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## House of Commons Standing Committee on Finance Pre-Budget Consultations in Advance of the 2019 Budget August 3, 2018

## **Executive Summary**

The Investment Industry Association of Canada (IIAC) welcomes the opportunity to put forward its positions and recommendations as part of pre-budget consultations on behalf of our 120-member firms in Canada's securities industry. Our members are the key intermediaries in Canadian capital markets, accounting for the majority of financial advisory services for individual investors, and securities trading and underwriting in public and private markets for governments and corporations.

The themes chosen for this year's consultations—competitiveness and economic growth—are interlinked. Productivity is the foundation of a competitive economy. A high level of productivity leads to faster economic growth and increasingly better standard of living for Canadians.

Canada has a competitiveness problem. It manifests itself in several ways:

- Non-residential private-sector investment in 2017 was almost 20% below the 2014 peak.
- Foreign direct investment in Canada dropped 26% in 2017 to \$33.8 billion, its lowest level since 2010.
- The World Economic Forum, in its most recent *Global Competitiveness Index*, identified several problematic areas including Canada's macroeconomic environment, insufficient capacity to innovate, inadequate supply of infrastructure, and effects of taxation on incentives to work and invest.

The federal government must change policy course and turn these negative trends around. The IIAC recommends that the government:

- 1. Chart a credible path back toward budget balance.
- 2. Undertake an independent and comprehensive review of the federal tax system to ensure it promotes, rather than hinders productivity and economic growth.
- 3. Leverage the private sector for infrastructure investment. Mechanisms are needed to better link public and private capital and expertise.
- 4. Introduce a broadly-based, market-driven tax incentive to attract equity capital for new business formation and expansion of existing small and medium-sized businesses.
- 5. Make improvements to tax-assisted retirement savings programs to enable Canadians to save more for retirement and future out-of-pocket health care costs.

First, the government should **chart a credible path back to fiscal balance**. Persistent government deficits limit fiscal maneuverability to meet desired policy goals and undermine business and investor confidence. The government needs fiscal flexibility to respond to changing circumstances, deal with the demographic crunch, and tackle areas critical to Canada's long-term competitiveness, such as high marginal personal income tax rates.

Second, there is a **need for an independent and comprehensive review of the federal tax system** to ensure it encourages productivity and growth, rather than stifle it. Such a review should include an analysis of the tax base (including a critical review of tax expenditures), the mix of income and consumption taxes, and personal and corporate income tax rates. The need to improve tax competitiveness is now more urgent with U.S. tax reform that has lowered the U.S. statutory tax rate to 21% from 35%, allowed firms to immediately write off investments in equipment, and removed the taxation of dividends. Higher relative tax rates in Canada versus the U.S. encourage the flow of productive capital to the U.S. economy. Additionally, efforts should be made to identify areas of the tax system that cause the most day-to-day complexity and uncertainty.

Third, state-of-the-art transportation, telecommunications and energy networks are central to Canada's prosperity and global competitiveness. **Mechanisms to link public and private capital and expertise are needed** to encourage increased infrastructure spending across the country. The government should develop a strategy to harness the available capital and expertise of the private sector, based on a "P3" financing model. Public funds could supplement private funding, with the benefit of relying importantly on private sector incentives to allocate capital to the right projects.

There are many mid and large-sized infrastructure projects across the country desperate for capital. At the same time, large pools of private sector institutional and retail capital are searching for high-yield opportunities. To link supply and demand of capital to capitalize on the opportunity for increased infrastructure spending, the government should i) provide "catalytic capital" to enhance the economic viability of large projects, and ii) structure projects to balance a healthy return to private sector investors with a "social return" to Canadians reflected in increased productivity. If the government can fully leverage public and private resources, more infrastructure projects could be efficiently built and operated.

Fourth, the government should **explore the possibility of a tax incentive to make it easier for smaller companies to attract equity capital**, **encourage start-ups**, **and strengthen the exit strategy** for the anticipated large-scale retirement of existing business owners, enabling a transition to new owners.

The IIAC has proposed a Canadian version of the UK Enterprise Investment Scheme. The EIS provides a 30% personal tax credit for the purchase of shares of eligible small and medium-sized businesses, an exemption from capital gains tax for shares held for more than three years, and a rollover provision exempting capital gains taxes on the sale of an asset, if the proceeds are reinvested in EIS shares. Businesses must have gross assets of less than £15 million and less than 250 full-time employees to qualify for EIS relief.

EIS has funded more than 26,000 small and medium-sized businesses in the UK, providing overall equity capital of £16 billion. Program is dominated by small-sized investments, with 80% of the investors making a claim for tax relief for investments of less than £50,000.

Investments in EIS-qualifying shares have a solid track record of success because the investor's own capital is at stake—unlike the professional fund manager. Many investors are knowledgeable and acquainted with EIS qualifying investments, as many of the businesses are local.

Cost-benefit analysis by the UK EIS Association has demonstrated that the employment gains from small business expansion are worth the expenditure. Moreover, the tax expenditures of the EIS Program are more than offset by the revenues generated from corporate taxes, taxes paid on salaries to employees, and VAT paid by EIS-financed companies.

Finally, with Canadians living longer lives and investment returns expected to remain relatively low, there is a significant risk that Canadians run short of adequate savings for their retirement. It is critical that the government **provide increased scope for Canadians to accumulate savings in tax-assisted retirement programs**. These increased savings are not just to meet the retirement needs of aging Canadians living longer lives, but for the inevitable and expensive long-term care. Government must address this reality now before assisted care needs escalate for ageing baby boomers. Without sufficient private-sourced resources, the funding problem will ultimately fall to the state.

Federal and provincial governments in recent years adjusted the Canada Pension Plan (CPP) to improve retirement income. For the most part, these CPP adjustments are designed to help working-age Canadians, but do not address the savings needs of younger Canadians and the self-employed.

Increasing the allowable annual contribution to RRSPs and extending the deductibility of payroll taxes for contributions to Group RRSPs would assist younger Canadians to save for retirement. Self-employed Canadians, on the other hand, would benefit from a larger annual RRSP contribution amount. The government should also increase the eligible age to make RRSP contributions beyond age 71, enabling older Canadians that work past normal retirement age, and other seniors, to supplement their private retirement savings.