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INFORMATION TECHNOLOGY
ASSOCIATION OF CANADA

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ASSOCIATION CANADIENNE
DE LA TECHNOLOGIE DE L'INFORMATION

Fiscal Measures to Build a Successful Digital Economy Strategy

ITAC Pre-Budget Submission 2010



The Information Technology Association of Canada (ITAC) is the voice of the Canadian information and communications technologies (ICT) industry. ITAC represents a diverse ICT community spanning telecommunications and internet services, ICT consulting services, hardware, microelectronics, software and electronic content. ITAC's community of companies accounts for more than 70 per cent of the 572,700 jobs, \$155.3-billion in revenue, \$6.2-billion in R&D investment, \$30.4-billion in exports and \$11-billion in capital expenditures that the ICT industry contributes annually to the Canadian economy. The ICT sector currently represents 4.9 per cent of Canada's gross domestic product (GDP) and accounted for 9.4 per cent of all real GDP growth since 2002. ITAC is a prominent advocate for the expansion of Canada's innovative capacity and for stronger productivity across all sectors through the strategic use of technology.

In its submission of recommendations on the formation of a Digital Economy Strategy for Canada, ITAC, the Information Technology Association of Canada, was cognizant of the period of fiscal restraint in which this strategy will be formulated. ITAC constructed its recommendations in a manner that recognizes the fiscal challenges faced by our governments at this time. It believes that a number of the changes necessary to enable a competitive Canadian digital economy may be made without requiring massive amounts of public spending. However, the consultation paper, 2010 Budget and the Speech from the Throne all outline very strong (and for ITAC very welcome) aspirations for a 21st century technology-enabled digital economy. Fulfilling these aspirations will require investment. The nations with which Canada will compete for leadership in the digital economy are committing significant, multi-billion dollar investments in their digital strategy, often in spite of comparably weaker fiscal situations. The point we wish to make is that leadership does not occur accidentally. It requires clarity of purpose and the will to commit efforts and resources. As was outlined in ITAC's Digital Economy Strategy submission, ITAC believes the following investments are necessary to position Canada to compete and lead in the digital age.

Overcoming Under-Investment in Information and Communications Technologies

This issue has been a growing concern of Canadian policy makers and commentators including ITAC. The key focus on this issue in the Digital Economy Strategy consultation document is most welcome. And fiscal measures to address this issue, such as the 100 percent capital cost allowance on computer equipment and some software, was applauded by the information and communications technology industry.

ITAC believes that closing the ICT investment gap between Canada and the United States must be a central priority in our Digital Economy Strategy. And clearly this priority is one that will incur cost. We will soon have the benefit of our own experience with accelerated CCA as a measure for incenting ICT adoption over a 24-month period. In the meantime, we have also accumulated knowledge from the experience of other nations attempting to improve ICT uptake in their jurisdictions.

A climate of fiscal restraint requires us to ensure that our investments to close the ICT adoption gap are effective. To do so, policy makers must assess the impact of CCA acceleration. If the assessment reveals that this course will not produce the outcome we need, Canada will have to consider other instruments or move to a combination of direct and indirect inducements to invest in ICTs. These may include voucher programs which appear to be achieving results in some EU jurisdictions. They should also include relatively more modest investments in long range sustained government communications plans to change current business behaviour. One way or another, public policy makers who by now clearly understand the linkage between ICT under-adoption and lagging productivity must be prepared to invest in solutions to close the investment gap.

Apart from the design of effective public policy instruments to encourage innovation and technology adoption, government also plays a vital role as model user in encouraging new attitudes and approaches to technology-driven business and service delivery models. ITAC believes that our governments should plan to aggressively use advanced digital technologies, such as cloud computing, and to implement process changes that digital technologies can enable. This will require significant investment – investment that will deliver cost savings in return.

The Canadian Government is at a particular turning point at this time. With decaying technology infrastructures, and the looming impact of a major wave of public service retirements, Canadians know that new investments are unavoidable. But what is an unavoidable necessity may be seized as a virtuous opportunity. Canada can improve government procurement through measures such as the automation of procurement supply chains and investments in leading edge technology. These investments will set an example for the broader economy, encourage home-grown innovation, deliver superlative returns in cost saving and services delivery quality and restore Canada to a position of leadership in technology-enabled government operations.

Building a World Class Infrastructure

Broadband is a basic component of all digital economy strategies. ITAC outlined its view in its response to the digital economy consultation document that we should set a broadband infrastructure goal for Canada that provides a specific quality of on-line experience that will apply to all Canadians in all parts of the country – particularly those in rural and remote areas and on the fringes of our cities. We point out that the significant revenue infusions from upcoming spectrum auctions are a logical resource to deploy to fund the Digital Economy Strategy.

In order to achieve this, ITAC does not believe that we should start with the premise of massive government investment. First and foremost, we should set a goal that coalesces the efforts of all. We should monitor and report our progress towards that goal. We should create more certainty and the right environment for business investment, and leverage and promote opportunities on the demand side. Currently, investment in rural Canada is being driven by present broadband targets. Investors need an economic and technological roadmap to validate both current and future investment. Our strategy should include:

- Mapping out and announcing plans for availability of spectrum for the next 10 years.
- Developing spectrum auction plans that promote rural deployments (including dealing with the fringe areas around our cities).
- Using public services and public institutions to spur adoption and serve as anchor tenants.
- Focusing public support on what would otherwise remain unaddressed, which may be for backbone or backhaul rather than at the customer-end.
- Try to avoid spending public money to displace private sector investment, perhaps by using investment incentives rather than funding specific business plans that may displace existing operators.

ITAC's view is that we should leverage private sector investment rather than public sector investment as much as possible. In this regard, we should correct the fact that we presently tax, and thus disincite investment by applying government fees and taxes that run contrary to the general thrust we have been pursuing to reduce taxes on business investment.

Growing the Information and Communications Technology Industry

The recipe for successful ICT businesses has only three ingredients: great ideas, a strong talent pool to develop and bring the ideas to market, and a steady supply of capital to keep the operation running. Canada has no shortage of ideas. But while we do face a talent shortage, the biggest barrier to growth in the sector at the moment is the persisting crisis in venture capital in Canada.

ITAC's response to the consultation document on the Digital Economy Strategy called for a meaningful remedy to this crisis. It said "Address the venture capital crisis ... through new strategies (tax credits, flow-through shares, etc.) to make the retail venture capital sector more active in developing the ICT industry." The paper points out that present investment, such as the recent \$475 million allocation to BDC for early and late stage firms while welcome, have done little more than provide life support for funding deals already in place. We need new thinking and bold new measures to help Canada ensure a strong role in the creation of globally successful knowledge-based ventures.

ITAC is increasingly persuaded that one way to increase the volume of retail capital flowing to the knowledge-based sector is flow through shares. ITAC explored this idea in its Digital Economy Strategy submission and notes that it is an idea gaining strong currency in other research and development intensive sectors. It is, for example, one of five proposed solutions to the capital formation challenges faced by emerging companies in the biotechnology sector.¹

Another source of funding critical to the formation of ICT companies is the SR&ED program. Reform of SR&ED has been a long standing focus of ITAC's advocacy for the expansion of the ICT sector, the sector that has the most experience with the SR&ED program. We have, consistently over the past decade, suggested that our most important R&D incentive should be accessible to all R&D performers. Many Canadian firms have suggested this, but the need is particularly critical if we are to protect and grow the sizeable R&D investments made by Canadian subsidiaries of innovation-intensive multinationals. These companies have to compete with other jurisdictions to obtain or grow global mandates that represent a precious contribution to our digital economy ecosystem. Yet they do not have access to the same support as other firms.

¹ "Bio-economy Roundtable on Sustainable Capital Formation," BIOTECanada, June 2010, page 9.

For many of these companies SR&ED produces no direct incentive to maintain or expand R&D activity in Canada at all. The credits these subsidiaries earn on the millions of dollars they invest in R&D have the effect of reducing taxes payable in Canada while increasing taxes payable to the parent company in its headquarters' jurisdictions (particularly the United States). This effectively produces a flow of tax credits from the Canadian fiscal system into foreign treasuries without producing an incentive at all. We need measures to support the growth of these firms as we do for those that can benefit from our other programs.

In 2007, ITAC proposed a measure to address this, which involves a choice or trade-off that will mitigate the cost of dealing with this issue. The alternative design that we proposed would allow companies to choose between a refundable wage credit (similar to the research and development tax credit available in Québec today) and a non-refundable SR&ED credit as it now exists. The choice would be made in each taxation year. The taxpayer would be choosing between immediate cash in a lower amount or a higher value credit for future use.

Our view is that this approach would focus the refundable credit on companies with significant R&D work forces here in Canada, helping to grow our R&D centres here and in the process nurturing the commerce and management skills that help to fuel our whole innovation ecosystem. The level of the non-refundable SR&ED credit and the optional wage credit could be set at whatever level resulted in an appropriate level of tax expenditure.² We continue to believe that this measure would improve our chances for retaining and attracting new investments in Canadian R&D institutions in Canada.

Many of the leaders of qualifying Canadian-controlled private companies within the ITAC community have indicated to us that they are quite satisfied with the support the SR&ED program provides for research and product development. But for many of these firms, the task of marketing a technically superb product innovation in the global marketplace can be at least as challenging and risky as developing the product in the first place. Indeed, commercialization is the weak link in our technology ecosystem in Canada. That is why many have suggested to extend SR&ED tax credits, or find other ways to cover costs of global sales and marketing.

² "An Alternative for Extending Refundability of SR&ED Tax Credits," by Karen Wensley and Jacek Warda, 2007.

Finally, one overarching request made in ITAC's Digital Economy Strategy submission that may have relatively minor fiscal implications is to ensure that Canada is collecting and analyzing key data pertinent to the evolution of our digital economy. Setting targets for leadership in the global digital economy is inspired public policy making. ITAC is committed to doing the utmost to help ensure that the nation's ambitions are fulfilled. We need to measure how we are doing in achieving the targets we set for ourselves.

In sum, to fulfill ITAC's vision of a competitive Digital Economy Strategy for Canada, the following fiscal measures are necessary:

1. Investment in the appropriate tax, direct incentive and communications initiatives necessary to close the information and communications technology investment gap between Canada and its trade competitors, such as the United States.
2. Create the right climate for business investment, including predictable access to spectrum and reduction of fees and levies.
3. Strategic investments that will not only replace the Government of Canada's aging ICT infrastructure and overcome impending demographic challenges, but also return Canada to leadership in e-government.
4. New remedies, such as flow through shares, for the Canadian venture capital crisis to exponentially increase the pool of Canadian capital and channel its flow into the knowledge-based sectors.
5. Reform of SR&ED to improve accessibility and to expand the range of SR&ED eligible activities.