CMP
NEXT EDGE

An Introduction to Flow-Through Investing

FLOW-THROUGH SHARES: A MADE IN CANADIAN INVESTMENT

Flow-through investment is a unique Canadian investment vehicle offering investors tax benefits. Primarily used in the resource sector (mining, oil and gas), it allows companies to transfer certain exploration expenses to investors, who can in turn then claim these expenses as deductions on their personal income tax returns.

Investing in flow-through shares helps fund exploration and development activities in the resource sector, contributing to the Canadian economy. This flow-through investment mechanism enables the issuing corporation to transfer resource expenses to the investor. Companies in the mining, oil and gas, renewable energy, and energy conservation sectors can issue flow-through shares ("FTS"") to support their exploration and project development efforts.

Based on the information provided by the Prospectors & Developers Association of Canada (PDAC), flow-through share financing contributes nearly 70% of the funds raised on Canadian stock exchanges for exploration across the country, generating significant exploration activity within Canadian borders.[1]

BENEFIT FOR INVESTORS

1. **Tax Efficiency:** The primary benefit of flow-through shares is the ability to deduct the full amount of the investment against income. Investors may enjoy even greater deductions or tax credits in provinces with additional incentives, such as British Columbia, Quebec, or Ontario.

2. **Capital Gains Deferral:** Upon the sale of the Flow-Through LP Units, investors will realize a capital gain. Many issuers allow the LP units to roll into a mutual fund corporation that allows for the deferral of this capital gains tax until those units are sold. In addition, if capital gains are realized on the sale of the units, the proceeds can often be reinvested in other tax-advantaged accounts or investments, such as a new flow-through LP offering, further deferring taxation.

3. **Portfolio Diversification:** Flow-through shares offer exposure to the resource sector, which is typically underrepresented in traditional portfolios. This has the potential to enhance diversification and hedge against market volatility in other industries[2].

4. **Community and Economic Impact:** Investing in flow-through shares supports the development of critical infrastructure and resource projects, often in remote or underserved regions of Canada.

5. **Flow-Through Investing via a Limited Partnership (LP):** These pooled offerings provide for professional management, portfolio diversification, and administrative simplicity, making it an attractive option for investors seeking tax-efficient exposure to resource exploration.

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1. Prospectors & Developers Association of Canada (PDAC), 2024
2. https://www.goldmansachs.com/insights/articles/which-commodities-are-the-best-hedge-for-inflation

HOW FLOW-THROUGH INVESTMENT ARE STRUCTURED

The most common form of flow-through investment is via Limited Partnership (LP) units issued by entities that invest in a diversified portfolio of flow-through shares. LPs pool capital from multiple investors to purchase FTS issued by numerous resource companies. The LP is managed by a general partner who handles investment decisions and administration. Investors act as Limited Partners, contributing capital and receiving tax benefits while limiting their liability to their amount invested in the LP.

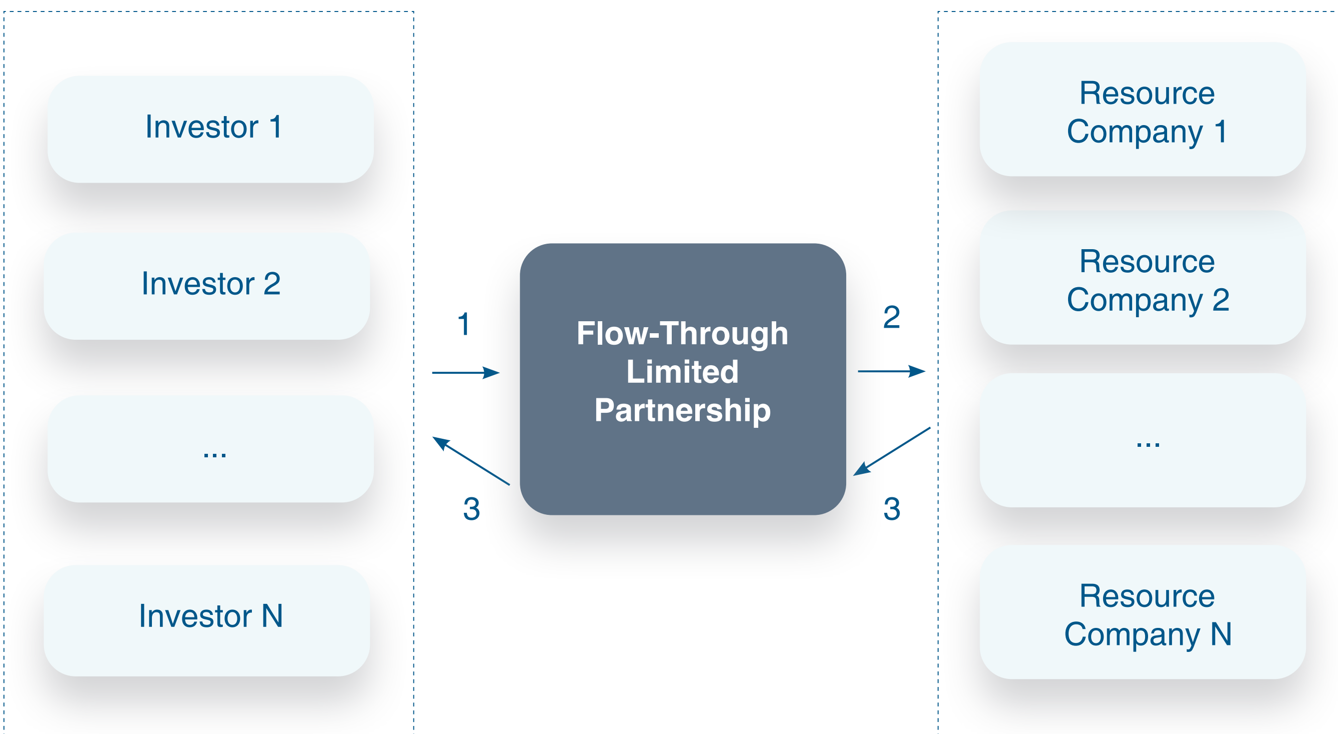
Unlike direct investments in flow-through shares, where only the initial investor can claim deductions for renounced expenses, with LP units, the right to deduct these expenses belongs to whoever owns the unit on the last day of the LP's fiscal year. Generally, approximately 90-95% of the investment is passed through as deductions in the first year, with the remaining 5-10% is carried over to subsequent years[3].

STEPS OF FLOW-THROUGH LP INVESTMENT[3]:

Step 1: The investor purchases units in a flow-through limited partnership.

Step 2: The partnership's partnership's portfolio manager invests in flow-through shares of resource companies.

Step 3: Resource companies use the raised capital for eligible exploration expenses. The tax credits received from the eligible exploration expenses are passed through to the limited partnership and in turn then on to the investor. The investor will receive a tax slip.

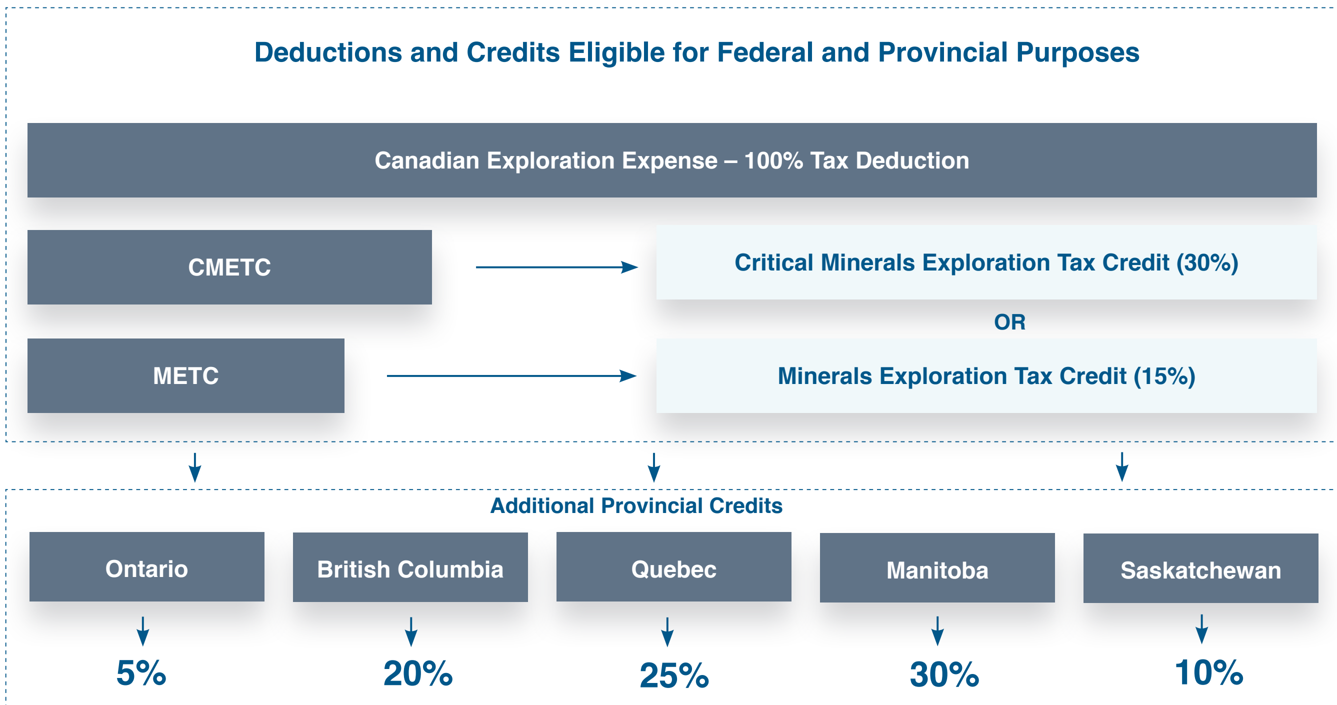


Source: Next Edge Capital Corp., 2025

3. The Navigator. Flow-Through Shares and Limited Partnership Units. RBC Wealth Management, 2022.

The limited partnership is typically dissolved in approximately 12–24 months after the closing of the limited partnership offering. LP Units are often rolled into a series of shares of a mutual fund corporation, allowing for continued tax-deferral of the investment until those mutual fund shares are sold. Investors can choose whether to hold or sell these mutual fund shares.

FLOW THROUGH STRUCTURE FOR INDIVIDUAL CANADIANS



Source: Next Edge Capital Corp.

This chart illustrates the tax benefits available for Canadians at both the federal and provincial levels. Investors can deduct 100% of eligible Canadian Exploration Expenses (CEE) from their taxable income. Additionally, they may qualify for one of two federal tax credits: the Critical Minerals Exploration Tax Credit (CMETC) at 30%, which applies to specific critical minerals, or the general Minerals Exploration Tax Credit (METC) at 15%.

Beyond federal incentives, investors can also benefit from additional provincial tax credits, which vary by location. These provincial incentives further enhance the attractiveness of flow-through shares as they can significantly reduce an investor's overall tax liability. Investments in provinces with higher credits, such as Manitoba and Quebec, provide the greatest combined tax benefits, making them particularly appealing for investors seeking to maximize their tax savings. Provincial credits apply only to exploration within the specific province and require investor residency.

TAX EXAMPLES FOR FLOW-THROUGH INVESTMENT

Below is an illustrative example of an Ontario resident investing in a flow-through limited partnership. The illustration assumes that the individual is at the highest marginal tax bracket. The calculations in the tax tables below assume that 75% of the limited partnership's portfolio will be used to acquire Flow-Through Shares of Resource Companies incurring Eligible Expenditures in 2025 that will entitled to the Critical Mineral Tax Credit and that 25% of the limited partnership's portfolio will be used to acquire Flow-Through Shares of Resource Companies incurring Eligible Expenditures in 2025 that will entitle a Limited Partner to the 15% federal non-refundable Mineral Exploration Tax Credit (METC). It is assumed that the investor disposes of their mutual fund shares the year the LP is rolled into the designated mutual fund corporation; as such, it is assumed that the investor will be subject to tax on the recapture of the investment tax credits in 2025. The illustration considers that the cost to the investor of any Flow-Through Share which it acquires to be nil and, therefore, the amount of such capital gain will generally equal the proceeds of disposition of the Flow-Through Shares.

FLOW-THROUGH INVESTMENT TAX ILLUSTRATION
ONTARIO TAX EXAMPLE

	Investment Year	Rollover Year	Net Cash Flow
Flow-Through LP Investment	-100,000	-	-100,000
Tax Savings [See note A]	65,728	-	65,728
Investment Redemption	-	100,000	100,000
Capital Gains Tax Payable [See note B]	-	-26,765	-26,765
Totals	-34,272	73,235	38,963
		Rate of Return	*113.69%*

Note A: Investment Year Tax Savings

Taxable Income Deduction - Flow Through Shares	100,000
Ontario Effective Tax Rate	53.53%
Tax Savings CEE	53,530
Tax Savings METC	1,743
Tax Savings CMETC	10,456
Tax Savings Total	65,728

Assumes 75% CMETC and 25% METC

Note B: Additional Tax in Rollover Year

	100,000
Less: Eligible Capital Loss Carry Forward	-
Net Taxable Capital Gain	100,000
Effective Tax Rate on Capital Gains	26,77%
Rollover Year Capital Gains Tax Cost	26,765

Source: Next Edge Capital Corp.

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