

February 17, 2010

The Right Honourable Stephen Harper  
Prime Minister of Canada  
Office of the Prime Minister  
80 Wellington Street  
Ottawa, ON  
K1A 0A2

Dear Prime Minister Harper,

I am writing on behalf of the Premier's Technology Council of British Columbia to follow up on the issue of Section 116 of the *Income Tax Act* that you and I discussed recently at the World Economic Forum in Davos.

On November 24<sup>th</sup>, 2009, the Premier's Technology Council held a round meeting with key members of British Columbia's venture capital community to discuss the challenges surrounding venture capital in Canada today. With most of Canada's major capital investors now distancing themselves from venture capital, the scarcity of funds to help our companies grow is becoming acute. In discussing ways to address this challenge it was clear that the most significant positive step that could be taken would be to remove the barrier to foreign investment created by Section 116 of the *Income Tax Act*.

When investing in Canada, US venture capital firms are subject to Section 116 in spite of being nominally exempt from Canadian taxes under the Tax Treaty. This requires a non-resident that disposes of certain taxable Canadian property (TCP) to notify the government and either pay the tax or provide a security payment order to receive a certificate of compliance. The CCRA will then settle out after an income tax return has been filed. The implications of this requirement are:

1. Obtaining a clearance certificate requires a signature for every investor in the fund. Many of these funds have multiple investors which can require hundreds of applications and hundreds of signatures for each transaction.
2. It can take four to eight months for the certificate to clear and the buyer must withhold 25% of the gross proceeds until the certificate is granted. If there is a decline in the market during this waiting period the stock value could drop at significant cost to the investor.
3. The US investors must obtain Canadian taxpayer ID numbers and file Canadian income tax returns in order to ultimately receive the withheld tax – even though, in most cases, no tax is owed as foreign investors are exempt under the treaty.

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4. Many US venture firms are prohibited by their own charters from investing in countries where foreign or private tax returns must be filed by their investors.
  5. To avoid the expense and time caused by Section 116 many investors try to reorganise the Canadian investee company into a subsidiary of a Delaware holding corporation. This also represents a significant expense in terms of money and time.

The difference between the per capital levels of venture capital investment in Canada and the US is already of an order of magnitude and it is growing.

Key measures include:

1. Canadian technology companies raise only one-third the venture capital of U.S. competitors.
2. Canadian VCs raise only one-half capital (GDP/population adjusted) of that raised by U.S. VCs.
3. Much of the \$9 billion in annual Canadian R&D effectively subsidizes U.S. businesses that buy capital-starved Canadian companies.
4. Over the five year period ending in the third quarter of 2008, venture capital investment in Canada as a share of GDP shrunk by a third in Canada yet grew by a fifth in the United States.

There are a number of possible reasons for the differing venture capital investment levels between Canada and the US. However, the venture capitalists at the PTC roundtable all agreed that Section 116 is the largest single contributing factor that both prevents US venture capitalists from coming to Canada to invest their funds, and drives Canadian companies to leave the country in search of better fund raising opportunities.

Amendments have been made in the past to Section 116 but they only amended the clearance certificate process and did little address the overall problem created by this Section. The Premier's Technology Council believes that to address the situation a more significant change needs to be made.

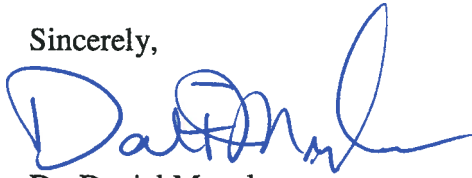
One potential solution was raised by the Canadian Venture Capital Association when speaking on behalf of the venture capital community prior to the 2009 budget. They recommended:

**That the definition of "taxable Canadian property" in the *Income Tax Act* be amended to exclude shares of private companies whose value isn't primarily derived from real estate, resource property or timber property situated in Canada.**

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Thank you for your attention to this matter. If you or your officials have further questions I would be happy to speak with them.

Sincerely,



Dr. Daniel Muzyka  
Dean, Sauder School of Business and  
Chair, Business Environment Task Force  
Premier's Technology Council