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Mr. Brian Ernewein

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Dear Brian:

Re: Request to Include Broker Warrant Change in Income Tax Act Technical Amendments/Regulation

We understand the proposed technical amendments to the *Income Tax Act*, released on December 21, 2012, will be introduced this fall. Among the draft changes are ones to section 142.2, which when previously amended significantly affected our small dealer members that accepted broker warrants as compensation for capital-raising in certain situations. As you may recall, we believe that when the mark-to-market rule was announced, the potential effect on broker warrants had not been considered, given these instruments are at best little known and limited to use by dealers typically arranging venture market or more speculative financings. For the reasons below, we are requesting a legislative amendment or, more straightforward, a regulation to make broker warrants “prescribed property” under paragraph 142.2(1)(e) of “excluded property”, and therefore not a “tracking property” that is a “fair value property” of the taxpayer for the taxation year. The wording of such a regulation, to limit use to the particular situations described in our earlier letters, could be as brief as:

‘non-trading, non-transferrable and non-extendible warrants paid as compensation to investment dealers’.

If necessary, to further circumscribe application of the rule, the phrase “regulated by the Investment Industry Regulatory Organization of Canada” or a reasonable equivalent could be added.

Background

When we first wrote in 2008 to request a legislative change, economic growth was continuing and markets were strong. Even when we wrote again in 2011, there was an expectation of recovery. This remains far from today’s situation. It is likely you will have seen in the press, as recently as July, the results on our institutional boutiques and retail investment firms of ongoing flat markets coupled with

rising costs. Expenses have been increasing in absolute and relative terms for all members, but moreso for smaller firms due to an increased need for scale. In the past six years, inflation grew by 12%. In contrast, and despite efforts to manage costs down, our institutional members' non-salary cost per dollar of revenue – reflecting growing amounts spent on meeting securities and tax reporting regulatory requirements, with the necessary technology – increased by 106% between 2006 and 2012 to now equal 61 cents of every dollar earned. While a few small firms have opened since when the market crash began in earnest, 42 investment dealers have merged, been acquired or closed down. Of particular concern, from an economic perspective, is when institutional firms that service niche markets and smaller issuers close.

In our submissions of [February 16, 2011](#) and [July 7, 2011](#), we emphasized that the use of broker warrants is NOT a way to avoid tax: broker warrants help, at the margin, some financing deals get done and at worst defer payment of tax for a year. For two years for which we provided data, 92% and 39% of warrants of one member expired unexercised. The cost of a delay in receipt of tax revenues on the ones that might be “in-the-money” after a year, were the former tax treatment to be restored, would be minimal given continued low interest rates and the fact that the following year, when the dealer seeks to exercise the marked-to-market warrants, their value may be negative and offset taxable earnings then.

What is not easily quantifiable from the change in broker warrant tax treatment is the cost of lost opportunities. We think that policymakers should be concerned by the effect the tax change some years ago is having on support for start-ups and small companies that may not otherwise be being served and that are unlikely to be serviced in the ordinary course by major integrated investment dealers (in rare cases, a large firm may be part of a syndication). The Prospectors and Developers Association of Canada reported in December 2012 the view of a well-known mining analyst that up to 700 exploration companies were in danger of disappearing this year given minimal working capital, reduction in available “risk-tolerant” investment money and the direction of what little there was to larger projects. Our smaller members, arranging financing for earlier-stage companies with smaller financing needs in the exploration, or equivalent parts of other sectors, help “prime the pump” of small enterprises, on which Canada is dependent to become the larger companies of tomorrow.

We believe that restoring the previous tax regime for broker warrants will contribute to Canada's smaller independent regional dealers continuing to service the stage beyond angel/venture capital into the small and mid-cap markets. We think that stipulating broker warrants to be “prescribed property” will help scores of regional junior issuers grow, with minimal if any negative impact on government revenues. Renewed issuance opportunities and reduced cash issuing costs are likely to contribute to job and tax revenue growth, and to a more diverse economic base. I would be pleased to arrange a quick call with IIAC members who have extensive experience in this area and will call you shortly to follow up.

Yours sincerely,


The logo for IIAC ACCVM features a stylized blue and grey graphic on the left, followed by the text "IIAC ACCVM" in a bold, sans-serif font.