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Presentation to the House of Commons Standing Committee on Finance
Pre-Budget Consultations in Advance of the 2018 Budget
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Thank you, Mr. Chair. My name is Ian Russell and I am President and CEO of the Investment Industry Association of Canada (IIAC).

It gives me great pleasure to come before this Standing Committee to present the views of the IIAC as you proceed with pre-budget consultations. As some of you may know, the IIAC represents 130 member firms in Canada's security industry. Our industry plays a key role in Canada's economy. In 2016, it enabled the federal, provincial and municipal governments to raise almost $200 billion through debt issuance to fund improvements to public infrastructure and other services valued by Canadians. It also enabled Canadian businesses to raise $96 billion by issuing bonds and almost $50 billion in equity capital to invest in operations, expand and hire.

In Budget 2017, the government rightly made it a policy priority to augment the sources of equity capital available to small and mid-sized businesses. The flow of equity capital to small business has collapsed in recent years, partly reflecting a weak and uncertain business climate, poor long-term returns in the venture capital industry, and structural adjustments that have reduced investor participation in small business markets. Overall, small business financing transactions have fallen one-third over the last ten years, particularly worrisome in an expanding economy. The number of financing transactions on TSX Venture Exchange fell more than 40 percent, while the number of Canadian private equity financing transactions trended up slightly. The on-going decline of start-up capital in Canada has real repercussions for Canada's ability to develop global leading enterprises and competitive Canadian brands.

The Canadian economy needs steadily expanding capital flows, not stagnating flows, to drive productivity, job creation and economic growth. A strengthening U.S. economy, boosted by the likelihood of tax reform, will draw Canadian capital south of the border as well as reduce the capital flows of U.S. venture funds to the Canadian small business market.

The federal government should make positive proactive reforms to the tax system to promote equity investment in small private and public businesses.

One option that should be considered is a "roll-over" provision that enables investors to sell at least a portion of "locked-in" capital in financial and real estate investments without incurring capital gains tax, or with a substantial reduction in capital gains tax rate, if the proceeds are re-invested in the equity shares of small business. The tax owed on the proceeds of the "locked in" investment would not be exempt from tax, but in fact deferred as the proceeds, channeled into private equity and venture capital investments, are paid when these small equity investments are eventually sold. Without the deferral option, it should be recognized the federal government would collect no tax revenue at all, since the original investment would remain “locked in” and not subject to tax.

A further option that should be considered is a Canadian version of the UK Enterprise Investment Scheme. The EIS provides a 30% personal tax credit for the purchase of small business shares, 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 the an asset, if the proceeds are reinvested in EIS shares.

The EIS Program is dominated by small-sized investments, with 80% of the investors making a claim for tax relief for investments less than £50,000. This means the program is popular among individual investors.

Investments in EIS-qualifying shares of small business 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 the 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 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.

To summarize, we believe our proposals will enhance access to financing for small and mid-sized businesses and provide the incentive for increased risk-taking by entrepreneurs and investors, enabling successful businesses to grow, innovate and create jobs in Canada.

On a final note, the federal government's tax proposals to address the issue of tax planning using private corporations will result in much higher tax rates on income from passive investments paid out to individual shareholders. Private corporations are an important source of capital for private equity and venture public companies. These corporations typically invest in new and emerging businesses, providing the investment opportunities for venture capital funds, and encouraging capital formation in the country. The tax changes, unless modified, will constrict already scarce funds for small businesses. If these tax proposals for increased tax on passive income in private corporations go forward, there is even greater need for tax incentives to encourage equity investment in small business.

Thank you for your attention and I would be pleased to answer any questions you may have.