NACO Insights

August 2016

Innovation Policy: Stimulating Investment in Canadian Ventures

Executive Summary

NACO's objective is to promote policy initiatives intended to increase the number of successful startup companies, jobs, and wealth creation by supporting early stage capital investment provided by Angel investors in Canada.

NACO suggests the following policy initiatives:

- **Provide incentives for Angels to increase the supply of investment capital**
- **Eliminate deemed benefit tax on issuance of CCPC founders' shares or stock options to employees**

Investment Incentives

Provide federal investment incentives to Canadian Angel investors to encourage further investment in Canadian companies. This could be in the form of a federal refundable investment tax credit, accelerated investment write-off provision or co-investment funds.

To build a strong innovative economy, we must not only reward patience but acknowledge the fact that more risk capital from Angels is needed to grow successful companies. Angels provide both mentorship and support to growing ventures. However, the failure rates are high. When failure occurs, angels do receive some tax relief but because of the long time that their capital is committed, it would encourage Angel re-investment in other opportunities if this relief was available sooner.

Based on evidence from the two decades long use of tax-related incentives in British Columbia, NACO believes that the most effective way to increase the amount of patient capital that individual investors are willing to risk is by providing incentives at the time they make their investment. A national investment tax credit similar to that in B.C. or an accelerated write-off provision would increase the capital pool NOW rather than having to wait for successful outcomes to re-deploy capital.

Another form of support would be through the creation of angel co-investment funds that would match the capital that angels commit to qualified companies.

Eliminate deemed benefit tax on issuance of CCPC founders' shares or stock options to employees

Permit issuance of founders' shares or stock options of a CCPC with no tax liability until shares are sold and then only on the basis of proceeds received, not on the basis of an artificial interim deemed value.

Recruiting talent is a challenge. Issuing "founders' shares" (or stock options at a nominal exercise price) can create a powerful incentive for the recruitment and retention of top talent. While these shares are illiquid and often subject to vesting provisions, CRA taxes them when received. Although the tax can be deferred until shares are sold, if the Company fails the tax liability on this deemed benefit still becomes due. This means more capital must be raised in order for companies to offer competitive compensation, which is a major impediment for entrepreneurs.

NACO's Recommendations

- **Create a National Investment Tax Credit — a 15% refundable tax credit for investments made in qualified ventures**
- **Allow angel investors to take accelerated investment write-offs when making an investment in qualified ventures**
- **Establish funds that would co-invest with angels in qualified ventures**
- **Permit issuance of founders' shares or stock options of a CCPC with no tax liability until shares are sold and then only on the basis of proceeds received, not on the basis of an artificial interim deemed value**

To read the full paper, please visit:
www.nacocanada.com/naco-academy/public-policy/

To comment on NACO's policy recommendations, please contact: **policy@nacocanada.com**

For additional information on NACO, our membership and our activities, please visit: **www.nacocanada.com**