



The Future of Tax

Recommended tax measures to enhance economic prosperity for Canadians

Deloitte's pre-budget 2012 submission to the House of Commons Standing Committee on Finance

August 2011

Executive summary

As Canada's largest tax practice and as a global tax practice that advises governments and private sector clients in more than 150 countries, Deloitte has a unique perspective on competitive tax policy around the world and on the key drivers of national economic prosperity that include productivity, competitiveness, and innovation. Based on this global perspective and on our commitment to support a strong and growing Canadian economy through our [Future of Tax](#) initiative, we are pleased to provide our recommendations for consideration by the House of Commons Standing Committee on Finance ("the Committee") during the upcoming pre-budget 2012 consultations.

In this submission, we offer three recommendations that we believe will contribute significantly to the enhancement of economic prosperity of Canadians while supporting the objective of a balanced budget.

Although Canadians have long enjoyed a high standard of living relative to most countries, Canada continues to lag many other nations in terms of productivity, one of the most important drivers of prosperity. Canada's productivity challenges can be attributed to a number of factors, including business leader risk aversion, chronic under-investment in machinery and equipment, lack of risk capital for start-ups, a sheltered economy, increased competition for global talent and insufficient support for innovation. As discussed in our recent report, *The future of productivity: An eight-step game plan for Canada*, we believe that Canada has a window of opportunity to address these challenges and thereby, significantly improve productivity. To bolster economic growth and close Canada's productivity gap, we need to focus on ways to attract and retain global talent, bolster the pool of capital for start-ups, foster business innovation and invest in research and development in key sectors.

Accordingly, it is our view that the following three initiatives should be key priorities in the upcoming budget in order to improve Canada's global competitiveness and, thereby, achieve sustainable economic growth in Canada:

1. Improving incentives for Research & Development (R&D) – key to job creation and innovation in Canada

The scientific research and experimental development (SR&ED) tax regime should be improved by extending refundability of the investment tax credit to all businesses. Expanding the refundable credit to all corporations would appropriately reward the risks inherent in carrying out R&D in Canada, and would help attract foreign companies seeking global investment opportunities.

2. Introducing an Angel Tax Credit – key to financing our innovation ecosystem

An angel tax credit should be introduced to increase the amount of risk capital available for start-up companies. This will help build an environment that fosters innovation and entrepreneurship, leading to job creation and economic growth.

3. Lowering Canada's personal income tax rates – key to attracting global talent

Personal tax rates should be lowered to retain productive individuals in Canada and to attract immigrants with the requisite skills to support Canada's long term economic prosperity.

We welcome the opportunity to discuss our recommendations with the Committee and to lend our expertise and support as needed.

Deloitte's recommendations

Budget 2012 will provide the Government of Canada with an opportunity to continue its commitment to economic prosperity for Canadians. Canada has weathered a challenging global economic cycle more successfully than most countries around the world, as a result of strong fiscal leadership by Government. It is now time to look forward to the future and plan for greater growth and opportunity in the face of further global economic uncertainty as evidenced by the recent sovereign debt crises in Europe and the United States.

The Committee is seeking input regarding four primary issues: How to achieve a sustained economic recovery in Canada; how to create quality sustainable jobs; how to ensure relatively low rates of taxation; and how to achieve a balanced budget. We share the Committee's view that these are key areas of concern and opportunity.

Our key tax policy recommendations for budget 2012 reflect the Committee's goals of economic recovery and job creation while working towards a balanced budget. They are:

1. Improving incentives for R&D,
2. Introducing an angel tax credit, and
3. Lowering personal income tax rates.

1. Improving incentives for R&D – key to job creation and innovation in Canada

Innovation is identified as one of the key contributors to persistent and sustained productivity growth. Although a number of processes can lead to innovation, R&D is one of the most important.

Canada has historically led the way in tax policies that encourage innovation, primarily through its SR&ED incentive regime. The concept of these incentives is well founded and sophisticated, and can be seen as efficiently targeted government expenditure. The Canadian regime is recognized as a model upon which new regimes have been based in many countries.

The Minister of Finance has consistently acknowledged the importance of innovation for the Canadian economy, as a driver of productivity and, ultimately, employment and business success. The Canada Revenue Agency, an independent expert panel headed by Thomas Jenkins (Executive Chairman of OpenText), and the Taxpayers' Ombudsman are each reviewing various aspects of the SR&ED program. In our view, the current framework has served Canada and Canadian taxpayers well and we recommend that the current SR&ED framework be retained.

However, we applaud the Government for looking for ways to further stimulate innovation. Competition for global R&D investment is intensifying. It is therefore critical for Canada to improve its SR&ED programs in order to remain competitive. In 1996, only 12 OECD countries offered R&D tax incentives; today, 35 countries offer them, with more countries, such as Germany and Sweden, considering the

introduction of such regimes. Furthermore, other countries such as France and Brazil have dramatically improved their programs.¹

A necessary improvement to the SR&ED regime is the extension of refundability of the investment tax credit to all businesses, as is the case in a number of other countries and many provinces. Refundability, for many US-based multinational enterprises, means the difference between the incentive being a permanent tax savings or a tax deferral, which can be a powerful distinction in perceived value.

Currently, only Canadian-controlled private corporations (whose income does not exceed the specified limit) may claim a refundable credit. Furthermore, large companies only receive the benefit of the credits in years with taxes payable. For these organizations, planning becomes a challenge as many operate in cyclical industries and have difficulty predicting the years in which they will have sufficient corporate tax liability to absorb the SR&ED tax credits. Expanding the refundable credit to all corporations would appropriately reward the risks inherent in carrying out R&D in Canada. This would send a strong message to foreign companies seeking new investment opportunities.

Introducing refundability of investment tax credits for all businesses will not only increase investment in R&D but also increase overall economic spending. It is estimated that full refundability will generate an additional \$520 million in R&D spending just from companies that currently claim SR&ED incentives but do not include SR&ED in making their R&D investment decisions. This change alone will generate more than \$1.1 billion in total spending across the Canadian economy which will result in a positive GDP impact of almost \$650 million and an increase in total employment of almost 9,400 full-time equivalents (FTEs). Estimates of the increase in R&D spending for companies, who currently do not claim SR&ED credits but would do so if they were refundable, are difficult to determine. However, in general, for each additional \$1.0 billion of additional R&D spending undertaken in Canada, the GDP impact is approximately \$1.2 billion and the employment impact is an increase of almost 18,000 additional FTEs.²

Global organizations value stability in making long-term investment decisions. The more predictably and consistently our SR&ED program is administered, the higher its value is to any large organization choosing between jurisdictions in which to invest. We encourage the Government to work with industry groups and other key stakeholders to identify points of anxiety and uncertainty in order to provide a more stable planning horizon for organizations considering Canada as the place in which to invest.

2. Introducing an Angel Tax Credit – key to financing our innovation ecosystem

Knowledge-based industries will contribute significantly to Canada's productivity and economic growth. This sector will develop exponentially in the near future as well as in the long term. Canada has an opportunity to claim global leadership in industries such as life sciences, alternate energy, clean technology, digital media and other areas of technology and innovation.

The tax system can play an important role in securing Canada's leadership in these fields. In addition to tax incentives for specific activities (such as the SR&ED incentives noted above and incentives to encourage innovation clusters), support for financing is essential. In particular, consideration should be given to targeted credits, specifically for venture capital investors: an angel tax credit to support early stages of innovation industry development when risks are higher and a later stage credit for corporate venture investors. We recommend that priority be given to an angel tax credit as it is the logical starting

¹ Aronshtam, Natan and Joanne Hausch, "Innovation and the SR&ED Program", Canadian Tax Foundation 62nd Tax Conference, 2010 (Report forthcoming).

² Ibid.

point for the renewal of Canada's innovation initiative and it is the incentive that can have the greatest impact on growing our economy.

Since 2003, British Columbia has successfully provided a provincial angel tax credit as part of its Equity Capital Program. This program was implemented to help create new businesses and expand existing ones. Based on an evaluation of that program in 2010, the angel tax credit is estimated to generate \$2.91 in federal and provincial consumption and income taxes for every dollar of credit claimed.³ British Columbia's experience suggests that the introduction of a federal angel tax credit would not result in any long term cost to the federal government as the credit would generate more tax revenue than the actual cost to the federal government.

3. Lowering Canada's personal income tax rates – key to attracting global talent

To improve Canada's economic growth, a key focus must be the retention of productive individuals and the attraction of new immigrants who will be able to contribute to Canadian prosperity. Accordingly, we encourage the Government to focus on enhancing the competitiveness of the personal income tax regime.

Retaining and attracting globally mobile and highly productive individuals depends upon many factors - not only economic drivers. Canada is a wonderful place in which to live and a stable environment in which to raise a family. These factors are already a powerful source of attraction to Canada. We believe, however, that more individuals would stay in Canada or move to Canada if the government were to lower personal income tax rates, starting with an increase to the threshold at which the top rate of tax begins and also reducing the top rate of tax. The personal income tax rate differential between Canada and the United States is of particular concern.

In this regard, Canada's human capital needs should be articulated in a reasoned and practical multi-year plan aimed at increasing immigration to fill gaps in the Canadian workforce and to support an innovation based economy. A larger population of well paid, skilled individuals will contribute significantly to an increase in the overall amount of personal taxes collected, even with our recommended personal tax rate reductions.

The suggested enhancements to the personal income tax regime can be introduced gradually over the next four to six years, in much the same manner as the reductions to corporate tax rates were phased in. Just as the anticipated benefit of lower corporate rates influenced corporate behaviour before the rate reductions were complete, we believe that the anticipation of phased in personal income tax rates will influence productive, innovative and mobile individuals to remain in or immigrate to Canada before the rate reduction is fully effectuated.

We believe that a reduction in personal income tax rates in conjunction with other measures designed to increase productivity and overall prosperity should not result in a reduction of overall personal income tax collected. However, if the government believes that it must offset these reductions with increases elsewhere in the tax system, we believe that there is room to do so with consumption taxes, which are low by global standards.

³ Helleman, Thomas and Paul Schure. "An Evaluation of the Venture Capital Program in British Columbia" British Columbia: Ministry of Small Business, Technology, and Economic Development. 2010.

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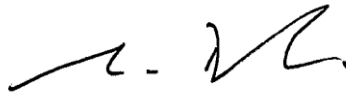
We are grateful for the opportunity to appear before the Committee and provide our views with respect to priorities for budget 2012. We believe that the three priorities that we have identified in this submission - improving the R&D tax incentive, introducing an angel tax credit, and lowering personal tax rates - will create sustainable economic growth at a limited cost to the federal government.

We look forward to additional opportunities to contribute to discussions on the future of Canada.

Deloitte is committed to helping shape tax policy that will foster long term growth in the Canadian economy. Our [Future of Tax](#) initiative is our vehicle for communicating our tax policy vision to our clients, governments, academia and the Canadian community at large.



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