Submission to the House of Commons Standing Committee on Finance

Pre-Budget Consultation in Advance of the 2017 Budget

Presented by:

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Executive Summary

Toronto Stock Exchange and TSX Venture Exchange are pleased to recommend actions that are directly aimed at helping Canada's businesses and entrepreneurs innovate, grow and scale up, while also contributing to high quality economic growth and enhancing our country's capacity to innovate.

First, we recommend that the flow-through share program be directed to industry sectors that will define Canada's knowledge economy. The flow-through shares program is a successful Canadian financial innovation that has demonstrably supported the growth of Canada's natural resources industry since its introduction into the Income Tax Act in the 1950s. The federal government now has the opportunity to replicate the success of this program in additional strategic clusters that represent the innovation economy.

Second, we recommend that the Scientific Research and Experimental Developments (SR&ED) Tax Incentive Program level the playing field between early stage public companies and private companies of comparable size and stage of development. If a burgeoning company launches an IPO on a public venture capital market, the investment tax credit under SR&ED drops from 35% to 15% and becomes non-refundable. The SR&ED program already contains an appropriate threshold that considers the size and stage of financial maturity of the applicant company. We are firmly of the view that the supplemental eligibility test requiring a company to be private to access SR&ED's full benefits is not only redundant, it works against the public policy objective of the program itself.

The actions proposed in this submission have the potential to provide momentum to emerging businesses, create high quality jobs across Canada, enhance Canada's capital markets strength, and help our country's entrepreneurs to commercialize important discoveries and technologies. Together, we can enhance Canada's commercial success to help our country better compete in the global race for advantage.

Introduction

Toronto Stock Exchange (TSX) and TSX Venture Exchange (TSXV) are pleased to submit recommendations to the House of Commons Standing Committee on Finance ahead of the 2017 federal budget. We appreciate the work of the committee and Members of Parliament as they consider new ways to strengthen the Canadian economy. We welcome the federal government's commitment to develop a national innovation strategy and a federal budget that emphasizes innovation, productivity and competitiveness as important building blocks of a strong, diversified economy that stimulates growth and job creation.

As Canada's leading stock exchanges, TSX and TSXV are focused on powering the development of an innovation economy. Canada's capital markets are vital to helping emerging companies and entrepreneurs both as they start up and develop, and later in the financing chain as they commercialize and scale up to eventually become market leaders in their respective industries. The success and vibrancy of our country's capital markets are integral to the government's focus on innovation economics. Indeed, companies that access public growth capital to commercialize innovative ideas have a direct impact on economic development, productivity and employment in Canada.

The recommendations below present actions which, in our opinion, would help Canada's businesses and entrepreneurs innovate, expand and prosper, while also contributing to high quality economic growth and enhancing our capacity to innovate.

Recommendation 1

Apply the flow-through share program to technology and innovation sectors

We recommend that the flow-through share program be directed to industry sectors that represent the "new economy"—in particular, sectors such as technology, clean technology and life sciences.

Flow-through shares are a successful Canadian financial innovation introduced into the Income Tax Act more than 60 years ago and has proven effective to help spur the growth of Canadian resource companies. The federal government now has the opportunity to replicate the success of the flow-through program into additional strategic clusters that will define Canada's knowledge economy. Doing so would help drive growth and stimulate additional financing for the commercialization of discoveries in the technology and innovation sector, which is comprised of the technology, clean technology and life sciences sectors.

Where the development of Canada's natural resources industry has demonstrably benefited from the visionary and innovative flow-through share program to encourage capital formation for oil & gas and mineral exploration, fiscal programs to foster capital formation for the commercialization of substantial investment into research and development in the technology and innovation sectors tend to fall short.

There is a social and financial cost to Canada if we do not close the measurable gap between the excellent Canadian research in these fields and the eventual commercialization of the fruits of that research. Extending the flow-through share program to innovation economy sectors is consistent with the federal government's innovation agenda in the 2016 Budget and aligns with the statements made in the Budget that, in these times, "*fiscal policy is the right policy lever to use to support long-term growth,*" and that the "*Government believes strongly that the best way to deliver more prosperity to more Canadians is by investing in the economy today.*"

There are structural parallels between the resource and innovation sectors:

- High risk/reward;
- Significant up-front expenditures required;
- Long timeframe between expenditures and revenues; and
- Expenditures that are, in many cases, never offset against revenues for tax purposes.

Flow-through shares allow qualifying expenditures to be used by those bearing the economic risk of the expenditures—the shareholders providing the capital. In the same way that flow-through shares have sustained the resource sector, in particular the mining sector, a similar incentive in the technology and innovation sector can be an important stimulus to enable the commercialization of activities that evolve from expenditures eligible under the Scientific Research and Experimental Developments (SR&ED) Tax Incentive Program.

Like the resources sector, innovation is about discovery and commercialization, and requires significant, calculated investment to enable success. A market with accessible risk capital will draw innovators, entrepreneurs and investors and create a self-reinforcing cluster that is continuously replenished with new talent and intellectual capital. We have a unique opportunity to leverage the strength of Canada's world-class capital markets and our world-leading scientific research by extending an existing program with a proven track record of success. Applying the benefits of the flow-through-share program would allow the government to facilitate and attract new growth capital to the technology and innovation sector, which is far more impactful than direct government funding, while also generating investment activity for local economies across Canada.

Recommendation 2

Create a level playing field for innovative Canadian SMEs under SR&ED

We recommend that the SR&ED program maintain its size test, but remove the private company condition for access to the full benefits of the program.

Canada's small and medium-sized enterprises operating in the technology and innovation sector need additional sources of financing to grow their businesses as they eventually reach the commercialization and scale up stages.

Currently, many early stage Canadian technology and innovation companies are faced with the choice between accessing capital by listing their shares on a stock exchange, or staying private to maintain their eligibility to access significant financial benefits provided by the enhanced, refundable tax credit under the SR&ED program. We believe that these options should not be mutually exclusive.

Under the current SR&ED eligibility criteria, Canadian entrepreneurs and early-stage private companies are led towards private sources of funding, such as Venture Capital (VC) or Private Equity (PE), because doing so allows them to retain access to the full benefits under the SR&ED program (the enhanced, refundable 35% tax credit). However, once a company goes public the investment tax credit (ITC) drops from 35% to 15% and becomes non-refundable—this applies to *all* public companies regardless of size or cash flow.

However, Canadian-controlled private corporations (CCPCs) and companies listed on TSXV, Canada's public venture capital market, are often similar in terms of stage of development, size and value. Eligibility criteria under SR&ED already has a threshold that considers the size and stage of financial maturity of the applicant company. This is an appropriate cut-off that, if surpassed, renders the applicant ineligible. That said, we believe that the supplemental eligibility test requiring the company to be a CCPC to access the enhanced, refundable ITC is not only redundant, it works against the public policy objective of the SR&ED program itself.

There are over 275 technology and innovation companies listed on TSXV, many of which are burgeoning—the vast majority of them have revenues under $1 million. However, these young companies still develop promising innovative technologies, and funding provided by SR&ED is often a crucial source of operating funds. We believe more entrepreneurs would consider taking their idea or business to new heights if launching an IPO did not negatively impact their SR&ED status.

Moreover, extending the benefits of SR&ED to small and early stage technology and innovation companies listed on a public market in Canada would also help keep them growing at home and grow the base of Canadian businesses. In many cases, VC or PE-funded companies who stay private to enjoy the full benefits under SR&ED end up being acquired by large firms outside of Canada. Conversely, by offering SR&ED's full benefits to early stage public companies on the same basis as CCPCs of the same size, the program would serve the very companies that it is designed to support. This would also provide further incentive to access public growth capital in Canada to position these companies for further expansion beyond start-up and initial commercialization.

Conclusion

The actions proposed in this submission have the potential to provide momentum to emerging businesses, create high quality jobs across Canada, enhance Canada's capital markets strength, and help entrepreneurs to commercialize important discoveries and technologies in the sectors that will define the post-industrial knowledge economy. Public policies that invest in and nurture entrepreneurship and innovation will enhance Canada's commercial success and help it better compete in the global race for advantage.

TSX and TSXV are committed to helping Canadian companies succeed as they grow from start up to scale up to multinational enterprises. Ultimately, Canada's capital markets play vital, intrinsic role in the success and competitive strength of Canada's economy and its future prosperity. Encouraging investment in ideas and nurturing an environment where those ideas can grow and be commercialized is a pivotal part of any growing economy.

We appreciate the review of this submission and welcome any questions from committee members. We would also be pleased to appear as witnesses during the pre-budget Finance Committee hearings in September.

Sincerely,

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