



SENTINEL HILL ENTERTAINMENT  
CORPORATION

February 22, 2011

Dear Limited Partner:

Re: Sentinel Hill 1998 Master Limited Partnership (the “1998 Partnership”) Update:  
Canada Revenue Agency (“CRA”) – Appeal to the Tax Court of Canada  
**ACTION REQUIRED BY FORMER LIMITED PARTNERS**

We are writing this letter to the former limited partners (the “Limited Partners”) of the 1998 Partnership concerning the current status of the litigation process for the reassessments issued by the CRA. Our last correspondence to you on this matter was on August 5, 2008. The 1998 Partnership wound up its business affairs in 2008 and was subsequently dissolved following a meeting of the Limited Partners on December 10, 2008.

The history of Sentinel Hill’s dealings with the CRA is set out in more detail below, but can be summarized as follows: following protracted negotiations, we (and our counsel) were reasonably optimistic that we would either receive an acceptance of our counter/counter proposal by the CRA or a further counter proposal, being a denial of deductible expenses somewhere between 12.5% and 19%. But on July 6, 2010, to our disappointment and surprise, we received a one sentence letter from the Department of Justice categorically rejecting our counter/counter proposal for each of the 1998 Partnership and the 2001 Partnership. No explanation or analysis was provided.

Sentinel Hill and its principals have paid, to date, in excess of \$380,000 to lawyers for work directly related to the 1998 Partnership (which figure excludes those costs and expenses that arose in the normal course of business). In addition, over the past 10 years countless hours and additional hundreds of thousands of dollars have been expended for matters related to the 1998 Partnership indirectly: for instance, dealings with the CRA resolving the disputes for the Sentinel Hill 1999 Master Limited Partnership (the “1999 Partnership”) and the SHAAE (2001) Master Limited Partnership (the “2001 Partnership”). The time and money expended has benefited and will significantly benefit the investors in the 1998 Partnership.

Unlike with the other Sentinel Hill Partnerships, the CRA has issued individual reassessments to investors in the 1998 Partnership. For that reason, as well as the circumstance that all our efforts to date have been unsuccessful, we have put in place a mechanism for a joint appeal by the Limited Partners, involving three “test case” partners. To this end, we have negotiated a very favourable fee arrangement with Thorsteinssons LLP to carry this litigation through to a resolution at the Tax Court and the Federal Court of Appeal (or a reasonable settlement), all on behalf of the Limited

Partners who choose this option. The fees would be capped at \$400,000, plus disbursements (and taxes). We have chosen the three “test case” investors and Thorsteinssons LLP is ready to proceed with this litigation, so long as they receive adequate funding.

If you choose this option (and enough of the other Limited Partners do), you will be a client of Thorsteinssons LLP on the terms set out below under “Joint Appeal Retainer Terms”. **Any Limited Partners who wish to proceed independently may do so and will be excluded from that joint litigation process.**

While the principals of Sentinel Hill will continue to offer their support without any remuneration for their efforts, at this junction it is for each of the Limited Partners to decide how to proceed.

### **Update regarding the 1999 Partnership**

The Determination of the 1999 Partnership was settled with the CRA in April 2009. The settlement was based on a denial of a percentage (the exact amount was the subject of a confidentiality agreement) of the deductible expenses of the 1999 Partnership.

As part of the settlement process, we applied for interest relief for a period of 51 months. This would have enhanced the value of the settlement and brought it to a level generally comparable with the settlement reached for the 2000 Partnership (previously settled), being a denial of approximately 9.4% of the otherwise deductible expenses. We ultimately received interest relief for 45 months and were notified to that effect by the CRA on May 4, 2010. In August 2010 the CRA then issued a redetermination to the 1999 Partnership implementing the settlement. In December 2010 the CRA started issuing Notices of Reassessments for the 1999 and 2000 tax years to the limited partners in the 1999 Partnership. The CRA advised the limited partners that they intend on calculating the interest relief at a later date. They have also failed to recognize any pre-payments that were made in anticipation of these Reassessments. We have been in contact with the CRA on behalf of the limited partners, and the CRA has stated that they recognize their oversight and will be correcting the Reassessments near the end of February.

In our view, and that of counsel, the settlement of the 1999 matter with the CRA, after interest relief, was comparable to the settlement reached for the 2000 Partnership and was satisfactory when compared to the alternative of tax litigation.

### **Update regarding the Tax Litigation for the 2001 Partnership**

The CRA threatened to confirm the Determination of the 2001 Partnership’s losses in 2005, but never actually did so. After protracted fruitless discussions with the CRA, we appealed to the Tax Court of Canada on July 7, 2009, which commenced the tax litigation process.

The CRA’s Reply was filed on March 31, 2010. Our counsel reviewed the Reply and advised that it should be challenged as it contained numerous instances of improper pleading. On the advice of counsel we filed a motion to strike significant portions of the Reply. This motion was heard by Chief Judge Rip of the Tax Court on September 22, 2010. We are awaiting a decision.

## **Further Settlement Discussions**

After appealing the 2001 Partnership Determinations we contacted the CRA in the summer of 2009 in an attempt to settle before litigation activity started in earnest. We were told that we should call back in October 2009, which we did. A meeting was arranged for January 2010 with John Crowley, the Director of Appeals, and a number of other senior CRA and Justice Department officials. The principals of Sentinel Hill attended the meeting and discussed the concept of putting forward a numbers based settlement (a denial of a percentage of the losses) rather than a settlement based on an examination of the various issues. Our objective was to reach a "percentage of losses" settlement comparable to the settlements reached for the 1999 and 2000 Partnerships.

In early February 2010, the CRA invited us to put forward a proposal for the Determinations for the 2001 Partnership on a percentage of losses basis. The CRA also requested a proposal for the 1998 Partnership. Shortly after the meeting, with the assistance of Thorsteinssons LLP, we put forward a settlement proposal that would have resulted in a denial of approximately 10% of the otherwise deductible expenses of each of the 1998 Partnership and 2001 Partnership. This would have been roughly equivalent to the settlement parameters for the 2000 Partnership.

We received a response from the CRA on April 20, 2010. The CRA rejected our proposal and made a counterproposal with respect to the 2001 Partnership for a denial of approximately 19% of the otherwise deductible expenses. The CRA surprisingly rejected the proposal for the 1998 Partnership out of hand.

After analysis and discussion with Thorsteinssons LLP, we responded in May 2010 to the CRA with a counter to the CRA's counter proposal. Our revised proposal for the 2001 Partnership would have resulted in a denial of approximately 12.5% of the otherwise deductible expenses, together with a request for interest relief. Upon receipt of the counter/counter proposal, the CRA advised that they would not respond to it unless and until we re-included a further revised proposal for the 1998 Partnership. That proposal would be percentage based, together with an analysis of our position on the issues. We put forward the revised counter/counter proposal, including an offer to resolve the 1998 Partnership reassessments, on June 11, 2010. We, and Thorsteinssons LLP, were reasonably optimistic that we would either receive an acceptance of our counter/counter proposal by the CRA or a further counter proposal, being a denial of deductible expenses somewhere between 12.5% and 19%. During this time, we were verbally in contact with Mr. Crowley, of the Appeals Division of CRA, about the progress of our negotiations and we were reasonably optimistic about our prospects for settlement.

On July 6, 2010, to our disappointment and surprise, we received a one sentence letter from the Department of Justice categorically rejecting our counter/counter proposal for each of the 1998 Partnership and the 2001 Partnership. No explanation or analysis was provided.

## **Status of the Reassessments regarding the 1998 Partnership**

The Limited Partners of the 1998 Partnership were reassessed individually in 2003 for the 1998 and 1999 tax years. Those reassessments were objected to by Thorsteinssons

LLP on behalf of each of the Limited Partners. The principals of Sentinel Hill paid all costs and fees associated with those filings. The file was then moved to the Appeals Division of the CRA. After numerous delays within the Appeals Division, the CRA decided to send Notices of Confirmation to the Limited Partners, confirming the original reassessments.

We then asked the Limited Partners to authorize Thorsteinssons LLP to file a Notice of Appeal to the Tax Court of Canada on behalf of each of the Limited Partners. The principals of Sentinel Hill paid all fees and costs associated with those filings. We had anticipated we would be in contact with you when we received a Notice of Reply (essentially a statement of defense to the Notice of Appeal) from the Federal Government. This Notice of Reply, was finally received in February 2010, long after the actual due date (delayed until the resolution of the motion described below).

As we previously advised you, the CRA had made a preliminary Motion to deny the Limited Partners the ability to refer to the 1998 advance income tax rulings. Chief Judge Bowman of the Tax Court dismissed CRA's Motion and characterized the CRA's tactics as "at least presumptuous and at most insulting and offensive", "deplorable" and "appalling". For a copy of this powerful rejection of the CRA's position, please contact Eau-Vive Rivest (contact information below).

Having succeeded on the Motion to permit the Limited Partners to refer to the advanced rulings, we were confronted with a Reply that, on Thorsteinssons LLP's advice, was grossly improper and overstepped the boundaries of a proper Reply under the Tax Court Rules (essentially, amounting to another delaying tactic from the CRA). At our expense, we made a Motion before Chief Judge Rip of the Tax Court to strike the offensive portions of the Reply. This motion was heard in September of 2010 and we await a decision.

Assuming some success, the CRA will be required to amend the Reply and the litigation process for the test cases will begin in earnest. This will include discovery of documents, discovery of witnesses, and a trial.

### **Mandate for Litigation from the 1998 Limited Partners**

The action and inaction by the CRA concerning the 1998 and 2001 Partnerships is unfortunate. Our efforts to resolve matters through settlement negotiations have either been stonewalled (in the case of the 1998 Partnership) or have been met with unreasonable, hard line positions (in the case of the 2001 Partnership) that are completely inconsistent with the settlements reached for the 1999 and 2000 Partnerships.

Unlike the other Sentinel Partnerships (which were issued Partnership Determinations by the CRA), the Limited Partners in the 1998 Partnership were separately reassessed. This means that rather than the Limited Partners having to act in concert as in the other Partnerships' situation, each of the 1998 Limited Partners has the right (and obligation) to either appeal, settle, or pay the reassessed amount individually. For this reason, we have put in place a mechanism for a joint appeal by the Limited Partners, if they so choose, using three "test case" partners. To this end, we have negotiated a very favourable fee arrangement with Thorsteinssons LLP to resolve the outstanding reassessments (be it settlement or litigation), on behalf of the Limited Partners who choose this option. The fees would be capped at \$400,000, plus reasonable

disbursements and any applicable taxes. Thorsteinssons LLP are requesting that the Limited Partners who choose this option fund a retainer for this amount before they proceed.

### **Procedure to Participate in the Joint Appeal**

We previously sent you a Letter of Authority which you were to sign and return to us. Regardless of your choice in that letter, if you wish now to authorize Thorsteinssons LLP, please sign the enclosed Letter of Authority and include it with your payment as discussed below.

If you wish to proceed in the joint appeal with our "test case" investors with Thorsteinssons LLP as counsel, you will need to remit to Thorsteinssons LLP \$13.40 per unit plus applicable tax (calculated below). This figure is comprised of the \$400,000 retainer, plus an estimated \$50,000 in disbursements. Thorsteinssons LLP will return any funds left over from the litigation or settlement to the Limited Partners.

Since you held \_\_\_units, your share before tax is \$\_\_\_\_. HST or GST based on your province of residence is \$\_\_\_\_. **Your total share of the Thorsteinssons LLP retainer is therefore \$\_\_\_\_\_.**

If you choose to proceed with Thorsteinssons LLP, you need to provide them with payment **no later than March 18, 2011** to fund the joint tax appeal, along with the signed Letter of Authority. **Your participation will indicate your agreement to be bound by the retainer terms set out below.** The funds will be treated as directly-incurred legal fees incurred in disputing a reassessment, and the expenses will be fully tax deductible as they are incurred. At the end of the calendar year, Thorsteinssons LLP will summarize the amounts in a letter which will be sent to you for inclusion with your income tax return.

Any Limited Partners who wish to proceed independently may do so at their own cost and expense and will be excluded from this joint litigation process.

Your funds will be placed in Thorsteinssons LLP's trust account and will be used exclusively for legal fees and third party costs for litigation or settlement negotiation. The funds will not be used to remunerate the principals of Sentinel Hill. As always the principals of Sentinel Hill will continue to devote their time and resources to this matter, without remuneration.

### **Joint Appeal Retainer Terms**

If you choose to pursue the joint appeal with Thorsteinssons LLP as your counsel, and they have received adequate funds such that the joint appeal can proceed, the retainer will have the following terms:

- Thorsteinssons LLP's fees in the matter through completion of the Federal Court of Appeal (if applicable) will be billed at normal hourly rates and capped at \$400,000, plus reasonable disbursements (which are estimated to be \$50,000).
- Each of the participants would be responsible for their own taxes (which would depend on their applicable provincial tax jurisdiction).
- Thorsteinssons LLP will submit formal offers to settle in accordance with the Tax Court rules as instructed.

- However, Thorsteinssons LLP will have your authorisation to settle on your behalf a denial of deductible expenses of up to 10%.
- The 3 "test case" investors will be indemnified against any adverse costs awards by the participating investors. Conversely, the test cases will, if applicable, be obligated to share any favourable costs awards with the other participants.
- Any unbilled amount will be returned, pro rata, to the participants.
- Thorsteinssons LLP will contact each participant to enter into a retainer agreement directly with them; this is necessitated by the need to cover conflict of interest situations and is standard procedure in joint representations.

Thorsteinssons LLP will resign as counsel of record in the tax appeal of any Limited Partner(s) who do not wish to proceed with Thorsteinssons LLP as counsel in the joint litigation. Should Thorsteinssons LLP decide not to accept any or all of the retainers, they will return the respective funds.

### **ACTION REQUIRED**

**It is imperative that Thorsteinssons LLP receive your response by March 18, 2011.** If you want Thorsteinssons LLP to proceed with the litigation on your behalf, please check the box beside "Litigation Option" on the enclosed sheet, and sign and return it along with your cheque payable to "Thorsteinssons LLP in trust re 1998 Sentinel Hill tax appeal" in the amount of \$\_\_\_\_\_.

It is unfortunate the matter has not been resolved through administrative appeal to the CRA, or by negotiation. However, based on Thorsteinssons LLP's legal advice, we are optimistic that the prospects for substantial success in the tax litigation are very good.

### **Contacting Sentinel Hill or the CRA**

As always, we continue to stand behind the Limited Partners and dedicate our time and resources to the favorable resolution of this matter. Eau-Vive Rivest can be reached at [erivest@sentinelhill.com](mailto:erivest@sentinelhill.com) or 604-692-2414.

If you are as frustrated as we are with the lack of settlement progress with the CRA, you may contact the CRA directly. We believe that the decision maker to contact is John Crowley, Director of Appeals. His telephone number is 613-960-2307 and his email address is [john.crowley@cra-arc.gc.ca](mailto:john.crowley@cra-arc.gc.ca).

Yours truly,

Sentinel Hill Productions Corporation (formerly the General Partner)



per:

### **Letter of Authority/Options**

To: Thorsteinssons LLP

And to: Sentinel Hill Productions Corporation (former General Partner)

As described in the former General Partner's letter of February 22, 2011, I am in favour of (check one):

**Joint Litigation Option. I enclose a cheque payable to "Thorsteinssons LLP in trust re 1998 Sentinel Hill tax appeal" in the amount of \$\_\_\_\_\_.** These funds will be used to pay legal fees and disbursements, including taxes, incurred in settling or litigating the outstanding reassessments of the former Limited Partners of Sentinel Hill 1998 Master Limited Partnership. I acknowledge that Thorsteinssons LLP may choose not to accept this retainer, in which case they will return to me the funds I have provided to them.

I wish to opt out of being part of the joint litigation and will seek my own legal advice.

Date: \_\_\_\_\_, 2011.

Signature: \_\_\_\_\_

Number of units:

Email address: \_\_\_\_\_

**Return this sheet together with your cheque in the enclosed self addressed envelope to Thorsteinssons LLP by March 18, 2011.**