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Lowering capital gains tax rate best way to encourage financing for entrepreneurs

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VANCOUVER—Eliminating, or at least lowering, Canada's uncompetitive tax rate on capital gains is the best policy for encouraging entrepreneurial financing, which is critical for new business startups, finds a new book released recently by the Fraser Institute, an independent, non-partisan Canadian public policy think-tank.

The book, ***Demographics and Entrepreneurship: Mitigating the Effects of an Aging Population***, spotlights declining growth rates in small business startups, a key measure of entrepreneurship, and explores policies to encourage and enhance entrepreneurship.

"Governments across Canada have tried all sorts of different policies to encourage small business financing and entrepreneurship, but the best policy lever at government's disposal is lowering the capital gains tax rate," said Douglas Cumming, professor of finance and entrepreneurship at York University's Schulich School of Business and co-author of the chapter ***Financial Markets, Laws, and Entrepreneurship***.

Cumming's work finds that the preferential tax rate for small businesses does not encourage entrepreneurship, and actually acts as a barrier for small businesses to grow into medium and large businesses, because doing so triggers a substantial tax increase.

Likewise, Labour Sponsored Venture Capital Corporations (LSVCC), which were reintroduced by the current federal government, have widely been seen as failures because LSVCCs are used largely for their generous tax credits, and often fail to deliver financing to entrepreneurs.

"With the rate of small business startups on the decline and venture capital near anemic levels, Ottawa and the provinces should lower capital gains tax rates to improve entrepreneurial finance," Cumming said.

A second related chapter in the book—***Spurring Entrepreneurship through Capital Gains Tax Reform***—looks specifically at the economics of capital gains and Canada's current competitiveness.

Among other insights from the chapter, it notes how several developed countries, including New Zealand, Switzerland and Belgium don't have capital gains taxes. Others including Australia, Britain, Germany and Japan have lower rates than Canada, which in 2015/16, had a top personal marginal capital gains tax rate of 26.5 per cent—higher than the OECD average (25.5 per cent).

Not only do lower capital gains tax rates incentive greater entrepreneurial activity by increasing the potential reward for starting a business, a lower rate also frees up capital and encourages investment in business startups by similarly increasing the potential reward for investors if a new company is a success.

"Instead of pursuing policies, such as lower capital gains tax rates, that are proven to encourage entrepreneurial activity, the federal government is doubling down on failed policies that actually hinder business growth," said Charles Lammam, director of fiscal studies with the Fraser Institute.

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