ITAC ONLINE DIGEST

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FOCUS ON TAX AND FINANCE

in ITAlics ITAC's Fiscal Foresight

By Lynda Leonard, Senior Vice-President, ITAC

We spend a considerable amount of time engaged in discourse with public policy makers on behalf of our members on matters relating to the health of our industry. And, as a national organization, a large part of this activity is focused on the federal government.

So, when the Minister of Finance rises in the House to deliver his annual budget, it serves as something of a report card on how effectively we are conducting this discourse. It registers how effectively we have presented our case for the fiscal measures our industry needs to grow and prosper; so we follow the annual budget process with keen interest.

The key focus for this interest is ITAC's Tax and Finance Committee, which scrutinizes fiscal policy to identify measures that can spur or impede the success of Canada's ICT industry. This issue of ITAC Online focuses on this important activity.

The Tax and Finance Committee is chaired by Karen Atkinson, who is a member of the ITAC Board and Partner, Business Tax Services at EY (Ernst and Young). As she explains, one of our areas of key concern is the state of venture capital in Canada. Access to financial support is key to the growth of ICT companies, and ITAC has advocated a more rigorous pace for the roll out of Canada's Venture Capital Action Plan. As Karen highlights, this advocacy has recently borne fruit with the recent announcement of the first of the planned VCAP fund of funds.

Sometimes, the work our Tax and Finance Committee does feels like toiling in the wilderness. For example, we were part of the advocacy to reform retail sales tax, and then worked to ensure that the harmonization of retail sales in Ontario does not adversely impact our ability to serve the financial services community. ITAC has relied on the retail tax expertise of PWC for their analysis and guidance and as Michael Firth explains, that work may soon be reaching a positive outcome.

Our Tax and Finance Committee covers a broad range of issues from the support for the SR&ED tax credit program for R&D investment to fiscal measures to accelerate the use of ICT tools across the whole economy. If you have an interest in any of these issues please contact me (leonard@itac.ca).

Action and Innovation From Canada's Venture Capital Action Plan

By Karen Atkinson, Tax Partner, EY, and Chair, ITAC Tax and Finance Committee

On February 11, federal Finance Minister Jim Flaherty will don the traditional new pair of shoes, enter the House of Commons, and bring down a new budget for Canada.

On behalf of Canada's ICT sector, ITAC has played an active role in submitting ideas for consideration. During the pre-budget consultation process, ITAC President and CEO Karna Gupta was invited to appear before the House of Commons Finance Committee, while I represented ITAC's views at a briefing Minister of State (Finance) Kevin Sorenson organized in December.

Both of these invitations gave us the opportunity to reinforce the key messages in our pre-budget submission: the need for action in the Venture Capital Action Plan (VCAP—first announced in the 2012 budget); our ongoing insistence that predictable programs like SR&ED are the best mechanism for incentivizing private companies to invest in R&D, and our request for measures to encourage the use of productivity-enhancing technology.

Venture capital is critical to the formation of innovative companies, and ITAC has been persistently outspoken about the need for measures to improve the state of venture capital in Canada.

In January 2014, we applauded the introduction of the Northleaf Venture Catalyst Fund, the first of the two so-called funds of funds, which had its initial closing with $217.5 million in commitments, of which $145 million is from private-sector investors and $36.3 million is from each of the governments of Canada and Ontario. The fund has an overall target size of $300 million, and will invest primarily in Canada-focused early-stage and mid-stage venture capital funds and directly in companies across Canada. The governments of Canada and the Government of Ontario have agreed to make a combined capital commitment of $1 for every $2 committed by private-sector investors, up to a maximum of $50 million each.

Last September, $50 million was allocated to several high performance VC funds including two funds actively funding ICT companies. Other money—$250 million—has been earmarked for the creation of new funds of funds. And $100 million will be used to recapitalize existing private sector-led funds of funds in partnership with willing provinces. Leverage and private sector partnerships are key principles of the VCAP design.

Clearly the Government of Canada has engaged the top minds from both the private sector and Finance Canada in VCAP's design. They have consulted with more than 250 stakeholders from the financial as well as the investee communities.

A key issue in the success of the plan is leverage. By our estimate, the $400 million committed in 2012 is about one-third of the capital needed to restore the funding platform for early stage companies in Canada's innovation sector. If it goes according to plan, VCAP will bring an overall infusion of $1.2 billion.

The announcement of the Northleaf Venture Catalyst Fund represents an important step, and Elisha Ram, Director, Microeconomic Policy Analysis at Finance Canada, has told us that another fund of funds focused on the general and clean tech industries is pending. The initiation of these funds together with the best talent and research coming out of Canada will make Canada the irrefutable leader of innovation in 2014 and beyond.

Financial Sector Spending Surge: New IT Project Needs

By Michael Firth, PricewaterhouseCoopers LLP

Finally, something about the GST that is all good news for outsourcing providers. No, really.

Significant changes to the way that GST/HST works for financial institutions (FIs) and services could reduce or remove the GST/HST barrier to outsourcing by the financial sector. That barrier, raised from five to thirteen percent when Ontario harmonized its sales tax in 2010, has been a real damper on outsourcing. This is because suppliers of financial services generally cannot recover any GST/HST borne, and so moving the salary and financing component of any function outside the entity comes at a significant sales tax hit. In addition to lowering the effective cost of outsourcing to the FI, implementation of the changes themselves will create new back office and client interface system needs. So, tax changes that will lower the effective price to your client, and possibly many new projects to be had. The only downside would be if you did not see this coming, and missed the boat. This article is your boat ticket.

Wrong Way, Canada

Some years ago the European Union became concerned that the Value Added Tax (Europe's GST) barrier to outsourcing was constraining a business evolutions that were vital if EU banks and insurers were to remain competitive in the global market. The EU has been changing its VAT system to remove the VAT barrier to outsourcing, facilitating increased specialization, and shared service centers for both back office and client interface functions. Canadian GST changes in recent years have gone in the opposite direction, raising the GST/HST barrier to outsourcing, adding more GST/HST cost to the distribution chain for financial products and services, and making Canadian banks and insurers less and less competitive.

Changes – What Changes?

Canada may be about to execute a smart U-turn in GST policy for FIs. A team of six at the federal Department of Finance has been working for about 18 months on a comprehensive review of the way that GST/HST applies to financial services, with a view to modernizing the Canadian approach. The team recently shared its thinking with many stakeholder bodies, setting out the options for change that are under consideration. There are several change options, including:

- addition of GST/HST to non-life insurance premiums;
- allowing the supplier of financial services a partial recovery of GST/HST borne;
- making supplies of financial services to a business 'zero-rated' for GST/HST purposes, thereby allowing the supplier to recover all GST/HST on related costs;
- a new set of rules for supplies between FIs – complex, but one result of these would be a lower GST/HST barrier to outsourcing; and
- applying GST/HST on a calculated 'margin' of profit on lending and deposit business.

There is a catch, though. This review of the GST/HST has not been announced in any formal document; it is being described as a "below the radar" review. In other words, the government has not promised to do anything here, and so doing nothing remains a policy option.

Most are being optimistic, however, and proceeding on the basis there will be a package of changes. Announcements of the specific changes are predicted for the fall of 2014.

What should ITAC members do?

In preparation for the possible changes, you can do three things:

1. Review all projects discussed with FIs over the last five years, and reopen the dialogue with the prospective buyer. Given the height of the HST barrier, sales tax may have been the 'no-go' reason; 'no go' may be about to change to 'go now.' Be close to your client when that change happens.
Get smart on what the changes are, in two ways:

2. How will the changes impact your buyer or market sector? The impact will not be uniform between FIs, or across product lines within any one FI, so a working understanding of the changes is necessary to support a credible and informed dialogue with the FI buyer.

3. What new IT outsourcing needs are created in your buyer or market sector? A quick glance at the possible changes reveals a number of significant new IT needs for the FI. FI's will have to quickly commission major projects combining deep GST/HST expertise with systems know-how. All IT providers are starting equal on the GST/HST piece – there will be a market prize for the first to show the FI buyer technical mastery that earns buyer confidence. Think about your approach – will it be bolted on, in-house, or a mixture?

ITAC Events

February 4 - Executive Briefing with Kevin Radford, Senior Assistant Deputy, Minister, Operations Branch, Shared Services Canada – Ottawa

February 11 – ITAC Board of Governors Dinner with Bruce Croxon, one of the stars of CBC's Dragon's Den and co-founder of Lavalife – Toronto

February 13 – SMC Best Practice Forum – Montreal

February 24 – Canadian Reception at HIMSS – Orlando, Florida

February 24 – Women in Corporate Leadership – Janet Kennedy, President, Microsoft Canada Inc. – Toronto

February 27 – Marketing Roundtable – Toronto

March 4 – Executive Briefing with Tom Ring, Assistant Deputy Minister, Acquisitions Branch, Shared Services Canada – Ottawa

April 8 – Executive Briefing with Dave Adamson, Deputy CIO of the Government of Canada

April 10th – CCIO Breakfast and Panel Discussion – Toronto

For more information on any ITAC event, contact mlepage@itac.ca.

ITAC News

Governments of Canada and Ontario Launch New "Fund of Funds"

The governments of Canada and Ontario have jointly created the Northleaf…

ESDC Changes the Rules for Access to Temporary Foreign Workers

Employers making use of the Temporary Foreign Worker Program should be…

Ontario Privacy Commissioner Honours ITAC Health President

ITAC Health President Brendan Seaton has been been named a Privacy By…

Meetings:

January 30 – HR Forum Planning Session for 2014 – Toronto

February 25 – Federal Public Sector Business Committee Meeting – Ottawa

March 4 – Ontario Public Sector Business Committee Meeting –Toronto

March 11 – Cyber Security Forum Meeting – Ottawa

March 25 - Federal Public Sector Business Committee Meeting – Ottawa

April 29 - Federal Public Sector Business Committee Meeting – Ottawa

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To submit articles/news items/comments or to subscribe/unsubscribe please send an email to Lynda Leonard, Senior Vice-President at leonard@itac.ca