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

TD West Tower | 100 Wellington Street West
Suite 1910, PO Box 173 | Toronto, ON M5K 1H6

416.364.2754 | www.iiac.ca

www.iiac.ca

House of Commons Standing Committee on Finance
2017 Pre-Budget Consultations
August 3, 2016

Executive Summary

The Investment Industry Association of Canada (IIAC)[1]welcomes the opportunity to participate in the House of Commons Finance Committee's pre-budget consultations and to provide our recommendations on behalf of the Canadian securities industry. The Canadian economy has achieved improved stability and the outlook is for modest growth in 2016. Business investment remains weak, but will likely stabilize in the second half of 2016. Residential investment remains strong, but is projected to gradually decelerate. Exports are expected to be a key driver of growth supported by a competitive Canadian dollar and healthy U.S. demand. The priority for public policy is to provide modest stimulus through a judicious mix of tax cuts and infrastructure related spending, without jeopardizing the general business climate to attract investment and growth.

We recommend the measures in the upcoming 2017 federal budget focus on the following four principles:

1. ***The importance of fiscal prudence:*** Well managed public finances that ensure stable, low tax rates, and a predictable fiscal climate, are important to strengthen private sector investment spending. Public sector spending can provide important stimulus but does not have the scope to provide for sustained growth.

2. ***Leveraging the private sector for infrastructure investment***: Harnessing available capital and expertise of the private sector, and combining this with "catalytic capital" provided by the public sector, will ensure a more broadly based and powerful national infrastructure program, to rebuild Canadian infrastructure across the country, and engineer a more effective fiscal stimulus for the national economy.

3. ***Providing incentives for investment in growing Canadian businesses***: Addressing the shortage of local investment capital to finance growing small- and mid-sized Canadian businesses (for example, by

[1] The Investment Industry Association of Canada (IIAC) is the national association representing the position of 133 IIROC-regulated Dealer Member firms on securities regulation, public policy and industry issues. 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.

implementing a broadly based, market-driven tax incentive) will be particularly helpful enabling mid-sized successful tech businesses to grow and prosper in Canada.

4. ***Fully address the retirement savings gap***: Improvements to the CPP will not properly address the challenges faced by younger Canadians, who need strong employer-based savings plans to supplement the CPP (such as Group RRSPs), and Canadians close to retirement, who need to work and save longer than ever before. It is critical the benefits of the tax-assisted retirement savings program are adjusted to accommodate this changing pattern of retirement savings.

Introduction

The global economic recovery has been weaker than anticipated, and other global events, such as the outcome of the UK's referendum on membership in the EU, have contributed to uncertainty in the global marketplace. In the current challenging economic environment, it is important for the federal government to reassess the fundamentals of public policy making, and utilize the tools at its disposal to strengthen the Canadian economy and improve the investment climate for growing Canadian businesses and Canadians saving for retirement.

The importance of fiscal prudence

Well-managed government finances are the cornerstone of business and consumer confidence, and are critical to robust private sector investment spending and overall economic growth. The deficits projected for the next six years can be traced to a number of factors, including public investment on infrastructure projects; however, as described below, private sector capital can, and should, play a larger role in funding infrastructure projects, limiting the outlay of public funds and ensuring efficient projects go forward.

It will also be important for the government to restrain increases in program spending, benchmarking to real GDP growth, and improve efficiencies in spending. The policy options to contain indebtedness will narrow significantly as demographic changes—a rapidly aging population and slower growth in the labour force—presage significant pressures on the public purse and difficult policy choices. A smaller share of workers will shoulder a larger share of the tax burden. Canada must modernize its tax system to reduce its heavy dependence on personal income taxes and rely more on consumption-based taxes. High marginal tax rates are often a disincentive to work and capital formation; consumption taxes are not.

Leveraging the private sector for infrastructure investment

The government's current strategy to grow the economy is predominantly focused on public sector infrastructure spending. This spending is the primary reason behind the large federal deficits projected until at least 2020-21. However, if the federal government develops a complementary strategy to harness the available capital and expertise of the private sector, based on a "P3" financing model, it could tap into the large pool of available private capital, thereby reducing the need to rely so heavily on the public purse for these projects. It could also rely on private sector mechanisms to allocate capital to the right projects.

There are many mid- and large-sized infrastructure projects in Canada in need of capital, and which could be designed to generate long term stable returns on investment; there is also private sector institutional and retail investment capital available in Canada which could be invested in these projects. To fully capitalize on this, the critical role of the government is two-fold: (1) to provide “catalytic capital”, to help enhance the economic viability of these large projects; and (2) to ensure projects are structured to balance a healthy return to private sector investors with the needs of the public and the “social return” to Canadians in the form of increased productivity. If the government can fully leverage public and private resources, the success of infrastructure projects will be enhanced, in terms of the number of projects that can be completed, and developing projects that are more efficiently built and operated. Facilitating this kind of role would not require an independent Canadian Infrastructure Bank, and the related and unnecessary cost and expense borne by the taxpayer.

Developing incentives for investment in growing Canadian businesses

We remain concerned that the government’s primary focus on infrastructure investment neglects the shortage of capital needed for growing small- and mid-sized Canadian businesses that create the jobs and set the trajectory of future growth in the country. The aging demographic of retail investors has sharply reduced interest in speculative equities. Previous governments have failed to put in place an effective tax incentive to promote small business financings, and past decisions affecting the taxation of income trusts and the reduction in the annual contribution to TFSAs, have choked important financing vehicles for small business. If this situation is not remedied, many small- and mid-sized businesses will stay private longer, look to complete an IPO and stock exchange listing at a later stage of development, or be sold to larger foreign entities, and Canada will lose future opportunities to generate local employment and tax revenue.

The solution is a market-driven tax incentive for small- and mid-sized business that 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 the financing of UK small businesses and startups. HM Revenue & Customs (HMRC) data show that since the EIS was launched in 1993-1994, more than £14.0 billion has been invested in over 24,500 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 4,660 startups have received over £424 million in investment.

For businesses to qualify for the EIS relief, 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. Both programs are 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 higher risks associated with investing in small companies. For the EIS, tax 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, and 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 designed as an expansion of the EIS program to stimulate entrepreneurship, and

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.

The IIAC believes that an EIS/SEIS type scheme in Canada would be far more effective than restoring Labour Sponsored Venture Capital Corporation (LSVCC) tax credits, as LSVCCs have a proven mediocre track record.

Fully address the retirement savings gap

The recent push by the federal and provincial governments to make modest enhancements to the CPP will provide incremental improvement in the retirement income of Canadians, but will not fully address the savings challenges faced by specific groups, such as younger Canadians, who need strong employer-based savings plans to supplement the CPP (such as Group RRSPs), and by Canadians close to retirement, who would benefit from being able to save in these plans later in life, and by having more flexibility to manage those savings. In addition to the efforts made to enhance the CPP, the government should also consider options to strengthen existing tax-assisted savings vehicles to ensure that all Canadians have access to adequate income replacement upon retirement.

The importance of Group RRSPs has been overlooked in the debate about the adequacy of retirement savings. There are approximately 34,948 companies that sponsor Group RRSPs for 2.82 million employees, with $74.3 billion under management. Group RRSPs face tax disadvantages versus Defined Contribution pension plans and Pooled Registered Pension Plans. This tax unfairness disenfranchises the many Canadians that rely on Group RRSPs from saving for their retirement. For example, employer contributions to a Group RRSP are treated as earnings and, hence, payroll taxes like CPP and EI are deducted from those 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 recommends that the government relieve employers' and employees' contributions to Group RRSPs from payroll tax, which will lead to higher savings for individuals using these plans.

Canadians with RRSPs are required to stop saving in these plans, and convert them into Registered Retirement Investment Funds (RRIFs) at 71. These Canadians with RRIFs are required to withdraw a prescribed 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. It is critical the benefits of existing tax-assisted retirement savings program are adjusted to accommodate the changing demographics and the changing pattern of retirement savings. Therefore, the IIAC recommends the age of eligibility for contributing to RRSPs be extended beyond age 71, and that the rules mandating minimum yearly drawdowns from RRIFs and similar accounts be eliminated to provide seniors with more flexibility and longer income tax deferral.