

Submission to the Competition Policy Review Panel
Consultation Paper
Sharpening Canada's Competitive Edge

Submission from

BIOTECCanada

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Executive Summary

It is critically important to the success of Canada's 532 biotechnology companies and to the health of the industry in Canada that the Federal Government create an advantageous business climate to sustain and grow these companies in the new global economy. By making Canada more competitive, the federal government can help establish a climate for investment, both foreign and domestic, that is conducive to having key corporate functions located in Canada. The federal government must take action now to create a robust climate of investment, both foreign and domestic. Critical components include an open investment regime that provides certainty for foreign investors and the lessening of the regulatory burden on Canadian companies.

Canada's biotechnology sector has grown and achieved a market capitalization of \$22 billion. The technologically advanced products and processes that this research enables improve people's lives, clean up the environment, and transform Canada's economy.

Canada's competitiveness in the global biotechnology industry needs to be enhanced to capitalize on economic opportunities. An increasingly large gap has emerged in Canada between funds needed to commercialize products and the actual investment provided. This is especially true for small and medium sized biotechnology companies (SMEs) in Canada, three-quarters of which have fewer than 50 employees. The recently released BIOTECanada–PricewaterhouseCoopers *Canadian Life Sciences Industry Forecast 2007* highlights that more than 40% of these companies are looking to secure more than \$20 million in their next round of financing. Canada's capital market is too small and too risk-averse to provide this assistance directly; thus, the SR&ED program needs to be modernized to become a more effective tool to prevent the hollowing out of the emerging technology sector in Canada. If Canada does not act, we not only risk losing the biotechnology industry to competing jurisdictions, we also risk not getting the return on investment back from investments in research in the emerging technology sector in Canada. This sector provides a forum for employment for many of our advanced science graduates from universities in Canada whom taxpayers have subsidized throughout their education. If we have no jobs for these graduates and lose them to foreign employers, we will also lose this return on our investment.

This paper comments on the objectives posed in the consultation paper to enhance Canadian competitiveness and to capitalize on economic opportunities that arise outside of its national borders. We have focused our recommendations on the impact on SMEs and changes to the current SR&ED program that are the business case for keeping attractive, high-paying, emerging technology jobs and investment in Canada. To attract foreign direct investment, to provide Canada's emerging technology sector with the tools to compete in the global marketplace and to create a competitive edge to do R&D in Canada we recommend the following changes to SRED:

1. **Remove the current Canadian-controlled private corporation (CCPC) restriction on SR&ED for refundable credits, while maintaining eligibility requirements (taxable income and taxable capital thresholds); and,**
2. **Increase the annual R&D expenditure limit from \$2 million to \$10 million and adjust the taxable capital threshold from \$10 million to \$50 million.**

Submission to the Competition Policy Review Panel Consultation Paper *Sharpening Canada's Competitive Edge*

BIOTECanada is Canada's leading national industry-funded biotechnology association with over 200 member companies representing the broad spectrum of biotech constituents including emerging and established companies in the health, agricultural, and industrial sectors, as well as academic and research institutions and other related organizations. We are dedicated to the sustainable commercial development of biotechnology innovation in Canada and regularly contribute to the policy discourse on government policies that impact our industry.

BIOTECanada and the member companies we represent, support the need for fundamental changes to modernize the SR&ED program that was developed twenty-two years ago, in a pre-NAFTA environment. As recognized in the consultation paper, the economic conditions of 1985 are vastly different than the reality of 2007. The SR&ED program is not as effective today as it needs to be for small and medium sized companies who generate little or no revenue. The majority of Canada's biotechnology companies are small and medium sized enterprises, with less than two years of operating cash on hand.

While it is clear that changes need to be made, it is important to recognize that the Government of Canada's support for research and development is meaningful and has helped spur the creation of many emerging technology companies. It has also encouraged economic and labour market growth in areas of knowledge-based innovation; according to Statistics Canada, Canada's biotechnology industry achieved 13 percent growth in employment over the past two years. As noted in Industry *Canada's Mobilizing Science and Technology to Canada's Advantage* document, "Organizations at the forefront of scientific development and technological achievement create high-quality, knowledge-intensive jobs with high wages. They make our economy more competitive and productive, giving us the means to achieve an even higher standard of living and better quality of life."¹

The SR&ED tax incentive program is critically important in helping to enhance Canadian productivity and competitiveness and is especially important for Canada's emerging technology sector, whose major challenges remain access to capital and adoption of innovation. The SR&ED program is needed to help Canadian firms compete in this global economic environment with companies in other jurisdictions who have access to similar, and in some cases stronger support. Companies locate their R&D operations wherever they can best align labour, facilities, and financing, and the economic support provided by governments plays a large role in their decision in terms of where best to place their R&D investments. While the Department of Finance has determined that the SR&ED tax credit creates a gross economic gain of \$1.11 for every dollar spent on it, and a net economic gain of 11 cents per dollar, there are other jurisdictions whose tax incentives provide more significant returns.² The Government of Canada can take real steps to mitigate that imbalance and make the SR&ED tax credit more attractive to foreign investors by ensuring it has greater refundability, higher limits and fewer ownership restrictions.

¹ Industry Canada. "Mobilizing Science and Technology to Canada's Advantage: Executive Summary." p. 3. <http://ic.gc.ca/epublications>. Accessed October 30, 2007.

² M. Parsons and N. Phillips (2007), "An Evaluation of the Federal Tax Credit for Scientific Research and Experimental Development," Department of finance, Working Paper 2007-2008.

Canada is but one player in an active, global marketplace; both developed and developing nations have recognized the opportunities emerging technologies present and are investing heavily in R&D. For example, in OECD nations, the share of biotechnology in all business-sector R&D is used as an indicator of the level of focus a country is placing on biotechnology research. In Iceland, biotechnology R&D accounts for 51.4 percent of all business sector R&D. Other countries including Denmark (23.8 percent) and New Zealand (20.9 percent) are significantly out-investing Canada (12 percent).³ Even developing nations such as China, India, Singapore and Malaysia are investing billions of dollars to capture the strategic value biotechnology offers to their emerging economies. They offer lower wage rates, larger knowledge-based labour pools in addition to the increasingly attractive support from their government.

Canada used to be one of the most generous countries in the world in its tax credit programs to assist emerging technology companies; however, over the past five years, Canada is being left behind as over 30 countries have developed R&D tax credit programs. Countries such as Britain, Australia and France have recognized the critical importance of their emerging technology SME sector and have taken a number of steps to ensure that they are globally competitive. For example, Britain has eliminated any "CCPC" ownership requirements and has not only adopted the broader EU definition of "SME", but has recommended eligibility be further expanded for the purposes of R&D tax relief, allowing more companies to benefit.⁴

There is an increasingly competitive global market for R&D technologies and as such, there is an urgent need to modernize the incentive provisions of the SR&ED program so that R&D investment remains in and is attracted to Canada.

While BIOTECANADA has member companies of all sizes, it is our small and medium sized members who are the most challenged as they try to access venture capital to take them through the early product development stages. Unfortunately, many small and medium sized emerging technology companies are not in a profitable position so the current SR&ED program does not allow them to take advantage of all of the investment tax credits, ironically just when they need them the most. The challenge of raising capital has forced many early stage companies to explore all available options for financing such as pursuing public listings, seeking equity from public or foreign investors, or relocating operations to another jurisdiction to access U.S. venture capital. These companies lose their CCPC status and, as a result, their access to the refundable investment tax credits. IPOs used to be used as an exit strategy for these small and medium sized companies; now they are used solely for financing.

The removal of the current CCPC restriction needs to be made immediately so that the SR&ED program can be used to prevent the hollowing out of the emerging technology industry in Canada; at its core, this change presents the business case to keep these jobs in Canada and attract foreign direct investment in R&D. The CCPC restriction for refundability is counter productive to the original goals of the SR&ED program. Country of ownership is blurred in today's economy; there is simply no

³ OECD "Science, Technology and Industry Scoreboard 2007," <http://oberon.sourceoecd.org/vl=1533348/cl=15/nw=1/rpsv/sti2007/f-2.htm> Accessed November 1, 2007.

⁴ The definition of an SME for the purposes of R&D relief is based on an EU recommendation that captures companies with fewer than 250 employees and either turnover not exceeding €50m or gross assets not exceeding €43m. Britain has proposed that for UK legislation for the purposes of R&D relief, these limits be doubled to apply to companies with fewer than 500 employees and either turnover not exceeding €100m or gross assets not exceeding €36m.

rationale for the current CCPC restriction in a global business environment. The goal is to stimulate work in Canada irrespective of corporate ownership.

Companies are portable, especially small, early stage companies. They want to be able to establish their companies and develop their products in Canada, through the entire product lifecycle, but we are losing out to competing jurisdictions that do not impose similar restrictions on ownership. In fact, in 1999 the Government of Ontario recognized the barrier this posed to investment and revised the criteria for the Ontario Innovation Tax Credit, making it eligible for all qualifying public and private sector corporations, not just Canadian-controlled private corporations. In order to ensure that the benefits are accrued to Canada, SR&ED eligibility could be limited to companies where greater than 50% of the employees are employed in Canada.

Canada's interest must focus on having the research and development activity, with the employment and investment it brings, located in Canada. Canadian capital markets and life science venture funds are simply too small and risk adverse to meet the demands of our industry. Small and medium sized emerging technology companies do not have the same access to venture capital in the early development stages as large companies. Due to the difficulty obtaining solely Canadian venture capital, many of the early-stage Canadian companies seek support from public and foreign markets, giving up their CCPC status in order to remain viable companies. In the absence of a compelling domestic business case, once these companies receive funding from jurisdictions such as the United States, it becomes easier for them to leave Canada and establish their operations, along with those jobs, elsewhere. These are the companies that need the refundability aspect of the SR&ED program the most, yet disqualify themselves as a result of the restrictive CCPC requirement.

The current \$2 million expenditure limit for refundable tax credits was established in 1985, pre-NAFTA and does not accurately reflect either Canada's current economic position or the global competition for corporate emerging technology investment. The end result of this expenditure limit is that it impedes growth. It has neither been adjusted to reflect inflation nor the increased costs of research and development as 70% of our SMEs spend above \$2 million annually in R&D. We are advocating increasing the expenditure limit from \$2 million to \$10 million with the enhanced rate of 35 percent for SMEs. The current taxable capital limits that determine entitlement to refundability pose another barrier, as they impose a size constraint thereby limiting value to growing companies. This should be increased from \$10 million to \$50 million as the current limit does not reflect the need of these emerging technology companies to raise more capital to support the entire product development life cycle. Adjusting the threshold to reflect the new expenditure limit and the reality of operations in 2007 will make the SMEs more attractive to foreign direct investment and help extend the viability of firms to grow and meet the long term lifecycle demands of commercialization.

By making the recommended changes in these two areas to modernize the SR&ED program, the Government of Canada can meet its commitment to create a climate of innovation and discovery, "...providing an enabling environment that promotes private investment in R&D, advanced technologies, and skilled workers."⁵

⁵ Industry Canada. "Mobilizing Science and Technology to Canada's Advantage: Executive Summary." p. 9. <http://ic.gc.ca/epublications>. Accessed October 30, 2007.

Last summer, the BIOTECanada-PricewaterhouseCoopers *Canadian Life Sciences Industry Forecast 2007* was released. This forecast found that 78 percent of respondents identified financing as the most important critical success factor for Canadian biotechnology companies.⁶ In addition, the majority of respondents said that they will be seeking more than \$10 million in their next round of financing.⁷ The Government of Canada has a real opportunity to create an economic climate where Canadian financial markets and foreign investors find R&D an attractive area in which to invest. The government's renegotiation of the US Canada Tax Treaty in 2007, including the recognition of Limited Liability Companies (LLCs) in Canada was a good first step towards breaking down barriers for foreign direct investment.

However, as previously articulated, Canada is lagging behind in terms of the structure of the incentives it is offering. A solution can be found through the implementation of the recommended changes to the SR&ED program; it is estimated that these changes will result in a minimum net economic benefit of \$160 million dollars annually, through increasing access to capital, lengthening the runway of each round of financing and further leveraging additional investment from private sources. It is critically important that the SR&ED program be an effective tool to lever foreign investment. We know that investments such as refundable tax credits for emerging technology companies make a large difference to investors, leveraging other investments and stimulating jobs in related sectors. This is particularly true for small and medium sized emerging technology companies who find it more challenging to attract investors than larger companies. It will only be through the private and public sectors working together that we will be able to secure Canada's future as a leader in the knowledge-based economy.

We advocate the need for the federal government to provide an open and attractive investment climate that provides certainty to potential foreign investors.

Increased free trade and globalization of investment mean that Canada competes with other countries for new investment (and to maintain investments that are made in Canada). To enhance Canada's competitiveness, Canada's competition laws, as with our other regulatory regimes, must be "competitive" when compared against other jurisdictions. Our competition laws must be predictable and transparent and promote efficiency and encourage competition as well as, or better than, our principal trading partners. Canada must do what it can to eliminate barriers for foreign investors.

Canada's international commercial policies need to be intrinsically linked to our domestic policy and be seen as an integral part of Canada's economic strategy. Numerous policy areas (including taxation, regulation, skills development, innovation and R&D and commercialization) are engaged in facilitating international commerce. There needs to be a government-wide focus and engagement on our international commercial strategy.

To be attractive to foreign investors, Canada needs a skilled workforce that meets the needs of industry. For Canada to be attractive to these individuals, we need to ensure that their applications are processed in a predictable and timely fashion and, once in Canada, they are able to put their skills to work. The domestic tax regime should support and encourage immigration of a skilled workforce. Making

⁶ BIOTECanada. "PricewaterhouseCoopers' Canadian Life Sciences Industry Forecast 2007.", p. 4.

⁷ Ibid. p. 3.

Canada a competitive economy will provide benefits to Canadian businesses, by providing them the conditions they need to grow and succeed internationally. At the same time, these competitive conditions will make Canada a more attractive locale for foreign investors, skilled workers and innovators.

Summary

Canada's biotechnology industry plays a pivotal role in the country's productivity, aiming to turn excellent Canadian research and scientific discovery into commercialized products for the global marketplace and high-paying jobs for Canadians.

The Government of Canada, through Industry Canada's plan to Mobilize Science and Technology, has committed to increase the impact of its business R&D assistance program.⁸ We encourage the Government of Canada to modernize the SR&ED tax incentive program. It can not be said strongly enough that the recommended changes are the business case for preventing the hollowing out of Canada's emerging technology sector and for making Canada attractive as a destination for new foreign investment and talent. They are easily implementable by the Government of Canada. They are capped and contained in terms of their direct application. They will allow Canada to secure and improve the future of our nation's biotechnology industry and other knowledge-based industries. They will provide Canada's emerging technology sector with the tools to compete in the global marketplace. They will stimulate jobs and encourage further, significant foreign direct investment. And they will have a positive and immediate impact on small and medium sized Canadian emerging technology companies. BIOTECanada strongly urges the Government to make these changes immediately as the future of our industry itself is at stake.

Respectfully submitted,



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⁸ Industry Canada. "Mobilizing Science and Technology to Canada's Advantage: Executive Summary." p. 7. <http://ic.gc.ca/epublications>. Accessed October 30, 2007.