Flow-through limited partnerships

SENTRY INVESTMENTS

Flow-through limited partnerships are one of the few tax-assisted vehicles available in Canada, and offer investors significant tax advantages.

What are flow-through shares?

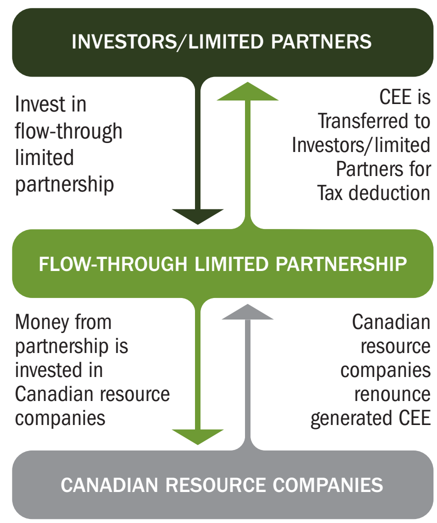
To encourage the exploration and development of Canada's vast natural resource potential, the federal government allows mining and oil and gas companies to deduct up to 100% of their eligible Canadian Exploration Expenses (CEE) and Canadian Development Expenses (CDE).

However, these companies are often years away from production or revenues and need to raise money to fund that exploration and development. As a result, they may offer flow-through shares to attract investors. Flow-through shares are a type of common share that allow issuing resource companies to "flow through" eligible CEE tax deductions to investors. Resource companies renounce their correlated CEE deductions to the investor, who can in turn deduct up to 100% of the amount against taxable income.

Certain flow-through investments may also be eligible for an additional 15% federal investment tax credit (extended by the government to March 31, 2014) for grassroots mineral exploration in Canada. Eligible shares are sometimes referred to as "super flow-through shares". Some provinces offer a provincial tax credit as well (amounts may vary).

How do flow-through limited partnerships (FTLPs) work?

Flow-through shares can be acquired directly from a Canadian resource company, but typically investors purchase units of a FTLP by private placement or through a public offering. An FTLP consists of a general partner that manages the operations and investments, and limited partners (the individual investors). The capital is invested in flow-through share offerings from a variety of Canadian resource companies. Professional investment managers manage the portfolio with an eye to achieving capital appreciation and maximizing the tax benefits available to investors.



Most FTLPs have a maximum life span of approximately two years, as funds raised by the resource companies must be used for exploration and development activities within 24 months of flow-through shares being issued. At maturity, the assets of the FTLP are transferred, on a tax-deferred basis, to a resource-based open-end mutual fund corporation, for which limited partners receive shares.

Since an investment's adjusted cost base (ACB) is reduced by CEE deductions received, the ACB is typically reduced to zero. However, the Manager of the FTLP will sometimes sell shares held in the portfolio following the end of the flow-through holding period. This does not affect the flow-through tax deduction, but the sale will result in a capital gain. Since capital gains are taxed in the year incurred, the ACB may increase during the life of the FTLP, resulting in an ACB greater than zero at the time the FTLP is transferred to a mutual fund corporation. When investors eventually redeem the mutual fund shares following the transfer of the FTLP to a mutual fund corporation, they will typically realize a capital gain based on this ACB.

After-tax cost of a $5,000 investment by an individual investor by province, 2014[1,2]

		AB	BC[5]	MB	NB	NL	NT	NS[5]	NU	ON[5]	PE	QC	SK	YK
FEDERAL TAX RATE	A	29.00%	29.00%	29.00%	29.00%	29.00%	29.00%	29.00%	29.00%	29.00%	29.00%	29.00%	29.00%	29.00%
PROVINCIAL TAX RATE	B	10.00%	16.80%	17.40%	17.84%	13.30%	14.05%	21.00%	11.50%	20.53%	18.37%	20.97%	15.00%	13.40%
Combined fed./pro. tax rate	**C**	39.00%	45.80%	46.40%	46.84%	42.30%	43.05%	50.00%	40.50%	49.53%	47.37%	49.97%	44.00%	42.40%
Amount of investment	**D**	$5,000	$5,000	$5,000	$5,000	$5,000	$5,000	$5,000	$5,000	$5,000	$5,000	$5,000	$5,000	$5,000
Less: tax benefit of deduction of FT investment - federal	**D x A**	-$1,450	-$1,450	-$1,450	-$1,450	-$1,450	-$1,450	-$1,450	-$1,450	-$1,450	-$1,450	-$1,450	-$1,450	-$1,450
Less: tax benefit of deduction of FT investment - provincial	**D x B**	-$500	-$840	-$870	-$892	-$665	-$703	-$1,050	-$575	-$1,027	-$919	-$1,049	-$750	-$670
Subtotal		-$1,950	-$2,290	-$2,320	-$2,342	-$2,115	-$2,153	-$2,500	-$2,025	-$2,477	-$2,369	-$2,499	-$2,200	-$2,120
Net cost of $5,000 investment in FT shares (capital at-risk)[3,4]		**$3,050**	**$2,710**	**$2,680**	**$2,658**	**$2,885**	**$2,848**	**$2,500**	**$2,975**	**$2,524**	**$2,632**	**$2,502**	**$2,800**	**$2,880**

ASSUMPTIONS: Taxpayers are subject to highest marginal income tax rates; CEE are 100% deductible; Investor takes available tax deductions in full.

The benefits of investing in FTLPs

Investing in flow-through shares through a limited partnership provides several key benefits when compared to investing in independent resource companies:

- DIVERSIFICATION
  A portfolio of companies can lessen risk compared to owning a single stock.
- PROFESSIONAL INVESTMENT MANAGEMENT
- ACCESS TO AUXILIARY OPPORTUNITIES
  Managers may have access to investments not available to individual investors.
- INCREASED LIQUIDITY
  FTLPs are transferred on a tax-deferred basis, generally within 24 months, to a corporate class mutual fund.

Tax-planning advantages

Investing in a FTLP can offer several key tax advantages:

- TAX DEDUCTION. Investors may claim the renounced CEE as a deduction of up to 100% against taxable income. Typically, all or most of the deduction can be claimed in the year the amount was invested.
- TAX DEFERRAL. Investors may defer income taxes for all or a portion of the amount invested, until the FTLP is dissolved and the investment is redeemed. Alternatively, investors may roll flow-through assets into a mutual fund corporation, deferring taxes until they redeem their mutual fund shares. The deferred amount will be reduced by any taxable portion of income and capital gains allocable to investors in a taxation year.
- TAX SAVINGS. By investing in a FTLP, income that would be fully taxable in the current year is converted into more favourably taxed capital gains payable in the current or future years. In addition, the tax payable on capital gains resulting from the redemption of the mutual fund shares could be offset in cases where the proceeds of the redemption are reinvested in a tax-sheltered account such as an RRSP.

For more detailed information about flow-through limited partnerships or specific investor examples, visit www.sentry.ca.

[1] This table is strictly for illustrative purposes only. [2] This table does not take into account any relevant costs or fees generally associated with a Limited Partnership. [3] Federal and provincial investment tax credits (super flow through) are not examined in this illustration. [4] Capital gains tax applicable when the shares are sold is not examined in this illustration. [5] BC, ON and NS have a top bracket above the top federal tax bracket. The rates used are for taxable income above $150,000 in BC and NS and above $514,090 in ON.

The tax implications and tax deductions are particular to the circumstances of each potential investor and each limited partnership. Anyone considering a flow-through investment should consult a professional tax advisor and/or financial advisor before making such a purchase.

The information contained in this guide is general in nature; it is not intended and cannot be considered professional tax advice. Each potential investor's situation is unique and advice should therefore be received from a qualified tax specialist.

This is not an offer nor a solicitation to buy a security. Such an offer can only be made by prospectus.