



Innovation and Productivity Tax Credit (“IPTC”) Overview

1. Recommendation Summary:

The National Angel Organization is recommending that the Government of Canada and provincial governments adopt an Innovation and Productivity Tax Credit (“IPTC”) similar to the United Kingdom’s successful ten-year-old Enterprise Investment Scheme and B.C.’s Small Business Venture Capital Program. The IPTC would encourage Canadians to invest directly in start up and early stage companies as individual or angel investors.

The IPTC would define eligible companies as meeting certain simple size and type criteria. Once a company was approved as being eligible and allocated a specific tax credit allotment, individual investors could invest up to that amount in the eligible company. Upon making their investments investors would apply for a 30% refundable tax credit. The tax credit would be funded 50/50 by the federal government and participating provinces.

The compelling reasons for the Innovation and Productivity Tax Credit are as follows:

- IPTC can be used to cut taxes while generating more tax revenue than it uses;
- It can generate great social returns through high quality job creation, regional development, product innovation and reduced tax burden;
- It can create net new investment for economic growth.
- It increases the chances of success for start up and early stage companies by attracting more capital and individual investors;
- It mobilizes individual investors with expertise, skill and contacts to help SME’s;
- It benefits high-growth and knowledge-based SME’s the most.
- It can be embraced by all members of the risk capital sector and many other sectors of the economy
- It is not subject to abuse like the SRTC program in the 80’s;
- It is relatively simple and cost-effective to administer;
- It can be limited to a pre-determined budget amount by allocation.
- It can be used to improve federal/provincial relations and integrate with labour sponsored funds
- It greatly increases availability of risk capital in rural areas, outside major financial centers.

These reasons for implementing the tax credit are discussed in more detail in the attached briefing documents.

2. The Innovation Funding Gap

For Canada to be successful in the highly competitive global market of the 21st century, it must create a steady stream of new and more innovative companies. New companies create net new jobs, in new fields with new workers. Unfortunately, many new businesses do not get off the ground, or eventually fail, due to lack of capital.



Sustainable Development Technology Canada has estimated that there is a \$5 billion funding gap that is holding back the country's economic development.

The NAO believes that the most efficient way for government to encourage new businesses is by mobilizing Canada's individual investors who bring capital and strategic direction to entrepreneurs by virtue of their own experiences, thus helping to increase their odds of eventual success. In the United States individual investors fund thirty to forty times as many entrepreneurial firms as the formal venture capital industry and invest three to five times more money.

The NAO has undertaken advocacy because of the poor state of individual investment in Canada. The Global Entrepreneurship Monitor (GEM) Canada 2002 study revealed that the USA has 53% more angel investors per capita than Canada (4.9% vs. 3.2%). The study's authors found this surprising given the fact that Canada fared well in every other indicator of entrepreneurial activity. The lack of individual investors is a critical bottleneck in Canada's commercialization strategy.

The current markets for seed and early stage funding are small, inefficient and imperfect in Canada. Canadian angel investors face unique challenges while banks, venture capital firms and the BDC are structurally impeded from properly servicing this market. There is a critical need for government intervention.

Generally, people are more concerned about losing their money, than they are excited about making more. In the absence of any special incentive they will therefore invest more conservatively in later stage and public companies, with limited benefit to the economy. Current capital gains tax breaks do not work as an incentive in seed financings because investors discount them or do not consider them when investing, not all companies are successful and as a result capital gains tax advantages are not always realized. The advantage of the tax credit is that people have the incentive **up front** on the way **into** the investment rather than after the investment has run its course. The Innovation and Productivity Tax Credit would encourage earlier stage, higher risk investments by many more individuals.

3. The BC Model Works!

We are aware that most appeals for tax incentives are not adopted because governments are worried about abuses, the cost of administering the program and the precedent it may set for other areas. Government must see that they are going to get something that they never had before. In 1985, the British Columbia provincial government began offering a tax credit program for retail investors to pool their risk capital into specific businesses or multiple businesses. In early 2003, the program was modified to include direct investments into approved EBC's (Eligible Business Corporations). The credits are capped annually for government budget purposes and are focused on selected industries.



The program has been demonstrably successful according to all traditional measurement tools:

- increased number of jobs;
- total new capital investment; and
- diversity of investment in various regions of the province,

The BC experience has ultimately led to the creation of some very successful companies:

- ALI Technologies - life sciences;
- Aspreva Pharmaceuticals; and
- Redlen Technologies - semiconductors.

These companies would almost certainly not have existed without angel investors, who were influenced through tax incentive programs. The new jobs, and the corporate and individual income taxes more than pay for the cost of running the program. The program has a two-year payback according to a Grant Thornton study. The BC Government officials are willing to share their structure, their data and their statistics to help create a national program to assist all Canadians in all Provinces. There is also a comprehensive study on the UK Enterprise Investment Scheme over 10 years of successful operation.

In June of 2004, the Canadian Task Force on Early Stage Funding was struck, co-chaired by the Acting President of NRC and the Dean of UBC's Sauder School of Business, with representation from all sectors of the private equity "ecosystem" – from governments and institutions to venture capitalists and individual investors. After extensive study, that group delivered its final recommendations in December, which included strong endorsement of the NAO's IPTC proposal.

The Public Policy Committee has been gaining steady support for the Innovation and Productivity Tax Credit (IPTC). Organizations formally supporting the tax credit initiative are:

- Canadian Advanced Technology Alliance (CATA)
- Canadian Task Force on Early Stage Funding
- Canadian Federation of Independent Business (CFIB)
- Conference Board of Canada
- Ottawa Centre for Research & Innovation (OCRI)
- Foragen Technology Ventures Inc.
- MaRS Discovery District
- Primaxis Technology Ventures Inc.
- Petroleum Technology Alliance Canada
- Sustainable Development Technology Canada (SDTC)

For additional resource materials and information please contact:

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