Written Submission for the Pre-Budget Consultations in Advance of the Upcoming Federal Budget

By: Canadian Venture Capital and Private Equity Association (CVCA)

CVCA's Recommendations

Recommendation 1:

That the government deliver on the commitment to recapitalize the Venture Capital Catalyst Initiative (VCCI) program by $1B, strengthening Canadian leadership and sovereignty in the innovation economy.

Recommendation 2:

That the government recommit $1B towards a mid-cap sized companies fund to invest in homegrown companies, co-investing alongside qualified private sector fund managers.

Recommendation 3:

That the government incentivizes investment in Canadian-domiciled early-stage companies through a 100% capital gains tax exemption on qualified startup equity, up to $15 million and with a five-year holding period that extends to Limited Partnership structures. This incentive would level the playing field with competing markets, aligning Canada with the successful Qualified Small Business Stock (QSBS) exemption provided in the United States.

Recommendation 4:

That the government adopt an evergreen model for Venture Capital Incentivized Programs (VCIP), allowing reinvestment of the programs' exited proceeds back into the ecosystem and into strategic initiatives that can continuously leverage essential private-sector capital.

The Canadian Venture Capital & Private Equity Association (CVCA) welcomes the opportunity to share with you our views and recommendations in advance of the upcoming Federal Budget 2025.

The CVCA 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 tens 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, they 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 destination.

We see strong alignment between our members' work and your government's ambition to build a strong Canadian economy. A significant component of Canada's current productivity crisis is domestic underinvestment and challenges in scaling up companies. It is vital we continue to support and scale Canada's private capital availability to address both.

This submission offers practical policy recommendations aimed at: accelerating and expanding the flow of capital to Canada's startups, scaleups, and small and medium enterprises (SMEs); and rebalancing incentives to attract more private investment into one of the riskiest but most productive asset classes supporting Canada's long-term growth. We believe that by implementing the below recommendations, the federal government can support a more robust and dynamic investment environment that drives innovation and economic success:

- **Recommendation 1:** That the government deliver on the commitment to recapitalize the Venture Capital Catalyst Initiative (VCCI) program by $1B, strengthening Canadian leadership and sovereignty in the innovation economy.

  Canada has built a vibrant venture capital ecosystem through targeted public-private investments. The 2013 Venture Capital Action Plan (VCAP) and its successor, the Venture Capital Catalyst Initiative (VCCI), launched in 2017 and renewed in 2021, have been transformative. These are market-based co-investments designed to increase the availability of financing for innovative Canadian firms, catalyze private investment and help make Canada's ecosystem globally competitive. Together, the VCAP and VCCI are known as the Venture Capital Incentivized Programs (VCIP).

  Over the last decade, the VCIP have supported the growth of Canadian venture funds and helped launch startups that today compete globally across knowledge-based industries. The VCIP programs exemplify public-private partnerships that have made significant strides in enhancing Canada's venture capital landscape and successfully crowded in private capital, enhancing the overall investment landscape. The VCIP have further achieved their objectives across several key metrics, stimulating private capital formation and delivering solid returns to both private investors and government, in line with market benchmarks.

  Key Metrics:

  - Together, the VCAP and VCCI's combined success in committing and attracting capital has leveraged $1.25 billion in federal commitments to catalyze over 3x in private sector capital, amounting to $3.53 billion in private investment and led in great measure by the funds-of-funds stream.
  - The VCIP have significantly contributed to capital formation in the Canadian VC market. Investment has reached a total of 36 Canadian venture firms, raising 93 funds.
  - The increasing average fund size post-participation in VCIP programs attests to the programs' success in attracting private capital and reducing reliance on government dollars, fostering a more

sustainable Canadian VC ecosystem over time.
- These investments have delivered tangible, measurable results, with investment flowing to over 730 innovative Canadian startups and scaleups and creating nearly 50,000 net new jobs.

The VCIP anchor Canada's innovation sovereignty by ensuring Canadian innovation is backed by domestic capital, fueling a pipeline of Canadian funds that can scale alongside startups and scaleups.

Considering the investment cycle and earlier recapitalization rounds in 2017 and 2021, the market now urgently requires a clear signal from the Federal government to deliver on the commitment included in the Liberal platform to recapitalize the VCCI by $1 billion.

Recapitalizing the VCCI's funds-of-funds stream, with its proven track record catalyzing private investment, should be a leading priority, at a time when Canada's venture capital sector faces prolonged challenges raising capital. In the current context of ongoing economic uncertainty, an accelerated selection process for the Funds-of-Funds and attractive terms would reflect the realities of a rapidly evolving funding landscape and help attract even greater institutional investment, including from Canadian pension funds. Moreover, flexible portfolio construction should direct investment to critical sectors and parts of the ecosystem that are aligned with national strategic priorities.

By combining the stability of public funding with the agility of private capital, Canada's VCIP stands as a world-class model of public-private collaboration and impact.

- **Recommendation 2:** That the government recommit $1B towards a mid-cap sized companies fund to invest in homegrown companies, co-investing alongside qualified private sector fund managers.

  CVCA recommends that the federal government recommits a $1B fund towards investment in mid-cap growth companies, bolstering access to the capital needed for long-term growth and underscoring support for highly productive homegrown enterprises. Inspired by the VCIP model, which offers invaluable lessons in shaping government-led investment programs and leveraging private risk capital, these investments could be made alongside qualified fund managers with a proven and demonstrable track record of deploying capital to Canadian mid-cap growth companies. Fund managers selected on competitive basis would then leverage public dollars to crowd in additional private capital into the growth equity market.

- **Recommendation 3:** That the government incentivizes investment in Canadian-domiciled early-stage companies through a 100% capital gains tax exemption on qualified startup equity, up to $15 million and with a five-year holding period that extends to Limited Partnership structures. This incentive would level the playing field with competing markets, aligning Canada with the successful Qualified Small Business Stock (QSBS) exemption provided in the United States.

  This approach would incentivize more high-risk capital to flow into the innovative startup ecosystem, creating a targeted incentive focused on the most innovative and strategic technology startups. By significantly reducing the tax burden on investments in early-stage companies, an incentive that extends to Limited Partner structures would position Canada as a globally competitive destination for investment, attracting capital to this high-risk/high-reward asset class, and supporting tech-oriented and innovation-focused investment funds.

  The proposed incentive would apply exclusively to eligible Canadian-controlled private corporations (CCPCs), their employees, founders, and investors across economic sectors. Considering that 74% of the capital in Canada's innovation sector is non-Canadian, harmonization would have a limited impact on tax revenue loss. Conversely, the accrued benefits over time would be significant.

Analysis conducted with EY in 2024 estimated that full harmonization with the QSBS would reduce tax revenue over the short term by approximately $860 million per year, equivalent to 1.8% of Canada's total R&D investment. However, this does not take into consideration the spillover effects of a corresponding boost in investment in Canada's innovation ecosystem, the resulting creation of new companies, expansion of the tax base, and the significant effects on talent development and attraction.

The United States' QSBS provides a useful model, having been immensely successful in driving investment thanks to the program's clear and simple eligibility requirements and consistency over more than 25 years. QSBS has catalyzed large-scale, high-risk investments over the long term that have driven U.S. productivity and global dominance in risk capital and talent-driving innovation. The introduction of QSBS resulted in a 12% increase in investment per funding round, while between 2010 and 2020, early-stage deal volume increased by 23%, in large part due to QSBS and other incentives.

Presently, the absence of a high-risk investment incentive drives capital away from Canada, and combined with QSBS availability in the U.S., this dynamic further amplifies capital flight south of the border. This incentive is critical for Canada to stimulate economic growth and productivity, cultivate a thriving domestic investor base, and ensures that CCPCs remain competitive in the knowledge economy, retain Canadian ownership, and attract and retain top talent.

- **Recommendation 4:** That the government adopt an evergreen model for the Venture Capital Incentivized Programs (VCIP), allowing reinvestment of the programs' exited proceeds back into the ecosystem and into strategic initiatives that can continuously leverage essential private-sector capital.

As described in Recommendation 1, the VCIP have successfully catalyzed over 3x in private sector capital against public dollars from private-sector investors including: corporations, high net worth individuals, angel investors and institutional investors including pension funds.

The VCIP have provided a sustainable foundation for the venture ecosystem, demonstrating the power of public-private collaboration. More than a decade since its inception, the VCAP is set to achieve competitive returns in line with or exceeding relevant benchmarks, yielding significant returns to both private investors and to the government, which stands to benefit from the fund's performance. The VCCI, meanwhile, is on a similar track. As the VCIP near the end of their cycles and exit proceeds stand to flow back to the Crown, we strongly recommend that the government adopt an evergreen model for both VCIP (VCAP and VCCI), reinvesting returns and putting this capital back to work.

A strategic, budget-neutral reinvestment of the VCIP would allow the sector to continue expanding on the strength of its own successful investments. Allowing redeployment into strategic initiatives that can continuously leverage essential private-sector capital would position Canada on a path to a self-sustaining innovation economy. This approach would further enable the formation of more robust funds that can scale over time and support successive domestic fundraises for Canadian innovation.