Standing Committee on Finance (FINA)

Pre-budget consultations 2012

Deloitte Touche LLP

Responses

1. Economic Recovery and Growth

Given the current climate of federal and global fiscal restraint, what specific federal measures do you feel are needed for a sustained economic recovery and enhanced economic growth in Canada?

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. In our view, the key to driving economic growth and prosperity in Canada is to address Canada's lagging productivity. Thus, we recommend the following policy initiatives: Improve incentives for research and development (R&D) – Innovation is a key driver of both productivity and, ultimately, employment. However, Canada's historic leadership in encouraging innovation is under threat. With the competition for attracting global R&D investments intensifying, it is critical for Canada to improve its Scientific Research and Experimental Development (SR&ED) tax regime to remain competitive. The SR&ED investment tax credit should be improved by extending refundability 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. Introduce an angel tax credit – Support for financing is essential to driving economic growth in Canada. Significant gaps exist in Canada's financing ecosystem – from early seed financing through to initial public offerings, it is our observation that Canada does not do enough to support home-grown enterprises with world-class potential. We recommend introducing an angel tax credit to increase the amount of risk capital available for start-up enterprises. This will help build an environment that fosters innovation and entrepreneurship, leading to job creation and economic growth. Lower Canada's personal income tax rates – A key focus must also be attracting and retaining globally mobile and highly productive individuals. Personal tax rates should be lowered to retain such individuals in Canada and to attract immigrants with the requisite skills to support Canada's long term economic prosperity. The Government should start with an increase to the threshold at which the top rate of tax begins and a reduction in the top rate of tax. The suggested enhancements to the personal tax regime can be scheduled over the next five to ten years. We believe that there is room to offset these reductions with consumption taxes, which are low by global standards.

2. Job Creation

As Canadian companies face pressures resulting from such factors as uncertainty about the U.S. economic recovery, a sovereign debt crisis in Europe, and competition from a number of developed and developing countries, what specific federal actions do you believe should be taken to promote job creation in Canada, including that which occurs as a result of enhanced internal and international trade?

Small Canadian firms have been credited as the engines of Canadian job creation. However, statistics tell a more complicated story. From 1993-2003 small firms of less than one hundred employees created 86% of net new Canadian jobs, while large firms with more than five hundred employees made no contribution to job growth, shedding an average of 35,000 jobs per year. However, data from 2004-2010 indicates that 51% of all new jobs were created by large firms and small firms contributed only 37% of new jobs. While policies geared towards driving new employment tend to focus on the size of firms, data suggests that their growth rates are a more important predictor of their job creation role. From

2001-2006 only 4.9% of private sector firms had annual growth rates greater than 15%, but these firms were responsible for 43% of new jobs created over that time. Moreover, small firms were no more likely to be high growth than their larger peers, with the proportion of high growth companies among firms with as few as 10 employees being roughly equivalent to those with 250 employees. Canada's biggest challenge revolves around maintaining the rapid growth of these firms beyond their early years. Canada has a large share of high growth companies among firms less than five years old, significantly higher than the United States and on par with Israel, a country that is known for its best practices in generating high growth companies. However, conditions are not in place to maintain this growth. The penetration of high growth firms more than five years old is significantly weaker in Canada than in the U.S. and Israel. Deloitte research suggests that this is driven by the limited availability of growth and expansion funding to firms during this critical phase of development. Therefore, the key to job creation is to provide effective support to growing firms – particularly in terms of financing. We believe that improving the SR&ED program by extending refundability to all businesses and introducing an angel tax credit for investments in early-stage companies will help to create the financing ecosystem needed by growth firms.

3. Demographic Change

What specific federal measures do you think should be implemented to help the country address the consequences of, and challenges associated with, the aging of the Canadian population and of skills shortages?

To address Canada's aging population and skills shortage, a key focus must be attracting and retaining the individuals most likely to drive economic innovation and improve Canada's productivity. Accordingly, we encourage the Government to focus on enhancing the competitiveness of the personal tax regime, the immigration policies and the incentives to encourage retirement savings. Reduce personal tax rates – Attracting and retaining globally mobile and highly productive individuals depends upon many factors. Canada is a wonderful place to live and a stable environment in which to raise a family. However, as noted above, we believe that more individuals would stay in Canada or move to Canada if the Government were to lower personal tax rates. Increase targeted immigration – With Canada's aging population, our country'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 a sound knowledge base. We applaud the Government for announcing steps to transform Canada's immigration system to ensure that more individuals with the necessary skills have ready access to the appropriate sectors of the Canadian economy. We encourage the Government to continue improving the immigration process by increasing overall targets and sharpening existing programs. Encourage retirement savings – The Government has recognized the importance of encouraging retirement savings today to avoid an economic crisis in the future. However, Canadians still do not save enough, with almost $600 billion in RRSP contribution room remaining unused. Clearly, additional approaches are required, as noted by Andrew W. Dunn and others before the Standing Senate Committee on Banking Trade and Commerce. A specific proposal put forward by Deloitte to the Committee is a flow-through of the tax benefit of certain forms of income (e.g., dividends paid by Canadian corporations) when withdrawn from Canadian retirement vehicles. We strongly encourage the Government to introduce creative and appropriate incentives to increase savings such as the recommendations outlined in The Final Report of the Standing Senate Committee on Banking, Trade and Commerce, Canadians Saving for their Future: A Secure Retirement.

4. **Productivity** *With labour market challenges arising in part as a result of the aging of Canada's population and an ongoing focus on the actions needed for competitiveness, what specific federal initiatives are needed in order to increase productivity in Canada?*
With the significant demographic shifts underway in Canada, an increasingly smaller subset of the population will be responsible for improvements in living standards. Thus, continued economic growth will only be sustained through ongoing, persistent improvements in the productivity of our workforce. However, as mentioned above, Canada's productivity continues to lag many other nations. Several factors cause this low productivity: risk aversion among business leaders, chronic under-investment in machinery and equipment, lack of risk capital for start-up enterprises, sheltering of certain industry sectors, increased competition for global talent, and insufficient support for innovation. According to Deloitte's report, "The future of productivity: An eight step game plan for Canada", Canada has an opportunity to address the serious issues undermining Canadian productivity and, thereby, improve productivity through the following eight-step framework: Educate: ensure that our education system fosters entrepreneurship and innovation at all levels Populate: re-tool the immigration system to attract and fully utilize skilled immigrants Innovate: improve the effectiveness of R&D Incubate: bolster the pool of risk capital for start-up enterprises Co-locate: create a national clustering strategy Update: invest in machinery and equipment Accommodate: ease the flow of foreign direct investment Facilitate: reduce trade barriers and pursue new markets Many of our recommendations outlined above support these eight actions. In particular, reducing the personal tax rates, increasing targeted immigration and encouraging retirement savings will help to 'populate'. The action to 'innovate' is supported by our recommendation to introduce refundable SR&ED tax credits to all businesses. Finally, we believe that one of the keys to 'incubate' will be to introduce an angel tax credit to support early-stage financing.
5. **Other Challenges** *With some Canadian individuals, businesses and communities facing particular challenges at this time, in your view, who is facing the most challenges, what are the challenges that are being faced and what specific federal actions are needed to address these challenges?*
With its abundance of natural resources, Canada has been a global leader in the natural resources and mining sectors. However, Canada must diversify its economy if we want to experience continued and sustained economic growth. The knowledge-based industry will contribute significantly to Canada's productivity and economic growth; however, this sector is currently facing significant challenges in achieving success in Canada. In the knowledge industries, talent and innovation provide competitive advantages that help to drive success. Unfortunately, Canada is experiencing low rates of innovation in comparison to other countries, increasing competition and also a shortage of talent with an aging population. We believe that the challenges to this sector can be addressed by several of the recommendations noted previously. In particular, the recommendations most effective for this sector will be improving the SR&ED tax credit regime, reducing the personal tax rate, and providing financing support through an angel tax credit.