INVESTMENT INDUSTRY ASSOCIATION OF CANADA
ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÈRES

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Pre-Budget Consultations 2014
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EXECUTIVE SUMMARY - RECOMMENDATIONS

The Investment Industry Association of Canada (IIAC)[1] recommends the following policy actions for inclusion in the 2015 Federal Budget:

1. Adoption of a "rollover" provision for deferral of capital gains tax on the asset sold, conditional on the purchase of common shares of small listed Canadian companies within six months of the asset sale.

2. Implementation of a tax incentive program for new and emerging businesses. This program is modeled after the UK Enterprise Investment Scheme (EIS).

3. Increased annual contribution limits for TFSAs and RRSPs and compensatory adjustments for people who have missed annual contributions due to the temporarily interruption of their working careers due to job loss, early-stage child-rearing, or to upgrade education/qualifications.

4. Deduction of CPP and EI payments for employer and employee contributions to Group RRSPs.

5. Elimination of the minimum annual withdrawal requirement from RRIFs.

[1] The Investment Industry Association of Canada (IIAC) is the national association representing the investment industry's position on securities regulation, public policy and industry issues on behalf of our 160 IIROC-regulated investment dealer Member firms in the Canadian securities industry. These dealer firms are the key intermediaries in Canadian capital markets, accounting for the vast majority of financial advisory services, securities trading and underwriting in public and private markets for governments and corporations. The IIAC provides leadership for the Canadian securities industry with a commitment to a vibrant, prosperous investment industry driven by strong and efficient capital markets.

INTRODUCTION/BACKGROUND

New, emerging, and established small and mid-sized Canadian businesses find it increasingly difficult to access scarce equity capital to fund business expansion. The small business sector is the engine of the Canadian economy, creating jobs, investment, and business activity across the country.

The Canadian venture stock markets for publicly listed companies provide the deepest source of capital for emerging and small businesses. While angel networks and venture capital funds are an important source of capital for small business, these pools of capital are relatively small in financing scope, and perform a more specialized function at the pre-public state of the financing process, often before the business has grown to significant size. A key shortcoming in the Canadian business sector is the fact that growth of many small businesses is truncated before these companies reach maturity. Despite a good track record of start-up and early stage businesses in Canada, many small and thriving businesses are acquired, merged or terminate operations because they lack access to capital.

Federal policy has typically ignored the venture equity market, despite its proven effectiveness in funding a wide cross-section of small public companies. It appears the federal government has been hesitant to introduce a broadly based incentive to improve the capital-raising potential of the venture markets and listed small companies reflecting concern about unintended consequences of unexpectedly high tax expenditures, or possibly tax administration complications. However, we believe an effective incentive can be narrowly structured to meet specific policy objectives. Moreover, evidence from other jurisdictions demonstrates that such an incentive can be designed in practical terms.

BALANCING THE FEDERAL BUDGET

The IIAC commends the government for its careful management of public finances over the past five years of global economic uncertainty. Bringing Canada's budget into balance by 2015 remains critical, as healthy public finances are the key to sustainable social programs and to stable and declining tax rates. These conditions are important prerequisites for business investment in Canada.

The Canadian economy rebounded strongly in the second half of 2013, and, despite some retraction during the prolonged winter of 2014, the economy is in a modest upward trajectory for the balance of 2014 and 2015. Bank of Canada reports show that, investment in machinery and equipment is expected to increase over the next 12 months[2]. Recent investor surveys illustrate that Canadians are likely to increase investments of their income over the next year.[3]

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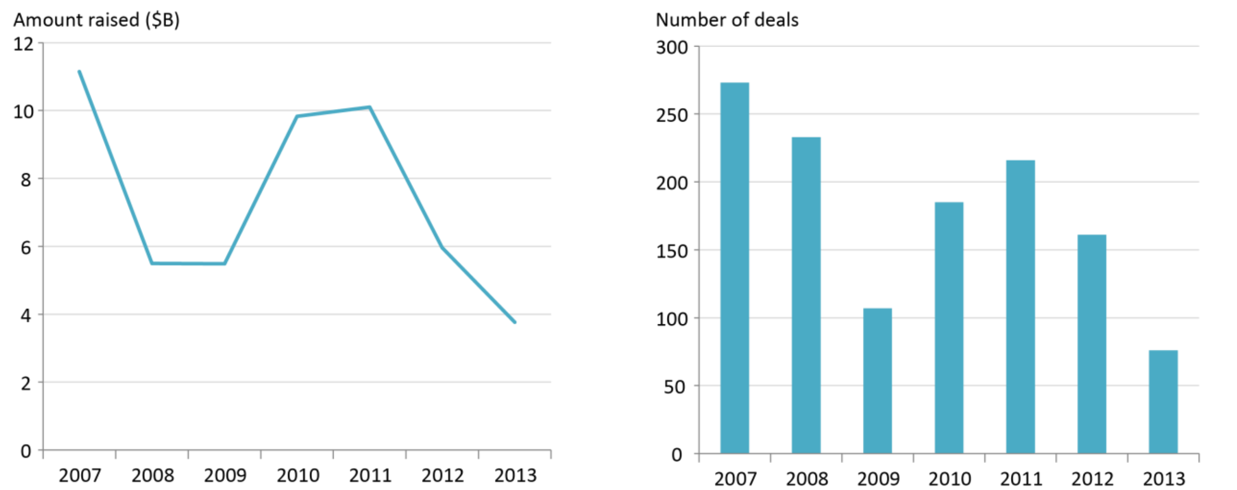
[2] Bank of Canada Business Outlook Survey, Vol. 11.2, July 7, 2014, p. 3. **http://www.bankofcanada.ca/wp-content/uploads/2014/07/bos-summer2014.pdf**
[3] "*Higher economic optimism spurs significant increase in investments by Canadians*", Investment Executive July 7, 2014 (quoting results from TD Investor Insights Survey).

The conflation of a balanced federal budget, improving state of the Canadian economy and greater optimism among Canadian business owners and investors provide a timely opportunity to introduce targeted policy initiatives to boost capital formation in the country: (1) tax incentives for investment in the equity shares of small cap enterprise, both private and public companies, to enable these companies to fund capital formation and growth; and (2) expanding and improving existing tax-assisted savings programs (such as RRSPs and TFSAs) to strengthen retirement savings for Canadians and to build the pool of savings to fund Canada's future.

INCREASING OPPORTUNITIES AND THE NEED TO COMPETE: ADDRESSING THE CAPITAL RAISING CRISIS FOR SMALL COMPANIES

Over the past year or so, financing activity in venture markets has collapsed to near-record levels. The amount of capital raised by TSX-V companies over the past three years has fallen 63% from $10.1 billion in 2011 to $3.8 billion in 2013. Over the same period, new listings on venture exchange have declined by near two-thirds to 76 listings in 2013[4].

Financing Activity in TSX Venture Markets



Source: TSX, IIAC

The shortage of capital channeled through the venture markets reflects several factors: (i) continued weak economic conditions that cloud the prospects for small resource and non-resource business; (ii) pervasive risk-aversion among investors reflecting the uncertain times; (iii) limited effectiveness of angel networks and venture capital funds in financing early stage companies; and (iv) the aging demographic that reduces speculative investment among retail investors.

What is called for in these circumstances is a tax incentive with the leverage to *unlock* significant amounts of capital tied-up in low-return investment and *re-direct* this capital to more productive

[4] Industry data available from TMX, TSX Review.

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investment. A "roll-over" provision that allows individual investors to sell real and financial assets, without incurring capital gains taxation as long as the proceeds are re-invested in small business shares, is the answer. These capital gains taxes, in reality, are deferred until the final eligible investment is sold, but, in the interim, the deferral is a powerful encouragement to re-invest capital in the shares of small businesses.

The key recommendation for the 2015 Federal Budget is a "rollover" or deferral of capital gains tax, conditional on the purchase of common shares of small listed Canadian companies within six months of the sale of the existing asset. The government could place certain conditions on eligibility for the tax-deferred rollover, such as hold periods on the new investment to limit the scope of the policy and provide greater stability to stock prices. The IIAC has commissioned research to describe the effectiveness of this investment incentive in other jurisdictions and demonstrate the administrative practicality of the roll-over provision.

The second recommendation is implementation of a small business financing incentive program targeted to startup and emerging companies. This incentive would complement angel investors and venture capital funds. The program could be closely modeled after the successful Enterprise Investment Scheme (EIS) in the United Kingdom, which has been in existence for more than 20 years. The EIS provides 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 has had a profound impact on financing small business in the UK. Since the EIS was implemented, over 20,000 small UK companies have raised over £8.6 billion in capital. The amount of capital raised through EIS in 2011-12 (the most recent year recorded) is the highest amount raised since 2000-01, with over £1 billion raised for 2,596 companies, of which 1,498 were companies raising funds for the first time.[5] An EIS-type program in Canada would complement the angel investor and venture fund network. More importantly, the EIS has been proven an effective incentive to assist small business. We believe that Canada can achieve similar results, and based on UK tax expenditures related to EIS, the benefits to the Canadian economy would greatly outweigh the expenditure of the program.

IMPROVING CANADA'S TAXATION AND REGULATORY REGIMES: FAIRNESS AND CHOICE IN RETIREMENT SAVINGS

Although most Canadians are building sufficient savings for retirement, both through registered and non-registered retirement savings vehicles, and through employer sponsored defined benefit and defined contribution pension plans, the evidence suggests registered plans need to be strengthened to ensure all Canadians have sufficient opportunity to build retirement savings. This is a far more effective approach to pension reform than expansion of the CPP or introduction of a similarly structured provincial plan.

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[5] "*Enterprise Investment Scheme Statistics*", HM Revenue & Customs, December 2013. **https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/302967/140213_EIS_commentary.pdf**

1. ***Increased annual contribution limits for TFSAs and RRSPs.*** The federal government committed itself to doubling the annual contribution limit for TFSAs once the budget is balanced. This promise, therefore, should be made good by next year. Modest increases in RRSP contribution limits would complement these increased TFSA savings, providing Canadians with more scope to build retirement savings.

2. ***Deduction of CPP and EI payments for employer and employee contributions to Group RRSPs.*** Group RRSPs should qualify for exemption from payroll taxes for contributions to Group RRSPs, similar to the tax treatment for defined benefit and contribution pension plans. Small businesses and their employees already have $57 billion in Group RRSPs and 20 million Canadians rely on Group RRSPs for their retirement.

3. ***Removal of the rules requiring minimum annual withdrawal from RRIFs.*** Canadians are living longer and earning lower returns on their investments than when these rules were introduced in 1992. This means Canadians may outlive their retirement savings.[6] Since the assets in RRIFs are taxable on the death of the account holder (or spouse/partner), eliminating minimum withdrawals from RRIF only means a tax deferral.

CONCLUSION

We thank the Committee for its diligence in carrying out its pre-budget consultations and look forward to appearing before the Committee and providing additional research material as required supplementing these recommendations.

[6] "*Outliving Our Savings: Registered Retirement Income Funds Rules Need a Big Update*" C.D. Howe Institute, William B.P. Robson and Alexandre Laurin.

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