Flow-through limited partnerships FAQs

What are flow-through shares?

Flow-through shares have helped expand Canada's resource sector since their introduction to the Canadian tax system in 1954. At that time, the Canadian government introduced provisions to allow for the transfer of tax deductions between companies, in an effort to assist in financing exploration projects in Canada. Resource companies could transfer certain exploration expenses to investors, who were then able to deduct these expenses against their own income.

What is a flow-through limited partnership?

A flow-through limited partnership is an equity investment in a portfolio of flow-through shares of Canadian resource companies that combines unique tax advantages with the prospect for capital appreciation.

Early-stage oil and gas, or mining exploration companies receive special tax deductions that flow through the limited partnership to investors, who receive a 100 per cent tax deduction for the amount invested. Typically, after a period of 18 to 24 months, assets of the limited partnership roll over tax-deferred to units of a resource-based mutual fund.

What are the advantages of flow-through limited partnerships?

Flow-through limited partnerships are valuable to investors who have current income that will be taxed at the highest marginal rate. This vehicle allows investors to defer and reduce tax.

The advantages are:
- Tax deduction of about 100 per cent of the amount invested
- Preferential tax treatment by converting current income to future capital gains
- Increased portfolio diversification reduces volatility and increases return potential
- Capital gains potential
- Tax-free rollover to a mutual fund after two years allows for further deferral of capital gains taxes.

Flow-through limited partnerships can be used to achieve specific goals, such as:
- Preventing or reducing Old Age Security clawbacks
- Utilizing capital loss carry-forwards
- Maximizing charitable donations

What are the risks associated with investing in flow-through limited partnerships?

Shares could decline in value: As with any investment in small-cap equities, market values can fluctuate widely. Since investments are concentrated in the resource sector, there is further potential for volatility.

A 100 per cent tax-write-off may not be achieved if investment proceeds cannot be invested by the manager before year-end.

Other factors affecting performance: Investors pay a higher cost for flow-through shares than for common shares due to a premium paid in return for the tax benefit. This cost must be recouped before investors make any capital gains on their investments.

For more details on the risks associated with investing in Sentry Select's flow-through limited partnerships, please refer to each offering's prospectus.

How does the tax write-off work?

The Canadian government allows exploration expenses known as Canadian Exploration Expense (CEE) to be transferred, or flowed-through, to holders of flow-through shares of resource companies. CEE is divided among the shareholders and usually represents an amount equal to the investor's capital outlay. In this way, investors can reduce their taxable income by the amount of their investment.

What happens on the rollover?

After two years, most partnerships allow for the assets to be rolled into an open-ended mutual fund, without triggering any tax consequences. The investor then has a choice to hold the mutual fund units, or sell and pay capital gains tax on the full disposition amount.

What is the adjusted cost base (ACB) of a flow-through limited partnership on rollover?

Due to the upfront tax deduction, the ACB is low or nil. As a result, when units are redeemed, all proceeds are treated as capital gains, which are taxed more favourably than interest income.

Which Sentry Select products invest in flow-through shares?

Click **here** for information on Sentry Select's flow-through limited partnerships.

Back to top