

## Take cover under the last tax shelter

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As the Gomery investigation into Liberal corruption reached its climax last week, I was in a bank writing out a huge bank draft to the Receiver General of Canada on behalf of my mother's estate.

This was a classic example of what British journalist Malcolm Muggeridge used to term "fearful symmetry."

The tax liability was triggered by the closing of my mother's Registered Retirement Income Fund. The bank teller's eyes nearly popped while processing a draft for more than she nets in a year. We joked how we could find better uses for the funds than the Liberals -- like going around the world together.

By the time Montreal ad executive Jean Brault spilled the beans on how the tax payments of millions of Canadians were squandered, some long-suppressed "tax rage" started bubbling up inside me.

But fearful symmetry wasn't done with me yet. The next day I got a call from Don Nash, a Vancouver broker who sells oil and gas tax shelters.

Nash, of National Bank Financial, shares my distaste for Canada's high taxes and how they are squandered. We chatted about how he helps his affluent clients "get back" at Ottawa by using a perfectly legal tax shelter encouraged by the mandarins who create tax policy.

They're called flow-through limited partnerships but Nash likens them to a "rich man's RSP."

Apart from RRSPs, these are the only tax shelters still sanctioned by Canada Revenue Agency. Ottawa has eliminated film deals, movies, software, MURBs and charitable gifting schemes.

But it has no problem motivating Canadians to develop our massive energy and mining riches. Ironically, Ottawa no longer requires Canadians to invest 70% of RRSPs or pensions in Canadian securities. But, as with the dividend tax credit for Canadian companies, the tax treatment for energy flow-through deals is an incentive to direct non-registered portfolios into Canadian securities.

Think of flow-throughs as Canadian resource mutual funds with tax advantages. An investor buys units in a Limited Partnership (LP) developing Canadian energy or mineral exploration properties. Exploration costs are "flowed through" to investors, giving them lucrative tax write-offs. Typically, 90% to 100% of the amount invested is tax-deductible for the tax year of purchase.

Say you had taxable income of \$200,000 in 2004. A \$100,000 purchase before Dec. 31, 2004 reduces taxable income to \$110,000 (assuming 90% writeoff first year and 10% in the second: ratio s vary with the product.)

If your top marginal tax rate is 46%, a tax refund of \$41,400 would be mailed to you this spring.

This provides investors a tax deferral rather than absolute tax savings. A top-bracket taxpayer converts highly taxed ordinary income (taxed at 46% in Ontario) into less harshly taxed (23%) capital gains. This can be a useful gambit if you expect to retire to a lower tax bracket in the new few years or move from a highly paid corporate position to a more relaxed part-time lifestyle.

Expect to tie up your cash for 18 to 24 months in a speculative investment concentrated in junior Canadian mining issues. These may drop slightly in value but they would have to drop more than 32% before the tax advantages were wiped out.

As Adrian Mastracci, president of Vancouver-based KCM Wealth Management Inc. reminds investors: "the investor must be able to withstand a loss of capital."

This is one investment investors really should scrutinize through the prospectus. It will reveal most such deals pay brokers a 4.5% commission, have an annual management fee of 1.5% to 2%, a service fee of 0.4% and may pay a performance bonus.

With minimums of \$5,000, they are best viewed as illiquid investments, Mastracci says. Investors should not bet the farm on any one and should diversify by holding a basket of flow-through deals.

Despite the possibility of loss, the perspective of top-bracket investors is that taxes also constitute a certain loss of capital and there's at least a chance of capital gains on these risky securities.

Once the hold period is up, you can sell and pay tax on any capital gains. Or you can do what Nash suggests and remain invested by rolling the LPs into more diversified, larger-cap mutual funds run by the same managers.

Typically, tax shelter investors start scrambling in the fall. This year's deadline is Dec. 31, 2005 but anyone who waits that long is bound to be disappointed. Some of the best deals were sold out as early as January of this year (including Front Street Flow Through 2005.)

Even waiting 'till the end of April may mean missing some issues. In descending order, Nash likes Creststreet, Front Street, Mackenzie 2005 Resource Limited Partnership, Qwest Energy, Middlefield Resource, and Canada Dominion Resources.

As with any tax shelter, investment quality is paramount. Nash doesn't recommend labour-sponsored venture capital funds but has no such concerns about energy or mining stocks selected by managers like Front Street's Normand Lamarsh or Mackenzie's Fred Sturm.

He's optimistic about the energy sector for the coming decade because Middle East instability has caused big U.S. oil to refocus on Canada as a long-term safe supplier of energy.

If, as Nash believes, the investments rise in value as well as defray taxes, you'll have a double win.

Fearful symmetry indeed!