote only at members’ meetings, regardless of the number of shares held.
- Recognizing that co-operatives do not have access to traditional private-sector capital markets, and are far less likely than private sector businesses to mislead their investors, they are permitted to seek capital from their communities without onerous securities regulation, in most jurisdictions.
- Co-operatives seek capital from their members, first, but also seek capital from non-members who support the economic, social, and/or environmental goals of the co-operative – in the case of worker co-operatives, focused on providing employment for its members. Shares sold to non-members are preference shares, not membership shares, and do not entitle the holder to a vote.
- The nature of co-op capital is different – it does not appreciate in value and does not generate capital gains for investors as the business of the co-operative succeeds.
- There is no market for a co-operative’s securities – the only purchaser is the co-operative itself.

As a result, co-operatives raise capital in fundamentally different ways from business corporations. They rely heavily on investment from their members,

but also from those non-members in the co-operative's community who support the goals of the co-operative.

We make this submission with the support of [Tapestry Community Capital, Co-operatives and Mutuels Canada](#) ("CMC"), the [Ontario Co-operative Association](#) ("OCA"), and [le Réseau de la coopération du travail du Québec](#) ("Réseau COOP"). Tapestry Community Capital is Canada's leading service partner in community bonds. CMC is the national, bilingual apex organization with a mandate to support the development of Canada's national ecosystem of 7,000 small, mid-sized and large co-operative enterprises; OCA has a similar mandate with a focus on Ontario. The Réseau COOP is a federation of Quebec worker co-operatives in a wide variety of sectors.

CWCF would like to add our support to the recommendations provided by Tapestry Community Capital in response to this consultation. By implementing both series of recommendations, we can foster a supportive environment for Canadian-based investments, and ensure that Social Purpose Organizations across Canada can continue to thrive and contribute to local community development and community wealth building.

In closing, we would appreciate further discussion among ourselves, our legal counsel Brian Iler, and Finance Department officials on this topic.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Hazel Corcoran". The signature is fluid and cursive, with a long horizontal stroke at the end.

Hazel Corcoran
Executive Director

cc: Mary Warner & Ryan Collins-Swartz, Tapestry Capital Co-Executive Directors, Hugues Bourgeois, Co-operatives and Mutuels Canada Executive Director, Isabel Faubert Mailloux, le Réseau COOP Executive Director, and Jennifer Ross, Ontario Co-operative Association Executive Director