

# THE WALL STREET JOURNAL.®

## ||| VENTURE CAPITAL

# Canada's tax effort gets chilly response in U.S.

BY DOUGLAS BELKIN

The Canadian government is aiming to amend a long-standing tax treaty with the United States in an effort to boost anemic investments by venture capitalists, but banking critics say the effort has fallen short of what is needed.

Included in the Conservative government's budget last week was an announcement that tax breaks will be extended to investments made in Canada by U.S. limited-liability companies, which are often partners in U.S. private-equity firms.

Because LLCs are excluded from a 1980 U.S.-Canada tax treaty the profits they generate are subject to taxation in both countries. As a result, the partners in LLCs are generally unwilling to invest in Canada. Prime Minister Stephen Harper is now seeking to amend the treaty to include LLCs and grant them tax relief in Canada.

Canadian officials said they believe the amendment will broaden interest among U.S. investors. The change must be ratified by Parliament and the U.S. Senate. It is expected to be in place in 2008.

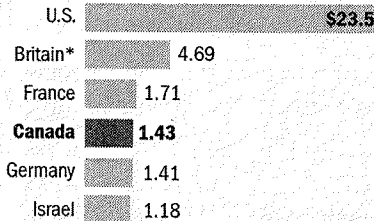
The budget doesn't address an even broader concern: the amount of paperwork U.S. investors have to wade through when they seek to cash out of their investments by selling a stake in a private Canadian company. While the tax treaty provides an exemption for these investors from Canadian taxes, they must fill out what can amount to thousands of pages of paperwork to access the tax break. Finance Minister Jim Flaherty said last week further changes could be coming.

"It is two sides of the same coin," Mr. Flaherty said. "I expect that we'll do more in the future on that."

Processing the paperwork can take months and cost hundreds of thousands of dollars in legal fees, said Stephen Hurwitz of Boston law firm Choate, Hall & Stewart LLP, who was part of a team that lobbied the Canadian government for both

## Seed money

Top recipients of venture capital from 2004-2006, annual average, \$billion (U.S.)



\* Figures are for 2003-2005

SOURCE: VENTURES WEST MANAGEMENT  
THE WALL STREET JOURNAL

sets of changes.

"The irony is that Canada has stellar talent and technology, but with this tax situation they are shooting themselves in the foot," Mr. Hurwitz said.

Large deals can bear that burden. But investments of a few million dollars in technology start-ups are frequently scuttled because of the paperwork, Mr. Hurwitz said.

"It's an unbelievable nightmare to exit a Canadian company," said Doug Redding, chief operating officer of Vimac Ventures in Boston, which frequently invests in Canadian companies. "It's just not sound economic thinking."

Canada is the fourth-largest recipient of venture capital behind the U.S., the U.K. and France. The effort to remove the barriers has been going on for about eight years and this is the first time it has gained traction, said Robin Louis, chairman of Ventures West Management Inc. of Vancouver.

But Mr. Louis expressed frustration that the paperwork issue hasn't been addressed. "The VC industry is relatively small in Canada in general, and the current government in particular has very little understanding of the crucial role venture capital plays in building new businesses," Mr. Louis said.

In 2005, emerging Canadian venture-funded companies raised an average of \$3.1-million. Their U.S. counterparts raised an average of \$10.4-million, according to Thompson Financial. Since these companies compete in the same North American market, under-funded Canadian companies frequently fold or are bought by U.S. interests, Mr. Hurwitz said.

In effect, Canada loses the subsidies it has invested in these companies that come in the form of tax breaks and university research grants. From the U.S. perspective, investment opportunities are diminished when the cost of doing business becomes too burdensome.

## ||| ENGINEERING

# Siemens for alle

## Latest scandal at be alleged payments to

BY MIKE ESTERL, FRANKFURT  
AND DAVID CRAWFORD, BERLIN

German conglomerate Siemens AG, weighed down by a bribes-for-business scandal, suffered another blow as a top executive was arrested in a separate probe into tens of millions of euros in alleged payments made to undermine Germany's trade union.

Siemens confirmed that Johannes Feldmayer, a member of an eight-person corporate executive committee, was detained by authorities yesterday for alleged breach of trust. He is the first sitting board member to be arrested in two widening criminal investigations buffeting the company, Europe's largest engineering firm by sales. Siemens also said police carried out a new round of searches at its Munich headquarters and offices in Erlangen and Nuremberg.

In the latest inquiry, prosecutors in Nuremberg are investigating payments made to a consulting firm owned by Wilhelm Schelske, the long-time head of an employee-friendly labour group who was arrested last month on tax-evasion charges. Authorities suspect funds were funnelled through Mr. Schelske to the labour group in order to

## ||| FLIGHT

# Sharper Image

BY ANDY PASZTOR

Sharper Image Corp. hopes to boost its fortunes by going where no retail firm has ventured before: selling airplane flights that replicate the weightless thrills of outer space.

The San Francisco specialty retailer has signed an exclusivity agreement with Zero Gravity Corp., a closely held Las Vegas start-up that pioneered the concept of flying passengers in a cor