

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				<i>offsets capital gain</i>	
Capital gains tax payable ⁴			\$0		\$0
After-tax cash flow	(\$4,650)	+	\$10,000	=	\$5,350
After-tax return 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%

THE TAX PLANNING ADVANTAGES OF FLOW-THROUGH INVESTING

WHAT IS FLOW-THROUGH INVESTING?

1

Canadian resource companies need capital for exploration.

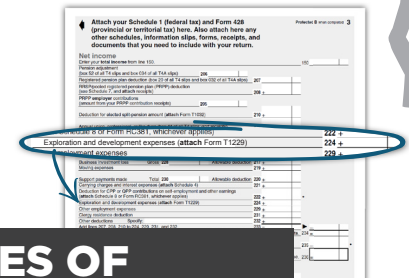


2

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.

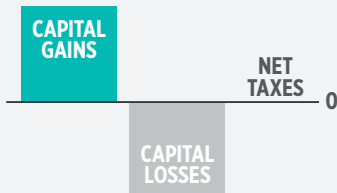


FINANCIAL PLANNING ADVANTAGES OF FLOW-THROUGH LPS FOR DIFFERENT INVESTORS

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.

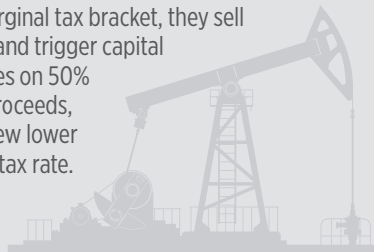
“I HAVE CAPITAL LOSSES THAT I HAVEN’T USED YET”

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

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