

House of Commons Standing Committee on Finance 2016 Pre-Budget Consultations February 19, 2016

Executive Summary

The Investment Industry Association of Canada (IIAC) welcomes the opportunity to participate in pre-budget consultations and to provide our recommendations on behalf of our 144 IIROC-regulated investment dealer Member firms in the Canadian securities industry.

The IIAC works to foster a vibrant, prosperous investment industry driven by strong and efficient capital markets. Well-functioning capital markets are essential for the Canadian economy. They facilitate efficient capital raising investment, thereby expanding business operations and job creation. Capital markets are where governments raise money and where Canadians invest their hard-earned savings. In 2014, Canadian businesses raised \$42.8 billion in equity capital in secondary offerings in public and private markets and an additional \$85.8 billion by issuing bonds. Canadian governments raised \$164.2 billion through debt issuance to fund improvements to public infrastructure and other public services valued by Canadians. The Canadian investment industry advised on the structuring of these public and private offerings and it managed the underwriting and distribution of these securities. The securities industry also advised and managed approximately \$330 billion in RRSPs, \$46 billion in TFSAs and \$95 billion in RRIIs on behalf of Canadians, helping them prepare for their retirement.

The economic and financial environment remains challenging. Continued weak global economic conditions and depressed energy prices have placed a stranglehold on economic growth. The near-term outlook for both growth and commodity prices has deteriorated since the previous government presented its budget in April 2015. The strategic focus of the new government on infrastructure project spending as the backbone of economic growth should be commended, but the government should also consider more innovative approaches to improving access to external capital for new and emerging businesses. Specific incentives can be targeted to take advantage of Canada's deep and effective capital markets, excellent availability of quality investments and the expertise to identify them, and the savings to fund attractive opportunities with good returns.

Federal policy should also continue to focus on creating a positive business climate—e.g. having competitive personal and corporate income tax rates and minimizing red tape—and on improving the existing tax-assisted retirement savings system.

Specifically, the IIAC recommends that the federal government:

1. Implement legislation to provide for the deferral of income taxation on taxable capital gains incurred in a taxation year when the proceeds are reinvested in small business shares within a six-month period.
2. Implement a tax relief scheme to spur investment in small Canadian companies and startups modeled after the successful UK Enterprise Investment Scheme (EIS) and Seed Enterprise Investment Scheme (SEIS).
3. Create targeted efforts to improve existing federal tax-assisted savings vehicles, including:
 - Relief of employers' and employees' contributions to Group RRSPs from payroll tax.
 - An increase to annual RRSP contribution limits and compensatory adjustments for individuals that have missed annual contributions due to temporary interruption of their working careers.
 - Elimination of mandatory minimum yearly drawdowns from RRIFs and similar accounts.

Introduction

Canada has witnessed a remarkable transformation in the business tax landscape over the last decade and a half. Once known for having one of the highest corporate tax rates among developing nations, the average combined federal/provincial tax rate has been reduced from 43% in 2000 to 26.5%. Nonetheless, we have not achieved the goal of a combined 25% tax rate because provincial tax rates have not followed in lock-step with federal reductions and have even backtracked in response to budget deficits. It is all the more important that the government hold the line on corporate tax rates because competitive tax rates create a fertile business environment for domestic and global capital.

The IIAC was disappointed in the decision of the new government to reinstate the \$5,500 TFSA annual contribution limit. Assets in TFSAs (e.g. equities and bonds) finance business capital investments (e.g. construction of factories and office buildings and purchase of machinery and equipment) which spur job creation and economic growth. Additionally, TFSA proceeds will eventually be spent, and this spending will generate further economic activity and GST/HST revenue for government coffers. Furthermore, TFSAs play a vital role in closing the retirement savings gap by serving as an important savings alternative for seniors over the age of 71 who are no longer able to contribute to their RRSPs.

Recommendation #1: Capital Gains Rollover

The IIAC's research has shown that access to capital is particularly acute for larger small-business firms—i.e. those successful businesses that are on the verge of making a significant difference in employment and investment and are also vulnerable to takeover and possible exit from Canada. While capital sourced from angel networks and private equity funds is relatively robust, it is the private markets that provide the greatest source of external capital. Access to external capital is more important for the larger small-businesses because: 1) they have outgrown access to angel networks or private equity; and 2) early-stage investors are demanding repayment.

What is called for in these circumstances is action from policymakers in the form of tax changes. **The IIAC recommends that the government implement legislation to provide for the deferral of income taxation on taxable capital gains incurred in a taxation year when the proceeds are reinvested in small business shares within a six-month period.** It would, in effect, unlock significant amounts of capital tied-up in low-return investments and would encourage investors to take advantage of opportunities offered by small-cap publicly listed companies with faster growth potential. It would improve overall financing conditions in the public venture markets.

It is imperative that Finance Canada carefully consider the parameters for the implementation of a deferral regime. For example, 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. Additionally, Finance Canada could look to other jurisdictions with rollover provisions (e.g. the UK and the U.S.) to see how they administer and track rollovers to minimize complexity.

Recommendation #2: A tax relief scheme to spur investment in small companies and startups

The IIAC also recommends that the government implement a tax relief scheme to spur investment in small Canadian companies and startups. The tax relief initiative would complement angel investors and venture capital funds and could be closely modeled after two successful programs in the UK—the Enterprise Investment Scheme (EIS) and Seed Enterprise Investment Scheme (SEIS).

These two programs have had a profound impact on financing of UK small businesses and startups. HM Revenue & Customs (HMRC) data show that since the EIS was launched in 1993-1994, more than £12.3 billion has been invested in over 22,900 small companies. Most notably, 58% of EIS investment has gone to companies raising EIS funds for the first time. Since SEIS was launched in 2012-2013, over 2,900 startups have received over £250m in investment.

The EIS is designed to help small UK businesses raise finance by offering a range of tax relief to individuals who purchase new shares in such companies. Tax breaks are offered to offset the high risks associated with investing in small companies. Relief is at 30% of the cost of the shares, to be set against the individual's income tax liability in the year the initial investment is made. The maximum tax reduction in any one year is £300,000 provided an individual has sufficient income tax liability to cover it. The shares must be held for at least three years or tax relief will be withdrawn. If an individual has received income tax relief on the cost of the shares, and the shares are disposed of, any gain is free from capital gains tax. Additionally, the payment of tax on a capital gain can be deferred where the gain is invested in EIS qualifying shares. In this instance, there is no minimum period for which the shares must be held.

The SEIS was launched to stimulate entrepreneurship and kick-start the UK economy. It offers income tax relief of 50% on a maximum investment of £100,000 for investments in very early-stage companies, with similar conditions as the EIS.

For businesses to qualify for the EIS relief—up to a maximum of £5 million per year—they must have gross assets of less than £15 million and no more than 250 full-time employees. Companies with assets of up to £200,000 and fewer than 25 employees can qualify for SEIS.

The IIAC believes that an EIS/SEIS type scheme in Canada could achieve similar results and, based on UK tax expenditure data, the benefits to the economy would greatly outweigh the expenditures of the programs.

Recommendation #3: Targeted improvements to existing federal tax-assisted savings vehicles

In a June 2015 report for the C.D. Howe Institute, pension expert Malcolm Hamilton wrote: “Canadians are reasonably well prepared for retirement... Most can retire comfortably on less than the traditional 70 percent replacement target.” With this in mind, the IIAC believes that neither a mandatory nor a voluntary supplemental expansion of the CPP is a high priority. Rather, targeted improvements to existing tax-assisted savings vehicles can help Canadian maximize their retirement savings opportunities.

The majority of Canadians do most of their savings in RRSPs. Many employers support their initiatives by organizing Group RRSPs. The importance of Group RRSPs has been overlooked in the debate about the adequacy of retirement savings. There are 34,948 companies that sponsor Group RRSPs for 2.82 million employees, with \$74.3 billion under management. Compared to Defined Contribution pension plans and Pooled Registered Pension Plans, Group RRSPs have some tax disadvantages that impede Canadians from saving cost-effectively. For example, employer contributions to a Group RRSP are treated as earnings and, hence, payroll taxes like CPP and EI are deducted. Additionally, employers must make automatic payroll deductions for employee contributions. This uneven treatment is justified on the spurious grounds that Group RRSPs are not really a pension plan as funds can be withdrawn before formal retirement. **The IIAC calls on the government to relieve employers’ and employees’ contributions to Group RRSPs from payroll tax.** This will lead to higher savings for individuals.

Annual RRSP contribution limits should also be increased. Yes, there is unused RRSP contribution room amongst Canadians overall, but individuals closer to retirement are most likely maximizing their RRSP contributions and could benefit from increased limits. Strengthening the voluntary component of Canada’s retirement income system would also enhance Canada’s ability to attract and retain the best and brightest people. While budgetary revenue will be lower, it is important to recognize that this is largely a deferral.

Additionally, life events such as layoffs or sabbaticals can affect one’s ability to contribute to an RRSP. **Compensatory adjustments should be put in place for people who have missed annual RRSP contributions due to a temporarily interruption of their working careers.**

Finally, Canadians with Registered Retirement Investment Funds (RRIFs) are required to withdraw a set minimum percentage from their account annually. With life expectancy steadily increasing and real returns on investments expected to remain low, many Canadians face a significant risk of outliving their savings. **The IIAC calls on the government to eliminate the rules mandating minimum yearly drawdowns from RRIFs and similar accounts** to provide seniors with more flexibility and longer income tax deferral.