FROM YOUR ADVISOR

LSIFs ARE A RISKY PROPOSITION

There are tax credits for investing in labour-sponsored investment funds, but most individual investors should steer clear

The federal government is restoring tax credits for labour-sponsored investment funds (LSIFs), but investors considering these securities should exercise a great degree of caution.

Tax credits should not drive your investment decisions, note investment experts such as Peter Bowen, vice president of tax research and solutions at Fidelity Investments Canada ULC. Furthermore LSIFs can be a risky proposition and exhibit a history of disappointing performance.

LSIFs, also called labour-sponsored venture-capital corporations, were first introduced in the 1980s as a way for small investors to invest in small to medium-sized businesses.

Eric Kirzner, professor of finance at University of Toronto's Rotman School of Management, says LSIFs are complex investments and carry high management fees.

"Would I recommend these as investments? No," he says.

Kirzner, who holds the John H. Watson Chair in Value Investing at Rotman, says the idea behind LSIFs was that investors would do well and companies that otherwise would not have been able to raise capital would get needed investment.

However, investing in early-stage small businesses is a speculative and risky proposition.

"There has been the occasional success. But, in general, the performance of these funds has been awful," Kirzner says.

He notes that for most individual investors, venture-capital investment is not an asset class he would recommend: "It is not until you get to very large portfolios that there's a place for [venture capital]."

LSIFs also have a holding period that can be as long as eight years. That means if the investment is sold before the end of the hold period, the investor may face penalties and lose the tax credits.

Many LSIFs also have higher fees than those associated with conventional funds, and that can eat away at investment gains.

Bowen also notes that performance has been a challenge for many LSIFs: "Tax efficiency is great, but you have to start with good, solid investment performance. And [in the case of LSIFs], that has not been the case in many situations."

Before you make a decision to invest your money in any sort of security, you need to look at the merits of the investment, Bowen says. "Just buying something because there's a tax credit or other benefit associated with it," he adds, "we don't think [that] is a good idea."

Ontario ended its tax credit for LSIFs in 2012. However, these investments have remained popular in Quebec, which continues to offer a credit.

The federal Conservatives had moved to phase out the federal tax credit by 2017, but the Liberals restored the incentive to 15% on purchases of provincially registered funds in 2016. Ottawa's credit applies to eligible investments of up to $5,000, making it worth up to $750.

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By Craig Wong (CP)

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