CVCA

Tax & Innovation Policies to Incentivize Investment in Canada

About CVCA

The Canadian Venture Capital and Private Equity Association represents some of the largest investors in Canada, with more than 350 member firms and 3,300 individuals.

Our members are the investors behind the creation of thousands of jobs, the advancement of innovative technologies, and the strengthening of local economies across the country. They are the backbone of Canada's entrepreneurial spirit, supporting businesses from startup to global expansion.

Together, Venture Capital and Private Equity play a critical role in Canada's economic success, and we believe that by growing the industry, they can help Canada rise to its full potential as a world-class investment and innovation destination.

Our Mission

CVCA's mission is to help our members fuel the economy of the future by growing the businesses of today. We do this by supporting and connecting a vibrant private capital industry with advocacy, research, and education. CVCA is also the nation's ultimate resource for data on Canadian private capital investments.

Our Vision

A thriving Canadian economy driven by private capital.

Contents

Unlocking Growth: How Private Capital Can Revitalize Canada's Economy 2

Policy Recommendations 4

Priority #1: Reward Risk-Taking 6

1. An Attractive and Globally Competitive Capital Gains Tax Regime 6
   1.1 Temporarily Reduce the Capital Gains Inclusion Rate for Productive Investments 6
   1.2 Expand the Lifetime Capital Gains Exemption 7

Priority #2: Strengthen Access to Capital 8

2. Offer a Federal-level tax credit for investments into Canadian domiciled eligible small businesses, modeled after existing provincial incentives and eliminating inter-provincial barriers to capital flow 8
3. Government as Anchor Investor: Attracting and De-Risking Institutional and Private Capital 10

Priority #3: Incentivize R&D and Productive Investments 11

4. Extend the Accelerated Investment Incentive 11
5. Reforming the Scientific Research and Experimental Development Tax Credit Program (SR&ED) to Maximize Impacts 12

Conclusion 13

Unlocking Growth: How Private Capital Can Revitalize Canada's Economy

Canada's economic growth faces important headwinds, with productivity declining to critical levels—placing us among the bottom G7 performers[1] showing up in our GDP per hour worked (or lack thereof). While Canada's economy has seen modest expansion, weak business investment and global trade uncertainties continue to weigh on long-term growth prospects. In this volatile economic climate, private capital—venture capital (VC) and private equity (PE)—plays a crucial role in strengthening Canada's economic resilience and driving productivity.

Unlike other forms of financing, VC and PE investors provide more than capital; they bring strategic expertise, operational guidance, and deep industry connections that accelerate business growth. General Partners (GPs) take active roles on company boards, offering mentorship and linking businesses to key stakeholders, including suppliers, customers, legal advisors, financial institutions, and talent networks. They also make a personal financial commitment—known as the GP commit—aligning them with investee companies, Limited Partners (LPs), and the fund's overall success.

This holistic approach delivers measurable economic benefits. Firms backed by venture capital experience total factor productivity (TFP) growth that is 43% higher than non-VC-backed peers, fueling innovation, enabling scale, and strengthening corporate governance. Likewise, PE investment has a powerful multiplier effect, with employment growth at PE-backed companies three times higher than at non-PE-backed firms, while productivity grows at twice the rate in the three years following investment[2].

[1] https://www.oecd.org/en/data/indicators/gdp-per-hour-worked.html?oecdcontrol-00b22b2429-var3=2022

[2] https://www.cvca.ca/wp-content/uploads/2024/04/PwC-Private-Equity-A-significant-driver-of-growth-for-Canadian-SMEs-FInal.pdf

Beyond direct company growth, private capital investment generates significant spillover effects, expanding Canada's tax base and driving employment creation. Businesses supported by VC and PE fuel demand for professional services, such as legal, accounting, and financial industries—key pillars of a thriving knowledge economy. With the backing of private capital, Canadian enterprises can become engines of economic activity and innovation while supporting the country's long-term competitiveness.

Unlike traditional sources of financing, private investors are inherently more risk-tolerant. By aligning incentives and fostering stronger collaboration between government and private capital, Canada can unlock new opportunities for economic resiliency. Encouraging more private capital investment is a strategic imperative for Canada's long-term prosperity. Next, we will cover recommendations on how policy-makers can leverage tax and innovation policies to attract and deploy private capital and maximize impact.

Policy Recommendations

Policy Recommendations

To unlock the full potential of private capital in driving economic growth and productivity, Canada must adopt an ambitious policy framework that enhances capital formation, incentivizes and rewards investment, and strengthens the innovation ecosystem. In an increasingly competitive global landscape—where major economies are aggressively focused on attracting and retaining investment—Canada cannot afford to stand still .

Extraordinary times demand extraordinary measures. Canada faces unprecedented economic threats just as our largest trading partner, the United States, retreats from international trade. This is aggressively reshaping the investment climate to attract and reshore global capital. In this environment, Canada must act boldly to retain productive investments, attract new capital, and send a powerful signal to markets.

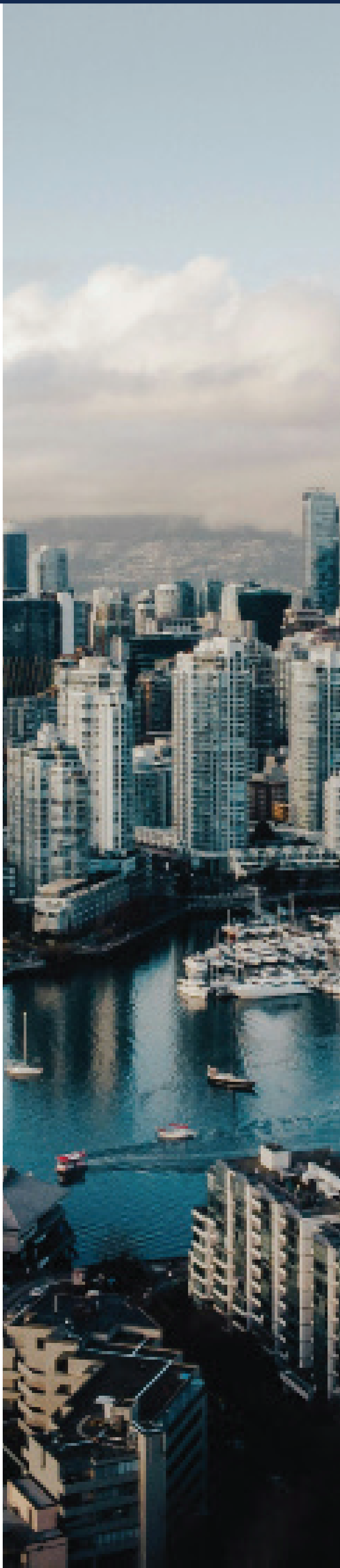
Investors must weigh multiple factors such as tax competitiveness, regulatory certainty, and return potential when deciding where to deploy capital. Without the right mix of incentives, capital will flow elsewhere, leaving Canada at a structural disadvantage.

The following policy recommendations are designed to reinforce Canada's position as a leading destination for private investment:

1. **Reward Risk-Taking** – Establish a globally competitive capital gains tax regime that incentivizes investment in high-risk, high-reward strategic sectors.
2. **Strengthen Access to Capital** – Work in partnership with the private sector to tap into more sources of capital through a mix of federal tax incentives and public-private partnerships. This will ensure that Canadian businesses can access the capital needed to scale.
3. **Incentivize R&D and Productive Investments** – Modernize Canada's innovation-focused tax incentives, such as SR&ED, and introduce measures that encourage long-term capital investment.

By implementing these measures, Canada can create a more dynamic investment environment to fuel innovation, strengthen economic resilience, and position the country for long-term prosperity.

Priority #1: Reward Risk-Taking



1. **An Attractive and Globally Competitive Capital Gains Tax Regime:**

A globally competitive capital gains tax regime is central to attracting and retaining capital. It has the most direct impact on investment decisions across all economic sectors while minimizing the disruptive effects of other tax policies.

Investments in high-risk venture capital and private equity funds are fundamentally different from passive investments such as those into publicly traded stocks, bonds, or real estate. Private capital investments require active involvement, expertise, and long-term commitments to build and scale businesses. Unlike passive investments, private capital investors take on substantial risk with direct stakes in company growth.

A well-structured capital gains tax policy is one of the most effective tools for driving investment into high-growth, high-risk sectors, by way of influencing investor incentives, and shaping the overall attractiveness of funding startups and growing companies.

1.1 Temporarily Reduce the Capital Gains Inclusion Rate for Productive Investments

To catalyze productive private investment, CVCA recommends that the federal government introduce a targeted capital gains tax incentive—reducing the capital gains tax inclusion rate from 50% to 25% exclusively for investments into eligible Canadian-domiciled startups and growing businesses. This incentive should be implemented over a three- to five-year period starting in fiscal year 2025.

Empirical research, including Canadian-specific data, demonstrates that higher capital gains taxes reduce private capital supply, limiting funding for high-growth businesses. CVCA research indicates that the capital gains tax increase proposed in the Federal Budget 2024 (from 50% to 66.67%) would have led to a 22% decline in venture capital deal activity and up to a 48% drop in private equity investment in certain categories.

Conversely, lower capital gains tax rates have been shown to enhance capital supply. For example, the U.S. Small Business Jobs Act of 2010, which temporarily exempted capital gains taxes on qualified small business stock, resulted in a 12% increase in investment per funding round, demonstrating the effectiveness of targeted tax incentives.

A preferential capital gains tax rate for private capital investment would anchor more investment and reinvestment into Canadian startups, small businesses, and scaleups. To encourage long-term investment, this incentive could be structured with a required holding period of 2-5 years, with greater benefits accrued for longer holding periods.

1.2 Expand the Lifetime Capital Gains Exemption

The federal government recently announced that it would maintain the proposed increase in the Lifetime Capital Gains Exemption (LCGE) limit to $1,250,000 on the sale of small business shares. While this is a step in the right direction, we believe this can be even more ambitious to drive further investment into Canada's high-growth businesses.

A temporary expansion of the LCGE, such as doubling the exemption over a three- to five-year period, would provide a strong incentive for investors to actively deploy capital now, rather than keeping funds on the sidelines. Many investors who have already used their exemption are no longer motivated by it, but a timely expansion could see them doubling down with new investment.

By implementing a higher exemption threshold for new investments, Canada could stimulate greater risk-taking in early-stage ventures while ensuring that capital gains tax policy remains a tool for economic growth, rather than a barrier to reinvestment.

Priority #2: Strengthen Access to Capital

2. **Offer a Federal-level tax credit for investments into Canadian domiciled eligible small businesses, modeled after existing provincial incentives and eliminating inter-provincial barriers to capital flow**

At a time when Canada is prioritizing national integration and strengthening inter-provincial trade, the free flow of capital should be an additional key focus.

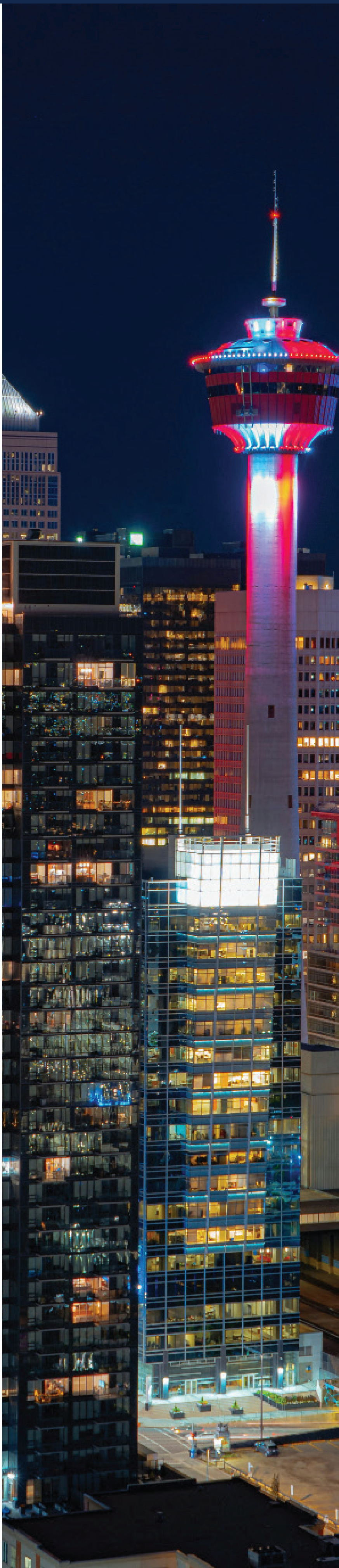
In the absence of a national-level incentive for investing in startups and small businesses, provinces have developed their own regional approaches. While these initiatives provide some support, they are fragmented, limited in scope, and fail to promote a cohesive national strategy for capital deployment. This lack of coordination increases business costs and risks, making it more challenging to scale companies across provincial borders.

A nationwide incentive would remove these barriers by rewarding inter-provincial investment, fostering seamless capital flow across Canada. Currently, as fund managers mature and seek larger investments beyond their home province, they often lose access to provincial incentives— creating a disincentive for scaling funds to a national level.

Several Canadian provinces offer targeted tax credits to incentivize investment in small businesses and venture capital funds, supporting domestic economic growth and innovation. These credits reduce the tax burden for investors, encouraging capital flow into high-potential enterprises. Canada's federal government should offer a federal-level tax incentive modeled after these initiatives to both a) spur domestic investment and b) eliminate friction in inter-provincial capital flow. Some examples:

- **New Brunswick Small Business Investor Tax Credit:**
  Offers a 50% non-refundable tax credit (up to $125,000 per year) for individual investors and 15% for corporations and trusts (up to $75,000 annually) who invest in eligible small businesses, community economic development corporations and associations in the province[3]. If unused, credits can carry forward seven years or back three years.

- **Nova Scotia Venture Capital Tax Credit:**
  Available until March 30, 2029, this 15% non-refundable credit for individual and corporate-eligible investors encourages investment in venture capital funds that support small and medium-sized businesses in Atlantic Canada[4]. Investors can apply the credit to reduce taxes to zero and carry unused credits back three years or forward seven years.

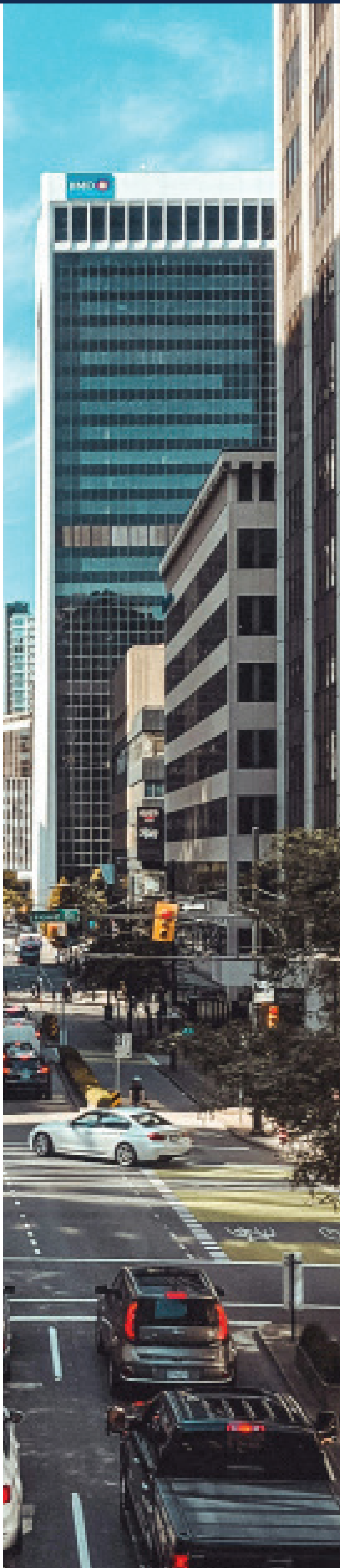


[3] https://www2.gnb.ca/content/gnb/en/departments/finance/taxes/credit.html
[4] https://novascotia.ca/finance/en/home/taxation/tax101/personalincometax/venturecapitaltaxcredit.html

- **Newfoundland and Labrador Venture Capital Tax Credit:** Provides a 30% non-refundable credit for corporations investing in venture capital funds, with a lifetime cap of $75,000.[5] Unused credits can carry back three years or forward seven years.
- **British Columbia Small Business Venture Capital Tax Credit:** Grants tax credits to individuals and corporations investing both directly into eligible BC-based business corporations (EBCs) and indirectly via Venture Capital Corporations (VCCs)[6]. EBCs and VCCs can claim tax credits on behalf of their BC investors and shares must be held for 5 years. B.C.-based individual and corporate investors receive a 30% tax credit (limits may apply) and individual investors may invest up to $400,000 per year (unlimited for corporations). VCCs are formed for the purpose of investing in start-upstartups and emerging and expanding eligible small businesses in BC and are usually managed by venture capitalists or angel| investors who provide small businesses with the benefit of their expertise, experience, and business knowledge. To be eligible, VCCs must be in the public register and have pre-approved authorization to raise tax credit-supported investment. VCCs function as an investment vehicle to channel individual and corporate investment into a limited partnership or eligible funds, whose objective is to mainly invest in BC companies. British Columbia's tax credit is exceptional in its definition of "Investment in small businesses,"[7] which extends to funds that invest in the acquisition of equity shares and of rescribed limited partnership units that are, in turn, invested in equity shares. Unused credits can carry forward for four years to offset British Columbia tax liabilities.

The above provincial programs target capital formation from eligible individual and corporate investors. British Columbia's Small Business Venture Capital Tax Credit—with a successful track record of over two decades—further extends the incentive to Venture Capital Corporations and introduces funds within certain parameters in the definition of eligible investments into small businesses. This extension, beyond direct investments from individuals and corporations, makes fundraising in alternatives significantly more compelling as it allows fund managers and investee companies to provide a tangible benefit to their investors.

CVCA recommends that Canada's Federal government offers a national incentive that builds on the best elements of provincial tax incentives, available to eligible individuals and corporate investors investing in eligible Canadian-domiciled small businesses. Such a measure would attract even greater capital flow into Canada's business investment ecosystem, support fund growth, and foster inter-provincial capital mobility.



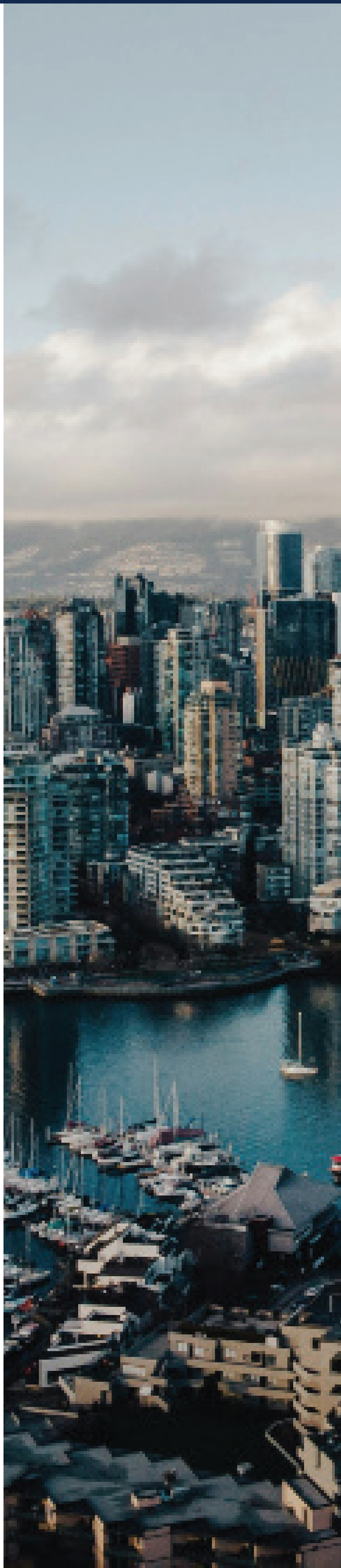
[5] https://www.gov.nl.ca/fin/tax-programs-incentives/business/venture-capital-tax-credit/
[6] https://www2.gov.bc.ca/assets/gov/employment-business-and-economic-development/investment-capital/venture-capital-programs/investment_capital_program_guidelines.pdf
[7] https://www.bclaws.gov.bc.ca/civix/document/id/complete/statreg/96429_01

3. Government as Anchor Investor: Attracting and De-Risking Institutional and Private Capital

Public-private investment programs have been instrumental in attracting institutional and private-sector capital to Canada's venture capital ecosystem. The Venture Capital Action Plan (VCAP) and its successor, the Venture Capital Catalyst Initiative (VCCI), have successfully leveraged public dollars to de-risk and attract private sector investment, generating billions in new capital for Canadian startups and scaleups. Unfortunately, the participation of large institutional investors in these programs remains modest, and so far, there have not been any policy levers designed to attract and incent more private equity fund formation, which typically focuses on business growth and productivity.

The Fall Economic Statement 2024 (FES '24) did build on previous approaches, committing $1 billion to recapitalize VCCI and an additional $1 billion to support mid-cap growth companies. Presented with an objective to offer more attractive terms for Canada's pension plans, these public-private investments could be transformative in attracting and deploying more capital domestically. CVCA supports ongoing efforts to get these programs off the ground.

Alternative assets have increasingly become a significant component of Canada's pension plans' asset mixes. Despite their appeal, however, there is a current mismatch between Canada's pension plans' capital allocation and the efficiency of deploying dollars into Canadian fund managers. This gap, unfortunately, ends up driving significant portions of their VC/PE allocations abroad. Encouraging greater domestic allocations will strengthen Canada's private capital ecosystem, ensuring more patient, long-term capital invests in high-growth Canadian companies and innovators.



Priority #3: Incentivize R&D and Productive Investments

4. Extend the Accelerated Investment Incentive

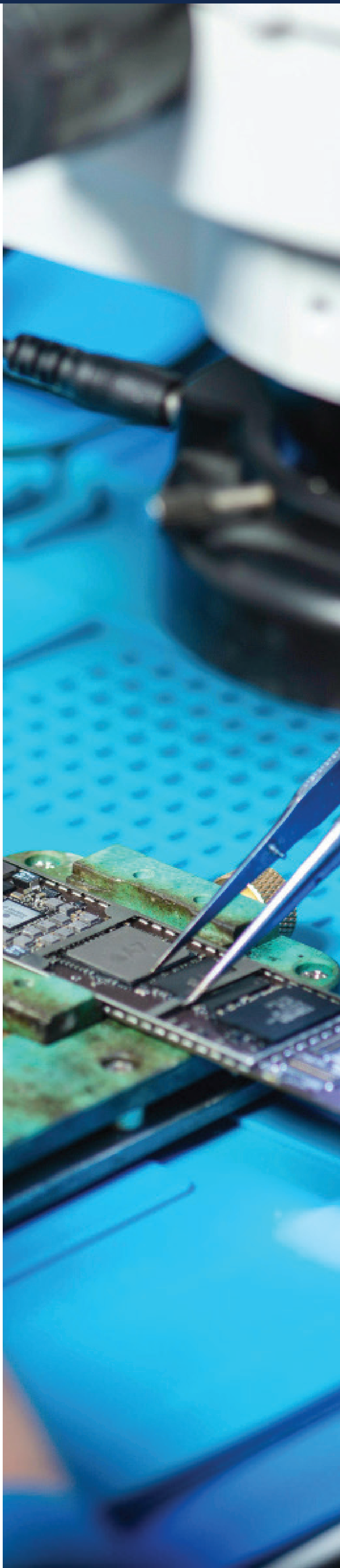
To maintain Canada's competitiveness and encourage capital deployment, the federal government should fully reinstate the Accelerated Investment Incentive allowing for immediate expensing measures for key capital investments.

Accelerated depreciation, first introduced in 2018, allowed businesses to deduct a greater share of their investment costs upfront, aligning Canada's tax treatment of capital investment on a more competitive footing than that of the United States. However, the temporary nature of these provisions means they are phasing out, starting in the 2024 fiscal year and full elimination scheduled by 2027. Without action, the effective tax rate on new investment in Canada will increase significantly, discouraging much-needed capital formation.

Tax experts[8] note that the impact of this phase-out will be particularly acute in capital-intensive industries. With the phasing out of accelerated depreciation, the effective tax rate on new investment is projected to rise from 13.7 percent to nearly 17 percent.

For instance, the tax on machinery and equipment investment, a key driver of productivity, is set to rise from 5.7 percent to 14.2 percent. These increases will make it more expensive for Canadian businesses to invest in growth-enhancing assets, widening the gap with competitor jurisdictions.

To prevent these negative consequences, the government should extend the Accelerated Investment Incentive beyond its current phase-out period and allow immediate expensing for critical capital investments. Doing so will ensure that Canada remains attractive for private capital, enabling businesses to scale, innovate, and drive productivity gains.



[8] https://thehub.ca/2024/05/16/trevor-tombe-canada-just-introduced-the-largest-tax-increase-youve-heard-of/

5. Reforming the Scientific Research and Experimental Development Tax Credit Program (SR&ED) to Maximize Impacts

The SR&ED tax credit program has been a cornerstone of Canada's innovation strategy, incentivizing businesses to invest in research and development (R&D). However, as the nature of innovation evolves, so must the framework supporting it. Modernizing SR&ED is essential as it effectively fosters high-growth, productivity-enhancing R&D investments and catalyzes a virtuous reinvestment cycle.

A modernized SR&ED should be aligned with current market dynamics and reflect the size of businesses it is seeking to support by raising the limits of both expenditures and taxable capital. Policymakers should seek to support companies typically below a certain maturity threshold by:

- Raising the annual expenditure limit for the enhanced 35% investment tax credit from a current $3 million to $5 million, and
- Increasing the taxable capital phase-out thresholds from a current $10–$50 million to $25–$100 million.

Building on these, CVCA further recommends additional modernization efforts, with a focus on administrative efficiency and streamlined access. Canada has a well-documented scaleup problem, and strategic SR&ED reforms can be part of the solution.

Conclusion

Canada is at a critical juncture. With declining productivity, increasing global competition for investment, and an uncertain trade environment, bold action will reorient, protect and strengthen our economy. Private capital—through venture capital and private equity—has a proven track record of driving innovation, scaling high-growth companies, and enhancing productivity. To harness its full potential, Canada must adopt policies that boldly encourage investment, facilitate access to capital, and incentivize risk-taking in strategic sectors.

The recommendations outlined in this paper—rewarding risk-taking, strengthening access to capital, and incentivizing R&D and productive investments—are essential for ensuring that Canada remains competitive in an increasingly challenging global landscape. A more attractive capital gains tax regime, targeted incentives for private capital investment, and modernized innovation-focused tax programs will drive capital formation and deployment to where Canada has the greatest potential. These measures will enable Canadian entrepreneurs to scale, encourage institutional investors to commit more capital domestically, and ensure that businesses have the resources to innovate and grow.

By implementing the proposed policy measures, Canada can unlock new economic opportunities, strengthen the innovation ecosystem, and drive long-term prosperity, bringing us out of the productivity lull we have had in comparison to our G7 partnerspeers. The time to act is now. By embracing a forward-thinking approach to private capital investment, Canada can position itself as a global leader in growth, innovation, and economic resilience.