VENTURE CAPITAL PROGRAMS

GUIDELINES

CREATING BUSINESS INVESTMENT, INNOVATION AND OPPORTUNITY

Accelerate your access to capital

BRITISH COLUMBIA

Ministry of Competition, Science and Enterprise

Investment Capital Branch

VENTURE CAPITAL PROGRAMS GUIDELINES

These guidelines are provided for information purposes only and do not replace or negate any requirements of the *Small Business Venture Capital Act*, R.S.B.C. 1996, Chapter 429 or the accompanying regulations and program policy statements.

VENTURE CAPITAL PROGRAMS GUIDELINES

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OBJECTIVES

The Equity Capital Program and the Community Venture Capital Program are provincial government sponsored investment capital programs that operate under the *Small Business Venture Capital Act*. These programs are designed to encourage investors to make equity capital investments in British Columbia small businesses that will enhance and diversify the provincial economy.

The Equity Capital Program provides tax credit incentives to stimulate early-stage investment in small businesses throughout the province, while the Community Venture Capital Program assists small businesses located outside of the Greater Vancouver and Capital (Victoria) Regional Districts.

Why Venture Capital

The government of British Columbia recognizes that the creation of new small businesses and the expansion of existing ones will lead to a more healthy economy. Small business now accounts for 98 percent of all businesses in the province and provides 93 percent of all the employment opportunities in the high-technology sectors.

The venture capital programs are designed to ensure that small business has continuous access to early-stage venture capital so that they may continue to lead in the development of new innovation and create job opportunities for all British Columbians throughout the province.

HOW THE PROGRAMS WORK

Investors resident in British Columbia earn tax credits for purchasing shares in either a Venture Capital Corporation or an Eligible Business Corporation registered under the *Small Business Venture Capital Act*.

The programs offer two different investment options:

1. Venture Capital Corporation – portfolio investing

Under this option, program investment is made through a holding corporation known as a Venture Capital Corporation or 'VCC'. The VCC raises investment capital from resident investors and then invests these funds into one or more qualifying small businesses. This investment structure is ideal for investors who want to invest their equity capital with others into a 'fund' that will rely on professional management to select and manage a diverse portfolio of investment opportunities.

2. Eligible Business Corporation – The 'direct' investment approach

Under this option, a small business registers as an Eligible Business Corporation or 'EBC' under the programs. This allows a small business to accept equity capital from investors without having to set up a holding company or VCC. This investment structure is ideal for an investor that is planning to be actively involved in the growth of the small business.

Qualifying small businesses under either program investment structure must, among other legislative criteria, be substantially engaged in activities defined under the regulations to the *Small Business Venture Capital Act* before an investment under the program can be considered eligible. The investments made in the small businesses are made without guarantee of return and must be maintained for at least five years.

To assist in program monitoring, annual returns are filed by VCCs and EBCs with the Investment Capital Branch of the ministry. These returns provide updated financial and corporate information about each VCC and its related small business investment(s), or EBC registered under the programs.

THE TAX CREDIT INCENTIVE

The government of British Columbia provides investors with a tax credit equal to 30 percent of their investment in a VCC or an EBC. To earn a tax credit, the investment may be made within a calendar year or within 60 days of the following year. Corporate investors are also eligible for a provincial tax credit equal to 30 percent of the amount invested in a VCC or an EBC.

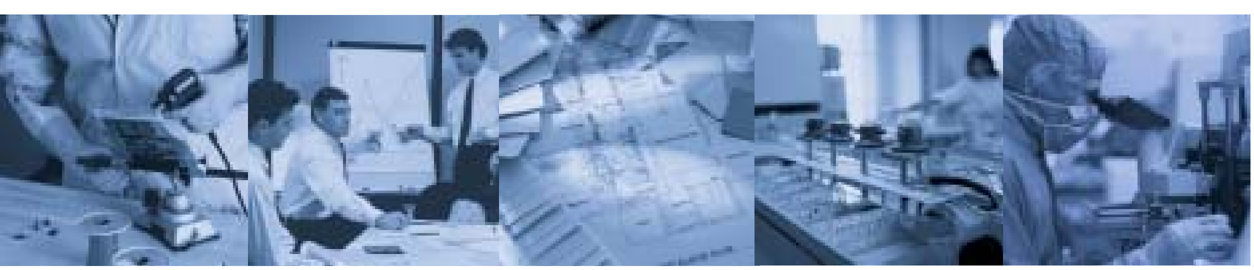
An investor who is an individual must deduct the lesser of the tax credit or $60,000 against tax otherwise payable under the *Income Tax Act* (British Columbia). If a tax credit for an individual exceeds the amount of provincial taxes payable, the individual will be entitled to a refund of the difference between the lesser of $60,000 or the tax credit and the tax otherwise payable, after deducting certain other credits available under the *Income Tax Act* (British Columbia).

The refund must first apply to offset other amounts payable, including arrears under both the *Income Tax Act* (Canada) and the *Income Tax Act* (British Columbia). If an individual has a tax credit in excess of $60,000, the excess may be carried forward and utilized, subject to the $60,000 annual limit, in any of the four subsequent taxation years.

An investor that is a corporation must deduct the tax credit earned in the taxation year from tax otherwise payable under the *Income Tax Act* (British Columbia); there is no annual limit on the tax credit for corporations. A corporation is not entitled to a refund in respect of a taxation year if the amount of the tax credit exceeds the amount of its tax otherwise payable under the *Income Tax Act* (British Columbia) for the taxation year. The corporation can carry forward and utilize any excess tax credit in any of the four subsequent taxation years.

Tax credit incentives are realized through the issuance of tax credit certificates. A VCC or EBC applies to the Administrator of the *Small Business Venture Capital Act* for provincial tax credit certificates on behalf of investors who have purchased newly issued shares. Investors then attach their tax credit certificate to their income tax return to be filed with the Canada Customs and Revenue Agency for processing. Tax credit certificates will be issued only if the VCC or EBC has complied with the technical requirements and the intent of the *Small Business Venture Capital Act* and Regulations.

In summary, the tax credit is refundable for individuals but not for corporations. The 30 percent tax credit is earned when an investor buys shares in a registered VCC or EBC during a calendar year or within 60 days of the year following. The individual must be a resident of British Columbia at the time of buying the shares.



THE VENTURE CAPITAL CORPORATION

A Venture Capital Corporation ('VCC') is a newly incorporated British Columbia company with activities restricted to investing in and providing managerial expertise to small businesses. The VCC, which is similar to a holding company, must invest equity capital in an eligible small business by investing in either voting or non-voting shares of the business. (See diagram overview)

Registration

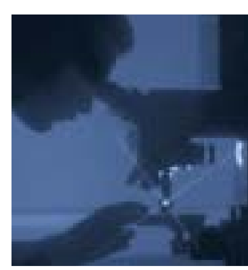
To obtain registration under the programs, the VCC must, among other things:

- Incorporate under the *Company Act of British Columbia*;
- Have a company name that includes the abbreviation 'VCC';
- Have never previously carried on business;
- Raise at least $25,000 of equity capital prior to applying for registration;
- Have authorized capital of one or more classes of no-par-value common shares with no special rights or restrictions except for those that apply to the redemption of shares by the company; and
- Have incorporation documents that limit the company to making investments permitted under the *Small Business Venture Capital Act,* and providing business and managerial expertise to the small business receiving the VCC investment.

Raising investor capital

Once registered, a VCC is provided with approval by the Administrator of the *Small Business Venture Capital Act* to raise equity capital from investors within a certain period of time. The VCC raises equity capital through public or private share offerings, and invests in eligible businesses. VCC investments are not capable of prompt liquidation, but may provide the investor with an opportunity for dividend income or long-term capital appreciation. Generally, there are no capital raising limits for a VCC; however, the annual budget for tax credits restricts how much capital VCCs may raise from investors year to year.

Note: VCC shares are most often offered for sale to investors pursuant to exemptions from the registration and prospectus requirements of the *British Columbia Securities Act*. VCCs should consult with their own personal advisors to ensure all legal requirements are met with respect to the purchase and sale of their shares.



VCC investment requirements

In recognition that it may take time to finalize its small business investments, a VCC need not invest immediately upon registration or when it raises equity capital from investors. The VCC is required to have at least 40 percent of its raised equity capital invested in eligible businesses by the end of its next fiscal year and 80 percent within the second fiscal year following the date of share capital issue. The VCC must maintain this level of investment for at least five years or it may have to repay all or a portion of the tax credits issued to its investors.

Investment protection account

From the date of registration, the VCC must deposit 30 percent of the money it raises in a special bank or trust account called an Investment Protection Account. When the VCC has made or plans to make an eligible investment in a small business, a withdrawal or payment from the account equal to 37.5 percent of the investment amount will be authorized. All of the account funds may be released when at least 80 percent of the equity capital raised by the VCC is placed into one or more eligible investments.

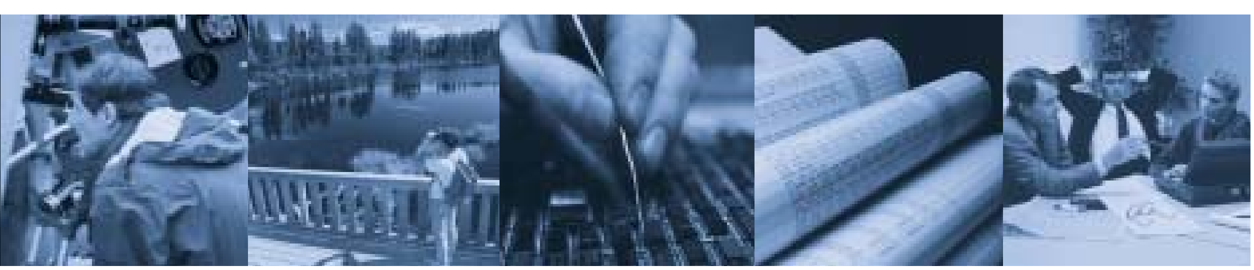
VCC expenses

The VCC may use up to 20 percent of its raised equity capital for administrative expenses such as:

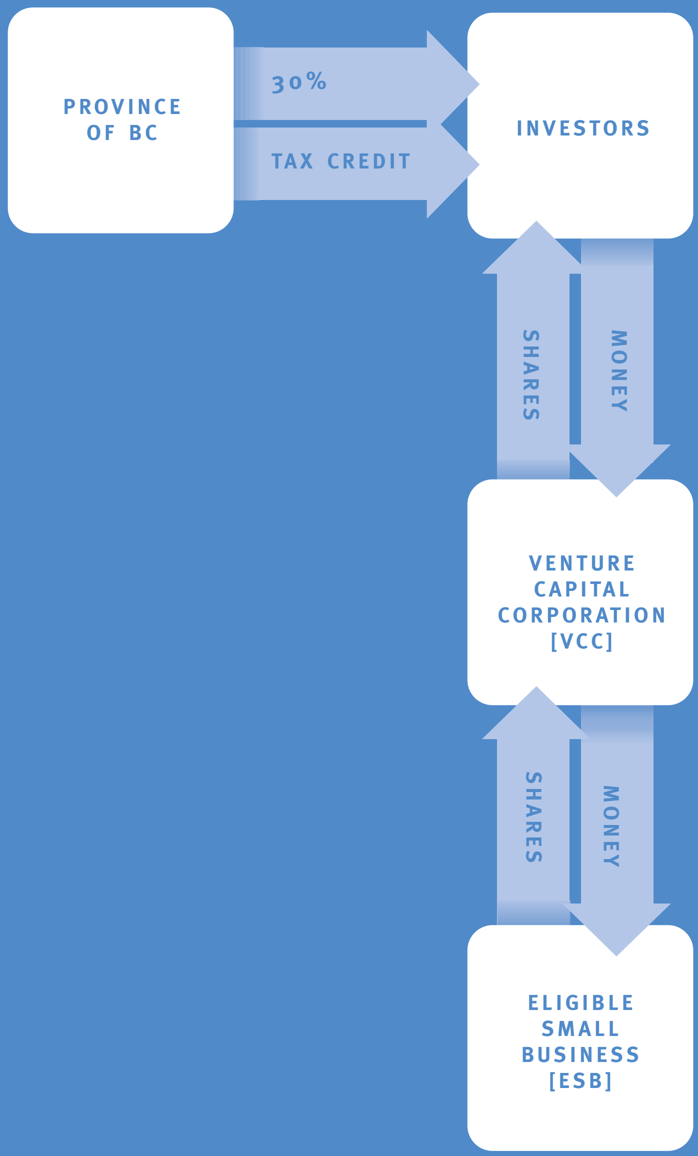
- Share issue costs;
- Office occupancy costs;
- Legal fees;
- Preparation of financial statements;
- Preparation of its annual return; and
- A management fee that does not exceed 3% per annum of the total equity capital raised.

Tax credit liability

Where a VCC has met all the legislative requirements, filed all of its required annual returns and has invested its money appropriately in small businesses for at least five years, its liability to repay tax credits will be removed. If the VCC fails to abide by the legislation, the VCC and the small business, and in some circumstances, their directors, officers or major shareholders may be held jointly liable to repay tax credits to the province.



THE 'VCC' OPTION (THE FOUR PLAYERS)



The VCC:

- Investors are BC residents or taxable corporations.
- Common no-par-value shares (may have multiple Classes).
- Shares redeemable after holding ESB investments for at least 5 years.

The ESB must:

- Have no more than 100 employees at initial investment.
- Pay at least 75 percent of its wages to BC residents (50 percent requirement if engaged in export activity).
- Be substantially engaged in an eligible activity.

The ESB shares:

- Voting or non-voting shares.
- Common or preferred shares.
- May be acquired indirectly by the VCC through an ESB affiliate or limited partnership.

THE ELIGIBLE BUSINESS CORPORATION

An Eligible Business Corporation ('EBC') may be an existing or new small business that wants to raise program capital from arms-length investors ('eligible investors') resident in British Columbia. An EBC registered under the *Small Business Venture Capital Act* may raise capital directly from eligible investors and provide them with a refundable 30 percent tax credit without having to set up a VCC.

Please note that a small business and its investors still have the option of registering a VCC under the program if their particular business needs warrant this investment structure.

Registration

To obtain registration under the programs, an EBC must, among other things:

- Have equity capital of at least $25,000 (note: this can be existing or new equity capital);
- Have the majority of its assets and expenditures substantially engaged in an eligible activity prescribed under Regulation 11(1), (discussed in the next section);
- Have no more than 100 employees including company affiliates;
- Pay at least 75 percent of its wages to employees who regularly report to work in British Columbia (50 percent requirement if engaged in export activity); and
- Maintain a 'permanent establishment' in British Columbia as defined under the *Income Tax Act* (Canada).

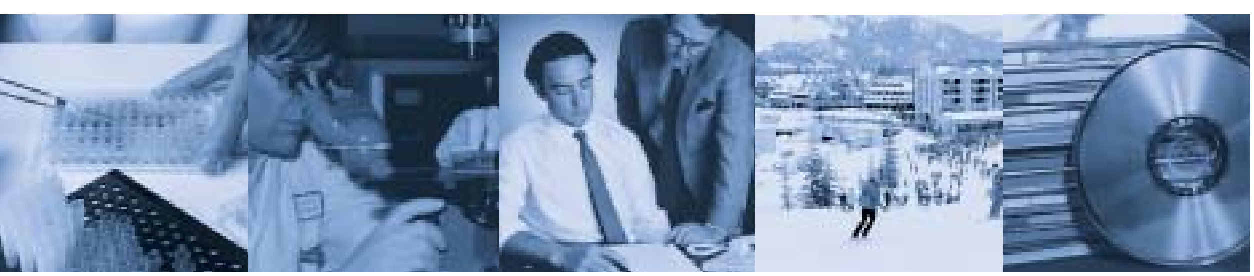
Raising investor capital

Once registered, an EBC is provided with approval by the Administrator of the *Small Business Venture Capital Act* to raise equity capital from eligible investors within a certain period of time.

Note: EBC shares are most often offered for sale to investors pursuant to exemptions from the registration and prospectus requirements of the *British Columbia Securities Act*. Investors should consult with their own personal advisors to ensure all legal requirements are met with respect to the purchase and sale of their shares.

To ensure tax credits are issued to investors, the EBC must ensure that the shares being issued to investors:

- In total will be less than 50 percent of the EBC's voting equity capital for the election of its board of directors;



- Do not come with rights or restrictions that: 1) create a debt between the investor and the EBC; 2) entitle the investor to reduce any EBC investment losses; 3) allow the investor to require the EBC to repurchase their shares before 5 years from the date of issue;
- Are not being issued to investors who, together with their associates or affiliates, control 50 percent or more of the EBC's voting equity capital for the election of its board of directors; and
- Are not being issued to investors that have disposed of any EBC shares in the past 2 years prior to the date of issue.
- Are without par value and fully paid for in cash.

In consideration of the above requirements, it is recommended that an EBC establish a separate class of equity shares for the purpose of raising capital under the program. Similar to a VCC investment, EBC investments are not capable of prompt liquidation but may provide the investor with an opportunity for dividend income or long-term capital appreciation.

EBC investment requirements

An EBC, once it has raised equity capital under the programs, may not acquire, cancel or redeem shares held by eligible investors for 5 years from the date of issue. Failure to comply with this requirement may lead to the EBC having to repay all or a portion of the tax credits issued to eligible investors. Further, an EBC may not transfer shares held by eligible investors for 5 years from the date of issue. Exceptions for EBC share transfers include cases where the transfer occurs to a Retirement Savings Plan or to an executor or estate due to the death of an eligible investor, or other permitted transfers that may be prescribed under regulation.

Tax credit liability

Where an EBC has met all the legislative requirements, filed its required annual returns and has maintained the share capital raised from eligible investors for at least five years, its liability to repay tax credits will be removed. If the EBC fails to abide by the legislation, the EBC and in some circumstances, its directors, officers or major shareholders may be held jointly liable to repay tax credits to the province.

THE 'EBC' OPTION - DIRECT INVESTMENT

Eligible investors:

- Investors are BC residents or taxable corporations.
- Shares may not be redeemed, aquired or cancelled for at least 5 years. [transfers permitted with conditions].

The EBC must:

- Have no more than 100 employees.
- Pay at least 75 percent of its wages to BC residents (50 percent requirement if engaged in export activity).
- Be substantially engaged in a prescribed activity.

The EBC shares:

- Voting or non-voting shares.
- Common or preferred shares.

SMALL BUSINESS ELIGIBILITY

Eligibility requirements

To qualify for investment from a VCC or as an EBC under the programs, a small business must meet the following criteria:

a) Have no more than 100 employees, including affiliates.
b) Pay at least 75 percent of its wages to employees who regularly report to work in British Columbia (50 percent if substantially engaged in export activities).
c) Have no more than 20 percent of the company's assets located outside of the province.
d) Maintain a 'permanent establishment' in British Columbia as defined under the *Income Tax Act* (Canada).
e) Be substantially engaged in one of the following activities:
   - Manufacturing, processing or export of value-added goods produced in British Columbia;
   - Destination tourism;
   - Development of proprietary technology;
   - Development of interactive digital new media product; or
   - Community diversification outside of the Lower Mainland and the Capital Region.

Please note that 'substantially engaged' means more than 50 percent of the assets and expenses of the business are used in (or more than 50 percent of the business revenue is derived from) one or more of the activities described above.

Ineligible small business activity

By Regulation, eligible small business activity does not include:

- Primary resource exploration or extraction;
- Provision of financial services;
- Property management or real estate development;
- Traditional agriculture;
- Retail and commercial services (with certain exceptions);
- Restaurant or food services; and
- Sale or lease of tangible or intangible personal property.

If a small business is uncertain as to whether or not it qualifies under the legislation, it is recommended that they seek an advance ruling from the Investment Capital Branch.

Prohibited uses of program capital

The programs allow small businesses to use equity capital for asset expenditures and working capital. However, the *Small Business Venture Capital Act* specifies prohibited uses of program capital including:

- Lending;
- Purchasing securities, unless a VCC is making a small business investment through a parent company or a limited partnership;
- Acquiring land, unless it is considered incidental to the eligible small business activity;
- Repayment of debt (with certain exceptions);
- Redeeming or repurchasing existing share capital;
- Payment of dividends to shareholders;
- Acquiring services or assets from a VCC or EBC investor that is not priced at fair market value;
- Acquiring another small business or all of its assets (with certain exceptions); and
- Investing outside of British Columbia.

Venture Capital for the heartlands of British Columbia

In order to promote venture capital investment outside of the Lower Mainland of the province, a portion of the tax credit budget has been dedicated for any VCC or EBC registered under the Community Venture Capital Program. In order to qualify for investment under this program, a small business must have a permanent establishment in the province outside of the Greater Vancouver Regional District and the Capital Regional District (Greater Victoria).

VENTURE CAPITAL FOR THE NEW MEDIA SECTOR

As part of its commitment to stimulate investment in the thriving ‘New Media’ sector, the government of British Columbia has dedicated $5 million of tax credits under the programs for venture capital investment in small businesses developing interactive digital media products. The tax credits will in turn lever up to $17 million in annual program investment in the New Media Sector.

In order to access tax credits reserved for the new media sector, a small business, in addition to meeting the legislated criteria, must be substantially engaged in the development within British Columbia for commercial exploitation of interactive digital media product that:

- Educates, informs or entertains and presents information using at least two of the mediums of text, sound or visual images;
- Is not developed for internal corporate use involving the promotion of products or services;
- Is not used primarily for interpersonal communication; and
- Is not a product for which public financial support would, in the opinion of the certifying authority, be contrary to public policy.

For more information about the small business eligibility criteria, contact the Investment Capital Branch with the ministry and request a copy of the policy statement discussing Eligible Small Businesses. This policy statement may also be viewed on the branch website at www.equitycapital.gov.bc.ca

ELIGIBLE INVESTMENT CRITERIA - EQUITY SHARES

Form of investment

In order for a small business investment to be considered eligible under the programs, it must either be an acquisition of 'equity shares' made by a VCC or the issuance of equity shares to eligible investors of an EBC.

The definition of an equity share under the *Small Business Venture Capital Act* includes:

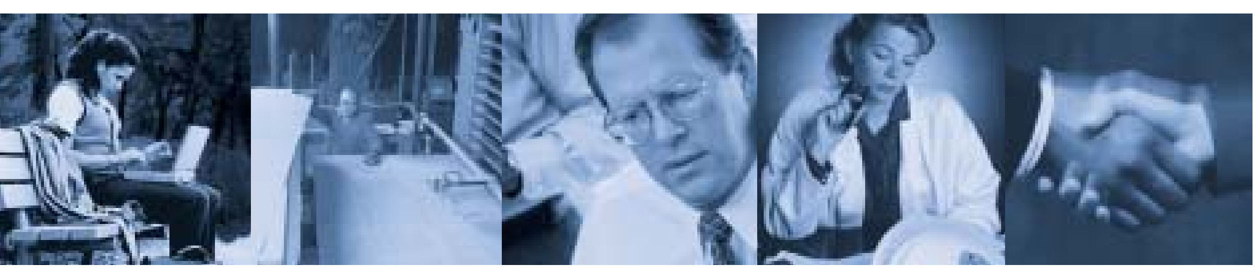
- A class of shares (common or preferred) that may or may not include voting rights, but does not include shares that have certain prescribed rights and restrictions; and
- Any warrants, options or rights to acquire the above shares.

Normally, a VCC acquires equity shares directly from a small business or indirectly through an affiliate of the small business. The same holds true for an EBC that issues equity shares directly to investors or through its affiliates.

There are two exceptions to this rule. First, a VCC is permitted to acquire equity shares of one or more small businesses indirectly through a prescribed limited partnership. Second, a VCC is permitted (with conditions) to acquire debt from a small business on a temporary basis that within 18 months will be converted into equity shares of the same business.

Arms-length investment

The investment in a small business must be made by a VCC with investors who are arms-length to the business' major or controlling shareholders. Investors cannot use their investment to take over, control or obtain other benefits from the small business. A VCC is not permitted to hold 50 percent or more of a small business' voting equity shares or control the small business in any manner.



Likewise for an EBC, it is not permitted to issue equity shares to eligible investors if the total offering exceeds 50 percent or more of the EBC's voting equity shares. Further, shares of an EBC may not be issued to any investors who together with their associates or affiliates control 50 percent or more of the EBC's voting equity shares.

Investor's money 'at risk'

An equity investment must be at risk both as to return of capital and return on capital. Investment structures that have the effect of reducing the amount of capital at risk or the time that it is at risk are not acceptable.

Returns only from profits or gains

Equity returns are not fixed obligations, but instead are contingent on earnings or appreciation in the value of the small business or EBC equity shares. If there are no profits or appreciation, there is no equity return.

Maximum program investment

The total investment by all VCCs under this program in any one small business, and its affiliates, cannot exceed $5 million. Likewise, the amount of equity shares that an EBC may issue to eligible investors may not exceed $5 million. An eligible small business is entitled to receive program investment as an EBC or from a VCC.

New equity to finance small business

The investment in a small business under the programs must result in expansion or new economic activity with a corresponding net economic benefit to the province. The investment must also result in new equity capital being available for the small business' use.

For more specific information about the small business investment criteria, contact the Investment Capital Branch with the ministry and request a copy of the policy statement discussing Equity Shares. This policy statement may also be viewed on the branch website at www.equitycapital.gov.bc.ca

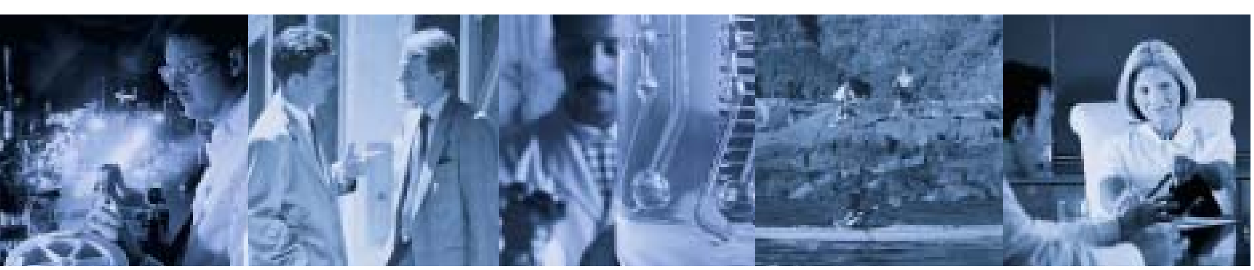
Program administration

Ministry staff are available to help in all areas of program administration. The Investment Capital Branch will accept and process applications for registration, approve the raising of equity capital, provide advance small business eligibility rulings, qualify investments for VCCs, issue tax credit certificates and review VCC and EBC annual reports.

The VCCs, the small businesses they invest in and EBCs are required to file annual reports with the ministry to assist with program monitoring and to assess compliance with the legislation. Ministry staff or their designates also routinely conduct detailed examinations of the records of a VCC, the small business it has invested in or an EBC to determine compliance with the *Small Business Venture Capital Act* and Regulations.

HOW TO GET STARTED

If after reading these guidelines you wish to learn more or proceed with an application, you should contact ministry staff in Victoria at (250) 952-0136 or toll free at (800) 665-6597. You will, at that time, be assigned to a Portfolio Manager who will be your contact for all subsequent matters. Please note that your Portfolio Manager will provide you with all the information needed to participate under the programs, but will not be able to give you legal or financial advice. You should consult your professional advisors in respect to these matters.



VENTURE CAPITAL CORPORATIONS

Step 1 – Small business eligibility

Generally, the first step is to determine whether the targeted business qualifies as an eligible small business under the program legislation. An application form is available on the branch website to pre-qualify a small business as being eligible under the program.

Step 2 – Incorporating the VCC

The person(s) wishing to form a VCC must request the ministry's consent to the use of the initials 'VCC' by filing a VCC name consent form with the Investment Capital Branch. The signed VCC name consent form is required by the Registrar of Companies for the incorporation of any company with VCC in its name.

Step 3 – VCC program registration

Submission of a VCC Registration Application must be made within 60 days of the approval of a VCC name consent form. The VCC Registration Application form can be downloaded from the branch website. Please note that a Share Purchase Report should be completed when investors are purchasing shares in the VCC. Usually at the time of VCC registration, or shortly thereafter, the Administrator of the *Small Business Venture Capital Act* will grant the VCC approval to raise additional equity capital from investors for a specified period of time and amount.

The Portfolio Manager will help the VCC complete the remaining steps such as:

- Obtaining investment approvals and Investment Protection Account releases;
- Processing tax credit applications on behalf of VCC investors;
- Filing its annual return with the Investment Capital Branch; and
- Assisting the VCC with reducing its tax credit liability and program cancellation.

ELIGIBLE BUSINESS CORPORATIONS

One of the benefits of registering under the programs as an EBC is that it is truly a one step process. While being registered as an EBC, a small business receives an activity eligibility ruling, registration certificate and approval to issue additional equity capital to eligible investors all at the same time.

In order to obtain EBC registration under the programs, a small business must submit an EBC Registration Application with the branch that includes the following documents:

a) Financial statements for the current year, projected financial statements or a copy of its most recent corporate income tax return;
b) The most recent copy of its:
  - Memorandum and articles of incorporation;
  - Registers of share capital allotments, members and transfers;
c) A business plan that includes detail on the proposed use of eligible investor funds; and
d) A detailed description of the type of share capital being issued to eligible investors including any special rights or restrictions.

Once registered, the Portfolio Manager will continue to work with the EBC to assist it with the filing of tax credit applications on behalf of its investors, and with the filing of annual returns with the Investment Capital Branch.

Regardless of whether you decide to register as an EBC or VCC under the programs, the earlier you consult with your Portfolio Manager and the more complete and accurate your submissions, the more quickly the branch will be able to serve you.

The Province of British Columbia in no way guarantees the value of any shares issued by an Eligible Business Corporation or a Venture Capital Corporation registered under the *Small Business Venture Capital Act*. Nor does it in any way express an opinion as to the financial condition of these companies or the merits of purchasing their shares.

Please also note that the ministry does not provide investment-matching services as part of program delivery. Participating small businesses are responsible for finding and attracting investors under the programs.

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