Finance & Taxation

1. Rebuilding the Economy - Reinvigorating Investment Attraction Policy in Canada

DESCRIPTION

The federal government has made efforts in the past to create a competitive investment and venture capital environment, however the current policy focus on sufficiently building the economy this way in recent years is seemingly lacking and not well understood. Although Invest in Canada's work is important and reports successful progress, more can and should be done (and in new ways) especially as the country re-builds from COVID-19.

BACKGROUND

"A core recommendation from CEOs of successful Canadian firms is that all players in Canada need to raise their game in investment attraction, learning lessons from best-practice jurisdictions …."

Invest in Canada is Canada's global investment attraction and promotion agency and the foreign investor's primary point of contact. Its customized services help global companies discover investment opportunities in Canada. Formally established in 2018, Invest in Canada works collaboratively with provincial, territorial and municipal governments to identify the gaps and barriers that exist to foreign direct investment to ensure its efforts and services are complimentary.

Key services are providing: A. Investment support; market intelligence, business case development and site visits. B. Introductions; connections in industry, academia, and government as well as to provincial, territorial, and local investment promotion agencies as well as to investment support professionals such as lenders, lawyers and accountants. C. Roadmaps; of industry regulatory environments and access tax and R&D credits as well as other incentives.

Ian McKay, Chief Executive Officer of Invest Canada reported to the Globe and Mail in 2019 that Canada's attraction of FDI increased by 60% in 2018, surpassing a 10 year over year average by 11 percent. This happened when global capital into developed countries dropped by 40 percent and outflows from China to Canada dropped by more than 20%. As well historically the US has been the dominant source of FDI into Canada however, in 2018 non-US FDI in Canada increased by more than 300 percent. McKay stated that we are, moreover, doing a better job of investment attraction across sectors. For new investment projects Canada's marginal effective tax rate is 13.8 percent, almost five full points below the US and lowest in the Group of Seven. Most importantly we also lead in talent attraction, retention and skilled labour pool that is also a currency attracting investors. In the past five years Vancouver and Toronto have recruited more technology workers than San Francisco and Seattle combined. There is also the federal government superclusters initiative of digital technology, protein industries,

advanced manufacturing, AI and ocean sciences. Canadian and multinational companies are collaborating to create innovative products, services, and solutions for the global economy. However, McKay also emphasizes that we are not out of the woods and "to encourage global investment, we need to recognize and articulate Canada's significant competitive advantages – including talent, corporate tax measures, natural resources while we address policies that impede capital flow."

The Fraser Institute and its November 2018 report, The Flight of Capital from Canada however paints a different picture:

"The federal government's introduction of higher taxes, mounting debt and increased regulation has left Canada a much less attractive place to invest." The results have been ominous, to say the least. "Crucially, Canadians have increasingly looked to other countries to invest, with the amount Canadians invest abroad rising 74 percent from 2013 to 2017," the report warned.

"At the same time…investment from other countries into Canada dropped a staggering 55.1 percent." What this signifies is tens of billions of dollars in capital investments and tens of thousands of well-paying jobs – all of it now occurring in other countries. " – Fraser Institute

It is also worth noting that the World Bank's most recent "Ease of Doing Business" analysis Canada dropped from fourth place in 2006 to 22nd in 2019 (Morgan 2019). Moreover, according to a Business Council of Canada survey, listed Canada's "uncertainty and lack of predictability in regulatory processes" as negatives for investors (Morgan 2019). Some argue that the current levels of government spending are being used to offset a dramatic loss of private-sector confidence (Morgan 2019).

The federal government has made efforts in the past to create a competitive investment and venture capital environment, however the current government's policy focus on sufficiently building the economy this way in recent years is seemingly lacking and not well understood. Although Invest in Canada's work is important and reports successful progress, more can and should be done (and in new ways) especially as the country re-builds from COVID-19.

This is particularly important given Canada has been taking on large sums of debt otherwise, left to repay through other means such as increasing taxes on families and the middle class.
The current market debt is 1 trillion dollars and our debt to GDP over 48% a near record high.

During the late 60s and through the 70s, federal spending rose from 30 percent to 53 percent of GDP and by 1981, Canada's prime lending rate reached an incredible 22 percent (Morgan 2019). The inability to meet skyrocketing interest costs induced widespread corporate and personal bankruptcies and mortgage rates caused many Canadians to lose their homes as well accessing business risk capital was virtually impossible (Morgan 2019).

When observing the current landscape of Canadian investment attraction initiatives a considerable amount of funding is focused on government marketing administration such as through Invest Canada and subsidy and program funding-based approaches. These

approaches can be viewed upon as stimulus strategies (debatable during a non-recession period) however, the exact return on investment and spillover effects on the economy is evasive and the cost to our national debt for such spending must be considered.

For example, the government's superclusters initiative is investing nearly $2B into the economy over the next 10 years. Furthermore, the government's Strategic Innovation Fund (SIF) has committed 1.26 billion over 5 years.

The government would benefit from finding new and innovative ways to implement tax breaks and related financial policy incentives as a more efficient method to mitigate national debt accumulation. For example, more advantages such as the Accelerated Investment Incentive which provides an enhanced capital cost allowance (CCA) on equipment purchases.
Full expensing in the first year for manufacturing and processing (M&P) and clean energy equipment purchases.

Venture Capital

Relatedly, enabling venture capital to help attract and grow investments is an area that government has traditionally played a role in, particularly in the past 30 years. Government has become to be involved for a few reasons including: investors tend to judge venture capital as too risky, government see private-sector led venture capital funds as to small to support fully certain company and portfolio requirements and the general perception that left to its own, the market has not provided sufficient venture capital (Remillard, 2017: 2).

In Canada, venture capital has generally experienced challenges that have constrained its ability to channel appropriate levels of capital and management support to potentially high growth Canadian companies. Policy experimentation and a patchwork of approaches and initiatives are reasons behind the challenges and stem from uncertainty about what is the most effective way to channel more capital to high growth SMEs and build an autonomous venture capital industry (Remillard, 2017: 2). However, there are several programs and initiatives at both provincial and federal levels, using a broad mix of tax preferences and program measures to grow venture capital investing volumes in Canada (Remillard, 2017: 3). The US is a significant source of Canadian FDI, with roughly 40 percent of all venture capital investment dollars in Canada (Remillard, 2017: 2). Government involvement sends out signals to venture capital funds and investors that are key and important signs of involvement. "To most Canadian venture capital funds today, securing funding from government or a government backed entity has increasingly become imperative (Remillard, 2017: 8)." Although, government funding does not guarantee success, it is a potential red flag if there is a lack of government funding (Remillard, 2017).

RECOMMENDATIONS

That the Government of Canada:

1. Re-evaluate Canada's investment attraction framework to better align strategies across all orders of government and improve investor confidence. This should include:
    - Improve existing and institute new investment incentives for both domestic and foreign investors
    - Expand capital cost allowances and classes
    - A dedicated venture capital framework
    - Enhance performance measurement to inform policy and regulation

NOTES

[1], [2], [3], [4], [5], [6], [7], [8], [9], [10], [11], [12], [13]

[1] Remillard, Richard. January 2017. C.D. Howe Institute. "Government Intervention in Venture Capital in Canada: Toward Greater Transparency and Accountability"
[2] https://www.investcanada.ca/programs-incentives/accelerated-investment-incentive
[3] https://www.investcanada.ca/programs-incentives/strategic-innovation-fund
[4] https://www.investcanada.ca/programs-incentives/innovation-superclusters-initiative
[5] https://www.investcanada.ca/programs-incentives
[6] Scoffield, Heather. The Star. May 5, 2020. "The federal deficit is hundreds of billions of dollars and about to get bigger — and that's OK" https://www.thestar.com/politics/political-opinion/2020/05/05/the-federal-deficit-is-hundreds-of-billions-of-dollars-and-about-to-get-bigger-and-thats-ok.html
[7] Global News. March 26, 2020. "Federal Government's Market Debt Tops 1 trillion" https://globalnews.ca/video/4107095/federal-governments-market-debt-tops-1-trillion
[8] Morgan, Gwen. C2C Journal. November 2, 2019. "Deficits and Debt How the Liberals created generation screwed" https://c2cjournal.ca/2019/11/deficits-and-debt-how-the-liberals-created-generation-screwed/
[9] Fraser Institute. November 19, 2018. https://www.fraserinstitute.org/studies/flight-of-capital-from-canada
[10] Mckay, Ian. 2019, May 22. "Why Canada saw a 60% increase in foreign direct investment last year." Globe and Mail (Opinion Editorial) https://www.theglobeandmail.com/business/commentary/article-why-canada-saw-a-60-increase-in-foreign-direct-investment-last-year/
[11] InvestinCanada-2019-2020-Departmental-Plan-ENG.pdf
[12] https://www.investcanada.ca/about
[13] https://www.ivey.uwo.ca/cmsmedia/2758461/investment-attraction-learning-from-best-practice-jurisdictions.pdf

2. Competitiveness for Canada's Gateway

DESCRIPTION

Canada's gateway sector is a key driving force for the nation's economy, facilitating the movement of Canadian goods across the country and to international markets. Improving the climate for infrastructure investment in Canada's gateway sector is imperative to address the growing pressures and demands on the sector, support the needs of our growing economy, ensure resilience to protect the nation from future economic shocks and to enhance our competitiveness in light of the recent U.S. tax reform.[14] [15] Further, enhancing the investment climate for gateway infrastructure will allow for private capacity enhancing investments that in turn support the whole national supply chain and economic recovery process.

BACKGROUND

International trade is the lifeblood of the Canadian economy. Throughout Canada's history, our open trade-based economy has successfully supported our rising standard of living. In 2018, the total value of trade in goods and services reached a record high of $1.5 trillion or 66 per cent of Canada's GDP.[16]

Canada's strong gateway sector underpins our competitiveness as a trading nation, ensuring the efficient and effective movement of vital goods through Canada and to the rest of the world.

A 2018 economic impact study by the World Trade Centre Vancouver found that BC's gateway sector alone supports nearly 310,000 jobs and contributes $34.3 billion to Canada's GDP.[17]

The onset of 2020 highlighted the national importance of railways and the gateway. Rail blockades resulted in hardships that were felt across the country as the movement of vital goods to and from communities across Canada were brought to an abrupt halt. Our current reality has increased the awareness and appreciation for a robust gateway sector and the importance of maintaining the fluidity of global supply chains. The health pandemic has drawn attention to the essential service that our trade corridors and broader gateway industries provide, as they facilitated continued access to essential goods such as food and personal protective equipment (PPE) throughout the pandemic.

Over the years, the Federal Government has meaningfully invested in critical capacity enhancing gateway infrastructure projects in a way that has incented the participation of private sector partners. Investment to date have resulted in increased capacity, fluidity and efficiency of the gateway.

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[14] In the United States, in 2017, the Tax Cuts and Jobs Act reduced the federal statutory corporate tax rate for U.S. companies from 35% to 21%, while the Base Erosion and Anti-Abuse Tax (BEAT) minimum tax increased costs for Canadian railways. This provision forces U.S. entities to pay the BEAT on payments made to foreign affiliates, without a corresponding offsetting credit or deduction for the equivalent amount of BEAT paid in the U.S.
[15] https://www.congress.gov/bill/115th-congress/house-bill/1/text
[16] https://www.international.gc.ca/gac-amc/assets/pdfs/publications/State-of-Trade-2019_eng.pdf
[17] https://www.boardoftrade.com/wtcref/

Through the $2.4 billion National Trade Corridors Fund (NTCF), a key element of Transportation 2030, the Government of Canada has focused investments in strategic infrastructure projects to address transportation bottlenecks, vulnerabilities and congestion along Canada's trade corridors.[18] As of February 2020, more than $1.7 billion had been committed to through the NTCF for 82 marine, air, rail and road projects.[19] These important initiatives help Canadian companies access and compete in key global markets and trade more efficiently with international partners.

However, the importance and relevance of trade is only expected to grow for Canada; the Federal Government's 2018 Fall Economic Statement set the target of increasing Canada's overseas exports by 50 per cent by 2025.[20] Implementing mechanisms that encourage investments in Canada's gateway sector will help expand the capacity and efficiency of our trade enabling infrastructure, which will be critical as our country prepares for economic recovery and beyond to prosperity.

The role of rail

The gateway sector is composed of the mix of industries whose main business activity is to facilitate trade activity. The railway industry is a key enabler for this sector as it connects our nation with our terminals and ports and the rest of the world.

Rail operators are an integral segment to Canada's gateway sector, as it transports approximately $328 billion of Canadian-originated goods each year, with freight rail moving 50 per cent of exported goods.[21] Each year, approximately 3,800 locomotives and 32,800 dedicated railroaders transport goods and people across 44,000 kilometers of rail track across Canada and several points in the United States.[22] These tracks require maintenance and upkeep to ensure efficient deliveries, but more importantly to ensure the safety of rail employees and the communities in which they operate.

The railway industry is uniquely positioned to reduce greenhouse gas (GHG) emissions while supporting the economy and enabling trade. Railways are among the lowest industrial emitters in Canada, accounting for just one per cent of GHG emissions. Despite rising ridership and increasing demand, railways continue to achieve emissions reductions. Since 1990, freight railways have reduced their GHG intensity by more than 40 per cent, while experiencing an 80 per cent increase in workload, and intercity passenger railway emissions have decreased by 55 per cent, while ridership has increased by two per cent.[23]

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[18] https://www.tc.gc.ca/en/programs-policies/programs/national-trade-corridor-fund-backgrounder.html
[19] https://www.tc.gc.ca/en/programs-policies/programs/projects.html
[20] https://www.budget.gc.ca/fes-eea/2018/docs/statement-enonce/chap03-en.html
[21] CANSIM. Tables 23-10-0062-01, 23-10-0063-01, 23-10-0216-01, Rail Trends Database, CN, and CP.
[22] CANSIM. 2018. Rail Trends Database.
[23] https://www.railcan.ca/wp-content/uploads/2019/08/August_2_-_2020_Prebudget_Submission_-_RAC_FINAL.pdf

Rail plays an increasingly vital role in Canada's trade corridors, particularly as it pertains to moving Canadian agricultural products. Canada's two largest railways, CN and CP, moved a record 15.4 million tonnes of grain in the final three months of 2019: CP set a new quarterly record by moving 7.9 million tonnes of grain and grain products and CN transported 7.5 million tonnes, which included an all-time monthly record of 2.79 million tonnes in October 2019 and the second best December on record despite a work stoppage.[24]

Rail is one of Canada's most capital-intensive industries and grain is one example of how important railway companies' annual spend on continuous improvement and maintenance is to the economy. Canadian railways are vertically integrated and own the track, real estate, and locomotives and rolling stock, which illustrates the need for significant investments. On average, Canadian railways invest between 20 and 25 per cent of their own revenues back into their networks each year — close to $30 billion in Canada alone since 1999.[25] These significant annual investments into rail infrastructure, support the strong and growing demand for Canadian products and supports the fluidity of getting Canadian products to global markets.

The need for a more competitive playing field

Canada needs a competitive tax framework to further incents railway infrastructure investment to ensure that the sector continues to have the ability to facilitate future volume growth including future demands for a growing gateway sector.

The recent U.S. Tax Reform has allowed for an even faster tax write-off of investment dollars compared to Canada. This has resulted in the after-tax-cost of investing in infrastructure to be higher in Canada than the U.S. New U.S. tax measures increased the bonus depreciation available in the year of acquisition from 50 per cent to 100 per cent for most property/capital acquired after September 27, 2017 and before January 1, 2023. While the Canadian Government tried to address this issue broadly in its 2018 Fall Economic Statement, their efforts not only fell short of the US Tax Reform but did not even come close to the US pre-reform rate of 50 per cent write-off in the first year.

With a lower after-tax-cost in the U.S., Canadian railways and customers, who invest in their own rail infrastructure, are at a tax disadvantage to U.S. railways. If this tax imbalance persist important economic opportunities and investments in Canada may be forgone.

The following table highlights the differences between the Canadian and U.S. tax regimes as they relate to railway capital spending.

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[24] https://www.cbc.ca/news/canada/calgary/grain-cp-cn-train-rail-shipping-fourth-quarter-1.5417334#:~:text=Canada's%20two%20largest%20railways%20moved%20a%20record%2015.4%20million%20tonnes,of%20grain%20and%20grain%20products.

[25] https://www.railcan.ca/101/investment/

Table 1: Canadian vs. U.S. Tax Depreciation Regimes for Rail*

Canadian Railways				U.S. Railways			
	Class Rates	CCA $ Claimed	% Claimed		Class Rates	CCA $ Claimed	% Claimed
Track Infrastructure							
Year 1	10%	$15	15%	Year 1	100%	$100	100%
Total by year 4		$38	38%	Total by year 4		$100	100%
Rail Yard Facility (Building)							
Year 1	4%	$6	6%	Year 1	100%	$100	100%
Total by year 4		$17	17%	Total by year 4		$100	100%
Railcars							
Year 1	15%	$23	22.5%	Year 1	100%	$100	100%
Total by year 4		$52	52%	Total by year 4		$100	100%
Locomotives							
Year 1	30%	$45	45%	Year 1	100%	$100	100%
Total by year 4		$81	81%	Total by year 4		$100	100%

*For $100 of capital spending

Source: Rail Association of Canada. Pre-budget submission 2020.

As recent U.S. tax reforms have altered the competitive landscape in North America, tax changes in Canada must ensure that the rail section and investment in rail infrastructure remains competitive. An important manner in which this could be achieved is through accelerated depreciation on capital investment. This significant measure would ensure that railways continue to make investments that improve safety, environmental performance, and enhance capacity meet the needs of customers and the Canadian economy.

RECOMMENDATIONS

That the Government of Canada:

1. Enhance the depreciation regime for rail infrastructure investment to promote greater investment in rail infrastructure, to support Canada's competitiveness as a trading nation, and to meet the needs of the growing national economy and trade volumes.
2. Continue working with gateway industries and stakeholders to explore a policy framework, including tax measures, to incent investment in necessary capacity enhancing gateway infrastructure.

3. Land Trust Initiative

DESCRIPTION

Community Land Trusts exist across Canada, are a proven vehicle to combat the affordable housing crisis in perpetuity, but they are crippled by current Federal tax law in their ability to acquire land donations.

This policy looks to mirror a proven, and robust mechanism for ecological land donations (2006), to include land donations to Community Land Trusts. This will provide a powerful incentive for individuals and corporations to donate land, enabling our Community Land Trusts across the nation to provide affordable housing solutions in perpetuity, unlike any other models currently in existence in Canada.

BACKGROUND

Land – The Key to Housing Affordability

Recent studies in Canada indicate that land prices now comprise anywhere from 30% to 75% of the total sale price of a dwelling and are a major contributing factor for housing supply and pricing (CMHC, 2018). As land becomes more valuable, there are increased incentives to build higher density and higher value buildings as well as to demolish older single-storey dwellings to replace them with more expensive homes.

This relationship is not new and is also not limited to Canada: many studies have been completed by economists around the world which find this same correlation. For example Knoll et al. (2017) find that land prices accounted for 80 per cent of the rise in global house prices since the Second World War.

Although housing affordability dynamics in Canada are complex, data shows that the key to finding a solution to the affordability housing crisis is intrinsically linked to availability and price of land.

Community Land Trusts

A Community Land Trust is a non-profit organization created to acquire and hold land for the benefit of the community. To do so, the trust acquires land and maintains ownership of it permanently. With prospective homeowners, it enters into a long-term (most frequently, 99 years), renewable lease instead of a traditional sale. When the homeowner sells, the family earns only a portion of the increased property value. The remainder is kept by the trust, preserving the affordability for future low- to moderate-income families. There are currently over a hundred Community Land Trusts across Canada.

By permanently limiting the land costs, Community Land Trusts help to ensure perpetual affordability so that the benefits accrue to each subsequent homeowner and hence guarantee that housing will remain affordable for future generations.

THE ISSUE:

Land Donations to Community Land Trusts

Most Community Land Trusts in Canada have not yet accumulated enough lease income to acquire additional parcels of land. As such, they are beholden to acts of philanthropy (land donations) from individuals, corporations or government bodies.

Many corporations and private landowners currently hold land titles for business operations, as passive income or for future growth. These individuals and corporations have a strong disincentive to donate land to a Community Land Trust because the tax credit or offset generated by the donation will not overcome the tax owing from the capital gain: They will lose the asset AND owe tax for doing so.

The result: parcels of land which are held in perpetuity (undeveloped) or sold. There is a strong tax disincentive to donate the land for affordable housing.

THE SOLUTION:

Ecological Land Reserves – A Precedent

In the 2006 Budget, the federal government proposed to eliminate the capital gains tax on certain gifts of publicly listed securities and ecologically sensitive land. The idea behind these measures was to provide the charitable sector with a "powerful set of tools" for raising funds and encouraging charitable giving.

The result was that donors would not be taxed on any of the capital gain accrued on the donated property AND would receive the full benefit of the donation tax credit on the donation.

Has this incentive proved successful? Since 2006, according to the 2015 Federal budget, close to $1 billion worth of ecological land has been donated for conservation efforts using this mechanism.

Much thought and revisions were required for the Income Tax Act resulting in robust anti-avoidance rules and a proven mechanism to incentivize land donation by individuals and corporations for ecological conservatories.

These changes would help communities through-out Canada, no matter their size, to provide affordable housing for lower income residents in the community, revitalize by driving new development, provide low and moderate-income people with the opportunity to build equity through homeownership and capture the value of public investment for long-term community benefit.

RECOMMENDATIONS

That the Government of Canada:

1. Make amendments and additions to the Income Tax Act to incentivize the donation of land to Land Trusts, for the purpose of developing affordable housing, by utilizing the same mechanisms as those already provided in the Act for individuals and corporations to make donations to ecological land reserves; and
2. Allow for donations of land to Community Land Trusts to be capital gains exempt IN ADDITION a tax credit or deduction can be provided in exchange for the land, based on the fair market value.

NOTES

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[26] Katharina Knoll, Moritz Schularick and Thomas Steger, 2017, "No Price Like Home Global House Prices, 1870-2012", American Economic Review, Vol. 107, No. 2, February, pp. 331-353.

[27] Canada Mortgage and Housing Corporation, 2018: "Examining Escalating House Prices in Large Canadian Metropolitan Centres". Ottawa: CMHC, 02-05-18

4. Simplifying and Modernizing the Scientific Research and Experimental Development (SR&ED) Program

DESCRIPTION

The Scientific Research and Experimental Development (SR&ED) Program uses tax incentives to encourage Canadian businesses of all sizes and in all sectors to conduct research and development (R&D) in Canada. These tax incentives come in three forms: an income tax deduction, an investment tax credit (ITC), and, in certain circumstances, a refund.

The program is administered by the Canada Revenue Agency (CRA). Corporations, individuals, trusts and members of a partnership can use these Government of Canada incentives.

While this has been a well utilized program, the rules and regulations under the program are outdated given new innovations, types of research and development and evolving sectors.

BACKGROUND

Current rules for the SR&ED program include the following. Canadian-controlled private corporations: Generally, a Canadian-controlled private corporation (CCPC) can earn a refundable ITC at the enhanced rate of 35% on qualified SR&ED expenditures of $3 million. You can also earn a non-refundable ITC at the basic rate of 15% on an amount over $3 million. However, if you are a CCPC that also meets the definition of a qualifying corporation, you also earn a refundable ITC at the basic rate of 15% on an amount over $3 million, and 40% of the ITC can be refunded.

Other corporations: You can earn a non-refundable ITC at the basic rate of 15% on qualified SR&ED expenditures. You can use the ITC to reduce tax payable.

Individuals and trusts: Individuals (proprietorships) and trusts can earn a refundable ITC at the basic rate of 15% on qualified SR&ED expenditures. You first must apply the ITC against tax payable before the CRA can refund 40% of the unclaimed balance of ITCs earned in the year.

Members of a partnership: Since a partnership is not a taxpayer, you cannot earn an ITC.
In general, the ITC is calculated at the partnership level then allocated to eligible members (individuals, corporations or trusts). If you are considering submitting a partnership claim for SR&ED, read the SR&ED Claims for Partnerships Policy.

The rules and interpretations by the Canada Revenue Agency of what expenditures qualify for the SR&ED program are too restrictive and often not claimed by companies. This creates a problem for the fair interpretation of investments in research and development particularly for life sciences, pharmaceutical and high technology sectors.

Today companies are investing in new, more collaborative models of R&D partnership with Canadian universities, hospitals, centres of excellence, early stage biopharmaceutical companies, and health charities. Innovative pharmaceutical companies are also investing millions of dollars into multinational clinical trials and new areas of science including real world evidence, epidemiology, pharmacoepidemiology, health economic research, outcomes research, and pharmacoeconomics – areas that are not captured by PMPRB's narrow and dated definition of R&D.

The program needs to better recognize investments in labour, specialized equipment and materials especially in laboratory settings as well as measuring equipment.

The life sciences and pharmaceutical sectors are particularly hamstrung by the investments that qualify for research and development in calculating the percentage of investment under patent protection rules.

RECOMMENDATIONS

That the Government of Canada:

1. Simplify and modernize the SR&ED program to promote greater innovation and investment into research by Canadian companies;
2. Change the program to ensure that labour, specialized equipment, materials in laboratory settings and measuring equipment costs qualify under the program;
3. Instruct the Canada Revenue Agency and Industry Canada to work closely with research and development industry sectors to seek input on modernizing the SR&ED program.

5. Child Care Credits For Small and Medium Size Businesses

DESCRIPTION

Owners of small and medium size businesses are unfairly treated when it comes to childcare expenses. Currently, childcare expenses can only be deducted against employment income of the lower income earner of the family. However, often owners of small and medium size businesses choose to pay themselves dividends, generally non-eligible,[28] rather than a salary and are often the lower income earner which then prohibits the owner from deducting child care expenses. The current rules,[29] don't help small and medium size business owners in their risky pursuit of creating business and wealth for the economy.

BACKGROUND

Childcare expenses are generally deducted from the lower income earner of a family, based on employment income with only the following exemptions presently in place[30] and with no proposal to change.

- Lower income earner is in the hospital or medically unfit
- Lower income earner is in school
- Lower income earner is in jail
- There has been a separation in the relationship

For a variety of reasons including managing cash flows, reducing the additional financial burden required of an employer in regards to the company portion of Canada Pension Plan contributions which would arise if the owner paid themselves a salary, adding an additional level of complexity in calculating the salary of the owner if they don't have employees or as a general rule of compensations, often times an owner of a small and medium size business will decide to take non-eligible dividends as compensation. This is usually not a significant amount but is just enough not to go bankrupt or under capitalize the company but is enough to live personally. However, in doing so it generally prohibits the owner of the small and medium size businesses from deducting childcare expenses because they are often the lower income earner and none of their income is eligible for the deduction of child care expenses.

This is a pressing issue since we know the majority of businesses in this country are private businesses that have access to this financial model. Small and medium size businesses are the engine of this country, and the drivers of those engines are the entrepreneurs that take the risks, including cash flow risk. They should not be unfairly treated with the current deduction policy.

[28] http://www.taxtips.ca/dtc/smallbusdtc.htm
[29] http://www.cra-arc.gc.ca/tx/ndvdls/tpcs/ncm-tx/rtrn/cmpltng/rprtng-ncm/lns101-170/120/menu-eng.html
[30] http://www.cra-arc.gc.ca/tx/tchncl/ncmtx/fls/s1/f3/s1-f3-c1-eng.html

RECOMMENDATIONS

That the Government of Canada:

1. Permit the owners of Canadian Controlled Private Corporations (CCPCs) receiving non-eligible dividend income to claim childcare expenses against that income.
2. Permit CCPC owners receiving non-eligible dividend income to transfer childcare expenses to the higher income earner of a family.

6. Increase the Small Business Deduction

DESCRIPTION

Small business enterprises are vital to the Canadian economy. The current Small Business Deduction limit has become restrictive and requires an increase in the threshold in order to allow for business sustainability and economic growth.

BACKGROUND

Separate rates for corporate taxation were initially introduced in 1949 to create an opportunity for Canadian business to retain more of its after-tax income to assist with growth and expansion by "self-financing" organic growth. The early iteration of this dual-tax approach applied to all forms of income, regardless of nature or source.

With the issuance of the 1966 Royal Commission Report on Taxation (also referred to as the "Carter Commission"), a recommendation was presented to eliminate the dual-rate approach to corporate taxation with the objective being improving equity and neutrality in the corporate income tax system. In addition to other measures aimed at promoting and supporting the growth of small business in Canada, the 1972 Income Tax Reform measures included the introduction of a "small business deduction" (SBD) limit that provided for a reduced rate of taxation be applied to the first $50,000 of corporate active business income.

The legislation applied to a Canadian-controlled private corporation (CCPC) and was designed to be shared between members of an associated group of corporations on an elective basis. The current legislation remains today with certain additional measures that are designed to minimize perceived "mischief" aimed at efforts to "multiply" the SBD limit. The upper limit has increased from the $50,000 amount in 1972 to $400,000 and then finally increased to the current federal limit of $500,000. In addition, in an effort to ensure the SBD limit was accessible only to "small business" corporations, additional legislation was introduced to proportionately reduce the availability of the SBD limit to a corporation and the members of an associated group to the extent that it's "taxable capital employed in Canada" exceeds $10 million up to a maximum of $15 million where it is completely eliminated.

The determination of the SBD limit appears to be rather arbitrary with very little literature supporting the selection of the various historical threshold amounts. It is largely believed that "the main argument for taxing small business more favourably is to compensate for their limited access to capital financing". With the global developments in capital markets that have adversely impacted the accessibility of capital for private corporations in general, as well as current market challenges in the light of the global COVID-19 pandemic, never has this been more applicable. CCPC's represent the largest employers and fundamentally the largest contributor's to GDP in Canada's economy. In 2018, private corporations employing fewer than 100 employees constituted 97.9% of all firms in Canada and accounted for over 40% of the gross domestic product of Canada. As the "backbone" of the Canadian economy, small business enterprises should be provided all available tools to secure their future, sustainability and opportunity for growth and transition to large firms.

To avoid the "threshold" effect that often serves to limit the growth of small business enterprises beyond the threshold of specific tax incentives (ie. The $500,000 SBD limit in this case) there is a distinct need to reconsider the current threshold and determine a more appropriate SBD limit in light of restrictive access to financing capital and the critical importance of small business enterprises to the Canadian economy.

RECOMMENDATIONS

That the Government of Canada:

1. Increase the current Small Business Deduction limit, as it is currently defined in the provisions of subsection 125(2) of the Income Tax Act, Canada, from $500,000 to $750,000.
2. Apply annual indexing to the Small Business Deduction threshold limit at a rate equal to the annual Consumer Price Index.

NOTES

[31], [32], [33], [34], [35]

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[31] Industry Canada (www.ic.gc.ca); Key Small Business Statistics – November 2019.
[32] Small Business Taxation: Revamping Incentives to Encourage Growth; Jack Mintz & Duanjie Chen; School of Public Policy; Calgary Alberta; SPP Research Papers; Volume 4, Issue 7, May 2011; p.3.
[33] ITA; subsection 181.2(1)
[34] Initially the legislation contained a number of other complexities and restrictions. Until 1984, a lifetime SBD cumulative limit existed starting at $400,000, increasing to $1 million before it was repealed and replaced with the "annual limit" approach that we are familiar with today.
[35] Canadian Income Tax Act, R.S.C. 1985, c.1, (5th Supplement) (ITA); section 125.

7. Time for a New Pension Paradigm

DESCRIPTION

Pension security is an important asset that employees require to be productive and loyal to employers. The current pension models used by Canada is dying and unable to account for the many employees due to the ineligibility for described benefit or described contribution. Additionally, the pensions are volatile and depend on market stability, which is not always the case. This leads to uncertain and unproductive employees.

There are still too many working Canadians that do not have an employer sponsored pension plan (Defined Benefit (DB), Defined Contribution (DC), or group Registered Retirement Plans (RRSP)) to supplement their retirement income, together with their CPP.

BACKGROUND

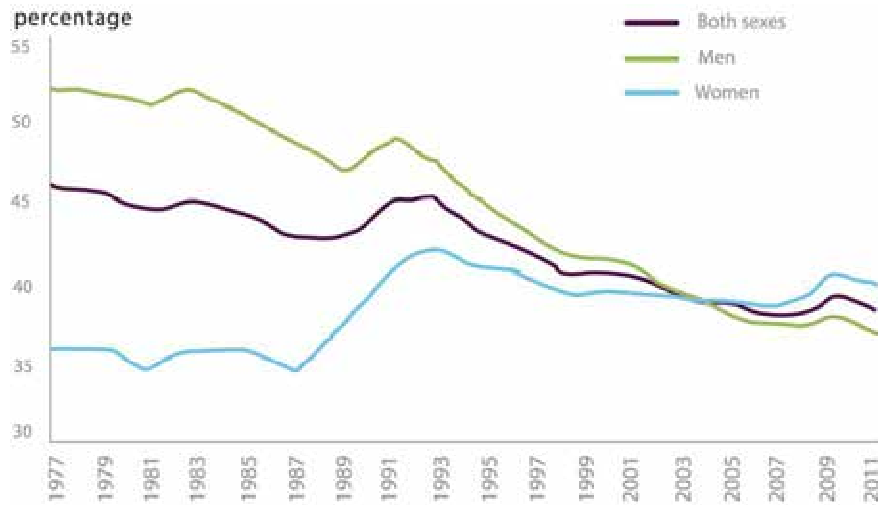
As a result, an increasing number of Canadian workers will likely require future financial support of the federal government's Guaranteed Income Support (GIS) program during their retirement years. Future Canadian taxpayers will therefore be subsidizing future GIS payments to today's workers who are not setting aside sufficient pension monies.

Over the long term, the funding risks to Canadian workers associated with DC Plans and RSPs has long been ignored by Federal and provincial stakeholders.

Constitutionally, the Provincial Governments have the responsibility for Pension Plans. In 1966, the Provinces, excluding Quebec, worked closely with the Federal Government to implement the Canada Pension Plan. Quebec brought in their own provincial Quebec Pension Plan at that time. Thirty years later, in 1996, important reforms were made to the CPP Plan, which raised contribution limits. That CPP implementation resulted in a dramatic decrease in 'poverty in Canadian seniors' over the following decades.

In 2017, further reforms were made to CPP. It has been written that these changes were principally motivated by the declining share of the workforce that was covered by an employer DP plan, which had fallen from 48 percent in 1971 to 25 percent by 2011. A further reason was the move by Ontario to launch its own Retirement Pension Plan. While the 2017 CPP change agreed by all provinces and the federal government to increase the level of 'replacement pension incomes from the level to 25% of 'earned income as defined' to a modest 33% is a very good start. Quebec followed the lead of the other provincials and made similar adjustments to its Plan. The number of people that have a registered pension plan has been declining in recent years (figure 1).

Figure 1



Percentage of employees with a registered pension plan through their job, by gender, 1977 to 2011[36]

In 2018, federal and provincial governments implemented important changes to the Canadian Pension Plan (CPP) to provide, when fully mature by 2063, retired workers a modest 33 percent of average worked earnings. This was up from the current level of providing 25% of average worked earnings.

A June 2019 paper issued by the C.D. Howe Institute – "The Great Pension Debate, Finding Common Ground" (#543) – Brown & Eadie should remind all of us in the business world that pension innovation is required in each of our Provinces with the full support of the Federal Government.

In February 2020, the National Institute on Ageing issued a discussion paper titled "Improving Canada's Retirement Income System", the authors, Ambachtsheer and Nicin, further supports the lack of political decision-making, regulation and retirement income research, and the fragmentation within Canada on pension – both limiting important pension innovation.

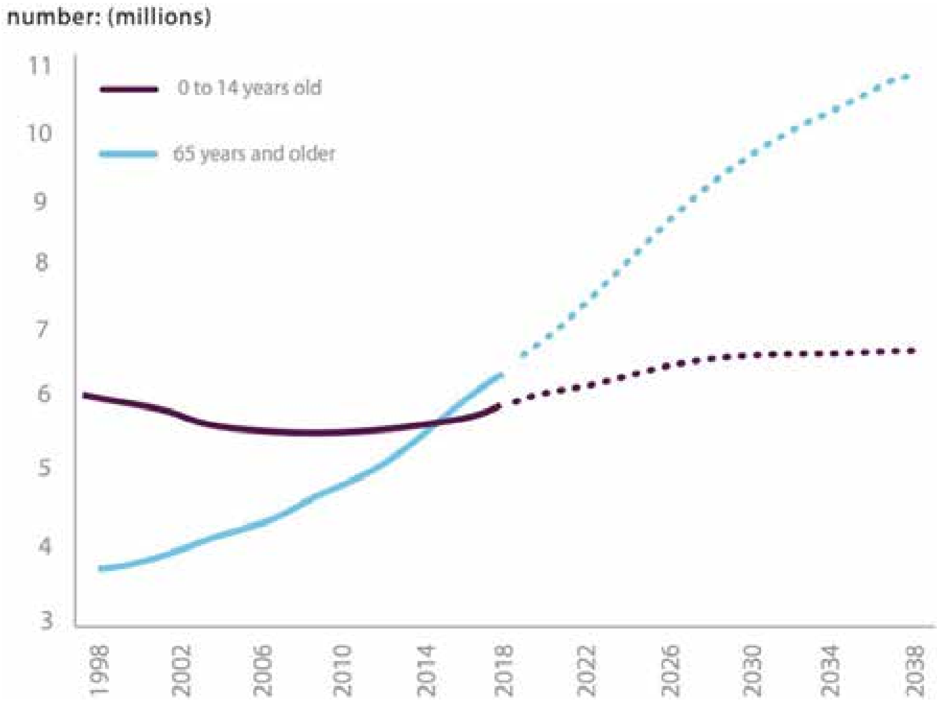
In Canada, there are currently approximately 20 million workers. Of the Canadian workers, 6.3 million participate in Registered Pension Plans and a similar number - 6.3 Million - participate in Registered Retirement Plans.[37]

As there will be some double participation in the above figures of individuals as they may be in more than one registered DB, DC and/or RSP plan, there are estimates that between 10 to 12 million Canadian workers, (50% to 60%), do not have Pension Plans other than CPP.

[36] Ambachtsheer, K., Nicin, M. (2020). Improving Canada's Retirement Income System: A Discussion Paper on Setting Priorities. National Institute on Ageing, Ryerson University
[37] https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=1110009401

Over the past decade, the private sector has moved away from offering Defined Benefit Plans and implemented Defined Contribution Plans. The dramatic increase of Canadians living longer (figure 2) combined with the significant reduction in the investment returns in the pension plans have resulted in many employers with DB Plans having to assume material pension liabilities as an outcome of how pension calculators work.

Figure 2



Population aged 0 to 14 years and 65 years and older, 1998 to 2018 (estimates) and 2019 to 2038 (projections), Canada[38]

While the private sector DC plans and RSP plans do not have the same level of financial risk as the employers with DB plans, the reduction in investment returns, and for many, the size of the plan's fund management costs (MERs) results in materially less pension monies available at the time of retirement.

When Canadian workers retire with their DC or RSP plans, there is currently little flexibility on how to manage their retirement monies And so they take on future investment return risk.

[38] Ambachtsheer, K., Nicin, M. (2020). Improving Canada's Retirement Income System: A Discussion Paper on Setting Priorities. National Institute on Ageing, Ryerson University

There are 10 million Canadian workers who are not members of a private sector pension plan. There is very clear evidence there is room for improvement in the pension plan governance model in Canada. We have a public policy vacuum. It would take a generation of workers to turn this matter around should important changes be made. For such an important matter, one suggests there should be a Federal Minister of Pensions and each province should have a Minister of Pensions. These ministers and offices would need to work collaboratively to navigate the regulatory hurdles and intra-provincial barriers to find a better solution to manage and grow private sector pensions.

According to Brown in the commentary paper titled "The Great Pension Debate: Finding Common Ground",[39] policies encouraging large, collective and pooled pension plans governed by independent management boards are the way forward. Concurrently, Ambachtsheer posits that due to the lack of protocol for updating federal tax policy and federal/provincial/ territorial regulatory fragmentation within and between the pension and insurance sectors, and between individual and group investment regulations, Canada has suffered from stagnated innovation in its retirement income system (RIS) [40]. It is vital that regulation and tax laws allow small and medium-sized employers to join in such collective systems to extend their benefits to the majority of working Canadians.

RECOMMENDATIONS

That the Government of Canada:

1. Modernize and innovate the federal pension program for Canadian businesses and citizens.

[39] Brown, Robert L., and Stephen A. Eadie. "The Great Pension Debate: Finding Common Ground." C.D. Howe Institute, Commentary, no. 543, 2019

[40] Ambachtsheer, K., Nicin, M. (2020). Improving Canada's Retirement Income System: A Discussion Paper on Setting Priorities. National Institute on Ageing, Ryerson University