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Canada Should Remove Bureaucratic Roadblocks to Much-Needed Foreign Private Equity: C.D. Howe Institute Study

Toronto, Feb. 13 – A web of counter-productive tax rules blocks the inflow of needed foreign cash to Canada's private equity sector, according to a study released by the C.D. Howe Institute. In *Financing Canadian Innovation: Why Canada Should End Roadblocks to Foreign Private Equity*, lawyers Stephen A. Hurwitz and Louis J. Marett argue that these rules needlessly, and unprofitably for Canada, block hundreds of millions of dollars in foreign (mostly US) investment capital.

Canada's private equity firms are not as well capitalized as their US competitors, and invest less, in turn, in promising Canadian companies. Canadian venture-backed companies have only one-third the capital of their US competitors in the North American marketplace. Further, the 10-year net horizon return of Canadian venture capital firms is a mere 2.5 percent, compared to 20.7 percent for US venture capital firms.

Canada's cross-border tax scheme, say Hurwitz and Marett, is particularly hard on gains realized by nonresidents on the sale of shares of private corporations, in sharp contrast to the treatment accorded under the tax schemes of other countries such as the United Kingdom and the United States.

The paper identifies ways to change tax laws to unblock the critical capital flow. Key recommendations:

- First, the federal government should end the tax-clearance process that foreign private equity investors must follow when selling shares of a private Canadian company.

- Second, to prevent double-taxation, changes to the Canada-US tax treaty should provide US limited liability companies the same tax treatment that ordinary US corporations receive when selling shares of a private Canadian company.
- Third, the federal government should permit tax-free rollover of shares of a Canadian company into shares of a foreign company.

Without change, the authors argue, capital-starved Canadian companies will fail to commercialize much of the nation's R&D investment, raising the risk of Canada's squandering a significant share of its intellectual capital, and needlessly imperiling its future economic growth.

The study, *Financing Canadian Innovation: Why Canada Should End Roadblocks to Foreign Private Equity*, is available at www.cdhowe.org.

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Financing Canadian Innovation: Why Canada Should End Roadblocks to Foreign Private Equity. C.D. Howe Institute Commentary No. 244, by Stephen A. Hurwitz and Louis J. Marett (February 2007). 11 pp; $12.00 (prepaid, plus postage & handling and GST — please contact the Institute for details). ISBN 0-88806-704-6.

Copies are available from: Renouf Publishing Company Limited, 5369 Canotek Road, Ottawa, Ontario K1J 9J3; or directly from the C.D. Howe Institute, 67 Yonge St., Suite 300, Toronto, Ontario M5E 1J8. The full text of this publication is also available from the Institute's website at www.cdhowe.org.