CDNX TIER 3 - SOME INCOME TAX CONSIDERATIONS

As announced in the CDNX news release dated December 20, 2000, the federal Department of Finance recently confirmed that it supports CDNX's request that the prescription of CDNX as a "prescribed stock exchange" (See endnote 1) for purposes of the federal Income Tax Act ("Act") will apply only to Tiers 1 and 2, and not to Tier 3. Further to that news release, set out below is a review of certain of the income tax considerations which follow from Tier 3 not being a prescribed stock exchange for purposes of the Act.

This summary is of a general nature only and is not exhaustive of all Canadian federal tax considerations. This summary is not intended to be, nor should it be construed to be, legal, business or tax advice to any reader. Accordingly, each reader of this notice should consult its own tax advisor regarding the federal and provincial tax considerations applicable to that reader based on its own particular circumstances.

BACKGROUND

Corporations trading on Tier 3 of CDNX were, prior to being listed on Tier 3, quoted on the Canadian Dealing Network ("CDN"). CDN was not a prescribed stock exchange for purposes of the Act. As a result, CDN-quoted corporations generally attracted unique income tax treatment that affected both the corporations and their investors. In addition, the eligibility of the securities of former CDN-quoted corporations for registered retirement savings plans ("RRSP") and other deferred income plans was more limited than for the securities of corporations listed on a prescribed stock exchange (such as The Toronto Stock Exchange, the Alberta Stock Exchange or The Vancouver Stock Exchange prior to the November 26, 1999 merger, and now CDNX Tiers 1 and 2). The potential for this unique tax treatment for former CDN-quoted corporations has been preserved for those now trading on Tier 3 of CDNX. Further details on certain of the income tax considerations are provided below.

ELIGIBILITY FOR RRSPs AND OTHER DEFERRED INCOME PLANS

Investors should bear in mind that securities of a Tier 3-listed corporation may not constitute a "qualified investment" for certain purposes of the Act. In the absence of the particular corporation and the particular investor meeting a number of requirements set out in the Act, the securities of a corporation listed on Tier 3 will not constitute a qualified investment for RRSPs, registered retirement income funds and other types of deferred income plans.

From this eligibility perspective, investors in securities of Tier 3-listed corporations are in the same situation as investors in the corporations which were previously traded on CDN.

In summary, the eligibility for RRSPs and other deferred income plans of securities of Tier 3-listed corporations depends on the circumstances of the particular corporation and the particular investor. Accordingly, it is essential that investors speak to their financial or tax advisors to determine the RRSP eligibility of any security trading on Tier 3 of CDNX.

THE DISTINCTION BETWEEN A "PRIVATE CORPORATION" AND A "PUBLIC CORPORATION" FOR PURPOSES OF THE ACT

Subject to the exceptions described below, by virtue of Tier 3 not being a prescribed stock exchange for purposes of the Act, generally a corporation listed on Tier 3 will be a "private corporation" for purposes of the Act and will not be a "public corporation" for purposes of the Act.

However, a Tier 3-listed corporation will be a public corporation for purposes of the Act in the following limited circumstances:

1. if the corporation has elected in prescribed manner to be a public corporation, at the time of the election it complied with certain prescribed conditions, and the corporation has not subsequently elected in prescribed manner not to be a public corporation;

2. if the corporation has been designated by the Minister of National Revenue to be a public corporation, at that time it complied with certain prescribed conditions, and the corporation has not subsequently elected in prescribed manner not to be a public corporation; or

3. if the corporation previously had shares listed on a prescribed stock exchange, unless it subsequently elected in prescribed manner not to be a public corporation.

Certain of the Canadian income tax implications to a corporation, or a holder of its securities, of the corporation being a private corporation and not listed on a prescribed exchange for purposes of the Act are reviewed below.

SUMMARY OF THE MAIN POTENTIAL INCOME TAX ADVANTAGES AND DISADVANTAGES REGARDING TIER 3

A. ADVANTAGES

Because Tier 3 is not a prescribed stock exchange for purposes of the Act, a Tier 3-listed corporation may qualify as a "private corporation" and possibly also a "Canadian-controlled private corporation" ("CCPC") for purposes of the Act if it meets certain requirements set out in the Act (e.g., provided, among other things, it is not controlled, directly or indirectly in any manner whatever, by one or more non-residents, by one or more public corporations, or by any combination thereof).

The main potential income tax advantages to a corporation of private corporation status and CCPC status include the following.

A corporation that is a CCPC is entitled to a deduction (referred to as the "small business deduction") in computing its net Part I tax payable based on up to $200,000 (up to $300,000 based on proposals in the February 2000 federal budget) per year of income from an "active business" carried on in Canada, subject to certain limitations in the Act. (see endnote 2). This deduction reduces an eligible corporation’s tax rate on its first $200,000 ($300,000) of active business income. A corporation that has a class of shares listed on a prescribed stock exchange (such as Tier 1 or Tier 2 of CDNX) is not a CCPC and therefore is not eligible to claim the small business deduction.

The taxation of investment income of a private corporation, within the meaning of that expression in the Act, is subject to a number of special rules designed (in part) to coordinate and integrate the corporate tax paid on such income with the personal tax that is paid by individual shareholders of the corporation upon receipt of a dividend out of the after-tax income of the corporation. For example, the non-taxable portion of capital gains realized by a private corporation may be distributed to shareholders who are individuals on a tax-free basis as "capital dividends". In addition, when a private corporation pays a taxable dividend it may be entitled to a refund of part of the tax previously paid or payable by it on its investment income, to the extent of its "refundable dividend tax on hand".(see endnote 3).

A corporation that has a class of shares listed on a prescribed stock exchange is not a private corporation for purposes of the Act, and therefore is not entitled to pay tax-free capital dividends, or to refunds of refundable dividend tax on hand. On the other hand, a Tier 3-listed corporation may qualify as a private corporation, in which case it potentially can benefit from the corporate tax integration rules in respect of investment income that it earns.

The Act provides for investment tax credits ("ITCs"), which reduce tax payable, in respect of certain property acquisitions and qualifying expenditures for scientific research and experimental development ("SR&D"). The general rate of ITCs for SR&D is 20%. This rate is increased to 35% for certain corporations that are CCPCs throughout a taxation year (Endnote 4).

A "qualifying corporation" that has earned ITCs but has not been able to use all of the ITCs in a year (e.g., because of an insufficient amount of Part I tax otherwise payable) will be eligible for a refund of 40% of ITCs earned in respect of certain property and qualifying SR&D expenditures. A qualifying corporation may be eligible for a 100% refund of ITCs earned in respect of current qualified SR&D expenditures.

For refundable ITC purposes a qualifying corporation is, in general terms, a CCPC throughout the particular year, the income of which, together with the income of all associated corporations, does not exceed its annual business limit for the previous taxation year.

Other, generally less significant, tax implications to a corporation of CCPC status or private corporation status include the following.

The "normal reassessment period" within which the Canada Customs and Revenue Agency ("Agency") may reassess a corporation is four years for corporations other than a CCPC; the reassessment period for a CCPC is only three years.

A corporation generally is required to pay the balance of its income tax liability for a taxation year within two months of the end of that year. However, for certain CCPCs the balance of the income tax liability must be paid within three months of the end of the particular taxation year.

Private corporations are exempt from paying Part IV.1 tax at 10% on any dividends received on "taxable preferred shares".

The main potential income tax advantages to shareholders and option holders of a Tier 3-listed corporation include the following.

An individual who owns shares of a Tier 3-listed issuer may qualify for claiming the capital gains deduction in respect of capital gains realized on "qualified small business corporation shares", if a number of conditions for eligibility are satisfied. On the other hand, shares of a corporation which are listed on a prescribed stock exchange are not eligible for that capital gains deduction.

A Tier 3-listed corporation may qualify as a "small business corporation" for purposes of the Act, in which case a shareholder who holds shares of the corporation as capital property may be entitled to claim an "allowable business investment loss" in respect of any loss realized on such shares. Allowable business investment losses are deductible against other sources of income. On the other hand, generally capital losses may be offset only against capital gains realized by the taxpayer. Shares of a corporation which are listed on a prescribed stock exchange are not eligible for allowable business investment loss treatment.

Employees who hold stock options of Tier 3-listed corporations that are CCPCs are able to receive more favourable tax treatment than is available to holders of options of corporations listed on a prescribed stock exchange (subject to certain relieving amendments introduced in the federal budget of February 28, 2000 regarding shares of a corporation listed on a prescribed stock exchange). Provided the employee deals at arm’s length with the CCPC, the employee is entitled to defer any taxable benefit income inclusion until the year in which the employee disposes of the shares. In addition, in such circumstances the employee also will be entitled to a deduction of 25% (proposed 50%) of the amount of the benefit if the employee holds the shares acquired under the stock option plan for at least two years after the exercise of the option (Endnote 5).

B. DISADVANTAGES

The main potential income tax disadvantages associated with shares of a Tier 3-listed corporation not being listed on a prescribed stock exchange are as follows.

As noted above, securities of a Tier 3-listed corporation may not constitute a "qualified investment" for RRSPs, registered retirement income funds and certain other types of deferred income plans.

For a Tier 3-listed corporation that qualifies as a "taxable Canadian corporation" for purposes of the Act, in certain limited circumstances its shares may be qualified investments for deferred income plans. The Income Tax Regulations set out a number of requirements that must be satisfied for shares of such a corporation to be a qualified investment to a particular holder. It is possible for shares of a Tier 3-listed corporation to meet all of the various technical requirements to constitute a qualified investment. However, a practical consideration is that trustees or administrators of deferred income plans typically will require an opinion from tax counsel for the corporation in question confirming that the corporation’s shares are qualified investments, prior to allowing a deferred income plan to acquire shares of the corporation.

A shareholder of a Tier 3-listed corporation who is not resident in Canada for purposes of the Act is subject to Part I tax on taxable capital gains realized on a disposition of such shares, subject to possible exemption from such tax under any tax treaty Canada may have with the jurisdiction in which the shareholder is resident. By comparison, generally a non-resident holder of a share that is listed on a prescribed stock exchange is not subject to Canadian tax on any gain realized on a disposition of such share (Endnote 6).

However, under most of the tax treaties that Canada has with other jurisdictions the general rule is that a resident of the other jurisdiction who is not resident in Canada would not be subject to Canadian tax on gains realized on shares of a Tier 3-listed corporation. The most common and significant exception to the foregoing rule is that where the value of the shares is derived principally from real property situated in Canada, gains on such shares are subject to Canadian tax.

There also are clearance certificate and withholding implications in respect of shares of Tier 3-listed corporations that are sold by a holder who is not resident in Canada for purposes of the Act (Endnote 7). A purchaser of a share of a Tier 3-quoted corporation from a non-resident shareholder is required to withhold and remit to the Agency 33 1/3% of the purchase price, unless the non-resident shareholder has obtained a clearance certificate from the Agency.

On the other hand, a share of a corporation that is listed on a prescribed stock exchange is "excluded property" which is excluded from the aforementioned withholding tax and clearance certificate provisions of the Act.

NOTES

Note 1: Income Tax Regulation 3200 currently prescribes the following stock exchanges in Canada for purposes of a variety of provisions in the Act: Alberta Stock Exchange; Montreal Stock Exchange; Toronto Stock Exchange; Vancouver Stock Exchange; and Winnipeg Stock Exchange. The Department of Finance in a December 16, 1999 news release indicated that Regulation 3200 will be amended to include CDNX in the list of prescribed stock exchanges in Canada. The prescription of Tiers 1 and 2 of CDNX will apply as of November 26, 1999, and will have effect for taxation years ending after that date. In a December 21, 2000 news release the Department of Finance announced that Tier 3 of CDNX will not be added to the list of prescribed stock exchanges in Canada.

Note 2: For example, associated corporations must share the annual deduction. In addition, a recent amendment phases out the small business deduction for so-called "large corporations", which are those corporations subject to Part I.3 tax in their preceding taxation year.

Note 3: CCPCs, private corporations and corporations controlled for the benefit of an individual or a related group of individuals are subject to certain refundable taxes on investment income. See Part IV and section 123.3.

Note 4: Also note that the $2 million expenditure limit is reduced for large CCPCs which have taxable capital in excess of $10 million as determined for purposes of the Part I.3 large corporation tax.

Note 5: Paragraph 110(1)(d.1). By comparison, in all cases (i.e., whether a CCPC or not) the employee will be entitled, under paragraph 110(1)(d), to deduct 25% (proposed 50%) of the amount of the benefit if the shares are "prescribed shares" and the exercise price under the stock option is equal to or greater than the amount by which the fair market value of the shares at the time the stock option was granted exceeds the amount, if any, paid by the employee to acquire the rights under the stock option plan. Proposed amendments to paragraphs 110(1)(d) and (d.1) announced on December 21, 2000 propose increasing the deductible portion of the benefit from 25% to 50%.

Note 6: An exception to this general rule is that a non-resident will be liable for Canadian tax on a share that is listed on a prescribed stock exchange if, at any time during the preceding five year period, the non-resident person, together with any non-arm's length persons, owned 25% or more of the issued shares of any class of the corporation. In addition a share that is listed on a Canadian stock exchange may be subject to tax if it is received in exchange for certain other "taxable Canadian property" within the meaning of that expression in paragraph 115(1)(b) and the proposed definition of that expression to be added to subsection 248(1).

Note 7: The shares of a Tier 3-listed corporation that is resident in Canada are "taxable Canadian property" within the meaning of that expression in paragraph 115(1)(b) and the proposed definition of that expression to be added to subsection 248(1). For purposes of the discussion herein it is assumed that each Tier 3-listed corporation is resident in Canada and therefore its shares are taxable Canadian property.