



New Brunswick Securities Commission
Submission Paper to the Select Committee on Tax Review

Response to *A Discussion Paper on New Brunswick's Tax System*

29 August, 2008

NEW BRUNSWICK
SECURITIES COMMISSION

COMMISSION DES
VALEURS MOBILIÈRES
DU NOUVEAU-BRUNSWICK



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1.0 Executive Summary

The New Brunswick Securities Commission supports the Government's objective to restructure the tax system. This will meet the primary objectives of ensuring New Brunswickers keep more of their income to save and invest; and to expand the economy by making the province a more attractive and competitive environment for business investment. The Commission's mandate directly supports three of the seven key policy goals identified by the Government. These are:

- Enhancing economic competitiveness
- Income growth
- Promoting entrepreneurship

Our response to *A Discussion Paper on New Brunswick's Tax System* has been prepared in the context of how the proposed options impact our stakeholders. In addition, we considered how they meet these three key policy goals and help achieve the overall stated objectives.

In general, we believe that the majority of the changes proposed are positive. They will have a positive impact on the ability of established New Brunswick businesses to grow, and on the ability of the province to attract new businesses here from other jurisdictions. However, our research indicates that these proposed changes will have only a limited ability to stimulate New Brunswick's capital markets. They will have little effect on the start-up and moderate sized companies and investors which operate within this market. Additional incentives need to be considered in order to encourage the development of this important component of the capital market. The focus of our submission is on the impact to this latter group of stakeholders.

We note that one option, the proposed carbon tax will pose a significant threat to New Brunswick based businesses if implemented in isolation of other jurisdictions and of other offsetting positive incentives. This tax may have the effect of limiting the desire of some companies to relocate and/or operate in New Brunswick if alternative locations with more competitive tax structures exist.

A major challenge facing innovative, growth-oriented companies located in New Brunswick is the difficulty in accessing capital. Promoting a means to enable New Brunswickers to invest in New Brunswick is a critical step in the process of attracting external capital sources to help grow our businesses. Improved access to capital for New Brunswick based entrepreneurs can make a fundamental change in the quality of our economy, employment opportunities for our youth and our ability to effect social change for the betterment of New Brunswick.

At present, New Brunswick capital markets are significantly underdeveloped when compared to other provinces and many American states. We believe that there is a real need for the Government to continue to stimulate growth of investment capital through taxed-based incentives.

Another significant issue impeding growth of the New Brunswick economy is that the majority of retirement investments made by New Brunswick residents do not remain in this province. As a result, we believe that the Government needs to take action through

taxation policy and other programs to help reduce this flight of capital. This will greatly help to stimulate economic growth within our province.

We believe that tax incentives to assist young companies to develop and bring their product or service to market are more vital to these stakeholders than the tax reforms highlighted in the discussion paper.

While reductions in corporate income tax rates are important for established, profitable companies, they play at most a secondary role to the founder or investor in an early-stage growth company. Focusing and enhancing the tax based incentive programs for early-stage companies will go a long way toward enhancing New Brunswick's competitiveness, growing income and fostering entrepreneurship. This focus will help meet and surpass three critical goals of the proposed restructuring of the tax system. Two important examples of tax incentive programs discussed in this submission are:

Small Business Investor Tax Credit (SBITC) - Programs such as the SBITC are critical to enable growth of early-stage companies in jurisdictions, such as New Brunswick, with limited capital market access. We recommend that the Government consider significant enhancements to this program to expand its use and impact. We suggest how this may be accomplished in section 6.1.

Scientific Research & Experimental Development (SR&ED) Investment Tax Credit (ITC) – We believe the SR&ED program is of significant benefit to companies at any stage of growth in New Brunswick. However, it is crucial to start-up and early stage companies which rely on innovation as their engine driving success. They need access to capital in limited-access environments. We encourage the Government to explore improvements to the program as described in section 6.2.

We also encourage the Government to investigate and champion other innovative means to stimulate capital investment in early-stage and growth firms. This will help create additional opportunities for entrepreneurship, global competitiveness, income and wealth growth in New Brunswick. A number of suggested initiatives have been documented in our *Fullsail 2008* report, *Venturing into a New Economy - Developing New Brunswick's Capital Markets*. These are discussed in Section 6.4. Vibrant capital markets will greatly contribute to achieving self-sufficiency for New Brunswick.

2.0 Introduction

We are the province's securities regulator. We regulate the securities and investment industry in New Brunswick. As an independent, Crown Corporation, we are funded indirectly by investors, through industry. Our legislated mandate is to not only protect investors from unfair, improper or fraudulent practices, but to also foster fair, efficient and confident capital markets. We champion initiatives that increase equity capital opportunities and encourage the growth of entrepreneurship in New Brunswick.

We believe that our efforts to develop robust capital markets in New Brunswick will achieve economic independence and wealth for our province and support the Government's objective of self-sufficiency. We are a catalyst for change and provider of leadership to capital market stakeholders.

Active capital markets are vital to any framework for growing businesses and wealth. It is important to recognize that investment decisions within an economy are impacted by many factors including availability and cost of resources and other inputs, government imposed regulations, taxation policies and incentive programs.

Our submission is in response to the request for comments on measures proposed in *A Discussion Paper on New Brunswick's Tax System* issued by the Department of Finance in June 2008. We have reviewed the implications of the proposed changes on New Brunswick's capital marketplace and the ability of stakeholders operating within the marketplace to attract and retain capital, and to function on a sustainable basis within the province. We have limited our comments to those proposed changes that we anticipate will impact the capital marketplace.

Our mandate directly supports three of the key policy goals stated within the Discussion Paper. We are concerned that the proposed changes may not have a sufficient positive impact on behaviour and investment decisions of New Brunswick residents or outside investors. This submission has been prepared to provide the Select Committee on Tax Review with what we believe are additional, important components of an enhanced and competitive tax structure.

3.0 Methodology

The Commission retained Grant Thornton LLP to assist it in preparing our submission and providing professional advice.

Grant Thornton conducted independent research into the implications of the paper's proposed options on our defined key stakeholder groups. They reviewed the public statements made by impacted parties and interviewed a number of our stakeholders throughout the province. In addition, they:

- Interviewed stakeholders from the business community including entrepreneurs, and representatives from capital management groups;
- Consulted with numerous Grant Thornton LLP, professionals with specific focus on areas of tax specialist expertise: (i.e. commodities, corporate tax, SR&ED, International tax, Alberta corporate income tax, various other corporate finance and assurance professionals);
- Reviewed comparative research conducted by Grant Thornton LLP staff regarding New Brunswick statutory tax rates relative to a number of select US states;
- Reviewed responses from other business groups. (i.e. New Brunswick Business Council, Growthworks Atlantic, Greater Moncton Chamber of Commerce, Saint John Board of Trade);
- Reviewed media articles regarding tax discussion paper items and other relevant topics; and
- Reviewed various provincial and federal government websites related to policies on programs such as Small Business Investor Tax Credit, Labour sponsored investment tax credits, etc).

Over the past four years, we have researched methods used in other jurisdictions around the world to promote and encourage capital markets development. In addition, we have consulted with New Brunswick stakeholders on what they see are their needs. We have brought in outside experts and shared this work through our Fullsail

Summits on capital market development. This research has formed the basis for recommendations and comments put forward as the Commission's position within sections 5.0 and 6.0. These views are not necessarily those of Grant Thornton LLP.

4.0 Background

4.1 Stakeholder Focus for This Submission

Our stakeholders include investors, investment or financial advisors, dealers and portfolio managers, accounting and legal professionals, entrepreneurs and future entrepreneurs, economic development agencies and government. While a number of the proposed options affect all of our stakeholders, for the purpose of this submission, our primary focus is on the entrepreneurial stakeholder group impacted by the challenges of accessing capital in a limited capital market.

This entrepreneurial stakeholder base includes start-ups, medium-sized companies and a limited number of larger New Brunswick enterprises whose capital is publically traded. These larger enterprises do not face the same challenges, or require the same development assistance as start-ups and medium sized established companies. However, entrepreneurs need support to develop and grow quality management teams and business models to stay and thrive in New Brunswick, thus generating employment and wealth. Given their greater need for support, focus is placed on three types of entrepreneurs:

- start-up companies looking for seed capital;
- companies with a need for capital to take them past the start up or prototype stage to commercialization; and
- established companies of moderate size who seek capital for growth or expansion.

These three groups typically seek private, external sources of capital ranging from \$50 thousand to \$10 million. They have the greatest challenge identifying and obtaining this level of investment. Our research suggests that early-stage companies suffer from the greatest sustainability challenge; that is, not traditionally financed through commercial debt or public equity.

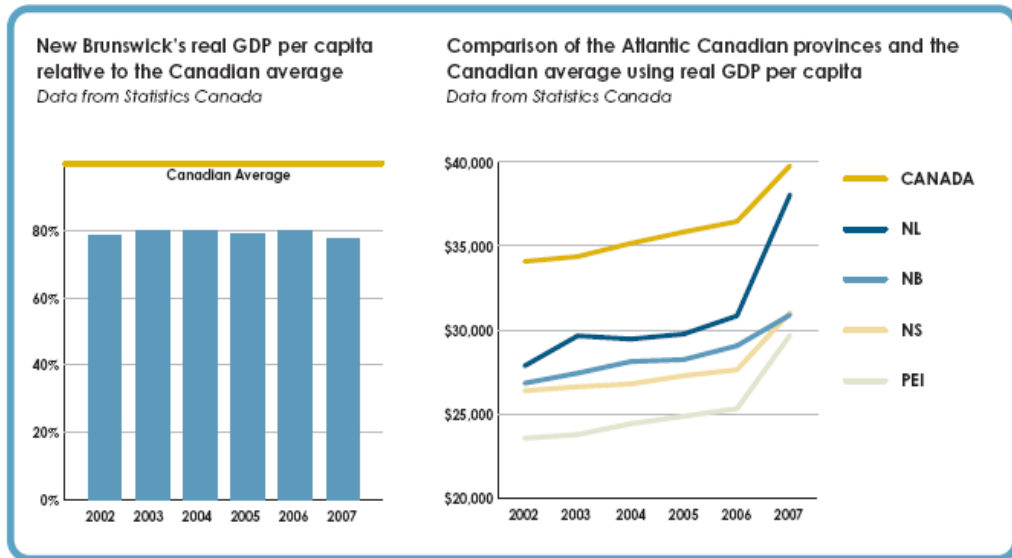
4.2 The New Brunswick Economy at a Glance

New Brunswick has an abundance of resources, human and natural, and strong potential for growth given the substantial energy projects which have or may be undertaken in southern New Brunswick (i.e. LNG facility in Saint John, Point Lepreau refurbishment, the anticipated construction of the new Irving oil refinery, etc). However, when we apply the metrics which are most often considered in assessing our standard of living, as well as general economic conditions, our economy currently lags well behind Canadian averages. Real gross domestic product/capita is an indicator that can be used to measure individual wealth creation, such as that resulting from entrepreneurial activities and changes in the capital markets.

New Brunswick's GDP per capita has consistently remained at just below 80% of the national average ([Figure 1](#)). In order to address this imbalance, we suggest there needs

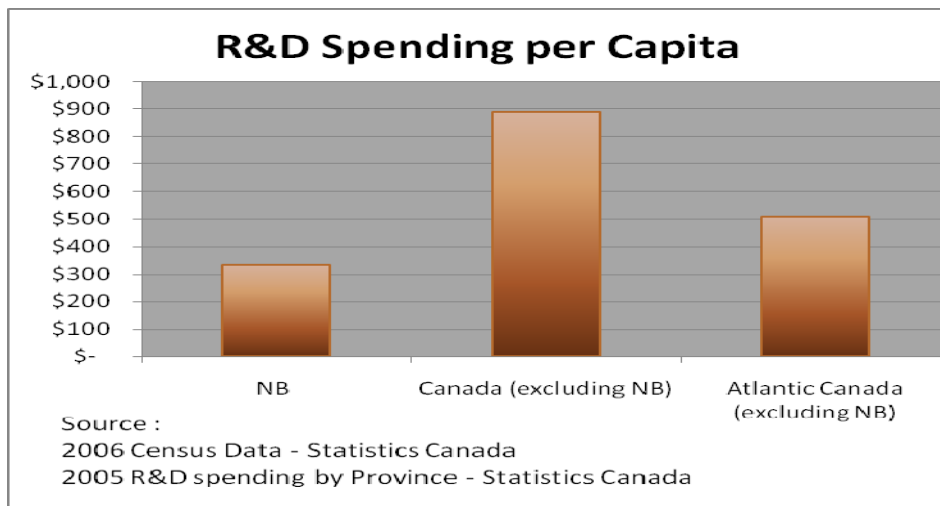
to be a focus on investing in and facilitating growth and development of the businesses and individuals that operate within the New Brunswick borders.

Figure 1



Research and Development (R&D) spending is an important component of a region’s economic development. Such investment spurs growth and innovation enabling successful businesses to better compete globally. The following chart (Figure 2) presents per capita information regarding R&D expenditures. In 2005, New Brunswick was notably behind other provinces in Canada. This leads to concern about the state of future innovation in the province.

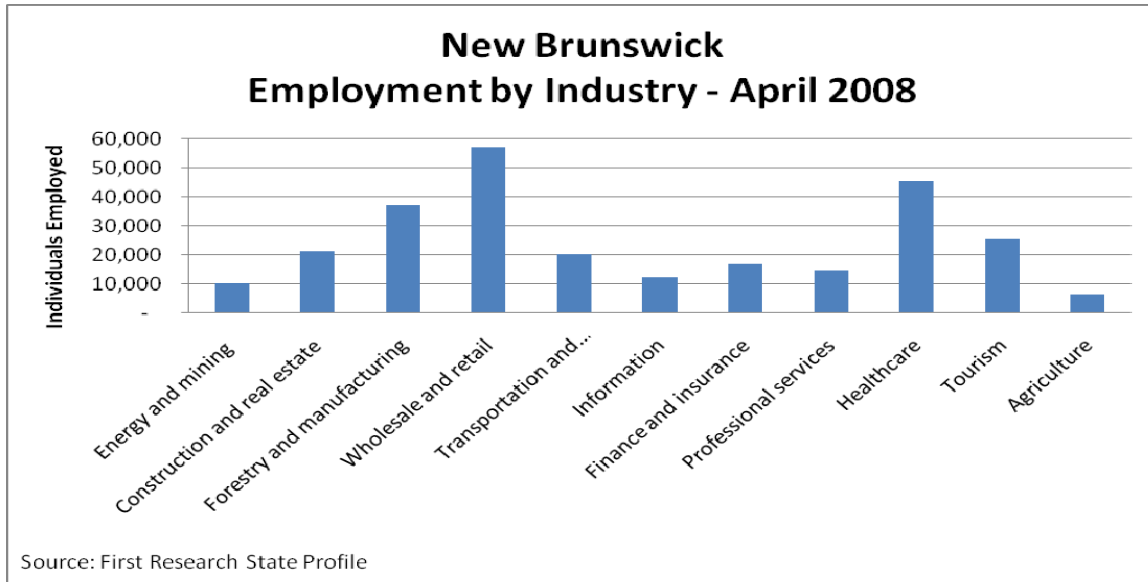
Figure 2



The following Figure 3 presents employment statistics by industry. These are relevant to the tax reform discussion as changes to taxation policies may have significant impacts

on some sectors, while playing a relatively insignificant role to other sectors. Despite the perception of New Brunswick being a primarily natural resource/agricultural driven province, it does appear that there is a well balanced economy, not solely reliant on any sector.

Figure 3



4.3 Current State of Capital Markets in New Brunswick

When an entrepreneur or company seeks money or capital for growth, there are usually two options: debt investment or equity investment. The capital market facilitates these transactions between investors and companies.

Some of the greatest challenges of early-stage growth companies in New Brunswick are that they are small and too few in numbers to attract significant and regular sources of capital. Early-stage companies seldom require large investments and are often considered too small for traditional funders. Traditional funders most often invest a minimum of \$2 million with a maximum participation of 33% of funds raised from external investors. As a result, early-stage entities in New Brunswick seeking capital of less than \$6 million have a challenge attracting investment. In addition, if those looking to raise capital cannot meet their needs in New Brunswick they may be compelled to relocate closer to capital sources. This contributes to the "Flight of the Entrepreneur" which strips out a critical component of our capital markets.

"Flight of Capital" is another significant issue we face. This detracts from the growth and development of entrepreneurial companies within our province. Key considerations:

- Although New Brunswick residents are actively investing, only a small portion of the capital they supply is invested in New Brunswick based companies.
- Certain capital raising initiatives which trigger the filing of a report with the Commission show that in 2007-08, New Brunswick investors, including some New Brunswick pension funds invested over \$711 million. Slightly less than \$13 million of that amount was invested in New Brunswick based corporations.

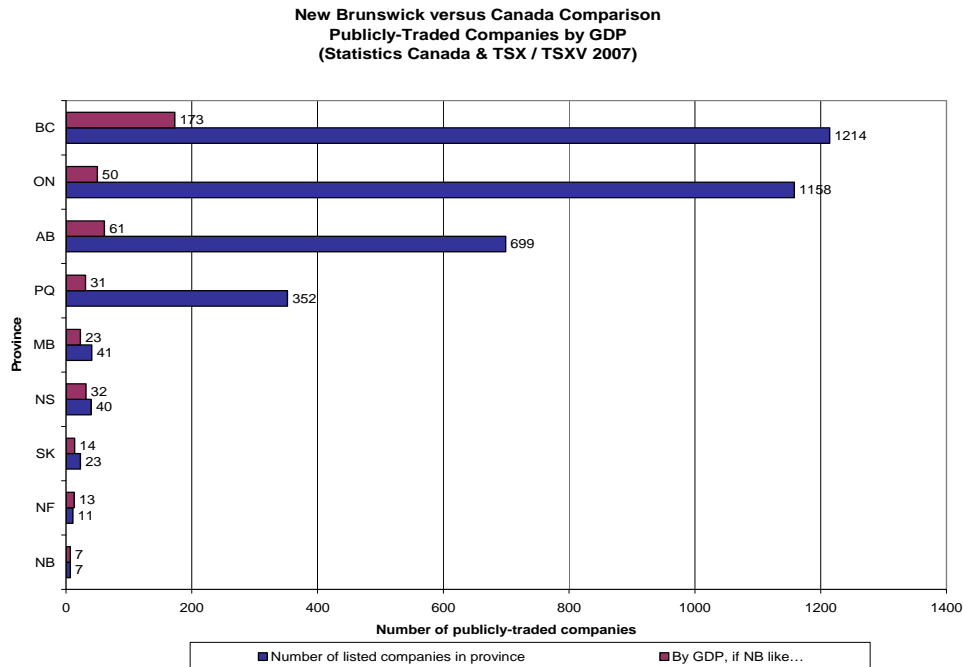
- Money from New Brunswick investors is typically being directed outside our province to global markets.

The number of publicly traded companies headquartered in a jurisdiction is also an indicator of the strength of capital market activity. This metric is an indication of the growth and attractiveness of the equity culture. In general, these companies are further along the capital raising continuum having outgrown their traditional means of financing through private equity networks, angel investors, venture capitalists, etc.

The following graph (Figure 4) shows that New Brunswick is significantly behind virtually every province in Canada as a residence for publicly traded companies. Even when scaled for the difference in total GDP, similar trends are noted when compared to population. Although there has been a slight increase to 10 listed publicly traded companies since 2007, we are lagging well behind the rest of Canada.

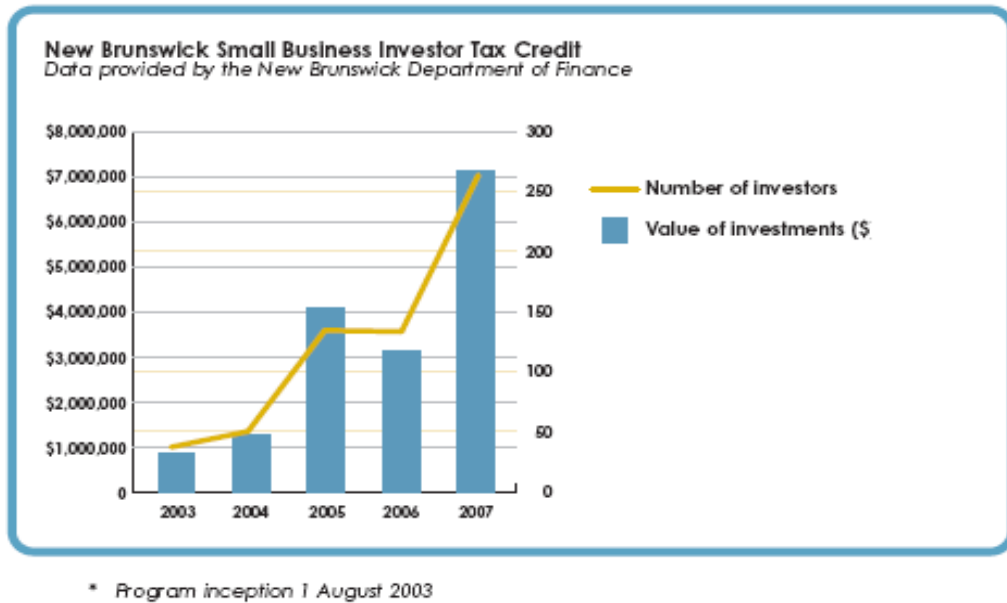
For example, if we compare ourselves to British Columbia, based on total GDP, if all other market characteristics were equal we would expect to have 173 publicly traded companies headquartered in New Brunswick. If compared to Nova Scotia, we would expect to have 32. Comments provided by our stakeholders and those that advise them suggests that our lack of publically traded companies is a function of the lack of capital options for those companies to seed them to the point of critical mass required to complete a successful public issue.

Figure 4



New Brunswick companies have had some success with the SBITC program as evidenced by Figure 5 below. Since 2003 the program has moved from below \$1 million of approved financing to just over \$7 million in 2007. This program will be further discussed later in section 6.1.

Figure 5



5.0 *A Discussion Paper on New Brunswick’s Tax System Proposed Changes*

5.1 Personal Income Tax

The Discussion Paper proposes a reduction in personal income taxes to a flat rate of 10% or two-tiered rate of 9% moving to 12% for income in excess of \$35,000. These changes will bring New Brunswick to one of the lowest personal income tax rates in Canada.

5.1.1 Implications

Our research has confirmed that personal income tax rate reductions would have a positive impact to New Brunswick investors by freeing up more disposable income for investing. In addition, this option would assist companies with the attraction and retention of a capable workforce. While this measure would be a positive one, the impact on capital markets for growth companies is considered to be secondary only. The prime financial concern for growth-based companies is achievement of sustainable profitability. Reductions in personal income tax rates may encourage high quality, high income professional managers to relocate to New Brunswick, or may reduce inflationary pressures on existing payrolls. However, the weight of sales tax increases that will be borne by individuals will offset those gains for individuals with low to moderate incomes.

5.1.2 Commission Position

A reduction in personal income tax is not a significant contributing factor in building capital wealth; we support the reduction in personal income tax as it makes more money available to individual investors to invest.

5.2 Carbon Tax

The Discussion Paper proposes the implementation of a tax on all carbon or carbon equivalent emissions in a manner similar to British Columbia. This will likely be the most challenging component of the overall reform to generate acceptance in the market place. Currently, only British Columbia and Quebec have carbon based tax structures. This concept is innovative. It is similar to tobacco taxes and will encourage social change through financial motivation. Carbon taxes have not been implemented throughout the majority of jurisdictions of the world. New Brunswick would be relatively unique in adopting this method of taxation.

5.2.1 Implications

Our submission emphasizes that New Brunswick must be competitive globally. The introduction of new tax measures that do not exist in competing jurisdictions comes with risk. In a global marketplace, investors do not view New Brunswick in isolation from other jurisdictions and will seek the best rate of return for their capital.

The implementation of such a tax in advance of the majority of jurisdictions in North America may have a negative impact on investment in New Brunswick's manufacturing, transportation and mining sectors. This may particularly be the case if other more attractive tax measures aren't in place to offset the impact.

Carbon based taxation is expected to have a limited direct impact on the majority of growth stage companies in New Brunswick attempting to attract capital. However, implementation of a carbon based tax will have a negative indirect impact on the cost to many companies of doing business in New Brunswick, through impacts on power rates, freight and transportation costs. At present, power generation in New Brunswick is much more reliant on carbon based fuels than both Quebec and British Columbia, meaning that implementation of a carbon tax would likely have a greater impact on New Brunswick energy rates, than in the provinces which have already implemented carbon based taxes.

Unlike income taxes, carbon based taxes are payable regardless of the financial situation of the entity, and thus would represent an additional risk factor to companies located in New Brunswick, regardless of whether they emit carbon directly, or indirectly. Since an investment's value is a function of the cash-flow that it is expected to generate and the risks surrounding that cash-flow, we anticipate that implementation of such a tax measure in advance of the majority of competitive jurisdictions will have a negative impact on New Brunswick capital markets. This impact will encourage resource and energy use businesses to locate and invest outside of New Brunswick and reduce the ability of those who remain here to attract outside capital. These businesses compete in a worldwide marketplace for capital. New taxation of carbon emissions will disadvantage those entities in the market.

According to a survey of corporate executives completed in 2007¹ energy availability and cost ranked higher than corporate or personal income tax rates in the selection of site locations by corporations.

¹ Area Development Magazine, December 2007

5.2.2 Commission Position

Implementation of carbon based taxation would have significant negative implications for companies involved in industries such as energy, manufacturing, transportation, etc. These industries have typically been a major contributor to employment (Figure 3) and economic activity within New Brunswick, providing long term employment stability since these companies are typically less mobile once established.

While we endorse the practice of businesses and consumers limiting carbon emissions, we are mindful of the potential impact that implementation of such a tax will have on the cost of operations for the majority of established and growth stage New Brunswick businesses, regardless of their ability to pay.

5.3 Corporate Tax Rates

The Discussion Paper proposes changes from the current provincial 13% general rate on taxable income to 10%, 7%, or 5%. As suggested, this change will provide increased incentive for companies to be productive and efficient, spurring growth and encouraging economic development. This reduction would give New Brunswick one of lowest combined general corporate tax rates in Canada and the USA. New Brunswick currently is very competitive with the other provinces in Canada and those US states which were compared in the research performed. This rate cut would provide additional incentive for companies which are already operating in a very competitive tax environment. See Figure 6 and Figure 7 below for comparison of New Brunswick rates to other Canadian provinces and select US states.

Figure 6

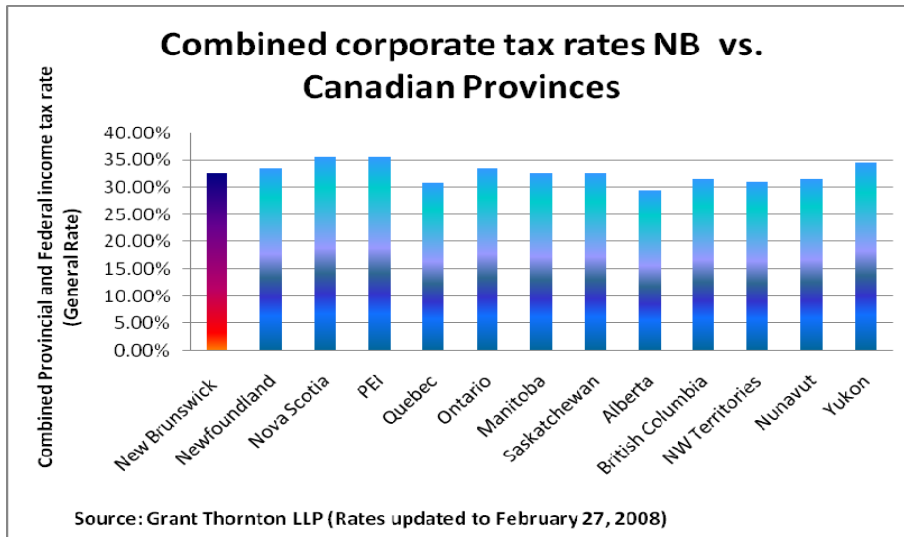
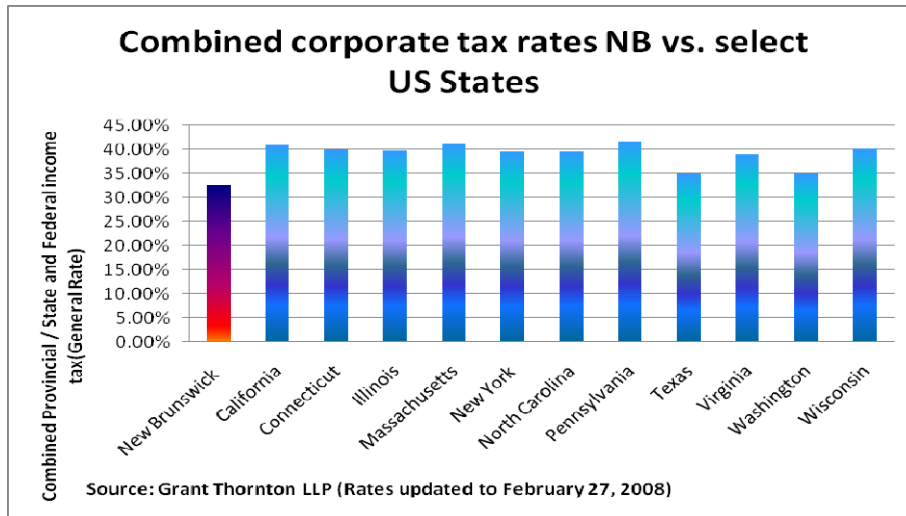


Figure 7



5.3.1 Implications

Overall corporate tax rate reduction will be viewed favourably by New Brunswick businesses and investors. New Brunswick based businesses will retain a higher proportion of their earnings, maintaining earned capital for organic growth.

A recent survey indicated that corporate income tax rates were an important or very important factor in consideration of site locations for 83.8% of corporate executives². The same survey indicated that six other factors including highway accessibility, labour cost, energy availability and costs; occupancy costs and availability of land were ranked higher than corporate income taxes on the priority scale.

Despite the results of a survey of overall corporate executives, our research and experience indicates that corporate income tax rates are at most a secondary factor of consideration for early stage companies seeking capital. Most early stage companies are not taxable as sufficient income has not been generated, and therefore most are focused on the path to sustainability, and means to fund their research, development and marketing costs until they reach profitability.

5.3.2 Commission Position

Based on our discussion with our stakeholders we believe that a reduction in the corporate tax rate will serve to benefit previously established companies who are operating with taxable income above the small business deduction threshold³; however, this will not typically have the same positive impact on our primary stakeholders as the current tax system. This provides credits which can benefit

² Area Development Magazine, December 2007

³ Canadian Controlled Private Companies engaged in active business qualify for a reduced income tax rate of 5% in New Brunswick on the first \$400,000 of annual taxable income. The combined federal and provincial tax rate on this income is 16%.

companies and investors prior to reaching the point where there is sufficient taxable income to be affected by the proposed changes. Although we see the reduction as positive overall, removing these tax based incentives, as proposed in the Discussion Paper will have a greater negative impact on capital market development than the anticipated benefits from the general rate reduction. (See 6.0 Other Tax Based Incentives).

5.4 Harmonized Sales Tax (HST)

The Discussion Paper introduces the option of increasing New Brunswick's component of the HST by 2% from the present rate of 8% to a new rate of 10%. This increase would essentially reverse the effect of reductions in the federal component of HST implemented over the past two years.

5.4.1 Implications

Most businesses face limited impact by sales tax changes. The majority of businesses collect HST on all sources of revenue and pay HST on most non-payroll input costs. Other than businesses who are lenders of money, providers of insurance, healthcare providers and residential landlords who will bear the proposed additional 2% cost of taxable goods and services received, the tax flows through most businesses but is not borne by the business.

There will be compliance costs and cash flow implications on the businesses, but these will have a limited financial impact.

There will be an impact on the businesses to the extent the additional 2% cost to the consumer impacts their ability or willingness to purchase.

Our research has indicated that the majority of businesses within our stakeholder target group, other businesses and consumers outside of NB and therefore will not face price pressure as a result of the increase.

While an increase in the effective HST rate will at least partially offset the advantages created by the proposed decrease in personal income tax rates, we do not believe that this increase will have a negative impact on the ability of New Brunswick based companies to attract capital.

5.4.2 Commission Position

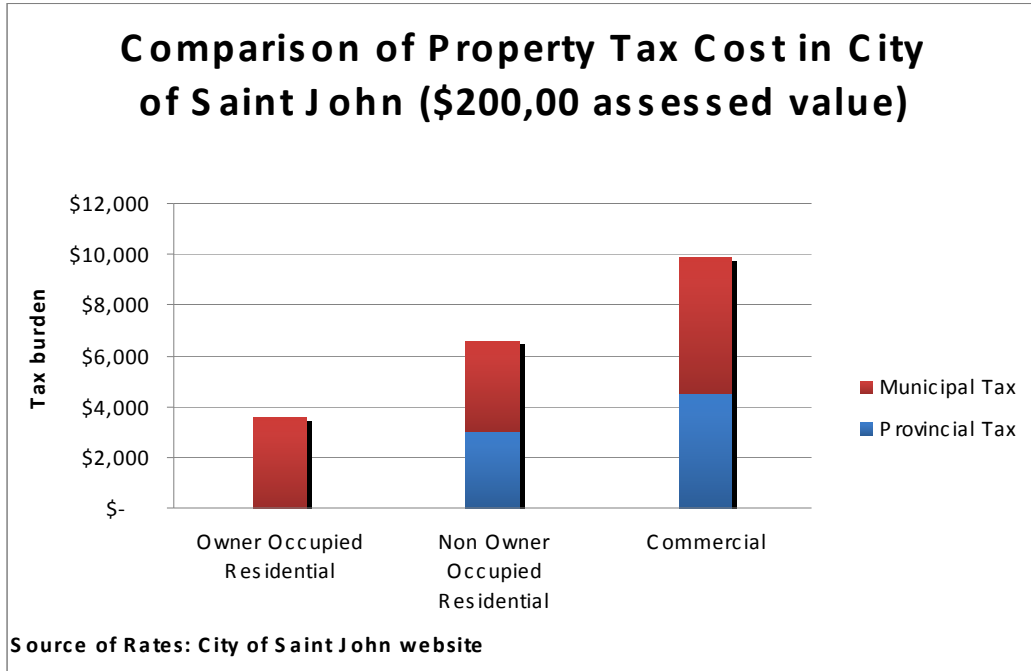
Changes to the Harmonized Sales Tax will have minimal effect on stakeholders' ability to access capital.

5.5 Property Tax

The Discussion Paper outlines a number of proposals, which would restructure the property tax burden, including reducing the non-residential rates, potential elimination of provincial residential rates allowing municipality's additional tax room and flexibility, as well as extending the Local Service District rates to all property types. One other option presented is the assumption of a three year averaging system for the assessed value. These changes are designed to even out the tax burden between residential

and non-residential, as well as owner occupied versus non owner occupied properties. The chart below (Figure 8) illustrates the current property tax burden that would be faced in the city of Saint John on a property valued at \$200,000 for owner-occupied residential, non-owner occupied residential and commercial use. As illustrated, the commercial and non-owner occupied residential users are faced with a significantly larger burden than that of the owner-occupied residential properties.

Figure 8



5.5.1 Implications

Canadian studies in various jurisdictions have shown that business does bear an inappropriate portion of the cost of municipal service delivery in locations that use an arbitrary means to levy a higher rate of tax on non-residential real estate (either directly, or indirectly to renters of office space).

The proposed changes will reduce commercial property tax and commercial rental occupancy costs and have a positive impact on the ability of New Brunswick companies to attract capital. This financial impact will be limited for the majority of growth stage companies that have occupancy requirements of less than ten thousand square feet.

5.5.2 Commission Position

Property tax is a direct cost to our stakeholders, whether renter or property owner. A reduction in the property tax will provide an increased level of cash available to our stakeholders to invest in growing their business. We therefore support reduction in the property tax rates of commercial property.

6.0 Other Tax Based Incentives

Perhaps our best opportunity to enhance economic competitiveness; grow income and promote entrepreneurship for our stakeholders exists within a heightened investment credit system. There is very little discussion of tax based incentives in the Discussion Paper. The experience of the Commission and the experiences of capital markets participants within New Brunswick's capital markets suggest that these incentive programs play a vital role in the development of early-stage growth oriented companies. While reductions in corporate income tax rates are important for established, profitable companies, they play at most a secondary role to the founder or investor in an early-stage growth company. Incentives to assist young companies in developing and bringing their product or service to market are much more important to these companies.

Although specific details regarding the intentions of phasing out various Sector and Industry Specific tax credits have not been provided in the Discussion Paper we would like to emphasize that similar incentive mechanisms are widely used by most jurisdictions in North America as a way to guide the direction of industry in line with the goals of the province or state. Eliminating the ability to provide strategic incentives to businesses within New Brunswick may limit growth and development of important business sectors.

We recommend that a number of tax-based incentives be either retained or enhanced to stimulate growth stage, innovative companies within our province. A brief discussion of a number of these programs is included below.

6.1 Expanding Scope and Limits on Small Business Investor Tax Credit (SBITC)

The SBITC is a provincial program that provides a 30% personal provincial tax credit on the first \$80,000 of qualifying investment per year. The tax credit is provided to private equity investors who invest in qualified New Brunswick based companies with assets under \$40 million.

Our research has indicated that this is a very important program to the growth of capital markets in New Brunswick. As illustrated by [Figure 5](#) of this report, uptake of this program has increased substantially in recent years. While less than \$1 million of private equity investment was raised for New Brunswick companies under the program in 2003⁴, over \$7 million was raised in 2007. The Government has been enabling private citizens to reduce the risk of their investment by providing a tax credit. At the same time, the Government is not taking on significant financial risk since the program generates \$2 of private investment for every \$1 of tax credit issued. These private funds are taking opportunities to market and enabling the development of early-stage companies to the point of potential follow-on equity investment from later stage funding sources (venture capital, public equity or both).

Many other provinces have programs similar to the SBITC. Some, such as British Columbia's, have a much higher cap on the level of personal investment that qualifies for the credit. Others, such as Nova Scotia's, provide credits for investment in a broader

⁴ Program inception date was 1 August 2003

category of investment vehicles, e.g. the Community Economic Development Investment Funds.

6.1.1. Commission Position

We believe that programs such as the SBITC are critical to growing early-stage companies in jurisdictions with limited capital market access such as New Brunswick. Based on discussions with various individuals within our stakeholder groups, this program is favourably recognized. The Government should consider significantly expanding the program scope to further enhance the benefits to users, and the spin off effects on the economy. These enhancements would include:

- Increasing the maximum investment eligible for the tax credit from \$80,000 to \$300,000, as recommended by our stakeholders in our Fullsail Summit reports and by the Self-Sufficiency Task Force in 2007;
- Harmonizing with similar programs in Nova Scotia and proposed for Newfoundland to enable investors from other jurisdictions to invest in New Brunswick;
- Modifying the criterion of the program to include:
- Community Economic Development Investment Fund investments, similar to Nova Scotia; and
- Capital pool companies⁵ in order to further encourage New Brunswick investors to utilize existing Canadian equity markets.

6.2 Scientific Research & Experimental Development (SR&ED) Investment Tax Credit

The New Brunswick SR&ED investment tax credit (ITC) applies to Canadian Controlled Private Corporations and other corporations with a permanent establishment in New Brunswick making eligible expenditures for scientific research and experimental development in the province. "Eligible expenditures" are those that meet the definition of a "qualified expenditure" under subsection 127 (9) of the *Federal Income Tax Act*. The New Brunswick SR&ED ITC returns 15% of all qualified expenditures to the qualifying company.

While Alberta, Northwest Territories, Nunavut and Prince Edward Island do not have a provincial credit to accompany the federal credit all remaining provinces and territories offer SR&ED tax credits, most between 10% (British Columbia and Ontario) and 20% (Manitoba).

There are clear benefits to the New Brunswick 15% SR&ED ITC at present:

1. It is refundable, or paid to a company instead of reducing a company's taxes payable. This is critical to start-up companies who may not generate taxable income for a number of years.

⁵ A Capital Pool Company (CPC) is a shell company created by several individuals, with an appropriate combination of business and public company experience, who combine their resources as seed capital with a view to using these funds to seek out an investment opportunity in a growing business. A CPC gives emerging businesses a foothold on TSX Venture Exchange and access to public financing when a traditional initial public offering is not the preferred route.

2. It is uniform and straightforward. It applies equally to all expenditures related to SR&ED including labour, capital, contracts, materials consumed and transformed, overhead and lease costs.
3. It is competitive with the SR&ED tax credits offered by other provinces. Only Manitoba and Quebec⁶ have higher ITC rates by percentage.

6.2.1. Commission Position

We believe the SR&ED program is of significant benefit to companies at any stage of growth in New Brunswick but crucial to start-up and early-stage companies depending on innovation as their engine toward success and needing access to capital in limited access environments. We encourage the Government to explore the following improvements to the program:

- Increase the provincial tax credit rate from 15% to 20% or more. This would stimulate companies to take advantage of the program and promote innovation within New Brunswick.
- Work with the federal government to improve the consistency, efficiency, complexity, administration and execution of the SR&ED program in line with the recommendations received from industry through Canada Revenue Agency's "Consultation Process" commenced in 2007. This would enable companies to prepare SR&ED claims with greater certainty of a consistent and uniform review process while receiving their much-needed credits expeditiously.
- The goal should be to ensure innovative New Brunswick companies achieve increased and immediate access to enhanced SR&ED tax credits, both federally and provincially. We strongly believe certain aspects of the SR&ED program beyond the provinces' control (its administration and non-refundability of certain federal tax credits to name but two) act as a clear disincentive for many New Brunswick companies to invest in innovation.

6.3 Labour Sponsored Investment Tax Credits

Labour sponsored investment tax funds are specified investment funds that have been created by an employee or union organization (labour sponsored). These funds are typically used to invest in small to medium sized businesses requiring additional equity. The Government currently provides a personal tax credit equal to 15% of up to a \$5,000 investment per year (total credit \$750) that is in addition to the federal 15% credit limit per \$5,000 investment as well.

The labour sponsored investment tax credit is a program that many other provincial jurisdictions in Canada have also adopted in line with the federal government program. Provinces such as Nova Scotia have recognized the importance of this program and have increased their annual maximum credit to \$2,000 based on a \$10,000 investment.

⁶ While Quebec has a refundable wage tax credit of 37.5% in certain situations, it is limited to labour expenditures.

Labour sponsored investment tax credits represent a relatively easy means for the Government to encourage additional capital investment since no provincial infrastructure is required to operate the program.

Non-government infrastructure is already in place to provide capital to New Brunswick companies: Growthworks Atlantic Venture Fund Ltd. maintains a full-time presence in New Brunswick and has already invested over \$20 million⁷ in New Brunswick companies.

The presence of Growthworks Atlantic within New Brunswick encourages other venture capital funds to participate in New Brunswick equity offerings, by participating in syndicated offerings led by the local fund.

6.3.1 Commission Position

We recommend an increase in the maximum labour sponsored investment tax credit to \$10,000 and an increase in the tax credit to 20%. By increasing the available credit New Brunswick would offer support for the program at a level similar to Nova Scotia and British Columbia.

This enhancement would enhance the level of capital available to New Brunswick based companies without additional infrastructure requirements of the Government.

6.4 Other Incentives

New Brunswick competes in a global environment for investment capital, which is the critical building block for innovation, income and wealth creation. Our research indicates that certain jurisdictions have provided effective stimulus to attract investment capital.

6.4.1 Commission Position

We encourage the Government to investigate and champion innovative means to stimulate early-stage capital investment. A number of these initiatives have been documented in our *Fullsail 2008* report, *Venturing into a New Economy - Developing New Brunswick's Capital Markets*. They include initiatives to:

- **Stimulate the commercialization of academic R&D and encourage entrepreneurial initiatives from faculty and students, it is recommended that the province's post-secondary institutions establish angel investment funds.** Similar to those in the United States, these funds would invest in faculty and graduates who establish businesses within the institution's jurisdiction. This would help retain the province's graduates and foster cluster development.
- **Encourage pension and investment fund managers serving clients in New Brunswick to actively participate in venture and public equity investment in New Brunswick companies.** Both publicly traded and privately held venture capital ready companies are finding it difficult to secure investment from outside the province. One reason often cited is the lack of investment fund managers serving clients in New Brunswick. Working within their mandate of allowable alternative investments

⁷ According to Growthworks Atlantic Venture Fund Ltd., statistics

and maintaining their fiduciary duties to their investors, these managers could be encouraged to invest in New Brunswick's venture capital ready and publicly traded companies. Additionally, these managers could be encouraged to aggressively use their leverage with Bay Street firms to help secure access to those firms' private equity divisions.

- **Encourage New Brunswick businesses to provide corporate venture capital.** A growing trend in business is corporate venture philanthropy. The idea first emerged in Silicon Valley, and the best example is probably Cisco Systems Inc. Cisco allocates a portion of its annual profits for investments in early and growth stage companies. Corporate New Brunswick should be encouraged to follow Cisco's lead. Entrepreneurs, the investing companies and the economy all stand to benefit from investments in New Brunswick's future.
- **Establish a sidecar or co-investment fund.** Co-investment funds de-risk investments for angels and thus stimulate angel investment, network creation, and the formation of early stage companies. It is recommended that a sidecar⁸ or co-investment fund be established to facilitate investment in New Brunswick companies.
- **Waive provincial income tax for senior level managers who move to New Brunswick to become part of a small and/or medium-size enterprise management team or for portfolio managers of venture capital firms.** Over the past two years we have continued to receive feedback about the difficulty that early stage and growth-stage companies have in obtaining and retaining senior, experienced management. In order to motivate potential senior management candidates to relocate to New Brunswick, the Government could forgo the collection of provincial income tax for the first year of residency, with a gradual increase to full rate over the ensuing four tax years. This may motivate firms to relocate their operations to the province and bring expertise closer to the province's entrepreneurs. There are also potential venture capital cluster benefits in the areas of accounting, legal services and conferences.
- **Actively brand and market the existing Small Business Investment Tax Credit program.** To realize the benefits of these changes we recommend that the SBITC be actively branded and marketed to students, entrepreneurs, accountants, lawyers and personnel at economic development agencies. Increased awareness about this valuable investment incentive will lead to greater use and demand, stimulating angel investment and promoting wealth creation. The ultimate goal is to make the SBITC an integral part of the high-growth entrepreneur's financial tool kit.

7.0 Conclusion

The Government of New Brunswick has an ideal opportunity to take innovative steps to expand its economy and promote significant investment in the province. Bold action is needed. Tinkering or fine adjustments to the current system will not be enough to spark the creation of a dynamic entrepreneurial culture and thriving capital markets. We need to provide the incentives that will increase investments in research and development and the commercialization of these opportunities. We need to retain capital investment in this province and provide viable opportunities to invest in New Brunswick based enterprises.

⁸ A pool of capital that invests alongside another investor. These funds invest in deals that have been sourced, vetted and invested in by a pre-approved investment partner. (Also called sidecar financing).

An innovative and competitive tax structure, including targeted incentives can play a significant role in reaching New Brunswick's goal of self-sufficiency by 2026. The tax reform that is currently being considered by the Government provides an excellent opportunity to make changes and stimulate the much-needed growth of our entrepreneurial environment and capital markets.

Keeping and enhancing the investment tax credit programs will go a long way toward **enhancing New Brunswick's competitiveness, growing income** and **fostering entrepreneurship** – meeting and surpassing three important goals of the proposed restructuring of the tax system.