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reduce taxable income

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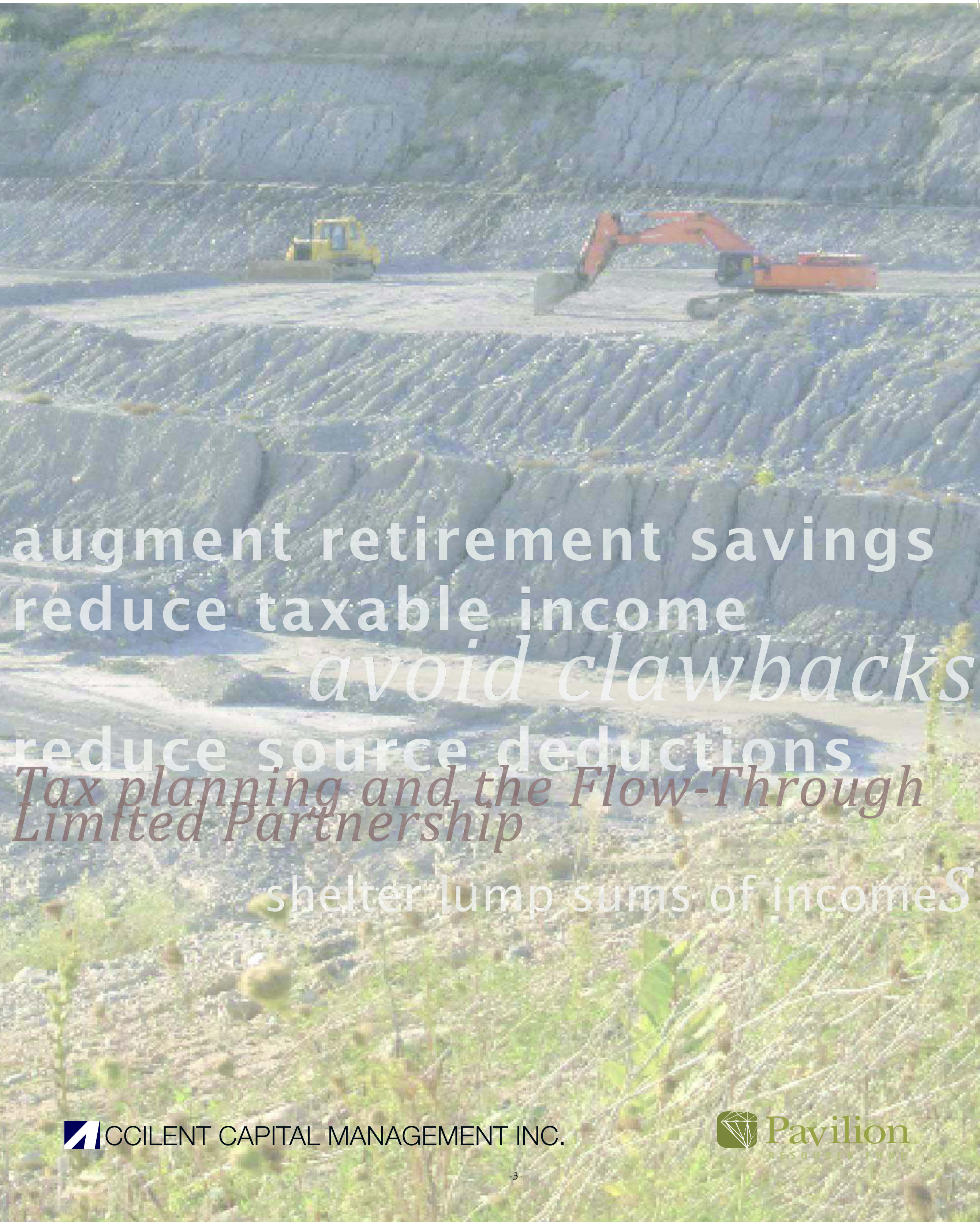
Tax planning and the Flow-Through Limited Partnership

shelter lump sums of income



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ACCILENT CAPITAL MANAGEMENT INC.

Pavilion

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Table of Contents

Tax planning and the Flow-Through Limited Partnership (FTLP)

"The benefits of FTLPs are unique, providing each investor with a solution to meet their specific needs. Everyone visualizes their financial goals differently - FTLPs can help you achieve yours."

– Dan Pembleton *MBA, CFA*

The company issuing the Flow–Through shares agrees to:

- Incur CEE expenditures at least equal to the amount of the Flow–Through shares issued,
- Renounce these CEE expenditures to the shareholders in proportion to the amount of capital invested by the Flow–Through shareholders, and
- Incur these CEE expenses within a period of 18 to 36 months.

| 01

About Flow–Through Shares

The term "Flow–Through Shares" is used to describe an equity investment and tax saving program which was created by the Canadian Federal Government in 1954 to assist companies in the resource exploration and extraction businesses (mining and oil and gas companies) to raise capital. This has been expanded much more recently to include alternative energy producers. The Canadian government has long recognized that Canadian resource companies operating in the Oil and Gas, Mining and Alternative Energy industries often incur significant expenses associated with their exploration and development activities. This program allows these companies to issue Flow–Through shares to raise the capital necessary to conduct these activities. By issuing these Flow–Through shares the companies are able to renounce their Canadian Exploration Expenses (CEE), Canadian Development Expenses (CDE), or Canadian Renewal and Conservation Expenses (CRCE) to Flow–Through shareholders. Flow–Through shareholders can then claim these deductions in proportion to these expenditures. (For the remainder of this brochure, CEE, CDE and CRCE will be referred to simply as "CEE" for simplicity as the Pavilion Flow–Through fund has traditionally invested 100% for CEE credits.)

RESOURCE DEDUCTIONS

In the case of a Flow–Through Limited Partnership ('FTLP') investing in resource companies, resource expenses are a discretionary deduction. This means that the taxpayer may claim at their own discretion any part or no part of the deduction allowed in a year. This allows an investor to fine tune their tax planning at any time up to the filing of their tax return. The investor can adapt to changing circumstances and not have to forfeit the advantages gained through their investment. An investor may choose to use their deduction for past tax years (up to 3 years back) or may carry it forward 20 years. This would make sense where the taxpayer has insufficient income to use all of their CEE deductions or where the Alternative Minimum Tax (AMT) may be triggered and the CEE deduction can simply be carried forward and used in future years. Investors who receive CEE deductions in a tax year are allowed to deduct this amount from any source of income.

Resource Flow–Through shares have been included in the Income Tax Act to provide resource companies with an attractive method of raising funds for resource exploration and development activities.

Special Considerations for Quebec Residents:

In Quebec, investors in a Flow–Through Limited Partnership can only deduct investment expenses incurred up to the amount of the investment income earned in a year. This means that deductible interest and losses as well as CEE cannot be deducted against any source of income - only investment income. However, CEE incurred in Quebec is exempt from this rule. Any excess over the amount of investment income must be included in income on the investor's Quebec tax return, although this excess may be deducted against investment income earned in any of the three previous tax years and any subsequent tax year. Therefore, Quebec residents should carefully plan their Pavilion Flow–Through investments because they do not have as much flexibility on the types of income they can deduct their investment from and they do not have the flexibility of carry forwards that other Provincial jurisdictions offer in alignment with the Federal allowances.

| 02

Tax Benefits

In addition to providing potentially attractive investment returns, Flow–Through shares offer direct tax benefits. The tax benefits to an investor are based on two major factors:

Benefit 1

TAX SAVINGS

Investors who purchase Flow–Through shares will enjoy a tax deduction over time equal to their investment. Because CEE is allocated to the investor, who can then claim a deduction for these amounts, it is generally fully deductible against any source of income. The tax savings reduce the "at–risk" amount, meaning the amount of money an investor has in the investment is reduced because of the tax savings. Investors are likely to have a low or nil adjusted cost base in the Flow–Through shares because the cost base (what the investor paid for the shares) is reduced by the CEE deductions. Therefore, when the Flow–Through shares are sold, the full proceeds of the sale are taxed as capital gains instead of only the increase in value above the purchase price being taxed at this lower rate. Since capital gains are taxed at only one–half the rate of ordinary income, this tax rate differential generates tax savings.

Benefit 2

ADDITIONAL TAX SAVINGS –
Super Flow–Through 15% Tax Credit

The Pavilion Flow–Through funds are considered "Super Flow–Through" funds because the majority of our investments are in mining companies. The CEE provided by these companies comes with a significant added benefit of a 15% Mineral Exploration Tax Credit (METC) and also an added benefit of the new Critical Minerals Exploration Tax Credit (CMETC). These credits are also applicable for the same tax year in which the Pavilion Flow–Through investment was made. The METC and CMETC are powerful and flexible deductions as they are applied (deducted) from an individual's federal tax liability for that year. For additional flexibility they can be applied back 3 years or forward 20 years and applied against federal taxes owing in those years. The METC cannot be used to reduce Alternative Minimum Tax and is a non–refundable tax credit.

Other Tax Considerations

PROVINCIAL DIFFERENCES

As a result of federal legislation relating to the taxation of royalties and similar payments, the major Oil and Gas producing provinces (Alberta, Saskatchewan, and British Columbia) allow extra tax credits which represent a refund of extra provincial taxes (or a portion of these taxes). Please refer to provincial tax information in the relevant province.

CONSIDERATIONS FOR SMALL BUSINESS OWNERS AND FARMERS

Renounced expenditures deducted by an individual tax–payer may affect the ability of the taxpayer to claim the capital gains exemption in respect of sales of qualified small business shares and certain farm assets, as the taxpayer's CNIL ('cumulative net investment loss') requires an inclusion of 50% of the deductions taken by the taxpayer in respect of Flow–Through share renounce–ments. The capital gains exemption is negatively affected by a positive CNIL balance.

"FTLPs provide potentially attractive tax benefits for the investor, while promoting the development of the natural resource sector, and the jobs associated with it."

– Dan Pembleton *MBA, CFA*

Photo: Accilent President Dan Pembleton, on–site with a quarry worker.

Benefit 3

ADDITIONAL PROVINCIAL DEDUCTIONS

Additional Provincial deductions are available depending on the Province. British Columbia, Saskatchewan, Manitoba, Ontario and Quebec all offer extra deductions to their residents for the portion of the Pavilion Flow–Through fund which is invested in companies that operate in their Provinces. We don't go into great detail here because the deductions available are only applied based on the proportion of the fund which is invested in each of those Provinces and we cannot know what those amounts are until the fund is fully invested at the end of each calendar year.

Benefit 4

TAX DEFERRAL

The ability to defer the sale of Flow–Through shares to a subsequent tax year allows an investor to defer their tax liability. Investors benefit from the time value of money associated with deferral of the tax liability. This tax benefit is further enhanced where the taxpayer has:

- Net capital losses carried forward (or potential to realize capital losses) against which to offset the capital gains from the disposition of the Flow–Through shares. This offset of capital gain from Flow–Throughs accelerates and crystalizes the value of those losses and further enhances the after–tax cash flows of a Pavilion Flow Through fund investment.
- An expectation of being in a lower tax bracket when the capital gains on the Flow–Through shares are realized.

Benefit 5

FLOW–THROUGH INVESTMENTS ARE TAXED AS CAPITAL GAIN WHEN SOLD

The proceeds of a Flow–Through investment are taxable as a capital gain in the year in which they are sold. Capital gains are taxed at only half the rate as income (technically only half the gain is taxed but at the normal rate, however the effect is the same as half tax and is commonly referenced in this way). This is a significant benefit and perhaps only second in importance to the deduction of Flow–Throughs from income. The ability of Flow–Through investments to be deducted from an investor's income and then only taxed as a capital gain is called the transformative property of Flow–Throughs. This is because all the money that passes through a Flow–Through invesment is transformed from being taxed at the investor's highest marginal rate to being taxed at ½ that rate. This is a powerful tax planning and wealth building tool that no other government sponsored plan does for investors (see the comparison chart of Flow–Through, TFSA and RRSP plans on page 14 of this guide).

Benefit 6

LIMITED PARTNERSHIP OPERATING EXPENSES ARE TAX DEDUCTIBLE

To gain the advantages of portfolio diversification and professional management, Pavilion Flow–Through is structured as a limited partnership. While the main purpose is for the former reasons a secondary benefit occurs because the management fees and operating expenses of the fund are business expenses of the limited partnership. These business expenses are also deductible against income and further increase the overall tax efficiency for the investor.

Benefit 7

FLEXIBILITY AND NO MANDATED LIMITS

The Flow–Through program does not have any imposed dollar amount restrictions. This is another key differentiator from RRSP or TFSA which both have limits to annual amounts. The flexibility in amount is especially helpful for high–income earners and for people or corporations that have large one–time gains where the other program limitations render them less effective. The “limit” on Flow–Through investing is what is practical from a tax efficiency point of view and also matching the investors risk tolerance. The ability to carry forward deductions, without penalty, also makes the use of Pavilion Flow–Through in your tax management tool kit very useful to fine–tune your deductions even after the year end has passed. If you mistakenly overcontribute you can simply carry it forward (CRA form T1229). In order for the deduction to be applicable to any given year's taxes, you cannot make additional investments after December 31st of that year. Therefore, make sure to invest at least the minimum you believe you need, or better yet, have a pro–forma tax return done to see what your needs are likely to be.

The Flow–Through deductions are also flexible because they can be applied to any source of income such as employment, business, capital gain, or pension. This applies even more–so for the 15% METC of the Super Flow–Through as that is deducted directly from any tax payable. This is another reason why Flow–Through is such an advanced tax planning and management tool.

About Flow–Through Limited Partnerships – the Logistics

Flow–Through shares are commonly acquired through a Limited Partnership to provide diversification, access to a broad range of resource companies, and professional management to reduce risk. This structure is used by the Pavilion Flow–Through funds. A Limited Partnership ('LP') is a legal arrangement between a General Partner, which for Pavilion funds is a corporation formed for this specific purpose, who takes responsibility for managing the affairs of the partnership. The Limited Partners or investors, whose role is restricted to investing in the partnership units, are not involved in managerial decisions.

The Flow–Through process explained:

1. An investor who purchases units of a Limited Partnership, which in turn invests the funds in Flow–Through shares of selected companies.

2. The companies spend the funds received from these investments on activities that qualify as CEE, and then renounce the tax deductions associated with these expenditures to the Limited Partnership.

3. The Limited Partnership allocates these tax deductions to investors each year in proportion to their investment.

4. Investors can then use these deductions when calculating their own taxes.

ADVANTAGES OF FLOW–THROUGH LIMITED PARTNERSHIPS

Flow–Through Limited Partnerships are excellent vehicles for investors who wish to receive all of the tax benefits of Flow–Through shares plus portfolio diversification, professional management, access to a broad range of resource companies, and reduced risk versus single stock Flow–Through investing.

TAX REPORTING

Limited Partners who invest in a Flow–Through Limited Partnership in a particular year will receive, in late March or early April of the following year, information necessary for them to complete their tax reporting for the previous year. The tax form investors receive from the Partnership is called a T5013 and it will contain all the information the investor needs for their annual tax filing.

How a Flow-Through Limited Partnership Works

The LP structure is used as an efficient way to 'flow- through' the tax benefits to the investors.

| 04

Tax Planning and Flow–Through Limited Partnerships

Investing in Flow–Through Limited Partnerships can be an important tool in tax planning. The chief benefits of investing in Flow–Through Limited Partnership units are tax deferral and the ability to derive tax–advantaged returns in the form of capital gains. There are numerous ways to use Flow–Through investments to manage taxes or build an investment that is capable of enhancing cash flow year after year.

On the pages that follow, we present a number of examples that demonstrate how investment in a Pavilion Flow–Through Limited Partnership may be used for tax planning and tax liability management. In each example three assumptions are made for simplicity:

1. *The Flow-Through investment is 100% tax-deductible in the year that it is made.*

In practice, the actual amount typically ranges from 98% to 103% in the first year, with additional amounts deductible in subsequent years. Some amounts deductible in future years may relate to the costs of organizing the Limited Partnership and operating expenses as outlined in the benefits previously. The additional 15% tax credit available on mining Flow–Through shares further increases deductions available. The total amount of deductions depends on the amount of the portfolio invested in mining Flow–Through shares.

2. *The value of the Flow-Through investment at maturity is the same as its original purchase price.*

In practice, the value of the Flow–Through shares of each company may rise or fall during the period of investment, changing the value of the FTLP units.

3. *The investor has a 50% marginal tax rate.*

Investors should obtain professional tax advice and prepare, or have an accountant prepare, a pro forma tax return to avoid incurring Alternative Minimum Tax (AMT). The amount invested in Limited Partnership units should not exceed the maximum amount the investor may deduct without incurring AMT, although Flow–Through CEE and METC deductions can be deferred, and unused deductions are available up to 20 years after making an investment. Therefore, an error can simply be corrected in future years. Because the market value of the Limited Partnership could decline, these strategies should be considered in relation to the investor's overall risk tolerance.

Example 1 | 05

To increase retirement savings

The contributor to a TFSA does not receive any tax deduction for contributions. However the benefit is investments are allowed to grow tax–free within the plan. Withdrawals from the plan are not taxed because no tax deduction was given when contributions were made. The TFSA has lower contribution limits than RRSPs. The current annual maximum contribution limit is $6,000.

RRSPs and TFSAs are an excellent vehicle with which to save for retirement and are also government sponsored like the Flow–Through program. The contributor to an RRSP receives a tax deduction for the amount of the contribution. Any investment return earned within the RRSP is tax–deferred until amounts are withdrawn. In any given year, an individual's ability to contribute to an RRSP is limited to the lesser of $26,500 (for 2019) or 18% of that individual's earned income for the prior year. The upper limit increases annually. Individuals who wish to increase the pace of their retirement savings beyond these limits can only do so in investments outside of the RRSP. When money is withdrawn from an RRSP that money is considered income and is taxed at the investor's marginal tax rate and is also used when calculating eligibility for the programs such as OAS and may cause reductions in those benefits.

The following table compares and contrasts investments in RRSPs and Flow-Through Limited Partnerships:

	Contribution to RRSP	Investment in Flow–Through Limited Partnership	Contribution to TFSA
TAX BENEFITS OF INITIAL CASH OUTLAY	Investor receives tax deduction equal to the amount contributed.	Investor receives tax deductions typically equal to (or greater than) the amount invested.	No tax deduction. Investments must be made with after–tax dollars.
TAXATION OF RETURN	Returns are tax–deferred within the RSP.	Returns may be tax–deferred within the fund although an investor may be taxed on distributions if declared by the fund.	Returns within the plan are tax–sheltered. No tax will be applied to the returns.
TAXATION OF CASH RECEIPTS	Amounts withdrawn are included in the investor's income.	Proceeds from fund liquidation will only be taxed as capital gain which means only 50% of which is included in the investor's income.	No tax is applicable upon withdrawal.
CONTRIBUTION LIMITS	Limited contributions.	No contribution limits.	Limited contributions

Example 2 | 06

To reduce taxable income

The power of Flow–Through investing can be compounded to generate free–flowing cash from a single $10,000 investment. This strategy is most suitable for individuals with current and anticipated income taxable at the highest marginal tax rate (we assume a 50% tax rate in this example). In general, the higher a person's marginal tax rate the greater the benefits from using Flow–Through deductions. The basis of this strategy is that the investor continuously re–invests in new Flow–Through LPs as their current Flow–Through LP investments are available for liquidation (assumed to be every 2 years in this example). The benefit of this strategy is that the investor is able to recycle their original investment dollars multiple times. Each time this is done they are able to receive a tax deduction on the re–invested dollars. The investor does have to pay capital gains tax on liquidated Flow–Through investments but there is a significant net cash gain each time this is done. In this example, the investor sets aside $10,000 to purchase FTLP units. In year 3, the securities purchased in year 1 will be sold (an assumed 2–year liquidation) and an identical amount will be invested in FTLPs offered that year. In year 5 the securities purchased in year 3 will similarly be sold, with an off–setting new purchase made. The whole cycle will simply repeat itself every second year until the investor chooses not to continue. Based on this table, the investor would generate after–tax cash flow of approximately $2,500 every second year, translating to an annual after–tax return of 12.5%. This strategy provides the additional benefit of regular reinvestment to mitigate the cyclical nature of the resource sector. The option is to decide how much to reinvest upon each maturity. We like to call this approach the Flow–Through Ladder™.

The assumption in the table below is that there will be no change in the value of the $10,000 invested. This is made to simplify the explanation. In fact, the value of the LP units may vary slightly with market fluctuations.

Year	A Amount (Invested) in LP units ($)	B Amount Realized on LP units ($)	C Net Amount (Invested in) Realized on LP units ($) (A + B)	D Tax Refund ($)	E Capital Gains Tax Paid ($)	F Net Tax Refund ($) (D + E)	G Total ($) (C + F)
1	(10, 000)		(10,000)	4,500		4,500	(5,500)
2	-	-	-	-	-	-	-
3	(10,000)	10,000	-	4,500	(2,250)	2,250	2,250
4	-	-	-	-	-	-	-
5	(10,000)	10,000	-	4,500	(2,250)	2,250	2,250
6							
7	(10,000)	10,000	-	4,500	(2,250)	2,250	2,250
8							
9	(10,000)	10,000	-	4,500	(2,250)	2,250	2,250
10							
11	-	10,000	10,000	-	(2,250)	(2,250)	7,750

MARGINAL TAX RATE 45%

To shelter lump sums of income from taxes

Many investors receive a large sum of income in a particular year, for example, from the sale of real estate with accrued gains, or the sale of a business. In this situation, investors can purchase Flow–Through Limited Partnership units to reduce their tax payable and defer their tax liability to a future year. Through this sheltering and deferral process, an investor can benefit from the lower tax rates applied to disposition proceeds and realize savings on the difference between these and the higher tax rates applied to the deductions.

The table below illustrates this – for this example, we assume the taxpayer's marginal tax rate is 50% and capital gains are taxed at 50% of the marginal rate.

Example 3 | 07

	Invest in Limited Partnership Units	Do Nothing
EARNED INCOME ($)	10,000	10,000
INVESTMENT IN FLOW–THROUGH LIMITED PARTNERSHIP ($)	(10,000)	-
INCOME TAX PAYABLE ($)	-	(4,500)
LIMITED PARTNERSHIP REDEMP–TION PROCEEDS ($)	10,000	-
CAPITAL GAINS TAX 50% OF MARGINAL TAX RATE = 22.5% ($)	(2,250)	-
TOTAL AFTER–TAX PROCEEDS ($)	7,750	5,550

Per $10, 000 the dollar advantage is $2,200, and the percentage advantage is a substantial 39.6%.

Example 4 | 08

To prevent or reduce Old Age Security and other clawbacks

Old Age Security (OAS) benefits begin to be reduced when taxable income reaches $75,910 as of the 2019 tax year. If a taxpayer's income reaches approximately $122,843 (2018), the OAS benefit is fully repaid. Other tax credits such as medical expenses are also a function of an individual's net income.

A senior investor with a taxable income of $122,843 who makes a $46,933 investment in limited partnership units may receive a number of immediate benefits:

1. Additional current year tax reductions of approximately $23,500 (can vary depending on their Province of residence and other factors).
2. Full restoration of OAS of approximately $7,289.52 (2019 taxation year).
3. Possible additional GST and/or medical tax credits.

Sheltering lump sums of income from tax allows an FTLP investor to hold onto more of their wealth.

Example 5 | 09

To manage registered accounts

Some taxpayers have accumulated significant amounts in their RRSPs. Income received from registered plans is fully taxable at an investor's marginal tax rate. For some investors, high retirement income may result in OAS payment clawbacks. Other investors may be considering an RRSP/RRIF withdrawal to reduce registered assets even before retirement. An investor may wish to do this because withdrawals from an RRSP are taxed as income, unlike Flow–Through, where proceeds from liquidation are taxed as capital gain. In these situations, investors may opt to withdraw a portion of their registered accounts to reduce the size of the plan and reduce future income from the plan and avoid higher taxes and OAS clawbacks. If an investor were to take out a lump sum and purchase an equivalent value of Flow–Through Limited Partnership units, he or she could off set the realized income from the RRSP/RRIF withdrawal and ultimately turn this income into capital gains. If the registered income is not needed to guarantee a lifestyle, some capital from the registered plan could be invested in Pavilion FTLP units to offset the income tax from the withdrawal.

Resource partnerships have a variety of advantages and can be used to achieve many different objectives.

Example 6 | 10

To enhance a corporate dividend account

Tax deductions are available for the same year the investment is made.

Corporations can also use Flow–Through Limited Partnership units with the only difference in tax deductions being that corporations do not get the 15% METC. If the corporation has capital loss carry–forwards, these can be used to offset the resulting capital gain on the redemption or sale of the units. Disposition of Limited Partnership units held by a corporation which result in a capital gain will increase the corporation's capital dividend account by the amount equal to the 50% non–taxable capital gain. At any time when there is a positive balance in the capital dividend account, the corporation may elect to pay a tax–free dividend to its shareholders.

Additonal Flow–Through Tax Planning Benefits

As illustrated in the preceding examples, many different objectives can be achieved through the built–in benefits offered by Flow–Through Limited Partnerships. In addition to these benefits, other considerations exist that allow the investor to maximize the versatile advantages of Flow–Through Limited Partnerships in tax planning.

Additional Benefit 1

REDUCE SOURCE DEDUCTIONS

Employees may consider applying on Form T1213 to the Canada Revenue Agency (CRA) to reduce the amount of tax withheld at source from their employer and receive an immediate tax benefit. Self–employed individuals who remit quarterly to the CRA may reduce or eliminate quarterly tax installment payments by investing in Flow–Through Limited Partnerships.

Additional Benefit 2

DEFER DEDUCTIONS TO A FUTURE YEAR

Canadian Exploration Expenses (CEE) that are renounced on a Flow–Through share – or through a Partnership that buys Flow–Through shares – are added to the taxpayer 's cumulative CEE account. Resource expenses are a discretionary deduction, meaning that the taxpayer may claim any part (or no part) of the maximum deduction allowed in a year. (This applies to all Canadians, except for Quebec residents.) Claiming less than the maximum allowed should be considered by taxpayers who:

1. Expect to be in a higher marginal tax rate in a future year, or
2. Will be subject to Alternative Minimum Tax (AMT) unless the deduction is limited.

Unused CEE balances may be carried forward indefinitely and claimed in a subsequent year. The 15% METC may be carried forward 20 years.

"Having multiple advisors in our network encourages diversification, creates opportunities for investors, and keeps broadening our investment horizon."
- Dan Pembleton *MBA, CFA*

Your Notes