



BCTIA
CAPITAL & INVESTMENT COMMITTEE

JUNE 30, 2003

FINAL REPORT

A Practical Plan to Improve Access to Capital for the BC Technology Industry

TABLE OF CONTENTS

| | |
|--|----|
| NOTE FROM THE EXECUTIVE DIRECTOR..... | 1 |
| NOTE FROM THE CHAIRMAN OF THE BOARD | 1 |
| NOTE FROM THE CHAIRMAN OF THE CAPITAL AND INVESTMENT COMMITTEE..... | 1 |
| COMMITTEE AND SUPPORTING FACILITATORS | 3 |
| MANDATE | 4 |
| RESULTS OF THE ACCESS TO CAPITAL SURVEY | 6 |
| Objective 1: Facilitate access to the local Angel community..... | 9 |
| Objective 2: Foster relationship with local Venture Capitalist community | 12 |
| Objective 3: Open channels to U.S. Angel and Venture Capitalist community..... | 16 |
| Objective 4: Improve channels to facilitate access to (junior) public capital..... | 18 |
| Objective 5: Consider ways to use the services of municipal governments to assist with the Committee's Mandate..... | 21 |
| Objective 6: Improve access to tax credits: establish positions re: early adoption of the proposed changes to the Small Business Venture Capital Act & removal of the labour sponsored fund cap..... | 23 |
| Objective 7: Improve access to tax credits: determine if other changes are needed to improve access to tax credits & if there are ways to make the tax regime more friendly to investors..... | 24 |
| Objective 8: Improve access to Provincial grants and loans and Federal grants and loans and secure governmental assistance in opening channels to U.S. angels and VCs | 26 |
| Objective 9: Determine if there are ways to make the tax regime more friendly to investors | 28 |
| NEXT STEPS | 38 |



BCTIA CAPITAL & INVESTMENT COMMITTEE

JUNE 2003 FINAL REPORT

Note from the Chairman of the Board

The BCTIA is driven by the importance of addressing those issues that can have the greatest positive impact on our technology community and its' ability to grow and prosper in BC. We continuously connect and assess our membership as to what business factors are encumbering their ability to realize the potential of their technology companies.

Access to capital continues to be the number one identified issue that we must address in this province if we are to achieve our vision – "BC will be a premier destination for technology enterprise through the fostering of best in class environment for the development of a world class technology community".

With the Board priorities clearly articulated by the membership, it was essential that we take a unique approach to addressing this issue. This involved establishing the Capital Investment Committee with a mandate to reach out into the community for collective expertise on this issue and to focus recommendations both from a longer term strategic and shorter implementation perspective.

Due to the importance of this issue the Capital Investment Committee received excellent support from across all sectors of our industry and has developed a plan and recommendations that can have a real impact on addressing this issue. This Report is a major step forward but the board of the BCTIA is committed to ensuring that actions are taken and recommendations implemented to ensure the desired long term impact occurs.

On behalf of the board, I would like to thank all the committee members for their contribution and I am confident that this Report is a major step forward in addressing what has been identified as the number one issue for the BC Technology community.

Morgan Sturdy
Chairman of the Board

Note from the Executive Director

The BCTIA is the voice of the BC technology community. Through this organization technology companies have the ability to deliver a unified and powerful message to all levels of government and the public, business and academic communities. Over the past few years we have and continue to use this voice effectively to drive forward major improvements to the BC business environment for technology.

Our strength comes from our ability to be responsive to the needs of the BCTIA membership and effective at delivering the changes required for our companies to flourish. To achieve this we have implemented a process within the BCTIA that involves continuous monitoring of critical issues and the willingness to restructure our Board in a manner that allows us to focus our energy on those issues deemed most critical to our members.

The Capital and Investment Committee was formed to engage the brightest minds in our community to address its number one issue, access to capital. The deliberations of this group of informed and

committed individuals will be used to guide the BCTIA's position with the Federal and Provincial on all aspects of capital and investment. It will further serve as a model for future policy development as new issues rise to importance within our community.

George Hunter
Executive Director

Note from the Chairman of the Capital and Investment Committee

I am a member of the Board of the BCTIA and Chairman of its Capital & Investment Committee. In this capacity, I am pleased to present our Committee's report entitled "A Practical Plan to Improve Access to Capital for the BC Technology Industry."

Frame of Reference

As the name of our Report would suggest, our Committee chose to approach our mandate (see "Mandate" below) from a very practical perspective. While we did involve numerous people in preparing the Report – over 30 industry representatives were actively involved in the preparation of the Report and many hundreds more provided input – we consciously chose not to restrict this exercise to a research project. Instead, we charged our participants with the task of coming up with enough data to identify problems we could all agree upon, and then provide not only long-term solutions which might require public policy changes or larger initiatives to be undertaken, but also short-term solutions that could be implemented quickly, easily and hopefully show immediate benefits for our members. I believe that we have met this objective.

Overview

With the foregoing in mind, in this Report you will find detailed suggestions on policy changes that will require further discussion, consideration and input such as the comments on tax reform, as well as some very simple and basic steps to assist our members such as improving our website to make it a more useful resource. In some cases, such as with respect to the objectives relating to Angel and VC investor issues, the results came down to simply improving the channels between these stakeholders and our association and its members. In all cases, the Report does provide very good data on what the "street" is telling us – and that is, we as an industry must work the process of improving access to capital.

Legacy

I do not see this Report as being an end-point. On the contrary, as our Committee is a new committee in its first full year of operation, I see this Report as the beginning of a long-term plan to ensure that the BCTIA serves a useful role in improving access to capital for our members. I would hope and expect that these objectives will be expanded upon, added to and evolve over the years, surviving both this Report, the current committee and this Chairman's involvement.

Acknowledgements

Finally, I would like to thank all of the Committee members and supporting facilitators for their hard work, dedication and effort that went in to creating this Report. I would also like to thank the hundreds of people who provided their input without which this Report could not have been created.

David J. Raffa
Chairman, Capital & Investment Committee



BCTIA CAPITAL & INVESTMENT COMMITTEE

JUNE 2003 FINAL REPORT

Committee and Supporting Facilitators

The Capital and Investment Committee consists of the following members:

| | |
|---|---------------------------------|
| David J. Raffa, Committee Chairman | Jim Mutter, jalaaM Technologies |
| Catalyst Corporate Finance Lawyers | Maria Pinelli, Ernst & Young |
| David Berkowitz, Ventures West | Don Rix, Cantest |
| George Hunter, BCTIA Executive Director | Morgan Sturdy, Chairman BCTIA |
| Ray Moschuk, Telus Ventures | James Topham, KPMG |

The Supporting Facilitators of the Capital and Investment Committee are the following industry people:

| | |
|---|--|
| Doug Blakeway, Strategic Technologies | Rory James, Comerica |
| Mike Brawn, KPMG | Paul Lailey, Davis & Co. |
| Jamie Brown, Canaccord Capital Corporation | John Lorenz, Industry Canada |
| Francis Caouette, City of North Vancouver | Bill Macaulay, KPMG |
| Geoff Catherwood, BDC Venture Capital | Mary MacDonald, Macdonald & Associates Limited |
| Jim Charlton, Growthworks/WOF | Dan Parmer, QuestAir |
| Dane Chauvel | Frank Pho, BDC |
| Bob Chaworth-Musters, Hybridge Investment | Howard Riback, Ventures West |
| Tran Chung, Creo Inc. | Cheryl Slusarchuk, McCarthy Tetrault |
| Robert de Wit | Fred Snow, Radical Entertainment |
| Gordon Dunn, Ernst & Young | Bruce Sprague, Ernst & Young |
| Brian Edgar, Rand Edgar Capital Corp. | Andrew Telford, 360 Networks |
| Haig Farris, Fractal Capital | Linda Thorstad, Vancouver Economic Development Comm. |
| Jim Fletcher, Chinacap | Joe Timlin, Growthworks/WOF |
| Canon Fung, MacDonald Dettwiler & Associates Ltd. | David Toyoda, Catalyst Corporate Finance Lawyers |
| Randy Garg, Discovery Capital Corporation | Quanny Van, PMC-Sierra |
| Bryce Hamming, KPMG | Michael Volker, Simon Fraser University |
| Linda Hepner, City of Surrey | Christopher Wales, Fincentric |
| Jim Heppell, Catalyst Corporate Finance Lawyers | Dale Wheldon, Chilliwack Partners |
| Steven Hnatiuk, Yaletown Venture Partners Inc. | Gary Wilson, Telus Ventures |
| Steven Ilkay, National Angel Organization | Ed Zacharuk, KPMG |
| Harry Jaako, Discovery Capital Corp. | |



BCTIA CAPITAL & INVESTMENT COMMITTEE

JUNE 2003 FINAL REPORT

Mandate

The following is the Mandate of the BCTIA Capital & Investment Committee.

Mission Statement:

To attract investment and improve access to capital for technology companies in British Columbia.

Broad Objective of Committee:

To prepare and begin implementation of a full two-year Strategic Plan for 2003 – 2004. The Strategic Plan will be divided up temporally as follows:

- Short term objectives (Jan. 1, 2003 – June 30, 2003) – Deliver preliminary Report.
- Mid-term objectives (Jan. 1, 2003 – Dec. 31, 2003) – Begin implementation of Report recommendations.
- Long-term objectives (June 30, 2003 – December 31, 2004) – Continue implementation of Report recommendations.

Implementation during the first year (2003) of our mandate will focus on achieving the short term objectives and beginning the mid and long-term objectives.

Outline of Strategic Plan:

The following objectives have been included in the Strategic Plan:

1. ***Private Equity:***

- (a) facilitate access to the local Angel community,
- (b) foster the relationship between the BCTIA and local VC community, and
- (c) open channels to the US Angel and VC community (specifically Washington State, Oregon and California).

2. ***Public Markets:***

- (a) in respect of the TSX-VN (formerly CDNX):
 - (i) promote deregulation to improve access to public capital, and
 - (ii) improve channels to facilitate access to (junior) public capital,

- (b) in respect of the TSX (formerly TSE), improve channels to facilitate access to (senior) public capital, and
 - (c) open channels to the US public markets (specifically NASDAQ, AMEX).
3. ***Municipal Governments*** – consider ways to liaise with Municipal Governments to assist with the Committee's Mandate.
4. ***Provincial Government:***
- (a) improve access to tax credits including, specifically:
 - (i) promote the early adoption of the proposed changes to the Small Business Venture Capital Act,
 - (ii) promote improving the labour sponsored fund program, and
 - (iii) determine if other changes are needed to improve access to tax credits,
 - (b) improve access to Provincial grants and loans for technology companies,
 - (c) determine if there are ways to make the tax regime more friendly to investors (capital gains exemptions, rollover treatment, stock options etc.), and
 - (d) secure the Provincial government's assistance in opening channels to US angels and VCs.
5. ***Federal Government:***
- (a) improve access to federal grants and loans for B.C. (to ensure B.C. receives its fair share),
 - (b) determine if there are ways to make the tax regime more friendly to investors (capital gains exemptions, rollover treatment, stock options etc.), and
 - (c) secure the Federal government's assistance in opening channels to US angels and VCs.
6. ***Profile:*** Actively promote B.C.'s tech sector internationally as a place to invest.

David J. Raffa
Chairman, Capital & Investment Committee



BCTIA CAPITAL & INVESTMENT COMMITTEE

JUNE 2003 FINAL REPORT

Results of the Access to Capital Survey

Introduction

Last summer the BCTIA conducted a survey of its members to find out what were the principal challenges facing them in building their technology businesses. The biggest concern cited by respondents was the inability to secure investment capital. Surprisingly, this concern was not limited to smaller companies but was shared equally by the larger and more well established companies as well. Clearly, everyone was feeling the pressure of the depressed technology markets.

In response to this the BCTIA created a new committee, the Capital & Investment Committee, to represent its members on this critical issue. I was asked to chair that Committee. In response to its members' concerns, the Capital & Investment Committee has adopted a Mandate with 18 key objectives and has begun implementing a Strategic Plan to achieve those objectives. The Strategic Plan will be carried out by the members of the Committee with the help of nearly two dozen supporting facilitators representing all areas of the local technology and finance sectors.

One of the first steps our Committee undertook was a follow-up survey (in December, 2002) to understand better the challenges facing our members in accessing investment capital. The results of that survey are now in and they help identify where the pressure needs to be relieved to help make 2003 a better year for the technology community. The following is a discussion of those results.

Key Findings of Survey

The key findings of the Access to Capital Survey are as follows:

- Financing has been difficult to secure by technology companies at every level. Thirty-five percent of respondents rated the \$750K - \$3.0M round (typically, the Series A venture capitalist round) as being the hardest round of financing to raise. The \$250K - \$750K round (typically, the angel round) and the over \$3.0M round (typically, the Series B or C venture capitalist round) were rated by 24% and 27%, respectively, as the next most difficult financing rounds to raise. The initial \$250K (typically, the friends & family round) was rated as the least difficult round to raise (cited by only 11% of respondents).
- Fifty-five percent of respondents believe that increasing the labour sponsored fund cap will have a significant or very significant impact on their ability to raise private equity. Lack of total venture capitalist dollars available, lack of total number of venture capitalists and lack of competition amongst VCs were all cited as significant problems.
- A significant majority of respondents indicated that the Provincial Government (70% of respondents) and Federal Government (73% of respondents) could significantly or very significantly improve access to capital by implementing general tax reform (income tax reduction, capital gains relief, improved rollover and stock option treatment, etc.).

- A lack of tax incentives to offer early stage investors was cited as the second most significant impediment to raising friends & family funding. The inability to find angels was also cited as a significant problem in securing early stage funding.
- One in three respondents accessed government loans or grants. The federal programs and specifically IRAP and SRED were much more favourably thought of by respondents as compared to provincial programs.
- A general lack of investment interest was cited as the biggest impediment to raising investment capital at all levels, public or private. Within the public markets, this was cited as far and away the biggest hurdle.

Full Discussion of Survey

Consistent with the response from the first survey that indicated that companies of all sizes were having problems securing investment capital, respondents in the follow-up Access to Capital Survey were split almost evenly over which financing round was the most difficult to raise: the \$250K to \$750K round (cited by 24% of respondents); the \$750K to \$3M round (cited by 35%); and the over \$3M round (cited by 27%). The initial \$250K was cited by only 11% of respondents as the most difficult round to raise. Consistent with these data, the friends and family group was cited by a wide majority of respondents (71%) as the easiest investors to secure. angels were next (18.4%) with venture capitalists (2.6%) and underwriters (2.6%) being the most difficult to secure.

Within each category of investor, lack of investment interest was cited as the biggest hurdle to securing investment, be it the friends and family category (cited by 38% of respondents), angel category (by 22%), venture capitalist category (by 40%) or underwriter category (by 40%). Clearly, the overall malaise in the market has been affecting all investors. The consistency, however, breaks down when looking at the next biggest hurdle. In the friends and family group, lack of tax incentives to offer investors was cited by 32% of respondents as the next biggest hurdle. Compare this with the angel world, where 29% of respondents indicated that the simple difficulty in finding angels was the next biggest hurdle. In the VC world, the inability to agree upon terms was cited by 26% of respondents as the next biggest problem, with 17% citing this as a problem in dealing with underwriters.

Lack of available capital, number of professional investors and competition amongst them were all cited as significant problems. Sixty-eight percent of respondents cited the lack of sheer number of angels as a significant impediment, with lack of opportunities to connect with US based angels and lack of competition amongst local angels each being cited by 50% as a significant problem. The results were similar in the VC world with 53% of respondents citing lack of available VC dollars as a significant problem and a similar number citing a lack of number of local VC firms as being a problem. Fifty-five percent cited the lack of competition amongst local VCs as being a problem and 51% saw better access to US based VCs as being very important to them. The change respondents wanted to see most to improve conditions for securing investment capital in the VC world was the lifting of the labour sponsored fund cap.

As to other sources of capital, the public markets were considered largely irrelevant by the technology community. Lack of interest on the part of underwriters was cited by a significant number of respondents (40%) as the single biggest hurdle to using the public markets. Interestingly, for those considering the public markets, they did not have a preference as to which market. The TSX Venture Exchange and TSX senior exchange were of equal interest to respondents, as were the US public markets.

One in three respondents accessed either provincial or federal government grants or loans for capital. What was very interesting was that more than half of the respondents indicated that six of the more well known provincial government programs were largely inconsequential to them. Compare this with the

federal government programs where 43% of all respondents cited the IRAP program as being important and a whopping 70% indicated that the SRED program was important to them. These data suggest that the federal government programs are much more favourably thought of by the technology community.

Tax reform continues to be a hot topic. Interestingly, 10% more respondents cited general tax reform (such as reducing income taxes, reducing capital gains and improving rollover provisions and stock option treatment) as being more desirable than increasing loans and grants. This suggests that the technology community is looking less for government handouts than for the government to simply create a better overall business climate. Where government assistance would be appreciated by respondents is with respect to helping open channels to US angels and VCs. One would assume from this that more initiatives like the Premier's recent tour of the Silicon Valley would be welcomed.

Conclusion

The results of this survey support what many of us have suspected all along, friends and family money is still the easiest money to find to help launch a new technology company. However, the general poor state of the technology markets has made this a tougher sell. The Provincial Government could help out the cause by providing some tax incentives for early stage investment such as pushing ahead with the proposed changes to the SBVCA. Within the professional investment community, a lack of numbers of professional angel investors and a lack of both VC dollars and number of VC funds are the most pressing concerns to the technology community. The Provincial Government could help address the former by giving some labour sponsored fund allocation to an angel fund, and the latter could be addressed by lifting the labour sponsored fund cap to allow existing LSFs to raise more capital, and to make it easier for new VC funds to be created. Finally, both levels of government could help by moving to lessen the overall tax burden.

David J. Raffa
Chairman, Capital & Investment Committee



BCTIA CAPITAL & INVESTMENT COMMITTEE

JUNE 2003 FINAL REPORT

Objective 1: Facilitate access to the local Angel community

Responsible Subcommittee Member: James Topham, KPMG

Supporting Facilitators:

- Don Rix, Cantest
- Mike Volker, SFU
- Bob Chaworth-Musters, Hybridge Investment Management
- Steven Ilkay, National Angel Organization
- Haig Farris, Fractal Capital
- Jim Fletcher, Chinacap
- David Raffa, Catalyst

Community Consultation

Input was received from over 30 B.C. Angels through roundtable discussions, questionnaires and individual meetings.

Objectives:

The Subcommittee identified the following objectives:

- Facilitate access to the local Angel community (the initial stated objective); and
- Increase the number of Angels and the number of investments from those Angels (objective added after consult).

Steps Undertaken:

The Subcommittee worked in conjunction with the National Angel Organization (“NAO”), specifically Steven Ilkay, which was conducting a survey in several cities on behalf of Industry Canada and the TSX Venture Exchange to find out what the current challenges and barriers are for Angel investing and to make recommendations to generate more participation and improve the overall success of Angel investing.

NAO also conducted a survey of Angels for the study which included responses from about 30 B.C. Angels.

The Subcommittee also conducted two Angel investor roundtable discussions in Vancouver in conjunction with NAO. The Subcommittee also discussed the topic with a number of other Angels individually.

With the data in hand, the Subcommittee conducted a brainstorming session with its supporting facilitators to determine a set of recommendations.

Results:

The key issues the Subcommittee identified were as follows.

Lack of liquidity on Angel investments is always a concern but particularly in the current market with merger and acquisition activity low and public markets challenged. Even when “normal” markets return, going public is costly.

Financing after the Angel investment round can be problematic from the perspective of Angels:

- Many venture capitalists have reduced their investments in early-stage technology companies
- Terms of venture capital investments now more frequently have conditions that can significantly reduce the value of earlier Angel investments.
- Not enough competition amongst venture capital companies.
- Public markets are currently not a viable alternative.

There are many more high net worth individuals who could become Angels but they don’t have adequate knowledge or investment mechanisms to enter this market.

Recommendations:

The Subcommittee developed eight ideas, set forth below, to help address the issues noted above. The next step is to further investigate and review them in conjunction with those from other committees to establish priorities.

1. Consider and determine if it would be appropriate to mandate labour funds and/or provincial pension funds to invest some portion of their funds in early stage companies in B.C. This could include requiring some of the VCC allocation to be directed to seed investments in early stage companies.
2. Facilitate angel investment fund matching. Establish a seed funding arrangement so that when private sector investments are made in early stage technology companies, additional funding can be sourced. This could be done in conjunction with the previous recommendation and may include the creation of a VCC fund in which Angels could invest directly. A different model to further explore would be a U.S. program which provides guarantees to banks who loan money to early stage companies who receive private sector equity funding.
3. Reduce costs of Going Public by avoiding onerous regulation that the U.S. is currently implementing. Three developments that should be supported and/or investigated, together with one of the other Subcommittees which is examining this issue, further include:
 - Supporting the B.C. Securities Commission proposed principles based regulatory environment as opposed to the detailed rules based that the U.S. and Ontario are implementing.
 - Support the CNQ. The Canadian Trading and Quotation System Inc. (CNQ) created a new marketplace for trading the equity securities of qualified Ontario Reporting Issuers by

participating Investment Dealers Association of Canada members. CNQ received a recognition order from the Ontario Securities Commission to operate a quotation and trade reporting system, which enables the company to proceed with implementation plans for a Friday, July 25, 2003 launch. This type of system could increase the number of early stage investors.

- If appropriate, harmonize securities regulation across Canada to reduce cost.
4. Improve tax deductibility of Angel investment – expand the "flow-through share" program from the resource and exploration industry to the technology sector.
 5. Facilitate bank financing for two situations:
 - When companies have firm orders from Canadian customers that need the working capital for order fulfillment.
 - SR&ED investment tax credit claims.
 6. Retain the refundable aspect of SR&ED investment tax credits for small technology companies on Canadian stock exchanges.
 7. Establish a percentage that the tax sheltered pension funds must invest in B.C. outside of Vancouver, to support the Provincial Government's Heartland strategy.
 8. Develop a marketing function to attract US venture capital into BC companies and expand BC's high net worth individuals not currently investing in technology companies to invest in local companies.

James Topham, KPMG
Responsible Subcommittee Member



BCTIA CAPITAL & INVESTMENT COMMITTEE

JUNE 2003 FINAL REPORT

Objective 2: Foster relationship with local Venture Capitalist community

Responsible Subcommittee Member: David Berkowitz, Ventures West

Supporting Facilitators: Morgan Sturdy, Chairman BCTIA
David Raffa, Catalyst
Jim Charlton, Growthworks/WOF
Geoff Catherwood, BDC
Steven Hnatiuk, Yaletown Venture Partners

Community Consultation

The Subcommittee consulted with the following VC's:

- Ventures West
- BDC
- Growthworks
- Discovery
- Yaletown
- MDS
- RB Capital
- Future Fund

Objective:

The primary objective of the Subcommittee was to consider how the BCTIA could foster its relationship with the local venture capital community, and identify how the two groups could work together for their mutual benefit.

Steps Undertaken:

The Subcommittee met three times to identify common ground issues affecting the industry.

The Subcommittee undertook a limited research exercise and gathered industry statistics on the state of venture capital investment in Canada and, in particular, B.C.

The Subcommittee surveyed the local VCs and considered the following questions:

- What role can the BCTIA play relative to the business interests of the VCs?
- What role can the venture capital community play to help the BCTIA with its mandate?
- Are there specific policies the BCTIA should pursue on behalf of the local VCs.

For its members, the BCTIA held a "Meet the Local VC's" lunch on May 8th with eight local VCs on a panel.

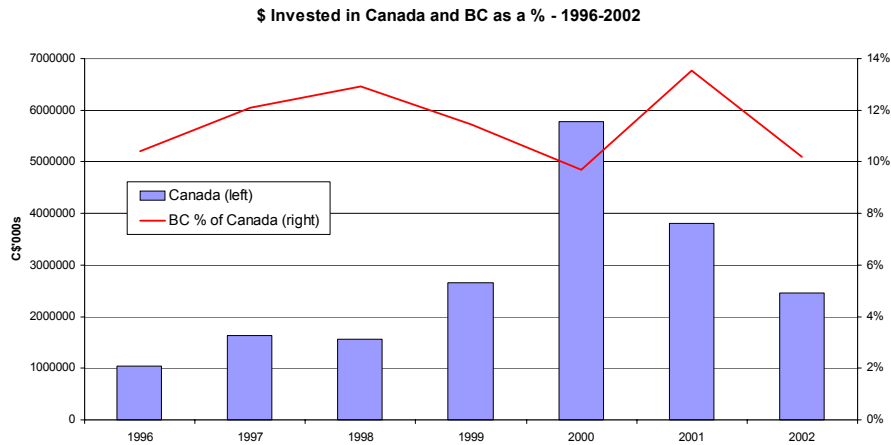
Results:

Our review of the state of the VC industry is summarized as follows:

State of the Industry: 1996 to 2002

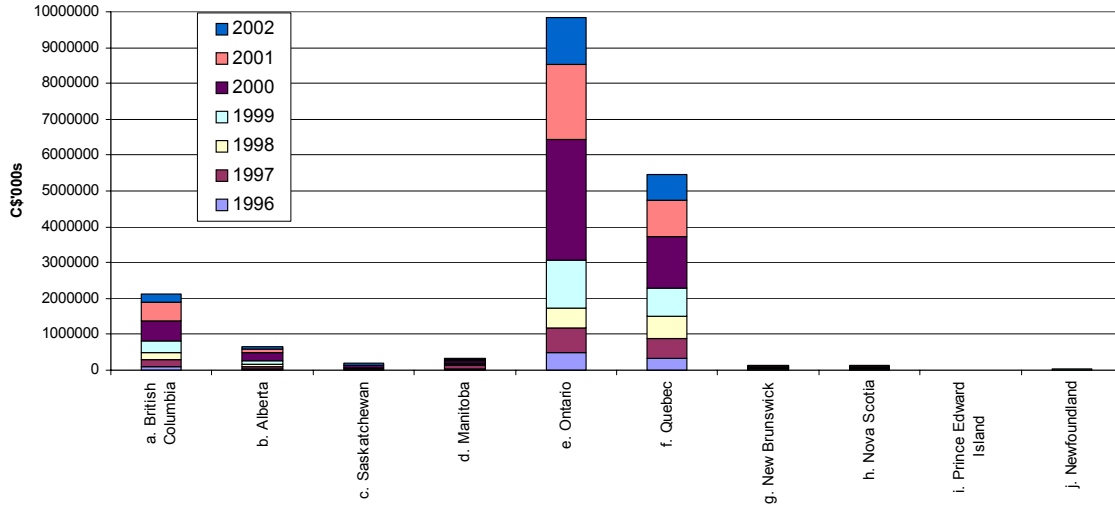
| | 1996 | 2002 |
|--------------------------|-------------|-------------|
| Vancouver VC Funds | 5 | 10 |
| Investment Professionals | 20 | 45 |
| Total Annual Investments | \$108 M | \$246 M |
| Nasdaq - Dec. 31 | 1291 | 1336 |
| TSE - Dec. 31 | 5927 | 6615 |

Note: Does not include 'Dot Com' Era funds that have come and gone.

Venture Capital Invested in Canada

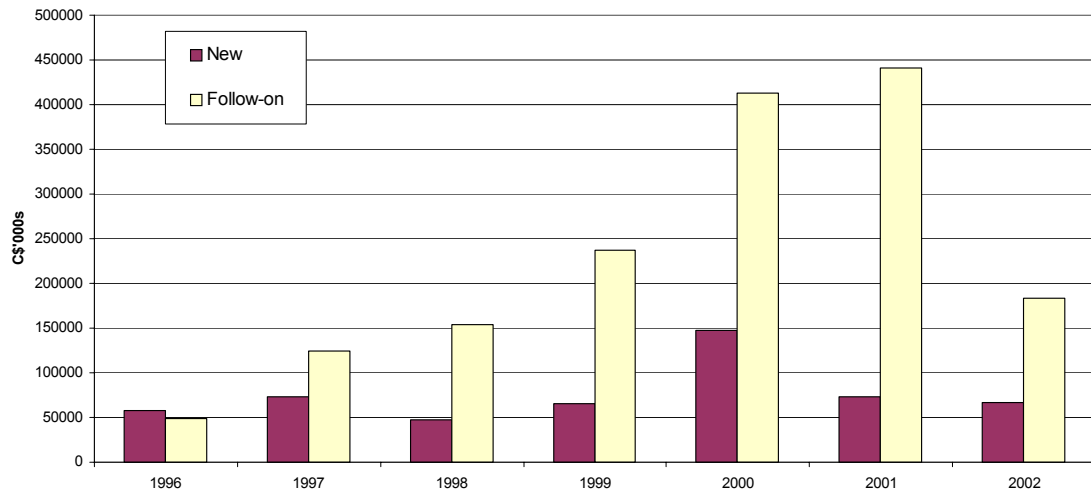
Are We Getting Our Fair Share?

\$ Invested in Canada 1996-2002 By Region



New Investments vs. Follow-Ons

\$ Invested in BC 1996-2002 By Round Type



Recommendations

The data suggests and interviews with VC's confirmed that the venture capital market in BC is far more healthy than is publicly acknowledged. Despite the difficult economic environment and the difficult state of the public markets, venture investment in BC remains relatively strong. There is anecdotal evidence that companies now find it easier to raise capital, under better terms, than in other technology markets in North America. Further, BC appears to be receiving its fair share of venture investment within Canada.

All parties agreed that a healthy venture capital environment is necessary for a healthy technology community. However, interviews with the VCs revealed widely divergent views depending on the types of funds being consulted: private, government, or labour-sponsored, particularly with respect to tax incentives for retail venture capital investors. As such, the Subcommittee came to the conclusion that the BCTIA should be careful not to endorse policies that may benefit particular funds at the expense of others.

The Subcommittee agreed that it would serve the interests of the VCs if the BCTIA could continue and accelerate its efforts to actively market BC as a high tech centre of excellence. This should not be done on a single investor basis, but part of a larger campaign with the assistance of the provincial government.

The provincial government wants BC to be a 'Top 10' technology centre yet it was acknowledged that we don't yet have adequate measures and statistics. The Subcommittee recommended that the BCTIA should gather data from leading technology centres to identify best practices and specific goals, and then monitor data over time to track our progress.

David Berkowitz, Ventures West
Responsible Subcommittee Member



BCTIA CAPITAL & INVESTMENT COMMITTEE

JUNE 2003 FINAL REPORT

Objective 3: Open channels to U.S. Angel and Venture Capitalist community

Responsible Subcommittee Member: Maria Pinelli, Ernst & Young

Supporting Facilitators: David Raffa, Catalyst Corporate Finance Lawyers
 Jim Mutter, JaalaM
 Joe Timlin, Growthworks/WOF
 Rory James, Comerica
 Mary MacDonald, MacDonald & Associates
 Cheryl Slusarchuk, McCarthy Tetrault

Community Consultation

The Subcommittee relied on the experience of its members and the results of the Access to Capital Survey. The results of the Access to Capital Survey highlighted, in particular, the importance that US venture capital has played in the local technology sector.

Objective:

To create linkages between the BC technology community and US sources of capital.

Steps Undertaken:

Research showed that foreign capital, in particular US capital, was a significant source of funding for the local technology industry. The Subcommittee's objective was to take steps to improve access to this capital. The steps taken by the Subcommittee included:

- Linked with the Washington Software Alliance investment forum to highlight BC companies by creating a separate BC selection committee presenting the merits of investing in BC to the Forum and ensuring minimum of six candidates were presenting companies.
- Arranged multiple venues to bring US capitalist ventures and angels to BC to meet the BC technology community.
- Arranged through the IT Financing Forum with the assistance of the BCTIA to bring 22 VC's to the forum recently held in Toronto and to ensure BC was visible
- Arranged on June 19th a Meet BC trip to Silicon Valley to portray BC technology companies.

Results:

The efforts of the Subcommittee helped raise visibility for the BC technology community in the US.

Recommendations:

Continue to brand BC technology community internationally and undertake steps to connect the local technology community with sources of capital in the US including:

- To arrange a number of road shows portraying Canada as an "Innovation Nation" across the US and, in particular, BC.
- To organize multiple venues and visibility for BC technology companies in Seattle and Silicon Valley.
- To create a Global Linkages Committee to help build the brand of the BC technology community.

Maria Pinelli, Ernst & Young
Responsible Subcommittee Member



BCTIA CAPITAL & INVESTMENT COMMITTEE

JUNE 2003 FINAL REPORT

Objective 4: Improve channels to facilitate access to (junior) public capital

Responsible Subcommittee Member: David Toyoda, Catalyst

Supporting Facilitators: Jamie Brown, Canaccord
Harry Jaako, Discovery Capital
Brian Edgar, Rand Edgar Capital
Doug Blakeway, Strategic Technologies

Community Consultation

The Subcommittee relied on the results of the BCTIA Access to Capital Survey, and input from the Supporting Facilitators and their business associates for data.

Objectives:

The Subcommittee identified two principal objectives:

1. Promoting deregulation to improve access to public capital; and
2. Facilitating access to junior public capital through the TSX Venture Exchange.

Steps Undertaken:

The Subcommittee met twice to develop a strategy and position paper to move forward on the objectives. Members also researched certain areas for background information to achieve the goals.

Results:

The results of the Subcommittee's efforts were as follows:

- A position paper (below) was prepared and delivered.
- An initial follow-on strategy was established.
- An initial set of Action Items were identified and allocated to Subcommittee members.

Recommendations:

After reviewing the position paper from January and discussing the recent events in the capital markets including the introduction of the new BC Model by the British Columbia Securities Commission and the changes to the B.C. Small Business Venture Capital Act and regulations (the VCC program), the Subcommittee determined that the potential exists to significantly increase the amount of public venture

capital that could be raised for B.C. technology companies by implementing certain fundamental changes. To be successful, these changes will require the approval, endorsement, concurrence and implementation efforts of many groups of stakeholders, from the highest political levels in the Province, to senior civil servants, securities regulators and the TSX Venture Exchange. The initial step would be to approach the Honourable Rick Thorpe, the Minister for Competition in British Columbia, to ensure that we have his support for:

1. conducting negotiations with his Ministerial counterpart in Alberta regarding initiatives required to streamline the TSX Venture Exchange Rules and Procedures to promote business growth and financing for technology companies;
2. addressing the changes needed to existing caps and restrictions on venture capital Investment Tax Credits to stimulate growth of the public venture capital market; and
3. politically supporting the lobbying of Ottawa to remove the differential in SR&ED benefits available to small private and public technology companies.

The three ways in which we propose to request that the Minister assist the BCTIA are further described as follows.

First, there is currently a stalemate with respect to the revisions to the TSX Venture Exchange Policies between the British Columbia and Alberta Securities Commissions - the two co-regulators of the junior exchange. This has resulted in a significant disincentive for companies to list on the TSX Venture Exchange as the timing and cost of listing through an RTO, CPC Qualifying Transaction or IPO are prohibitive. We will request that the Minister discuss with his counterpart in Alberta the need to resolve this stalemate so that the Exchange's Rules may be revised to reflect business realities and present a viable alternative for raising capital in British Columbia.

In the event that such resolution cannot be quickly obtained jointly with Alberta, we will recommend that BC and Alberta agree on an initiative to allow each Province to support the listing of junior technology issuers domiciled in each Province under rules specific to that Province and its securities regulator. This will allow each Province to proceed on its own initiative to facilitate investment and economic growth in the technology area. We are cognizant of the fact that our local market needs are significantly different from those of Alberta. As we have seen with the recently introduced BC Model, it is evident that BC may have to independently proceed with its agenda to effect the change that is necessary to promote investment and economic growth that is unique to British Columbia. The Subcommittee intends to continue working on presenting this message to the Minister.

The second focus in discussions with the Minister will be on increasing capital raising incentives (Investment Tax Credits) so that they are consistent with the financing requirements of the growing BC technology sector. They may, in fact, need to be more aggressive than those offered in other provinces and other programs. One way is to ensure that the "direct investment" provision enacted in the revised Small Business Venture Capital Act (eliminating the need for a single purpose VCC) can be accessed by public companies. This would make it similar to the QSSP program in Quebec. The Subcommittee is gathering information with respect to the QSSP program and will provide a summary of the potential benefits to our province if the VCC program can be used along the same lines as the QSSP program.

A third issue that the Minister will be requested to assist with is to lobby the federal government to treat SR&ED credits equally between private companies which now receive a 35% SR&ED Tax Credit, and public companies which now receive a 20% SR&ED tax benefit carry forward. The Subcommittee is preparing a paper regarding the differences between the tax credit under the current regime and his proposal for change to the SR&ED program.

Miscellaneous

The Subcommittee will discuss with Linda Hohol, President of the TSX Venture Exchange, the progress being made by the Subcommittee and ensure that she is kept aware of our initiatives moving forward.

The Subcommittee has recommended to the BCTIA Capital & Investment Committee and, in turn, to the BCTIA as a whole that they endorse the BC Model as presented by the British Columbia Securities Commission. Similar requests will be made to the BC Biotech Alliance and other industry associations and also to the TSX Listed Company Association.

The Subcommittee recommends to the BCTIA that it discuss with the Investment Dealers Association that the public venture capital market as it exists in western Canada is vastly different than the public markets in Ontario and Quebec. Therefore, the IDA should establish a public venture capital committee to address the needs of its members who participate in this market with the goal of establishing appropriate guidelines and rules.

We recommend that the BCTIA encourage industry research experts to consider providing a report on the state of public venture capital financing as it relates to the technology industry.

David Toyoda, Catalyst Corporate Finance Lawyers
Responsible Subcommittee Member



BCTIA CAPITAL & INVESTMENT COMMITTEE

JUNE 2003 FINAL REPORT

Objective 5: *Consider ways to use the services of municipal governments to assist with the Committee's Mandate*

Responsible Subcommittee Member: Linda Thorstad, Vancouver Economic Development Commission

Supporting Facilitators:
 James Topham, KPMG
 Francis Caouette, City of North Vancouver
 Linda Hepner, City of Surrey
 Dale Wheldon, Chilliwack Partners

Community Consultation

In 2001, the Vancouver Economic Development Commission, in partnership with the Canadian Advanced Technology Alliance, examined Vancouver's ability to support growth in the technology sector looking at five main components:

- access to capital,
- infrastructure,
- leadership,
- human resources, and
- innovation.

A survey of over 60 advanced technology leaders indicated that access to capital remained their greatest challenge and advised governments to adopt an internationally competitive tax regime as a priority.

Objectives:

To determine what, if anything, municipalities could do to help the technology industry address the lack of access to capital.

Steps Undertaken:

At the request of BCTIA Capital & Investment Committee, Linda Thorstad (Vancouver Economic Development Commission), Francis Caouette (North Vancouver), Linda Hepner (City of Surrey) and Dale Wheldon (Chilliwack Partners) convened to explore ways in which local governments can facilitate access to capital.

Results:

In British Columbia, local governments are currently governed by the Municipal Act, which may ultimately be replaced by the Community Charter. The Municipal Act expressly states that local governments cannot confer a benefit on one company versus another which limits their ability to play a significant, direct role with respect to enabling access to capital for technology in British Columbia.

Local governments can, however, play a role in creating infrastructure and enabling land use zoning to foster growth in the technology sector. In Vancouver, for example, local government has created I-3 zoning, where the intent is to permit the high technology industry and industry with a significant amount of research and development activity to locate and grow. There are numerous examples across the country where specific zoning has been created to foster technology parks.

In the United States, local governments have much greater powers and can support growth of the technology sector with tools that both enable land use zoning and may be linked with tax incentives. The designation of “enterprise” or “empowerment” zones has worked effectively in the United States through both federal and state initiatives, usually focusing on economically depressed areas. These zones are intended to stimulate business development and job growth as well as to improve the community in other ways. They are underpinned by employment wage tax credits to companies doing business in the zone, new-hire and job-creation tax credits, job training tax credits as well as modest corporate tax holidays. Similarly designated zones in Canada would work. Vancouver, already designated an international financial centre with the attendant tax benefits this confers on banking institutions, could be ideally situated as an initial showcase for this concept.

Two examples include the “Michigan Smartzone,” which can be reviewed at www.medic.michigan.org/smartzones and the Texas Enterprise Zone Program, which can be reviewed through www.txed.state.tx.us.

Recommendations:

Business development efforts spearheaded through local government offices, such as cluster analyses and subsequent targeted investment promotion, can play a role in defining and fostering the growth of key sub-sectors of the technology sector, providing economic development leadership on a municipal level that can be extended to concerted regional and industry-specific efforts.

While there currently exists no formal mechanism for engaging the Mayor's office, for example, in championing the technology sector, opportunities for city-sponsored angel forums and CEO roundtables with Mayor and Council may also be utilized to foster growth in the technology sector.

Linda Thorstad, Vancouver Economic Development Commission
Responsible Subcommittee Member



BCTIA CAPITAL & INVESTMENT COMMITTEE

JUNE 2003 FINAL REPORT

Objective 6: *Improve access to tax credits: establish positions re: early adoption of the proposed changes to the Small Business Venture Capital Act & removal of the labour sponsored fund cap*

Responsible Subcommittee Member: George Hunter, BCTIA Executive Director

Supporting Facilitators:
Morgan Sturdy, Chairman BCTIA
Don Rix, Cantest
Jim Heppell, Catalyst
Jim Charlton, Growthworks/WOF

Community Consultation

The Subcommittee relied on past data assembled by the BCTIA and the results of the Access to Capital survey.

Objectives:

The Subcommittee focussed on continuing the lobbying efforts to see the changes to the SBVCA adopted.

Steps Undertaken:

Active lobbying and statements of public support of the changes to the SBVCA.

Results:

The changes to the SBVCA were enacted in the Spring of 2003. The results of these changes will be seen in coming years.

Recommendations:

No further recommendations at this time.

George Hunter, Executive Director, BCTIA
Responsible Subcommittee Member



BCTIA CAPITAL & INVESTMENT COMMITTEE

JUNE 2003 FINAL REPORT

Objective 7: *Improve access to tax credits: determine if other changes are needed to improve access to tax credits & if there are ways to make the tax regime more friendly to investors*

Responsible Subcommittee Member: Bruce Sprague, Ernst & Young

Supporting Facilitators: Gordon Dunn, Ernst & Young
 Andrew Telford, 360 Networks
 Canon Fung, MacDonald, Dettwiler & Associates
 Christopher Wales, Fincentric
 Tran Chung, Creo Inc.
 Quanny Van, PMC-Sierra

Community Consultation

The Subcommittee relied on its own experiences and those of the members' immediate business associates, as well as the results of the Access to Capital survey.

Objectives:

The initial objective of the Subcommittee was to outline and prioritize taxation policy proposals that would increase the attractiveness of British Columbia to global technology corporations. To the extent that the corporate tax environment is enhanced, the ability to attract, retain and recruit highly skilled technology leaders will be achieved.

The Subcommittee also believes that world-class engineering teams will attract investor interest and facilitate the flow of capital to British Columbia.

Steps Undertaken:

Numerous meetings and discussions were held by the supporting facilitator work group to develop objectives and recommendations.

Recommendations:

The Subcommittee developed a number of personal and corporate taxation recommendations directed at both the federal and provincial government:

Federal

- Deductibility of stock option benefits at the corporate level would promote consistency with proposed changes in accounting policy as well as the income tax treatment of stock options in many other countries; and

- Elimination of the withholding tax levied on fees paid to non-residents of Canada would eliminate considerable administrative complexity built into the Canadian tax system and reduce the cost of doing business with non-residents.

Provincial

- Develop personal tax proposals specifically directed at attracting and retaining highly skilled technology workers including adoption of a 60 month provincial tax holiday for highly skilled technology workers in specific fields of technology and introduction of a B.C. stock option deduction;
- The B.C. SR&ED tax credit program has a sunset clause of September 1, 2004. This program should be continued indefinitely as it is an important source of capital for technology corporations;
- Changes to the International Financial Business (Tax Refund) Act to expand the definition of an eligible “international financial activity” to include SR&ED technology licencing transactions that would otherwise occur in offshore tax jurisdictions; and
- Introduce changes to the Assessment Act regarding the valuation of assets for property tax purposes in light of the unprecedented downturn in the high tech market.

Bruce Sprague, Ernst & Young
Responsible Subcommittee Member



BCTIA CAPITAL & INVESTMENT COMMITTEE

JUNE 2003 FINAL REPORT

Objective 8: *Improve access to Provincial grants and loans and Federal grants and loans and secure governmental assistance in opening channels to U.S. angels and VCs*

Responsible Subcommittee Member: Ray Moschuk, Telus

Supporting Facilitators:
 Bob de Wit
 Mike Volker, SFU
 Gary Wilson, Telus
 Randy Garg, Discovery Capital
 John Lorenz, Industry Canada

Community Consultation

The Responsible Subcommittee Member took the initiative to secure leading members of the major stakeholder groups involved in having access to information on Provincial and federal loans and grants. Within the supporting facilitator group, the Subcommittee had access to individuals with extensive experience in the Vancouver community dealing with early stage capital issues and angel networks, as well as links to the Science Council. The Subcommittee also included members with channels into the Provincial and Federal Governments, as well as a member with "on the street" experience in the private equity markets.

The Subcommittee met formally in the spring of 2003 and created a plan to address its first objective – that of access to grants and loans. The second objective was deferred pending outcomes related to parallel activities of other subcommittees.

Objectives:

The objectives were to:

- understand what grant and loan programs are currently in place that the BCTIA membership could avail itself of both provincially and federally;
- evaluate what are the current forms of access; and
- identify what improvements could be made, if any.

The first objective was to identify all government programs and the second objective was to consider the feasibility of a central database online accessible to members as none exists at the present time. A further objective would be to monitor and evaluate the success of the respective programs through dialogue boxes and then formulate recommendations that the BCTIA could take to the government for consideration of policy changes if needed.

Steps Undertaken:

Each Subcommittee member was asked to take part in identifying the government grant and loan programs from their particular vantage and report back whether there were programs in existence and whether the information could be part of a managed database. The second meeting confirmed the need for a managed database that was accessible and searchable. Considerable discussion took place on the appropriate fields and the top ten were chosen based on the degree of importance accorded by consensus.

Results:

As a result of the identification efforts it was established that there are no Provincial government programs of note providing grants or loans to early stage companies in the Province. There were, however, Federal Programs in existence and the information could be set up in a managed database to the benefit of BCTIA members. The Subcommittee took the initiative to develop a series of draft web pages which would assist members in accessing the information on the federal programs, if implemented.

Recommendations:

Add web access to the federal programs to the BCTIA website in 2003. The first stage would be online access to active programs with coordinating information. The second stage would be a refinement of the existing database with the addition of dialogue boxes.

The dialogue boxes would help for monitoring and evaluation purposes over six month period in order to assist Board members in their consideration of what needs changing in government policies and programs.

Ray Moschuk, Telus
Responsible Subcommittee Member



BCTIA CAPITAL & INVESTMENT COMMITTEE

JUNE 2003 FINAL REPORT

Objective 9: *Determine if there are ways to make the tax regime more friendly to investors*

Responsible Subcommittee Member: Bill Macaulay

Supporting Facilitators:

Working Group:

Paul Lailey, Davis & Company

Mike Brawn, KPMG LLP

Bryce Hamming, KPMG LLP

Ed Zacharuk, KPMG LLP

Advisory Group:

Dane Chauvel

Steve Hnatiuk, Yaletown Partners

Dan Parmar, QuestAir

Frank Pho, BDC

Howard Riback, Ventures West

Fred Snow, Radical Entertainment

Community Consultation

The Working Group consisted of tax practitioners focused on advising high tech companies on tax matters. It was supplemented by an Advisory Group of selected CFOs and representatives of Venture Capital funds.

Consultation with selected high tech tax practitioners across Canada was undertaken.

A presentation to high tech CFOs at BCTIA CFO Round Table was made on May 15, 2003, and a CFO Survey was circulated. In addition, directed interviews with 20 CEOs representing a cross-section of BC high tech companies by size is in progress.

Consultation with invitees to the Federal Department of Finance's Spring 2003 meeting in Vancouver with high tech and financial markets leaders on ways to improve capital attraction for the high tech industry was also undertaken.

Objectives:

Our Subcommittee identified the following objectives:

1. Survey industry leaders and tax practitioners to identify federal tax issues/concerns.
2. Identify "strategic" opportunities to enhance the federal tax regime for:
 - (a) Investors in BC high tech companies;

- (b) BC high tech companies, thereby enhancing their attractiveness to investors; and
 - (c) Employees of BC high tech companies.
3. Develop a framework so that the strategic opportunities can be advanced conceptually by the BCTIA over the summer months with a view to working on more detailed design issues through discussions with Department of Finance officials in Fall 2003.
 4. Catalogue “technical” issues and challenges that expose high tech companies or investors to unnecessary tax costs or uncertainty and develop a strategy for a strong submission to the Department of Finance.

Steps Undertaken:

The Working Group reviewed the top income tax rates on corporate and personal income in BC and compared them to the top rates in Washington, Oregon, California, Texas, Massachusetts and Georgia for the years 1998 through 2003.

In addition to the community consultation outlined above, we have also familiarized ourselves with the tax initiatives being undertaken by CATA, the Canadian Bar Association - Canadian Institute of Chartered Accountants Joint Committee on Taxation, the Tax Executives Institute, the BC Biotech Alliance, the Canadian Venture Capital Association and similar organizations with a particular interest in improving the Canadian tax environment.

Interim Results:

Combined Federal and BC Tax Rate Comparison with US States

Over the last decade a considerable amount of the industry’s energy on tax matters has been focused on the need to significantly reduce Canadian federal and provincial income tax rates to bring them into line with the rates of competing US jurisdictions. High personal tax rates and high capital gains inclusion rates were strong disincentives in the recruitment of suitably experienced high tech executives from the US. Corporate business profits were also subject to much more onerous levels of tax in Canada.

Federal and Provincial Budget changes over the last five years have succeeded in bringing down tax rates to the point that they are equivalent to, and in some cases, better than the tax rates found in competing US jurisdictions.

Appendix 1.1 compares the highest personal marginal tax rates on employment income in BC with the equivalent rates in Washington, Oregon, California, Texas, Massachusetts and Georgia over the years 1998 through 2003. It is noted that the comparison of nominal tax rates is a simplistic analysis and falls short of a proper “apples to apples” comparison. The US jurisdictions have a significantly higher income threshold for the imposition of top marginal rates and US individuals generally benefit from a lower taxable income base as a result of the deductibility of mortgage interest expense, etc.

In 1998, BC’s personal tax rate of 54.2% was significantly higher than Washington and Texas (two jurisdictions with no state income tax) at 39.6%, Georgia and Massachusetts at 43.2% and Oregon and California at approximately 45%. By 2003, BC’s personal tax rate is down to 43.7% which compares favourably with 44.1% and 44.3% in Oregon and California but still lagging the other states. Washington’s rate is only 38.6%. The personal tax rate gap on employment income has been significantly narrowed to the point that it is viewed as a significant federal tax problem that has been fixed.

Appendix 1.2 compares the highest marginal personal tax rates on capital gains in BC with the equivalent rates in Washington, Oregon, California, Texas, Massachusetts and Georgia over the period 1998 through 2003. Here the BC rate benefits not only from the rate reductions for general income but also from the decline in the capital gains inclusion rate from 75% to 50%. Although the 1998 BC rate for capital gains of 40.6% was the highest amongst the 7 jurisdictions, by 2003 it was only 21.8%, significantly better than the 29% rate (approx.) in Oregon and California and only slightly higher than Washington and Texas at 20%. Further, in BC's favour, there is also the potential for Canadian resident individuals to claim the \$500,000 lifetime capital gains exemption.

Appendix 2.1 compares the highest general corporate tax rates on general business income in BC with the equivalent rates in Washington, Oregon, California, Texas, Massachusetts and Georgia over the period 1998 through 2003. The results of the corporate rate comparisons are similar to the personal rate comparisons. BC's general corporate rate has dropped from 45.6% in 1998 to 37.6% in 2003¹. The US rates were very static with the result that BC is the 3rd lowest tax rate of the seven jurisdictions, behind Washington and Texas, but ahead of Georgia, Oregon, California, and Massachusetts.

Appendix 2.2 compares the highest general corporate tax rate on capital gains in BC with the equivalent rates in Washington, Oregon, California, Texas, Massachusetts and Georgia over the period 1998 through 2003. As a result of rate reductions and reductions in the capital gains inclusion rate from 75% to 50%, BC's corporate tax rate for capital gains has dropped from 34.2% to 18.8%, far ahead of the equivalent rates for the selected US jurisdictions which are still generally in the mid to high 30s.

BC and Canada are both doing much better with their tax rates. Industry leaders recognize the efforts of the federal and provincial authorities to improve industry's competitiveness. There is, nonetheless, a continuing need to keep up the pressure on the federal and provincial governments.

Corporate Federal Tax Issues

SR&ED Eligibility for 35% Refundable Investment Tax Credits

Although BC's high tech industry has firmly established itself over the last decade, there are still relatively few corporations with sufficient profits to pay corporate income tax. Not surprisingly, most of the concerns relating to corporate tax regime for high tech companies centre on the federal Scientific Research and Experimental Development ("SR&ED") program and the related investment tax credits.

The SR&ED program and the attitudes of its administrators and beneficiaries have had ups and downs over the years. Low spots were the mid to late 1980s after the related scientific research tax credit ("SRTC") program was withdrawn amidst allegations of flagrant abuses by promoters and in the 1990s after the banks and other non-high tech companies made large multi-year software claims in 1994 that were challenged by the media and politicians. To their credit, CCRA has committed to improving service and delivery times.

Currently, there is a general perception that the SR&ED program is working fairly well in Vancouver.

Our CFO survey solicits input on:

- Experiences with CCRA office attitudes and processes;
- Appropriateness of current eligibility tests (Canadian-controlled private corporation ("CCPC") status, size limits, and taxable income limits) for refundable investment tax credits; and

¹ With a further proposed decrease to 35.2% for 2004.

- Alternative delivery mechanisms for tax assistance to research and development activities.

The single biggest issue that we have currently identified relative to SR&ED is the ongoing appropriateness of the eligibility tests for high rate refundable investment tax credits, particularly the requirement that the corporation be a CCPC.

Investment tax credits are generally earned at a rate of 20% of the amount of qualified SR&ED expenditures for the year. These 20% investment tax credits may only be applied to offset federal income tax otherwise payable. If there is no federal tax owing in the current year, there is no immediate cash benefit to the corporation but the credits may be carried back 3 years or forward 10 years to offset federal tax payable in those years. The 20% investment tax credits are only of benefit when the corporation is taxable.

Qualifying corporations are entitled to a 35% investment tax credit that is fully refundable² on the first \$2 million³ of expenditures each year. Even when the corporation is not taxable, the refundable tax credits provide a significant cash benefit to assist in the funding of research and development activities. In general terms, high rate refundable status will result in up to \$700,000⁴ of additional annual cash flow to a corporation.

A qualifying corporation is essentially a corporation that:

- Was a CCPC throughout the particular taxation year; and
- Had taxable income of less than \$200,000⁵ in the prior taxation year.⁶

To be a CCPC, a corporation must essentially be a corporation that is private and not controlled by any combination of public companies or non-residents (regardless of whether they have any common interest other than their shareholding in the same corporation). CCPC status is a condition for eligibility for many tax incentives and preferences delivered through the Income Tax Act.

The appropriateness of CCPC status for high rate refundable investment tax credits, in particular, is increasingly questioned given the relatively small Canadian venture capital markets, the cross-border nature of high tech firms and the global economy. Canadian attitudes about foreign investment have

² With the exception of capital SR&ED expenditures where there are special rules.

³ The \$2 million annual expenditure limit is shared with associated corporations.

⁴ Assuming a 35% refundable investment tax credit on \$2 million of qualifying current expenditures as compared to earning a 20% non-refundable investment tax credit.

⁵ Proposed to increase to \$300,000 as a result of 2003 Federal Budget.

⁶ As outlined in this note, it is possible to get a reduced claim for the 35% credit where prior year taxable income exceeds the \$200,000 threshold. The rules also require that the qualifying corporation's taxable capital be below \$10 million to get the maximum high rate refundable investment tax credit. Special rules apply if the corporation is associated with other corporations. The enhanced benefit is reduced on a sliding scale when taxable income of the associated group is in excess of \$200,000 in the prior year. As a result, the 35% rate is completely eliminated when taxable income reached \$400,000. Under the 2003 Budget Proposals, the phase-out between \$200,000 and \$400,000 will change to between \$300,000 and \$500,000. The same sliding scale reduces the 35% rate by the taxable capital of the associated group in excess of \$10 million in the prior year and is eliminated when taxable capital reaches \$15 million. The phase-out based on taxable capital is not changed under the 2003 Budget Proposals.

generally grown more positive over the last 30 years. The reality of the financial capabilities of public corporation has also changed over time. There are two separate concerns:

- Should a private corporation that is successful in attracting foreign sourced capital be severely penalized?
- Should a public company be denied access to the tax assistance that investment tax credits provide, particularly in a tax year when it is not generating taxable income (and by extension, cash profits)?

Relative to the first point, Canada should be encouraging the investment of foreign capital in a sector that would clearly benefit from additional capital attraction.

Many high tech corporations are successful in attracting US or other foreign source venture capital. In some cases the foreign investor will be a strategic business partner that is essential for the successful deployment of the Canadian company's technology. For those corporations that actively monitor their CCPC status, foreign investment is sometimes shunned, particularly where the foreign investor seeks a large position. This lack of interest by the Canadian corporation may be completely at odds with its commercial and capital objectives.

The test for CCPC status is not as straightforward as it might be as rights to convert to voting shares and *de facto* control are taken into account. Sometimes, corporations inadvertently lose their CCPC status.

Public companies were presumably excluded from the high rate refundable system as they have alternative sources of capital. Smaller early stage public companies have queried why they are not entitled to high rate refundable investment tax credits given their challenges in attracting market interest. Their cry rings true in today's depressed equity markets.

Our preliminary view is that the availability of high rate refundable investment tax credits should be extended to all corporations regardless of Canadian-controlled, private or public status.

We recognize that size restrictions based on capital and taxable income will still be required, but we will consider these limits more carefully.

Tax Loss Carryforward Period

In Canada, a corporation can carryforward its unused business losses for seven years⁷. Many high tech companies formed in the mid-1990s are now starting to have concerns about loss carryforward expiry. The long development cycle for many high tech sectors (e.g. biotechnology, fuel cell technology, etc.) is not adequately recognized in the Canadian tax rules.

The US recently increased its longstanding 15-year carryforward period for corporate business losses to 20 years. Canada has not revisited its loss carryforward rules since 1984.

Our preliminary view is that the federal tax rules should be changed to reflect a 20-year carryforward period. This is a change that will be relatively easy, and presumably not too costly, for the Department of Finance to implement.

Federal Large Corporation Tax

⁷ Unclaimed SR&ED expenditures may be carried forward indefinitely.

As discussed, high tech companies often do not become profitable for a long period of time. Large amounts of capital are required to fund the technology development and business expansion to economic levels. The imposition of capital taxes at both the federal and provincial levels has been an additional challenge to corporations trying to establish themselves.

The BC corporate capital tax will be eliminated for virtually all corporations in September 2003.

The Federal Large Corporations Tax ("LCT") is levied annually at a rate of 0.225 per cent of a corporation's taxable capital employed in Canada in excess of \$10 million. For taxation years ending after 2003, the 2003 Federal Budget proposes the threshold for application of the LCT will rise to \$50 million of taxable capital employed in Canada. In addition, the LCT rate will decrease:

- 0.200% for 2004;
- 0.175% for 2005;
- 0.1255 for 2006; and
- 0.0625% for 2007.

For years after 2007, the federal LCT will be eliminated.

Large high tech companies with taxable capital in excess of \$50 million will be adversely affected by the slow phase-out to 2008. After further community consultation, we will have to evaluate whether a quicker phase-out is an industry priority.

Personal Federal Tax Issues

Stock Options

There are two principal issues relating to stock options that we have identified to date:

- Significant complexity arising from the layering over of two tax regimes for each of the incentives noted above; and
- Problems with employees triggering employment income on the exercise of stock options⁸ and then, as a result of market declines, realizing a large capital loss which can only be claimed against capital gains.

In the early 2000s, there have been many industry challenges with underwater options. Tax professionals noted significant problems with the federal tax rules relative to the repricing of stock options. The concern was the adverse impact of repricing on the employee's entitlement to the special 50% stock option deduction. The federal tax rules were corrected in December 2002 technical proposals to facilitate the repricing of stock options while maintaining the 50% deduction

Stock options have been a significant component of high tech employee compensation packages over much of the last 15 years. Stock options provided employer corporations with the ability to offer employees additional compensation without negatively impacting corporate cash flow. The economic

⁸ The reporting of the stock option employment income may be deferred until the actual sale under either the CCPC stock option rules or the newer public company deferral rules introduced in the 2000 Federal Budget.

upside of options was also very attractive to potential employees when the equity markets were strong and the options served as a powerful recruiting tool for high tech employers.

Federal tax incentives for employee stock options are available as:

- A deferral of the taxation of the employment benefit until the sale of the shares⁹; and
- A special 50% tax deduction to bring the amount of income subject to tax to the equivalent of a capital gain.

Unfortunately, there are two separate ways to get each of these incentives. A deferral is available for most options issued by CCPCs. As a result of changes introduced in the 2000 Federal Budget, employees with certain public company options can also elect a deferral within specified dollar limits. The special 50% deduction can be achieved on certain CCPC options where the shares are held for a further 2 years regardless of how the strike price on the options was set. A separate rule provides the 50% deduction for options regardless of CCPC status so long as the strike price is not less than the fair market value of the shares.

Employees may hold identical shares that have totally different tax attributes as they were acquired under the following circumstances:

- With CCPC options (so the stock option benefit is deferred until the time of sale);
- With options granted when the employer was a private corporation not eligible for CCPC status (no deferral);
- With options granted by a public corporation on which the employee elected to defer the stock option benefit until the time of sale;
- With options granted by a public corporation on which the employee has been taxed on the stock option benefit;
- Purchased by subscription while the company was a private corporation; and
- Purchased in the open market while the company was public.

As there are these various sources of shares, a host of detailed tax rules relating to the pooling of various sources, ordering of option exercises, ordering of share dispositions, cost base calculations, calculating the gains on quick flips, etc. are provided in the Income Tax Act. Since the introduction of the public company rules and a number of related changes in the 2000 Budget, the rules have become so complicated that an employer has great difficulty giving employees anything other than the most basic tax advice on the consequences of exercising their options and selling the shares.

The complexities relate to the layering on of the public company deferral rules over the general rules and the special CCPC rules. It may be appropriate to consider a re-write of the rules.

Why not have a set of rules for so-called “good” options and one for “not so good options”? In principal, should the employees of both public company and CCPCs be entitled to a deferral of the taxation of their option benefit while non-CCPC private corporation employees are not?

⁹ Otherwise the benefit is taxed on the acquisition of the shares pursuant to the exercise of the option.

The US has a system that recognizes “good options” and “not so good” options. The “good” options (referred to as Incentive Stock Options or “ISOs”) qualify for a deferral and capital gains treatment. The “not so good” options (referred to as Non-qualifying Stock Options’) have ordinary employment income treatment, do not qualify for a deferral and are taxed at the time of the acquisition of the shares. While there are a number of requirements for an option to be an ISO, many of them deal with the attributes of the plan, but there are also holding period requirements. Conceptually, the key determinant in the classification is whether or not the strike price is equal to or greater than the fair market value of the shares at the time that the option is granted. If the employee is not getting a bargain, the options will be eligible for ISO treatment if the other requirements are met.

A separate but significant and longstanding problem that has caused tremendous hardship for some employees who have exercised stock options also needs to be addressed. It centres on the characterization of the stock option benefit (the difference between the strike price paid for the share and the fair market value of the share at the time of the acquisition of the share) as “employment income” (albeit only 50% subject to tax in most cases) with the subsequent increase or decrease in the value of the share between the time of acquisition to the time of sale as a capital gain or capital loss, as the case may be. If the share price increases during the holding period, the economic gain is taxed as a capital gain and that is satisfactory. If the share price declines during the holding period, however, the individual realizes a capital loss. One-half of the capital loss can be deducted against the taxable half of capital gains realized in the year or carried back to offset capital gains realized in the previous three years. If the employee has no capital gains to offset, the capital loss must be carried forward. The economic loss since exercise becomes a trapped capital loss.

This issue has been a problem since at least the mid-1980s. It regularly resurfaces as a significant concern after sharp stock market declines. It has been a big problem for many high tech employees who acquired shares in the market run up in the late 1990s and continued to hold the shares as the market plunged in Spring 2000. Colleagues at KPMG LLP recently initiated a call for review of this issue with senior Department of Finance officials. It was recommended that the employee be entitled to apply 50% of the capital loss against the taxable portion of the employment benefit.

In early May 2003, KPMG LLP received a response stating that the Department of Finance was satisfied with the trapped capital loss result as the employee after exercise was essentially an investor who made an investment decision to hold the shares. This is an oversimplification. The employee may be required under a shareholders agreement or other agreement to continue to hold the shares. The employee may have even decided to hold the shares for two years to qualify for the 50% stock option deduction for CCPC options. The tax regime impacts the employee’s behaviour. It is also worth noting that the public company deferral rules were introduced in the 2000 Federal Budget just as the stock market was peaking. Employees who acted on this opportunity and exercised to hold public company shares set themselves up for the trapped capital loss scenario. The Finance position also does not give adequate recognition to the fact that the employee has been required to pay tax on the employment benefit that is just a paper gain. This is very different than the ordinary investor. Another distinguishing factor is that many employees are not investors and may never realize capital gains on other investments to be able to use up the trapped capital loss.

Industry needs to keep up the pressure on the Department of Finance on the treatment of trapped capital losses after stock option exercises. This could be fixed as part of a major re-write of the stock option rules or as a stand-alone amendment.

Investor Federal Tax Issues

New High Tech Flow-through Shares or Tax Credit Vehicle

Based on our preliminary review, there is a fairly strong sense in the BC high tech community that Canada needs an investment vehicle to flow out tax benefits to high tech investors in the form of deductible expenses or investment tax credits that are otherwise left unclaimed in Canadian corporations to investors in high tech corporations. The experience with labour sponsored venture capital funds and resource industry flow-through shares has indicated that significant amounts of investment capital can be attracted if tax incentives are provided to the retail investor.

As discussed above in connection with the eligibility for the SR&ED program, many investment tax credits are stockpiled within corporations with no immediate prospects for monetization. It may be appropriate to allow a corporation to effectively provide investors with investment tax credits that the corporation cannot, or does not expect, use. The credits would then reduce the investor's economic cost of the investment.

The introduction of an investment vehicle to flow out credits to high tech investors will not be an easy-sell to the Department of Finance. Ottawa will have a long memory relating to its experiences with the SRTC program in the mid 1980s. Under that program, corporations were able to give investors a 50% federal tax credit when they invested in shares or debt issued by the corporation. The corporation thereby incurred a tax liability equal to the 50% tax credit that could be eliminated by effectively designating sufficient amounts of qualifying SR&ED expenditures to offset the liability. This mechanism placed the risk relating to the eligibility of the SR&ED on the shoulders of the corporation. That was one of the objectives of the structure. The SRTC program was extremely popular and it quickly replaced the R&D limited partnerships that were introduced in the early 1990s. The significant investor interest in the program caused the Department of Finance some anxiety concerning the estimated costs of the program. CCRA also contributed to the concerns about the program in Ottawa by providing rulings that allowed investors to "flip" their investments but still earn the tax credits. Perhaps most significantly, The quick popularity of the SRTC together with its cash up front attributes attracted some promoters who had little interest in conducting SR&ED activities. For a variety of reasons, a number of corporations failed to carry out eligible SR&ED activities and the federal government was left "holding the bag" on millions of dollars of SRT credits. The SR&ED program was abandoned after 1985.

We intend to review the appropriateness of recommending a revival of the federal Share Purchase Tax Credit ("SPTC") program which was introduced for a short time in the mid-1980s to flow out corporate investment tax credits for a relatively short time. Although it did not gain the notoriety of the SRTC program, it was abandoned after 1986, shortly after the demise of the SRTC program¹⁰. Alternatively, we will consider appropriate modifications to the program.

It should be recognized that this proposal will not attract foreign investment capital (unless the credits are payable to non-residents).

Capital Gains Rollover for Small Business Investors

The capital gains rollover was introduced in the 2000 Federal Budget when the equity markets were still strong. It allowed individuals to defer recognition of some or all of their capital gains arising on the disposition of an eligible small business investment when the proceeds are reinvested in other eligible

¹⁰ Interestingly, the federal tax legislation for both the SRTC and SPTC programs has not been repealed. The rules are still part of the Income Tax Act. The programs were shut down by adding rules that prevent corporations from making the necessary designations after 1985 and 1986 respectively.

small business. The deferral was only available with respect to the first \$2 million of the individual's original investment. There were no limits on the total amount that could be reinvested, but no more than \$2 million reinvested in shares of any particular company or related group qualified for the deferral. In addition, a very short timeframe was provided for reinvestment.

The 2003 Federal Budget proposes to eliminate the \$2 million limit on original and reinvested amounts for purposes of the deferral. The Budget also proposes to extend the period in which a reinvestment qualifying for the deferral may be made.

Our Committee will review this provision with the investment community to ensure that it offers a strong incentive.

Preliminary Recommendations:

The points we expect to include in our final recommendations include:

- Encourage the Federal Government to keep up the pressure on lowering tax rates.
- Extend the eligibility for high rate refundable SR&ED investment tax credits to include all public corporations and private corporations that are not CCPCs.
- Extend the carryforward period for corporate loss carryforwards from 7 years to 20 years.
- Simplify the stock option rules. Consider two rules: one for "good" options; another for "not so good" options similar to the US Incentive Stock Option rules.
- Correct the longstanding tax inequity that occurs when an employee realizes a capital loss on shares acquired through employee stock options by allowing the employee to deduct the loss against the taxable amount of the related employee stock option benefit.
- Encourage the Federal Government to implement a flow-through share or tax credit vehicle for high tech investors.

The Subcommittee looks forward to working with the BCTIA to advance these and other federal tax concerns.

Bill Macaulay, KPMG
Responsible Subcommittee Member



BCTIA CAPITAL & INVESTMENT COMMITTEE

JUNE 2003 FINAL REPORT

Next Steps

The individual recommendations of this Committee are set forth in the body of the Report above. There are more than 40 separate recommended steps to be taken or policy initiatives to be put forward.

The Board of the BCTIA has approved and adopted this Report and the recommendations set forth herein and agreed with the following implementation plan:

1. Formulate three working groups of the Capital & Investment Committee as follows:
 - (a) **Private Equity Working Group** – to further examine, consolidate and begin implementation of the recommendations set forth in **Objectives 1** and **2** relating to improving access to Angels and fostering the relationship with local Venture Capitalists.
 - (b) **Public Markets Working Group** - to further examine, consolidate and begin implementation of the recommendations set forth in **Objective 4** regarding facilitating access to public capital.
 - (c) **Tax Reform Working Group** – to further examine, consolidate and begin implementation of the recommendations set forth in **Objectives 7** and **9** regarding tax reform.
2. Implement the website resource referred to in **Objective 8** to facilitate member access to government loan and grant programs.
3. Continue to examine how the labour sponsored fund program might be improved to better serve the BC technology community - **Objective 6**.
4. Support the Global Markets Committee with its initiatives to expand channels to US angel and venture capital – **Objective 3**.

Private Equity Working Group

The recommended steps and policy positions to come under the auspices of this working group include the following. These will be reviewed by the working group, consolidated where appropriate and implemented:

- Develop a marketing function to attract US venture capital into BC companies and expand BC's high net worth individuals not currently investing in technology companies to invest in local companies.
- Continue and accelerate its efforts to actively market BC as a high tech centre of excellence. This should not be done on a single investor basis, but part of a larger campaign with the assistance of the provincial government.
- Consider and determine if it would be appropriate to mandate labour funds and/or provincial pension funds to invest some portion of their funds in early stage companies in B.C. This could include requiring some of the VCC allocation to be directed to seed investments in early stage companies.

- Establish a percentage that the tax sheltered pension funds must invest in B.C. outside of Vancouver to support the Provincial Government's Heartland strategy.
- Facilitate angel investment fund matching. Establish a seed funding arrangement so that when private sector investments are made in early stage technology companies, additional funding can be sourced. This could be done in conjunction with the previous recommendation and may include the creation of a VCC fund in which Angels could invest directly. A different model to further explore would be a U.S. program which provides guarantees to banks who loan money to early stage companies who receive private sector equity funding.
- Facilitate bank financing for two situations:
 - When companies have firm orders from Canadian customers that need the working capital for order fulfillment.
 - SR&ED investment tax credit claims.
- Encourage business development efforts spearheaded through local (municipal) government offices, such as cluster analyses and subsequent targeted investment promotion (i.e. city-sponsored angel forums and CEO roundtables with Mayor and Council).
- Working with the *Tax Reform Working Group*, work to:
 - improve tax deductibility of Angel investment – expand the "flow-through share" program from the resource and exploration industry to the technology sector.
 - retain the refundable aspect of SR&ED investment tax credits for small technology companies on Canadian stock exchanges.
- Support the *Public Markets Working Group* in its efforts to secure regulatory reform as it relates to reducing the cost of going public (to provide incentive for early stage investors and investing).
- Support the *Global Linkages Committee* of the *BCTIA* in its efforts to continue to brand BC as a place for investment, including supporting that Committee's efforts to expand access to US angels and venture capitalists including:
 - arranging a number of road shows portraying Canada's innovation nation across the US and, in particular, BC.
 - organizing multiple venues and visibility for BC technology companies in Seattle and Silicon Valley.
- Gather data from leading technology centres to identify best practices and specific goals, and then monitor data over time to track our progress.

Public Markets Working Group

The recommended steps and policy positions to come under the auspices of this working group include the following. These will be reviewed by the working group, consolidated where appropriate and implemented:

- Reduce costs of Going Public by avoiding onerous regulation that the U.S. is currently implementing. Three developments that should be supported and/or investigated, together with the *Private Equity Working Group* who first recommended these three steps, further include:
 - Supporting the B.C. Securities Commission proposed principles based regulatory environment as opposed to the detailed rules based that the U.S. and Ontario are implementing.
 - Support the CNQ. The Canadian Trading and Quotation System Inc. (CNQ) created a new marketplace for trading the equity securities of qualified Ontario Reporting Issuers by participating Investment Dealers Association of Canada members.
 - If appropriate, harmonize securities regulation across Canada to reduce cost.

Working with the Ministry for Competition in British Columbia, the TSX and the B.C. Securities Commission, undertake the following:

- Support the B.C. Minister for Competition in negotiations with his Ministerial counterpart in Alberta regarding initiatives required to streamline the TSX Venture Exchange Rules and procedures to promote business growth and financing for technology companies. Specifically, work to resolve the stalemate with respect to the revisions to the TSX Venture Exchange Policies between the British Columbia and Alberta Securities Commissions - the two co-regulators of the junior exchange - which has resulted in a significant disincentive for companies to list on the TSX Venture Exchange as the timing and cost of listing through an RTO, CPC Qualifying Transaction or IPO are prohibitive. The objective would be to suggest that the Exchange's Rules may be revised to reflect business realities and present a viable alternative for raising capital in British Columbia.
- In the event that a positive result cannot be obtained, support the "B.C. Model" of regulation proposed for adoption by the BCSC. If this becomes necessary, secure the support of other interest groups such as BC Biotech, other industry associations and the TSX Listed Company Association.
- Establish a liaison with the TSX Venture Exchange, B.C. Securities Commission and Investment Dealers Association to ensure that each is made aware of the progress of the working group, and to ensure feedback and an open channel.
- Approach the IDA to establish a public venture capital committee to address the needs of its members who participate in the local market. The goal is to establish appropriate guidelines and rules particular to the unique nature (ie. junior) of the public venture capital market as it exists in Western Canada (as compared to that in Ontario and Quebec).
- Working with the *Tax Reform Working Group*:
 - work to increase capital raising incentives (Investment Tax Credits) so that they are consistent with the financing requirements of the growing BC technology sector. This includes addressing the changes needed to existing caps and restrictions on venture capital Investment Tax Credits to stimulate growth of the public venture capital market. Also, work to ensure that the "direct investment" provision enacted in the revised Small Business Venture Capital Act can be accessed by public companies, and

- lobby the federal government to treat SR&ED credits equally between private companies which now receive a 35% SR&ED Tax Credit, and public companies which now receive a 20% SR&ED tax benefit carry forward.
- Encourage industry research experts to consider providing a report on the state of public venture capital financing as it relates to the technology industry in B.C, similar to that provided on private equity investment into the technology sector in B.C.

Tax Reform Working Group

The recommended steps and policy positions to come under the auspices of this working group include the following. These will be reviewed by the working group, consolidated if appropriate and implemented (with the assistance of the other working groups as noted above):

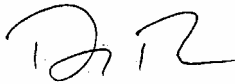
- Regarding stock options:
 - Propose to the federal government that deductibility of stock option benefits at the corporate level would promote consistency with proposed changes in accounting policy as well as the income tax treatment of stock options in many other countries.
 - Propose that the provincial government develop personal tax proposals specifically directed at attracting and retaining highly skilled technology workers including adoption of a 60 month provincial tax holiday for highly skilled technology workers in specific fields of technology and introduction of a B.C. stock option deduction.
 - Simplify the stock option rules. Consider two rules: one for “good” options; another for “not so good” options similar to the US Incentive Stock Option rules.
- Correct the longstanding tax inequity that occurs when an employee realizes a capital loss on shares acquired through employee stock options by allowing the employee to deduct the loss against the taxable amount of the related employee stock option benefit.
- Propose to the Federal Government the elimination of the withholding tax levied on fees paid to non-residents of Canada would eliminate considerable administrative complexity built into the Canadian tax system and reduce the cost of doing business with non-residents.
- Regarding the SRED Program:
 - Propose to the provincial government that the B.C. SR&ED tax credit program remove its sunset clause of September 1, 2004. This program should be continued indefinitely as it is an important source of capital for technology corporations.
 - Lobby the federal government to treat SR&ED credits equally between private companies which now receive a 35% SR&ED Tax Credit, and public companies which now receive a 20% SR&ED tax benefit carry forward.
 - Extend the eligibility for high rate refundable SR&ED investment tax credits to include all public corporations and private corporations that are not CCPCs.
- Propose to the provincial government changes to the International Financial Business (Tax Refund) Act to expand the definition of an eligible “international financial activity” to include SR&ED technology licencing transactions that would otherwise occur in offshore tax jurisdictions.

- Introduce to the provincial government changes to the Assessment Act regarding the valuation of assets for property tax purposes in light of the unprecedented downturn in the high tech market.
- Extend the carry-forward period for corporate loss carryforwards from 7 years to 20 years.
- Encourage the Provincial and/or Federal Governments to implement a flow-through share or tax credit vehicle for high tech investors.
- Encourage the Provincial and Federal Governments to keep up the pressure on lowering tax rates.

Conclusion

The Capital & Investment Committee will oversee the three working groups and continue to monitor the issue of access to capital to ensure that other initiatives are taken as and when appropriate.

Respectfully submitted,



David J. Raffa, Chairman
Capital & Investment Committee
draffa@catalyst-law.com
604-443-7014

APPENDICES

APPENDIX 1.1

Personal Tax Rates Employment Income

*Combined Federal & State
or Combined Federal & BC*

| | BC | Washington | Oregon | California | Texas | Massachusetts | Georgia |
|------|--------------|-------------------|---------------|-------------------|--------------|----------------------|----------------|
| 1998 | 54.2% | 39.6% | 45.0% | 45.2% | 39.6% | 43.2% | 43.2% |
| 1999 | 52.3% | 39.6% | 45.0% | 45.2% | 39.6% | 43.2% | 43.2% |
| 2000 | 51.3% | 39.6% | 45.0% | 45.2% | 39.6% | 43.1% | 43.2% |
| 2001 | 45.7% | 39.6% | 45.0% | 45.2% | 39.6% | 43.1% | 43.2% |
| 2002 | 43.7% | 38.6% | 44.1% | 44.3% | 38.6% | 41.9% | 42.3% |
| 2003 | 43.7% | 38.6% | 44.1% | 44.3% | 38.6% | 41.9% | 42.3% |

Above rates reflect the top marginal tax rate.

APPENDIX 1.2

Personal Tax Rates Capital Gains

*Combined Federal & State
or Combined Federal & BC*

| | BC | Washington | Oregon | California | Texas | Massachusetts | Georgia |
|------|-----------------------|-------------------|---------------|-------------------|--------------|----------------------|----------------|
| 1998 | 40.6% | 28.0% | 37.0% | 37.3% | 28.0% | 33.0% | 34.0% |
| 1999 | 39.2% | 20.0% | 29.0% | 29.3% | 20.0% | 26.0% | 26.0% |
| 2000 | 34.2% (Note 1) | 20.0% | 29.0% | 29.3% | 20.0% | 25.9% | 26.0% |
| 2001 | 22.8% | 20.0% | 29.0% | 29.3% | 20.0% | 25.9% | 26.0% |
| 2002 | 21.8% | 20.0% | 29.0% | 29.3% | 20.0% | 25.0% | 26.0% |
| 2003 | 21.8% | 20.0% | 29.0% | 29.3% | 20.0% | 25.0% | 26.0% |

(Note 1) The capital gains inclusion rate decreased from 75% to 66 2/3% effective February 27, 2000 and to 50% effective October 17, 2000. The 2000 rate reflects a 66 2/3% inclusion rate while the 2001 and subsequent rates reflect a 50% inclusion rate.

Above rates reflect the top marginal tax rate.

APPENDIX 2.1

Corporate Tax Rates General Business Income

*Combined Federal & State
or Combined Federal & BC*

| | BC | Washington | Oregon | California | Texas | Massachusetts | Georgia |
|------|--------------|-------------------|---------------|-------------------|--------------|----------------------|----------------|
| 1998 | 45.6% | 34.0% | 38.4% | 40.1% | 37.0% | 40.3% | 38.0% |
| 1999 | 45.6% | 34.0% | 38.4% | 39.8% | 37.0% | 40.3% | 38.0% |
| 2000 | 45.6% | 34.0% | 38.4% | 39.8% | 37.0% | 40.3% | 38.0% |
| 2001 | 44.6% | 34.0% | 38.4% | 39.8% | 37.0% | 40.3% | 38.0% |
| 2002 | 39.6% | 34.0% | 38.4% | 39.8% | 37.0% | 40.3% | 38.0% |
| 2003 | 37.6% | 34.0% | 38.4% | 39.8% | 37.0% | 40.3% | 38.0% |

Above BC rates apply to a non CCPC earning general business income while the State rates apply to business income within the tax bracket US \$335,000 - US \$10,000,000. Generally, slightly higher rates apply for income over US \$10,000,000.

APPENDIX 2.2

Corporate Tax Rates Capital Gains

*Combined Federal & State
or Combined Federal & BC*

| | BC | Washington | Oregon | California | Texas | Massachusetts | Georgia |
|------|-----------------------|-------------------|---------------|-------------------|--------------|----------------------|----------------|
| 1998 | 34.2% | 34.0% | 38.4% | 40.1% | 37.0% | 40.3% | 38.0% |
| 1999 | 34.2% | 34.0% | 38.4% | 39.8% | 37.0% | 40.3% | 38.0% |
| 2000 | 30.4% (Note 1) | 34.0% | 38.4% | 39.8% | 37.0% | 40.3% | 38.0% |
| 2001 | 22.3% | 34.0% | 38.4% | 39.8% | 37.0% | 40.3% | 38.0% |
| 2002 | 19.8% | 34.0% | 38.4% | 39.8% | 37.0% | 40.3% | 38.0% |
| 2003 | 18.8% | 34.0% | 38.4% | 39.8% | 37.0% | 40.3% | 38.0% |

Note 1 The capital gains inclusion rate decreased from 75% to 66 2/3% effective February 27, 2000 and to 50% effective October 17, 2000. The above 2000 rate reflects a 66 2/3% inclusion rate while the 2001 and subsequent rates reflect a 50% inclusion rate.

Above BC rates apply to a non CCPC earning general business income while the State rates apply to business income within the tax bracket US \$335,000 - US \$10,000,000. Generally, slightly higher rates apply for income over US \$10,000,000.