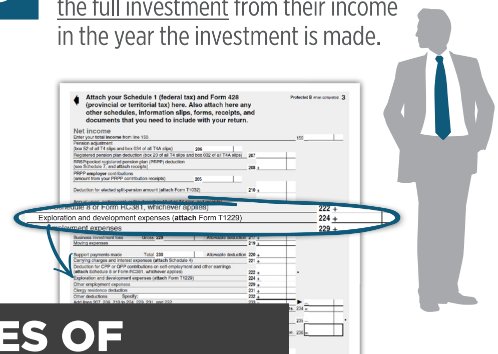
THE TAX PLANNING ADVANTAGES OF FLOW-THROUGH INVESTING

WHAT IS FLOW-THROUGH INVESTING?

1 Canadian resource companies need capital for exploration.

2 To encourage Canadian resource exploration, the government permits qualifying companies to “flow-through” unused exploration expenses to investors, for investor use as a tax offset.

3 Investors who invest in a Flow-Through Limited Partnership (LP) may deduct the full investment from their income in the year the investment is made.

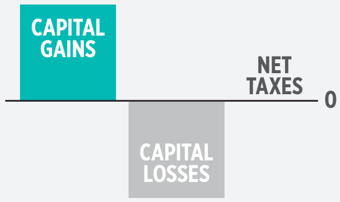


FINANCIAL PLANNING ADVANTAGES OF FLOW-THROUGH LPS FOR DIFFERENT INVESTORS

In 2 years or less (depending on the duration of the LP), the Limited Partnership terminates and the investment is rolled into a designated mutual fund corporation. The investor may now sell the fund, where their taxable capital gain is limited to 50% of the proceeds.

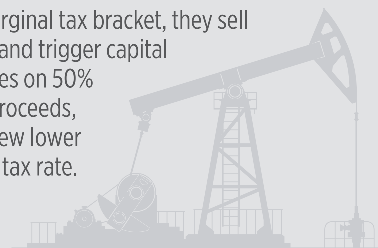
“I HAVE CAPITAL LOSSES THAT I HAVEN’T USED YET”

Investing in a Flow-Through LP effectively converts income into capital gains, **so investors can take advantage of any unused capital losses** they are carrying when they sell their shares in the mutual fund corporation, thereby reducing their taxable income.



“I’M MOVING TO A LOWER MARGINAL INCOME TAX BRACKET”

An investor who buys shares in a Flow-Through Limited Partnership decides to maintain their exposure to the resource sector and to defer their taxes further. As a result, they do not sell their shares of the mutual fund corporation. When the investor retires and is in a lower marginal tax bracket, they sell the fund and trigger capital gains taxes on 50% of their proceeds, at their new lower marginal tax rate.



“I HAVE A LONGER-TERM INVESTMENT HORIZON (5+ YEARS)”

Similarly, with a longer-term investment time horizon, an investor may be well-positioned to take advantage of a deferred tax strategy by remaining in the rolled-into mutual fund corporation, which then allows their investment to compound until one of several events occurs:

- **they experience capital losses on other investments which they can now use to offset their capital gain;**
- **they enter a lower marginal tax bracket.**

see examples

alt thinking

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TAX PLANNING EXAMPLES OF FLOW-THROUGH INVESTING

1

Flow-Through investing offers one of the few remaining advanced tax planning strategies in Canada:

Much like RRSPs, Flow-Through investing allows the investor to deduct 100% of the investment against personal income in the year of investment. On termination of the Flow-Through LP, the investment is rolled into a designated mutual fund corporation. The investor may now sell the fund, where their taxable capital gain is limited to 50% of the proceeds.

	YEAR 1		YEAR 2		NET 2YR CASH FLOW
Flow-Through L.P. investment	($10,000)				($10,000)
Tax savings[1]	$5,350				$5,350
Investment redemption[2]			$10,000		$10,000
Capital gains tax payable[3]			($2,675)		($2,675)
After-tax cash flow	($4,650)	+	$7,325	=	$2,675
After-tax return[4]					**57%**

[1] Assumes highest marginal tax rate in Ontario of 53.5%. Tax rates will vary by province.
[2] Assumes no net gain or loss at the end of the term. On redemption, in exchange for favourable tax treatment, full value of investment is treated as capital gains.
[3] Assumes a 53.5% marginal tax rate x 50% Capital Gains inclusion rate x $10,000 = $2,675
[4] After-tax cost of investment is $4,650. After-tax return calculated as: $2,675/$4,650 = 57%

2

An excellent wealth planning tool:

In combination with the tax deferral achieved by the corporate class roll-over described above, an investor may also take advantage of any capital loss carry-forwards they have, which can be used to offset their capital gain.

	YEAR 1		YEAR 2		NET 2YR CASH FLOW
Flow-Through L.P. investment	($10,000)				($10,000)
Tax savings[1]	$5,350				$5,350
Investment redemption[2]			$10,000		$10,000
Adjusted net capital loss of $10,000[3]			*offsets capital gain*		
Capital gains tax payable[4]			$0		$0
After-tax cash flow	($4,650)	+	$10,000	=	$5,350
After-tax retun[5]					**115%**

[1] Assumes highest marginal tax rate in Ontario of 53.5%. Tax rates will vary by province.
[2] Assumes no net gain or loss at the end of the term. On redemption, in exchange for favourable tax treatment, full value of investment is treated as capital gains.
[3] Assumes investor has an adjusted net capital loss carry-forward of $10,000 which they apply to this investment.
[4] Because capital gain has been reduced to zero, capital gains taxes are likewise zero.
[5] After-tax cost of investment is $4,650. After-tax return calculated as: $5,350/$4,650 = 115%