Written Submission to the House of Commons Standing Committee on Finance for the Pre-Budget Consultations in Advance of the 2025 Federal Budget

By the Investment Industry Association of Canada (IIAC)

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- **Recommendation 1:** That the government implement a program similar to the UK Enterprise Investment Scheme (EIS) to encourage investment in early-stage, unlisted businesses with high growth potential.
- **Recommendation 2:** That the government make improvements to tax-assisted retirement savings programs, notably that it (i) raise the age at which contributions to tax-deferred retirement saving vehicles must end and which RRIF withdrawals must start, and (ii) reduce the RRIF annual withdrawal rates mandated for each age, with the goal of abolishing mandatory withdrawals entirely.
- **Recommendation 3**: That the government re-balance Canada's tax system so it relies less on economically damaging income and profit taxes, and more on consumption taxes. The Budget 2024 tax hike on capital gains should be reversed, and the tax on share buybacks revoked.
- **Recommendation 4**: That the government undertake an independent and comprehensive examination of the federal tax system to ensure it adheres to long-standing principles of good tax policy.
- **Recommendation 5:** That the government undertake a comprehensive review of federal spending, including a thorough review of tax expenditures.
- **Recommendation 6:** That the government chart a credible path to budget balance, with a medium term goal of reducing the federal debt-to-GDP ratio below its pre-pandemic level.

EXECUTIVE SUMMARY

The Investment Industry Association of Canada (IIAC) is pleased to present its 2025 budget recommendations. The IIAC is the national association comprising investment firms of every type. Our members manufacture and distribute a range of investment products, including mutual funds, exchange-traded funds (ETFs), and prospectus exempt products; trade in debt and equity on all marketplaces; provide custodial and clearing services, issue securities in public and private markets; and underwrite issuers in public and private markets. We advocate for smart public policies, legislation and regulation that help investors and capital markets flourish.

Capital markets play a pivotal role in fostering economic growth and innovation by bringing investors and capital-seekers (entrepreneurs, businesses and governments) together. Businesses tap debt and equity markets to expand their operations, purchase machinery and equipment, and fund research and development, driving productivity gains and job creation. Governments issue debt securities to fund improvements in public infrastructure and other services valued by Canadians. Canadians rely on the proven power of our capital markets to achieve their financial goals.

The IIAC makes the following fiscal policy recommendations to strengthen Canada's capital markets, bolster economic growth, and create a conducive environment for citizens, entrepreneurs and businesses to thrive.

RECOMMENDATIONS

1. **Implement a program similar to the UK Enterprise Investment Scheme (EIS) to encourage investment in early-stage, unlisted businesses with high growth potential**.

   The EIS provides personal income tax relief of up to 30% on investments in EIS-eligible share purchases of up to £1m each year (or on investments of up to £2m per year if at least £1 million of that is invested in knowledge-intensive companies); an exemption from capital gains tax for EIS shares held 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-eligible shares.

   The Enterprise Investment Scheme Association (EISA) estimates the tax expenditures of the 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.

   Since its inception in 1994, the EIS program has been a resounding success, with 56,000 companies raising funds, of which more than 37,000 are companies raising much-needed capital for the first time, with investments to date totaling £32 billion. An evaluation of the program by the HMRC is available here.

2. **Make improvements to tax-assisted retirement savings.**

   Policies that foster saving enhance prosperity – i.e. citizens' personal solvency and independence, and the nation's long-term prosperity through the investments funded by its citizens' savings. Importantly, a nation's retirement savings system plays a major role in creating deep and liquid capital markets.

The tax rules that require individuals in the year they turn 71 to transfer their RRSP assets into RRIFs, and the RRIF rules which force individuals to make mandatory annual minimum withdrawals whether they need the income or not, are outdated. When the modern RRIF calculation was put in place in 1992, life expectancy at age 71 was 13.7 years. This number has increased steadily to 16.2 years for 2018-2020 (Statistics Canada, Table 13-10-0114-01). The overall survival rate at age 95 has increased from 7.5% in 1992 to 14% in the 2018-2020 period. Today, seniors have a higher chance of outliving their savings.

Canadians should not have to deplete their savings prematurely – they should have the freedom and flexibility to manage their savings according to their individual circumstances and in the most tax-efficient manner. We, therefore, recommend that the government (i) raise the age at which contributions to tax-deferred retirement saving vehicles must end and which RRIF withdrawals must start, and (ii) reduce the RRIF annual withdrawal rates mandated for each age, with the goal of abolishing mandatory withdrawals entirely.

The negative fiscal impact of reducing the RRIF annual withdrawal rates mandated for each age will be small on a present-value basis. Eliminating the annual minimum mandatory withdrawals entirely would simply delay the governments' receipt of tax revenue (since RRIF withdrawals are considered taxable income) to either when the RRIF holder voluntarily takes out savings, or when the individual dies.

3. **Re-balance Canada's tax system so it relies less on economically damaging income and profit taxes, and more on consumption taxes.**

The tax mix is important as it has far-reaching implications for economic growth. Corporate taxes are the most economically destructive (they discourage capital investment and productivity growth), followed by personal income taxes (which reduce the incentive to work and negatively impact saving and investment) and taxes on profits and capital gains (which distort investment decisions, entrepreneurship and venture capital funding). On the other hand, value-added taxes like the GST are less distortive as they do not affect decisions to work or invest.

According to the OECD, Canada relies heavily on the most economically damaging taxes:

- 36.3% of total tax revenue in Canada comes from taxes on personal income, profits and gains compared to an average of 23.7% in the OECD.
- 13.5% of total tax revenue in Canada is raised from taxes on corporate income and gains compared to an average of 10.2% in the OECD.
- A lower proportion of tax revenues comes from value-added taxes – 13.1% in Canada compared to 20.7% in the OECD.

Canada's tax system should be re-balanced, so it relies less on economically damaging income and profit taxes, and more on consumption taxes.

The government should reverse the budget 2024 tax hike on capital gains which discourages entrepreneurship and business investment and, according to Jack Mintz, affects 4.74 million Canadian investors, many with middle or modest incomes.

The government should also revoke the tax on share buybacks. According to the [Fraser Institute]: "Share buyback tax makes the capital market less efficient in discouraging the reallocation of financial capital from companies whose profits are expected to grow relatively slowly to companies whose profits are expected to grow relatively quickly. This likely means that financial capital will be used less efficiently than would be the case in the absence of the new tax, with a resulting loss of productivity for the economy. And that hurts everyone, not just shareholders."

4. **Undertake an independent and comprehensive examination of the federal tax system to ensure it adheres to long-standing principles of good tax policy**.

   There is broad consensus that a review of the tax system needs to be a priority for the federal government. The House of Commons and Senate finance committees, national business associations, think tanks, tax experts, the Advisory Council on Economic Growth, the Organisation for Economic Co-operation and Development (OECD), and the International Monetary Fund (IMF) have all highlighted the need for a targeted review of Canada's tax system. Years of tinkering with the system have added complexity and increased the compliance burden for individuals and businesses, and the administration burden for the government.

   The tax system should adhere to long-standing principles of good tax policy – neutrality, equity and fairness, efficiency, simplicity, and competitiveness. A tax system that reflects sound policy employs tax bases that are as broad and inclusive as possible. This results in a simpler tax system that is easier to administer, is fair and efficient, and reduces the potential for revenue shortfalls as economic circumstances change.

   Several countries have undertaken major tax system reviews in recent years, including the UK (Mirrlees Review) and New Zealand (Tax Working Group Review). Both of these reviews were independent, non-government reviews. Canada can learn from their experiences.

5. **Launch a comprehensive review of federal spending, including a thorough review of tax expenditures**.

   Balancing the budget requires spending restraint. A program review exercise is central to achieving savings. Programs and activities should be evaluated every three to four years based on the following criteria:

   - Does the program or activity serve the public interest?
   - Does the government have a legitimate and necessary role in delivering a particular program or activity, or can the private sector play a role?
   - Are Canadians getting value for their tax dollars (based on comprehensive cost-benefit analysis)?
   - Can the program's efficiency and effectiveness be improved? For example, by lowering delivery costs, employing cost-saving technologies, partnering with the private sector (i.e. public-private partnerships)?
   - Does the program or activity fall under federal jurisdiction, or is it better aligned with provincial/territorial responsibilities?

   Similarly, the government should undertake a systematic and comprehensive review every three to four years of the [over 220 tax-preferences] (exemptions, credits, deductions, rebates) that are part of the federal tax code. The federal government may be using tax preferences to achieve social objectives rather than funding the initiatives through direct program spending. Some tax credits may be subsidizing activities Canadian would have undertaken anyway. Other credits may stimulate spending in certain areas, prompting price increases that negate the benefit of the tax credit.

Tax preferences should be scrutinized to determine if they are:

- Effective. Are they achieving their intended goals?
- Efficient. Are the goals being met at a reasonable cost? Do the benefits outweigh the costs?
- Needlessly complex. Do they come with high compliance and administration costs? Can the government achieve similar outcomes though other means?

Those that do not pass muster should be eliminated or redesigned.

6. **Chart a credible path to budget balance, with a medium term goal of reducing the federal debt-to-GDP ratio below its pre-pandemic level.**

In fiscal 2019-2020, before the pandemic, the federal government's net debt-to-GDP ratio stood at 31.2% and public debt charges amounted to $24.4 billion (1.1% of GDP). The 2024 federal budget pegs the net debt-to-GDP ratio at 42.1% for fiscal 2023-24 and public debt charges at $47.2 billion (1.6%) of GDP. To put this into perspective, the cost to service the debt is approximately equal to the Canada Health Transfer to the provinces and territories ($47.1 billion in fiscal 2022-23; $49.4 billion in fiscal 2023-24), and almost twice as much as the government sends to families with children in the form of the Canada Child Benefit ($24.6 billion in fiscal 2022-23; $26.1 billion in fiscal 2023-24). This is lost opportunity. It underscores the need to get the nation's fiscal house in order, so there is more fiscal room to deliver public services Canadians value, including education, skills training, health care, and tax reductions.

All debt must be financed. When the government taps debt markets to meet its borrowing requirements, it competes with private businesses for the pool of available savings. This pushes up interest rates and crowds out investment by the private sector.