Understanding CEE and CDE Flow-Through LPs

In the early 1980s, the Canadian government established an incentive for Canadians to invest in companies in the natural resource sector. These companies were permitted to "flow through" their Canadian Exploration Expenses and Canadian Development Expenses to investors so that investors can deduct these expenses against their taxable income.

Flow-through Limited Partnership investments provide Canadians and Canadian resource companies the opportunity to invest together in our vital natural resource sector and also receive attractive tax deductions

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Executive summary

- Flow-through shares are common shares issued by resource companies.
- Flow-through shares allow resource companies to "flow-through" Canadian Exploration Expenses (CEE) and Canadian Development Expenses (CDE) to flow-through share investors.
- Resource issuers offering CEE flow-through shares typically demand a higher premium price than CDE flow-through shares.
- CEE flow-through shares are typically issued by smaller resource issuers (e.g. junior oil and gas companies) and CDE flow-through shares typically issued by larger junior and smaller mide-size companies.
- CEE flow-through shares offer 100% tax deduction and CDE flow-through shares offer a 100% tax deduction calculated on an annual 30% declining balance basis.
- There are numerous tax planning opportunities for individual investors and corporate investors who choose to purchase flow-through shares.
- Investors can invest directly in flow-through shares issued by resource companies. This is often challenging, if not available, to investors as "institutional investor" typically get all of the flow-through shares issued.
- Investors can participate in flow-through limited partnership offerings which are managed by portfolio managers and as an institutional investor typically access all flow-through share issuances.
- Flow-through limited partnerships typically provide liquidity by rolling, on a tax-deferred basis, to a mutual fund twelve to thirty-six months from partnership's closing date.
- Investors receive flow-through tax related information from their investment dealer or from the general partner of a limited partnership if investment is direct with the general partner.

What are flow-through shares?

Through job creation and tax revenue all Canadians benefit from investment in the exploration and development of our natural resources

Flow-through shares are common shares issued by resource companies which provide flow-through tax deductions to their flow-through share investors. Resource companies issue flow-through shares to attract capital to fund their exploration and development activities in Canada and then "flow through" their eligible Canadian Exploration Expenses (CEE) and Canadian Development Expenses (CDE) to their flow-through share investors. Flow-through investors, both individuals and companies, can deduct CEE and CDE expenses received from their flow-through investment against their taxable income.

Why does the Government of Canada provide investors with a flow-through tax deduction?

The Government of Canada recognizes the economic benefits of the exploration and development of Canada's natural resources and encourages investment by allowing CEE and CDE expenses to be deducted by flow-through share investors. Originally, CEE and CDE were only deductible against resource income generated by resource companies. However, in 1983 the federal government changed legislation which allowed qualifying CEE and CDE expenses to flow through to investors of flow-through shares. In recent years, the federal government and some provinces have also introduced additional tax incentives for investors purchasing certain flow-through shares issued by Canadian mining companies to provide additional incentive for investment in Canada's mining sector.

What are the tax benefits?

Both a CEE and a CDE flow-through limited partnership offer a 100% tax deduction. The difference is that CEE is deductible 100% in the year of the flow-through investment and the CDE deduction is calculated on a 30% declining balance basis starting the year of the flow-through investment.

How does a typical flow-through LP work?

1 Both individuals and companies may invest in a flow-through limited partnership ("LP").

2 The LP's portfolio manager will diversify investments in flow-through shares issued by resource companies.

3 Resource companies use the LP's capital to incur eligible CEE and/or CDE expenses.

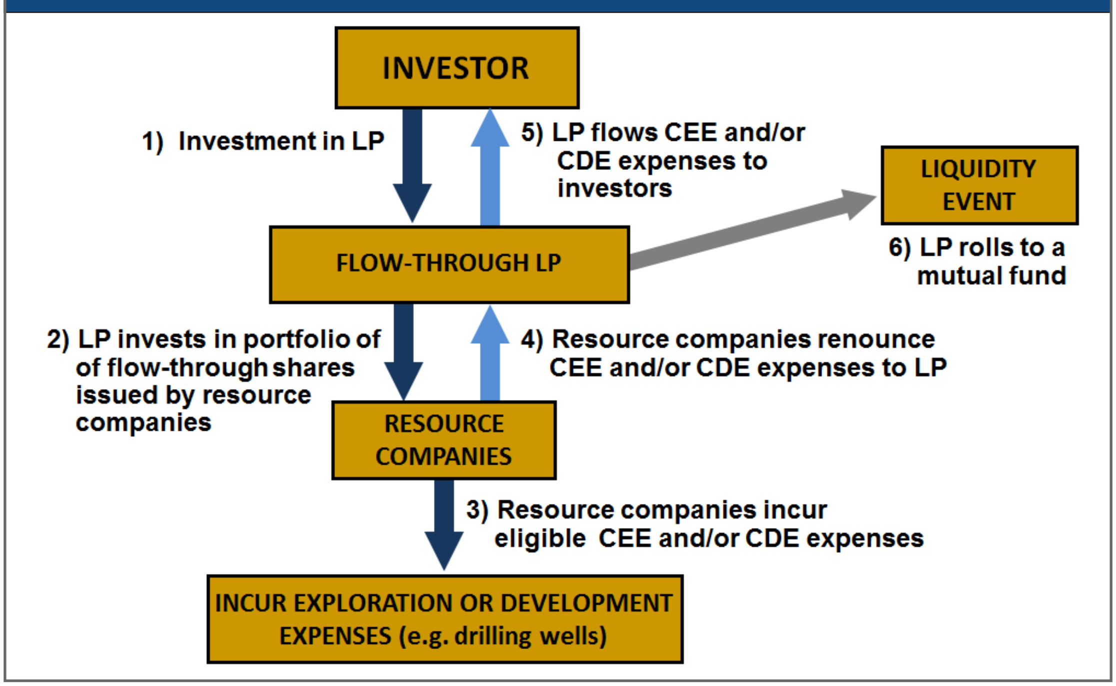
4 Resource companies then "flow through" the CEE and CDE expenses to the LP that invested in their flow-through shares.

5 The LP then flows the eligible CEE and/or CDE expenses to its limited partners by issuing a tax slip to investors.

6 LP investors then use a T5013 and a T1229 to claim their flow-through tax deduction against their taxable income.

7 The LP typically provides liquidity through a tax-deferred rollover of the LP's assets to a mutual fund and investors can choose to either hold or sell their mutual fund shares.

Typical Flow-Through LP Investment Structure



Important differences between CEE and CDE flow-through opportunities

The difference between a flow-through LP offering a CEE flow-through opportunity and a CDE flow-through opportunity comes down to the profile and activity of the natural resource company issuing flow-through shares. The following focuses on oil and gas companies only.

Flow-through LPs may provide investors with a solution that meets their investment and tax planning needs

Oil and Gas Company Profile	Issuing CEE Flow-through Shares	Issuing CDE Flow-through Shares
Typical oil and gas company activity:	Exploration activity creates CEE and is a higher risk but generally is a higher reward activity	Development activity creates CDE and is a lower risk but generally is a lower reward activity
Typical size of oil and gas company:	Mostly early stage companies through to larger junior companies	Larger junior companies through to mid-size companies
Typical stage of oil and gas company:	Start-up and earlier stage companies focused on rapid growth	More established companies focused on steady growth
Typical risk profile of oil & gas company:	Higher risk	Lower risk
Typical range of industry premiums:	**Range: 10% - 30%** Companies command a higher share price premium for their flow-through shares because of the tax deduction value and high demand for CEE flow-through shares	**Range: 0% - 15%** Companies offer CDE flow-through shares at a lower share price premium because of lower tax deduction value and lower demand for CDE flow-through shares
Investor tax deduction:	**100% tax deduction** in year of investment (reflects higher risk profile)	**100% tax deduction** calculated on a 30% declining balance basis starting the year of investment (reflects lower risk profile)

Benefits to investing in flow-through LPs

The following are examples of benefits that are available to investors who invest in flow-through limited partnerships.

Flow-Through LPs can be an important tool in wealth management and tax planning

Summary of benefits	
1	**Potential Investment Capital Appreciation** from flow-through LPs diversified investments in oil and gas growth companies.
2	**Reduce Tax and Marginal Tax Rate** by using flow-through LP's tax deduction.
3	**Defer Triggering Capital Gain Tax** by holding on to the flow-through LP assets that have rolled to a mutual fund until at a lower marginal tax rate.
4	**Use Flow-Through LP Capital Gains** against capital losses to reduce capital gain tax payable.
5	**Make a Charitable Donation** by donating the flow-through rollover assets (e.g. mutual fund shares) to qualified charitable organizations.
6	**Corporations and Personal Holding Companies** can use flow-through LP tax deductions and also use the company's capital losses to offset flow-through capital gains.

Qwest is pleased to provide more information on the various benefits and strategies that can be considered with flow-through LP investing at **www.qwestfunds.com**.

Limited Partnerships may offer a CEE fund and/or a CDE fund

Limited Partnerships allow investors the opportunity to tailor an investment, tax planning and risk tolerance solutions that meets their needs. Investors may choose to invest 100% of their flow-through investment into either an LP with a CEE fund; an LP with a CDE fund; or a percentage between an LP with CEE fund and an LP with a CDE fund.

Characteristics of LP CEE & CDE funds		
Characteristics	**CEE Fund**	**CDE Fund**
Typical company size:	Smaller junior oil and gas companies	Larger junior to smaller mid-size oil and gas companies
Tax deduction:	100% in year of investment	100% calculated on a 30% declining balance basis starting year of investment
Flow-through LP duration:	Liquidity event in year after investment	Liquidity event in year after investment
Typical premium range:	10% to 20%	5% to 15%
Risk profile:	Higher risk	Lower risk

An LP with a CEE fund or a CDE fund provides a lower break-even price point after taking into account the flow-through tax savings and the net after-tax investment cost.

Highest marginal tax rate by province: based on a $10,000 CEE investment example									
Province	**BC**	**AB**	**SK**	**MB**	**ON**	**NB**	**NS**	**PEI**	**NFLD**
Highest marginal tax rate:	47.70%	48.00%	48.00%	50.40%	53.53%	53.30%	54.00%	51.37%	48.30%
Flow-through investment:	$10,000	$10,000	$10,000	$10,000	$10,000	$10,000	$10,000	$10,000	$10,000
Less flow-through tax savings:	-$4,770	-$4,800	-$4,800	-$5,040	-$5,353	-$5,353	-$5,400	-$5,137	-$4,830
Investment at risk:	$5,230	$5,200	$5,200	$4,960	$4,647	$4,647	$4,600	$4,863	$5,170

Tax deductions for CEE funds and CDE funds

Investors can choose an LP with a CEE fund for a 100% tax deduction in the year of investment or may choose an LP with a CDE fund for a 100% tax deduction calculated on a 30% declining balance basis starting in the year of investment, as illustrated.

Tax Deduction Table for CEE Funds: Based on a $10,000 investment	
100% tax deduction	**Tax Savings**
Year 1 tax savings: $10,000 x 100 x 45%* =	**$4,500**

Assumes 45% marginal tax rate and full investment deduction

Note: *please refer to the previous page for the 2016 highest marginal tax rates by province.*

Investors who purchase a CDE fund on an annual basis will realize increasing cumulative percentage tax deductions (illustrates first 5 years only):

Year 1: 30%
Year 2: 51%
Year 3: 66%
Year 4: 76%
Year 5: 83%

Tax Deduction Table for CDE Funds: Based on a $10,000 investment		
30% declining balance basis tax deduction	**Tax Savings**	**Cumulative Tax Savings**
Year 1 tax savings: $10,000 x 30% = $3,000 x 45%* =	**$1,350.00**	**$1,350.00**
Year 2 tax savings: $7,000 x 30% = $2,100 x 45%* =	**$ 945.00**	**$2,295.00**
Year 3 tax savings: $4,900 x 30% = $1,470 x 45%* =	**$ 661.50**	**$2,956.50**
Year 4 tax savings: $3,430 x 30% = $1,029 x 45%* =	**$ 463.05**	**$3,419.05**
Year 5 tax savings: $2,401 x 30% = $720.30 x 45%* =	**$ 324.14**	**$3,743.69****

* *Assumes 45% marginal tax rate*

** *This table only shows the first 5 years of tax savings. Tax deductions continue until 100% of the investment is fully deducted.*

Note: *please refer to the previous page for the 2016 highest marginal tax rates by province.*

LP flow-through taxation cycle

Year of flow-through investment

1 Investor purchases units in a flow-through LP.

2 Investor receives a "T5013A Statement of Partnership Income" tax slip from their brokerage firm in the following year, typically in March, that assigns the amount of their CEE and/or CDE tax deductions.

3 Any capital gain realized in the flow-through LP portfolio during this year will increase the investment's Adjusted Cost Base ("ACB"). Investors will receive a T5013A tax slip the following year which indicates the amount of this capital gain created by portfolio activity.

Rollover year

1 The flow-through LP rolls its assets, on a tax-deferred basis, to a mutual fund and investors receive shares in the mutual fund.

2 Investors may hold on to the mutual fund shares.

3 Investors may redeem their mutual fund shares for cash, which triggers a tax event. The amount of capital gain or capital loss tax will depend on the value of the redemption proceeds minus the ACB.

4 Any capital gain realized in the flow-through LP portfolio during this year will increase the ACB. Investors will receive a final T5013A tax slip the following year which indicates the amount of this capital gain and any additional tax deductions.

Subsequent years

1 Investors may continue to deduct any unclaimed CEE and CDE flow-through tax deductions against their taxable income.

Completing your tax return to claim flow-through tax deductions

The following is an example of where to insert CEE and CDE flow-through information on tax return forms.

Net income — **T1 General**

Enter your **total income** from line 150.			150
Pension adjustment (box 52 of all T4 slips and box 034 of all T4A slips)	206		
Registered pension plan deduction (box 20 of all T4 slips and box 032 of all T4A slips)	207		
RRSP deduction (see Schedule 7, and **attach** receipts)	208 +		
Deduction for elected split-pension amount (**attach** Form T1032)	210 +		
Annual union, professional, or like dues (box 44 of all T4 slips, and receipts)	212 +		
Universal child care benefit repayment (box 12 of all RC62 slips)	213 +		
Child care expenses (**attach** Form T778)	214 +		
Disability supports deduction	215 +		
Business investment loss Gross 228 Allowable deduction	217 +		
Moving expenses	219 +		
Support payments made Total 230 Allowable deduction	220 +		
Carrying charges and interest expenses (**attach** Schedule 4)	221 +		
Deduction for CPP or QPP contributions on self-employment and other earnings (**attach** Schedule 8)	222 +		
Exploration and development expenses (**attach** Form T1229)	224 +		
Other employment expenses	229 +		
Clergy residence deduction	231 +		
Other deductions Specify:	232 +		
Add lines 207 to 224, 229, 231, and 232.	233 =	►	–
Line 150 minus line 233 (if negative, enter "0") This is your **net income before adjustments**.			234 =
Social benefits repayment (if you reported income on line 113, 119, or 146, see line 235 in the guide). Use the federal worksheet to calculate your repayment.			235 –
Line 234 minus line 235 (if negative, enter "0") If you have a spouse or common-law partner, see line 236 in the guide. This is your net income.			236 =

CEE and CDE claimed to reduce your taxable income. Calculation completed on a T1229 form.

Canada Revenue Agency / Agence du revenu du Canada — **T1229**

STATEMENT OF RESOURCE EXPENSES AND DEPLETION ALLOWANCE

Use this form to calculate your resource expenditure pools, exploration and development expense deduction, expenses renounced in respect of flow-through shares which qualify for investment tax credits and to claim your depletion allowance.
Attach your T101, T5013, T5013A and T5 slip(s) to the statement. If you do not have any of these slips, attach a statement that identifies you as a participant in the venture.
Attach a separate sheet of paper if you need additional space for Areas I, IV or V.
Attach a completed copy of this form to your T1 *General Income Tax and Benefit Return.*

I. Summary of T101 and T5013A slips (Renounced Canadian Exploration and Development Expenses)

Identification number (*)	Canadian exploration expense (CEE) Renunciation	Canadian exploration expense (CEE) Assistance	Canadian development expense (CDE) Renunciation	Canadian development expense (CDE) Assistance	Expenses qualifying for an ITC
Total					

Portion of any reduction subject to an interest free period.
Enter the total of the amounts reported in box 130 of your T101 or T5013A slips.

Portion subject to an interest free period
Enter the total of the amounts reported in box 129 of your T101 or T5013A slips.

(*) Identification number on Form T101 – *Statement of Resource Expenses* or the partnership's filer identification number on Form T5013A – *Statement of Partnership Income for Tax Shelters and Renounced Resource Expenses.*

CEE and CDE deductions received are provided in a T5013A tax slip from investor's brokerage firm

II. Canadian resource expenditure pools

The amounts calculated in Area I above form part of your CCEE (Cumulative Canadian Exploration Expense) and CCDE (Cumulative Canadian Development Expense) pools, as the case may be. In most cases the CCOGP (Cumulative Canadian Oil and Gas Property Expense) pool is relevant only if you have an opening balance.

		CCEE	CCDE	CCOGPE
Balance at the beginning of the year	(1)			
Add: Total current year renunciation from Area I				
Other resource expenses (T5013 slips: boxes 90 to 92)				
Other (specify)				
	Subtotal (2)			
Deduct: Total assistance from Area 1				
Previous year's claim for federal investment tax credit				
Provincial flow-through share tax credit received or entitled to receive				
Assistance (T5013 slips: boxes 96 to 98)				
Other (specify)				
	Subtotal (3)			
Balance available (If negative for CCEE or CCDE include the amount on line 130 or your return, a negative CCOGPE balance will first reduce your CCDE)	[(1)+(2)-(3)] A			
Rate		X 100%	X 30%	X 10%
Maximum exploration and development expenses available for deduction (If negative enter zero)	(4)			
Exploration and development expenses claimed Enter the amount in (4) or a lesser amount	B			
Balance at the end of the year	[A - B]			

Start with the unused balance from prior year

Add any new CEE or CDE received for the taxation year

The available balance in each pool

The maximum allowable deduction for the taxable year
100% of CEE pool
30% of CDE pool

Amount claimed for taxation year

Ending balance in the pool for deduction in future years

Qwest's oil & gas portfolio management team

Our Three Q's:

The following are our critical criteria for selecting oil & gas companies for flow-through share investments:

Quality
management team

Quality
oil & gas assets

Quality
balance sheet

Qwest Investment Fund Management Ltd.

Qwest's Calgary-based oil and gas portfolio management team has significant oil and gas industry knowledge and experience. Our team takes a disciplined and analytical approach to selecting oil and gas investments. Our team performs a thorough due diligence process and invests in companies with a combination of sound financial fundamentals, excellent growth prospects and a strong management team.

Don Short, CFA

Mr. Don Short is the Senior Vice-President and Portfolio Manager and a Director of Qwest Investment Fund Management Ltd. ("QIFM"), a registered investment fund manager and portfolio manager. QIFM is also an exempt market dealer in British Columbia, Alberta and Ontario.

As portfolio manager, Don is responsible for leading his Calgary-based portfolio management team in the research, analysis and selection of oil and gas investment opportunities for our various natural resource sector funds.

Born and raised in Calgary, Alberta, Don has focused his professional investment career on Calgary's oil and gas industry since the early 1990's with various positions at companies including: Raymond James Ltd., FirstEnergy, and Northridge Canada Inc.

Contact Us

For more information about Qwest Investment Management Corp., our flow-through products and flow-through information, please contact us 1-866-602-1142 (ext. #1) or at info@qwestfunds.com.

www.qwestfunds.com

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