PEERGROUP

INTEGRATING AUTOMATION AND INFORMATION

August 6, 2014

House of Commons Standing Committee on Finance
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Submission for Input into 2015 Federal Budget

Executive Summary

Thank you for the opportunity to provide input into the 2014 pre-budget consultations for consideration in the pending pre-budget report and ultimately the 2015 federal budget. As a business leader for a successful Canadian technology company (The PEER Group, Inc.), I am interested in a balanced federal budget that ensures fiscal sustainability and economic growth.

My main priorities focus on the following two themes identified by the House of Commons Standing Committee on Finance:

- Increasing the competitiveness of Canadian businesses through research, development, innovation, and commercialization
- Improving Canada's taxation and regulatory regimes

To help ensure continued economic growth in Canada, I believe we need to create and nurture the next generation of $100M companies with 500 or more employees. To do so, I would like to make the following high-level recommendations (specifics are included on the next page):

1. Continue to fund taxpayer R&D on an entitlement basis using refunds (rather than tax credits) to the greatest extent possible. Specifically, continue to fund the SR&ED program, but with these modifications:
   - Increase the "small business" limit from $500,000 to $750,000.
   - Increase the allowable expenditure limit from $3M to $15M.
   - Increase the capital taxable limit from $10M to $15M.
   - Simplify the claim format to streamline the process.

2. Eliminate international trade barriers for Canadian businesses.
   - Remove Japanese withholding tax on Canadian software royalties.
   - Remove German withholding tax on dividends paid to Canadian-owned companies.

I would be happy to appear before the Committee as a witness during the pre-budget hearings.

Detailed Proposal

Many Canadian companies — including PEER Group — benefit from the government's support for R&D via incentive programs like SR&ED. For over fifteen years the SR&ED program has been a key contributor to PEER Group's success, providing funding to develop world-class factory automation software solutions. Over the past five years, the government's investment in SR&ED has helped PEER Group grow revenue in Canada by 270% and raise our employment by 138%, from 45 to 107 people. Our revenue continues to be 100% export-driven and has helped PEER Group become one of Canada's leading technology companies, as recognized by Branham300.

I look forward to continuing our participation in the SR&ED program and appreciate the government's ongoing support for industrial R&D. However, while the SR&ED program is an excellent incentive program for smaller technology companies spending less than $3M on qualifying activities, it is my opinion that the Canadian government needs to invest in the next generation of $100M companies. Once a company hits the $3M R&D expenditure mark, they are grouped with multinational companies spending significantly more on R&D activity. A mid-size technology company requires ongoing incentives as it transitions from a smaller company with fewer than 100 employees to a mid-size company with 100-500 employees. The ultimate goal would be to support company growth to the $100M / 500+ employee size. Companies at this level are very profitable and can go public to grow even further. Additionally, if acquired by a foreign investor, there would be enough critical mass in Canada within the company to ensure the Canadian company would not be shut down; it could continue to be profitable in Canada.

We need the government to provide incentives to take the current smaller technology companies to the next level. Some specific suggestions include the following:

1. **Continue to fund taxpayer R&D on an entitlement basis using refunds (rather than tax credits) to the greatest extent possible.**

   When implemented well, R&D refunds can encourage private investment in research and development, encourage the establishment of R&D centres and global partnerships, stimulate the creation of new businesses, and promote innovation. Eligible companies can use the incentives to grow revenues and raise employment. I have the following recommendations for SR&ED program improvements, some of which are based on recent changes the French tax authorities have introduced through their ICR (R&D tax credit, which is getting good feedback via satisfaction surveys and is resulting in more R&D investment and innovation in France):

   - **Increase the "small business" limit from $500,000 to $750,000**. With the current limit for reduced corporate income tax rates set at $500,000 and advantageous SR&ED rules for small businesses, many companies manage their profits like small businesses and are forced to keep their taxable income below $500K to avoid benefit rate reductions above the expenditure limit. If the small business limit was increased to $750,000, more Canadian businesses would have the incentive to keep money within the company which would provide more opportunities to fund R&D initiatives within Canada, spearhead new innovations, invest locally, and potentially retain employees during future economic downturns.

- **Increase the allowable expenditure limit from $3M to $15M (i.e., 15% R&D for a $100M company).** The current allowable expenditure limit for SR&ED is $3M and potential refunds are capped, generally at 35%. Increasing the allowable expenditure limit would in turn increase the allowable expenditures and therefore increase the upper limit on R&D incentives. Larger refunds would provide more opportunities for Canadian businesses to reinvest in R&D within Canada. This could also provide the necessary additional funds to allow expansion, acquisitions, increase employment and head office critical mass here in Canada.

- **Increase the taxable capital limit from $10M to $15M.** The current taxable capital limit is $10M, which forces some companies to keep fewer funds in Canada. However, if this limit was raised to $15M, more Canadian companies would have the incentive to keep funds within Canada and use those funds to reinvest in expansion initiatives, ensuring more economic growth.

- **Simplify the claim format to streamline the process.** Currently, it can take several weeks to gather the financial data and relevant project information needed to complete one SR&ED claim for one project via Form T661. Additionally, there is significant ambiguity in the criteria: for example, what exactly constitutes "technological uncertainty" and how can companies always prove the measures taken to acquire knowledge through systematic investigation to achieve the objective? The act of *seeking* a technological advancement generates SR&ED eligibility but the new submission form indicates that the claim must also include details about *achieving* the advancement, which is a subtle distinction but worth noting as it is confusing (it is our understanding that in previous years, the failure to achieve the advancement was still SR&ED-eligible). Updating the submission format for clarity would benefit the taxpayer as it would remove confusion and therefore result in significant time savings. It may also benefit the CRA as they would presumably have to conduct fewer audits.

2. **Eliminate international trade barriers for Canadian businesses.**

Countries like Japan and Germany impose withholding taxes on Canadian-owned companies. We need the Canadian government to work with these countries to eliminate costly international trade barriers, including:

- **Remove Japanese withholding tax on Canadian software royalties.** Japan withholds 10% tax on software royalties to Canadian-owned companies. PEER Group deals with a Japanese distribution partner and software reseller which cost us $136,000 in software royalties in Japan in FY2013. This same distributor, Mizuho, does not withhold royalty tax to US businesses. Canadian-owned companies are at a disadvantage in the Asian market and this tax represents a significant trade barrier with Japan. We need Canada to work with Japan to eliminate the Japanese withholding tax.

- **Remove German withholding tax on dividends paid to Canadian-owned companies.** Germany withholds up to 20% of corporate dividends to foreign parent companies. PEER Group owns PEER Group, GmbH in Dresden and the German tax office withholds 5% of corporate dividends to PEER Group Holdings, Inc., the Canadian-owned parent company. Until this trade barrier is lifted, this tax removes any incentive to move our assets and IP from Germany to Canada. The German withholding tax introduces a disadvantage for Canadian companies attempting to expand in Europe and we need Canada to work with Germany to eliminate it.

PEER Group is helping the trade imbalance by exporting our software globally and we are helping to ensure economic growth in Canada by increasing our revenue and employment.

I would be happy to discuss any of these points further.

Sincerely,

Mike Kropp, P.Eng.
President & CEO