HOUSE OF COMMONS
CHAMBRE DES COMMUNES
CANADA

**House of Commons Standing Committee on Finance – Pre-budget Consultations 2013**

**This brief is submitted by:**

(●) **an organization** **Organization name:** Investment Industry Association of Canada (IIAC)

**or**

( ) **an individual** **Name:** _____

**Topic:** Financial services and other financial issues

## *Recommendation 1: Please provide a short summary of your recommendation.

The government should undertake a cost-benefit study on the impact of a lower capital gains tax rate for small business investments. The government should study the three following options: (1) a "roll over" exemption from capital gains tax conditional on the purchase of common shares of small listed Canadian companies within a six-month period; (2) a lower effective capital gains tax rate for the IPO shares and/or secondary offerings of treasury shares of small listed Canadian companies; (3) a lower effective capital gains tax rate for the traded shares of small listed Canadian companies.

**Expected cost or savings:** From the pull-down menus, please indicate the expected cost or savings of your recommendation to the federal government and the period of time to which the expected cost or savings is related.

≤$499,999

1 year

**Federal funding:** Please provide a precise indication of how the federal government could fund your recommendation. For example, indicate what federal spending should be reallocated, what federal tax measure(s) should be introduced, eliminated or changed, etc.

Conducting a study to determine the costs and benefits of such tax changes in Canada would incur only minimal costs. The total costs associated with foregone tax revenue would depend on how the incentive is structured and targeted. However, as described below in "General impacts", we believe that the costs would likely be outweighed by the improved growth in the Canadian economy.

**Intended beneficiaries:** Please indicate the groups of individuals, the sector(s) and/or the regions that would benefit by implementation of your recommendation.

The intended beneficiaries go beyond small and mid-sized businesses to benefit Canadians by energizing the Canadian economy, unlocking investment capital and creating employment. The government could structure a more targeted incentive aimed at benefitting small and mid-sized tech companies, thereby limiting the tax expenditure. The decision to target the tax incentives should be based on the effectiveness of the incentive in raising equity and minimizing the administrative burden for government.

**General impacts:** Depending on the nature of your recommendation, please indicate how the standard of living of Canadians would be improved, jobs would be created, people would be trained, etc.

Canada continues to face the dilemma of low productivity, and the supply of risk capital to innovative small and mid-sized businesses has been severely impacted. The government's commitment to provide $400 million for co-investment in private venture funds will stimulate investment in emerging firms in the private market; however the success sparked by that initiative depends critically on the ability of these companies to go public and remain in Canada.

**Topic:** Financial services and other financial issues

## Recommendation 2: Please provide a short summary of your recommendation.

The government should undertake a cost-benefit study of implementing a small business financing incentive program providing income tax relief equaling up to 30% of the value of small business common shares purchased, and a tax exemption from capital gains earned on these shares if held for three years. This program could be modeled after the successful Enterprise Investment Scheme, implemented in 1993 in the UK, which has been subject to independent review, and expanded in 2012. A tax incentive would attract capital back into the equity markets by improving after-tax returns on equity shares.

**Expected cost or savings:** From the pull-down menus, please indicate the expected cost or savings of your recommendation to the federal government and the period of time to which the expected cost or savings is related.

≤$499,999

1 year

**Federal funding:** Please provide a precise indication of how the federal government could fund your recommendation. For example, indicate what federal spending should be reallocated, what federal tax measure(s) should be introduced, eliminated or changed, etc.

The costs to conduct a study of such a program in Canada would be minimal. Our initial cost estimates for a similarly structured Canadian program, based on UK tax expenditures under the EIS in 2010, are approximately $240 million annually. However, as described below in "General impacts", we believe that the costs could be greatly outweighed by improved access to capital by small companies in the technology and knowledge-based sectors, necessary for expansion and growth.

**Intended beneficiaries:** Please indicate the groups of individuals, the sector(s) and/or the regions that would benefit by implementation of your recommendation.

The government's policy challenge is mobilizing capital to fund investment in small, emerging and midcap businesses. Adopting this model to unlock investment capital would go beyond helping small and mid-sized businesses and creating jobs. It would give more Canadians access to participate in the markets' growth, which will be critical as Canadians cannot rely on deposits to save for retirement, and regulation is leading to more private and exempt market issuance that everyday Canadians cannot access.

**General impacts:** Depending on the nature of your recommendation, please indicate how the standard of living of Canadians would be improved, jobs would be created, people would be trained, etc.

Institutional and retail investors in Canada have pulled roughly $10 billion in cash onto the sidelines in the four-year post-crisis period, reflecting high levels of risk aversion and weak conditions in the capital markets. Since the EIS was launched in 1993, over 18,500 companies have benefitted and over £8.6 billion in capital has been raised. In 2010/11, a total of 1,937 UK companies raised funds through EIS, of which 1,000 were companies raising funds for the first time. We believe that similar results could be achieved in Canada.

**Topic:** Retirement, pensions and seniors

## Recommendation 3: Please provide a short summary of your recommendation.

The government should remove CPP and EI taxation of employer and employee contributions to RRSPs, putting them on an equal footing with contributions made to defined benefit and defined contribution pension plans, and with the newly created Pooled Registered Pension Plans (PRPPs). Group RRSPs are the easiest and least risky retirement savings program offered by small businesses. Furthermore, the evidence shows that RRSP savings are predominantly used as retirement income.

**Expected cost or savings:** From the pull-down menus, please indicate the expected cost or savings of your recommendation to the federal government and the period of time to which the expected cost or savings is related.

$10 million-$99.9 million

1 year

**Federal funding:** Please provide a precise indication of how the federal government could fund your recommendation. For example, indicate what federal spending should be reallocated, what federal tax measure(s) should be introduced, eliminated or changed, etc.

Our estimates show that initially, this recommendation would reduce tax revenue by approximately $50 million in forgone tax revenue; however, we believe that the costs would be outweighed by the retirement savings benefit to Canadians and in reducing costs for small business, broadly regarded as the engine of job creation in Canada. The loss of tax revenue to the government is limited as yearly maximum pensionable earnings (around $50,000) cap CPP and EI contributions and limit RRSP contributions.

**Intended beneficiaries:** Please indicate the groups of individuals, the sector(s) and/or the regions that would benefit by implementation of your recommendation.

This is a matter of fairness: if DB and DC pension providers and holders do not pay CPP and EI on comparable amounts, nor should companies offering, and their employees, in group RRSPs. These changes will have an immediate benefit for small businesses and lower-income Canadians using group RRSPs. Businesses will be able to convert saved taxes into new products, services and jobs; individual Canadians will be able to save more for retirement. This recommendation will give Canadians more choice and fairer treatment between popular group RRSPs, PRPPs, and registered pension plans.

**General impacts:** Depending on the nature of your recommendation, please indicate how the standard of living of Canadians would be improved, jobs would be created, people would be trained, etc.

Eliminating payroll taxes from group and employer direct RRSP contributions will reduce costs for businesses, especially small businesses that are the majority of group RRSP users. These businesses would then have more money for growth, jobs or income on which taxes would be paid. Lower income individuals would also see an increase in net savings. Furthermore, the elimination of payroll taxes on contributions will give businesses more incentives to offer these plans to employees, reducing the need for government funding to meet income needs for retirees.

Please use this page if you wish to provide more explanation about your recommendation(s).

Canada needs direct business investment to expand existing enterprises and build new companies, creating new job opportunities for Canadians. Implementing tax incentives would attract capital back into the equity markets by improving the after tax rate of return on shares of small businesses. A vibrant public market for small companies is vital to improving access to capital to promote the growth of these companies.

We commend the government on its careful financial management during this era of ongoing economic uncertainty, and recommend continued prudent management of public finances to reduce the public debt-to-GDP ratio, consistent with government targets. Prudent financial management has allowed Canada to set competitively low corporate tax rate levels, and continued fiscal discipline will provide both domestic and foreign investors with confidence that the government will maintain these corporate tax rate levels. We note that lower rates have not resulted in a decline in corporate tax revenues, and that more corporate taxes were raised in 2012 than in previous years.

Small companies in Canada find it difficult to raise risk capital for expansion, a crucial issue for the government to address, as Industry Canada reports that small firms accounted for 43 percent of all jobs created, on average, in the private sector for the most recent 10-year period available. The government has acknowledged this through the $400 million grant for venture capital in its 2012 Budget; however, we believe that a widely-applicable tax-assisted incentive is the most effective means to channel capital to small companies. In this way, the market can determine the most attractive opportunities for support.

Diminished Canadian productivity and a lack of vibrancy in the Canadian capital markets have also affected the health of a key part of the financial sector in a way that negatively impacts Canadian investors. In just the four years since the financial crisis, we have seen the disappearance of more than 30 small and mid-sized investment dealers. The amalgamation of small dealers can lead to stronger firms; but an accelerated pace of consolidation foreshadows negative consequences for our markets and economy. The demise of the small dealer will limit consumer choice for wealth management services, aggravate the already difficult financing problem for small and mid-sized companies that were traditionally served by smaller dealers, and erode the liquidity of TSX and Venture listed shares. To ensure that small dealers survive, both industry and regulators must continue to monitor and adjust their business and rule-making models respectively to cope with new realities; however, this could be bolstered greatly by the adoption of the recommendations we have made to improve Canadian productivity and re-ignite participation in the capital markets.

*Please note that at least one recommendation must be provided