



SENTINEL HILL VENTURES  
CORPORATION

May 20, 2003

«ClientGiven\_Name» «ClientSurname»  
«Address» «Address2»  
«City»  
«Postal»

Dear «ClientGiven\_Name» «ClientSurname»:

Re: **Sentinel Hill 1998 Master Limited Partnership (“1998 MLP”)**

### **Important Action By Investors Required**

By now you will have received a letter from the Canada Customs & Revenue Agency (“CCRA”) advising you of its intention to issue a re-assessment to you denying the deductibility of certain business losses of the above-referenced partnership. This letter is to bring you up to date with respect to the 1998 MLP’s actions in dealing with the CCRA audit, and to provide you with information about how to deal with your re-assessment notice, when it arrives.

### **Current Status of the 1998 MLP**

In February 2001 CCRA commenced what was described by them to be a routine audit of the 1998 MLP. In late February 2002 the CCRA auditor first expressed concerns with respect to the 1998 transactions, which resulted in the auditor issuing a detailed proposal letter challenging the transactions on March 21, 2002. These events resulted in our letters of March 7 and March 27, 2002 to you recommending that 1998 MLP investors provide CCRA with “time compliance waivers”. Despite the positions expressed in the proposal letter, the auditor confirmed that the transactions, as implemented, were in accordance with the transactions presented to the Rulings Directorate of CCRA and that none of the transactions were misrepresented. On May 14, 2002, legal representatives for the 1998 MLP provided a very detailed response to the auditor to address his concerns. On November 18, 2002, the auditor issued a partial response to the May 14 letter, although to this date, these issues have not yet been resolved.

On February 7, 2003 the Sentinel Hill 1999 Master Limited Partnership (the “1999 MLP”) heard for the first time from the auditor via a detailed proposal letter that CCRA had very fundamental issues with respect to the structure of the 1999 transaction. This was surprising in that CCRA had not yet asked for any financial records of the 1999 MLP. The proposal letter was coincidental with the 1999 MLP investors becoming “statute barred” at approximately March 31, 2003, much the same situation as the 1998 investors found themselves in the year before. We believe that you will find relevant the situation of the 1999 MLP.

### **Current Status of 1999 MLP**

On February 7, 2003 CCRA proposed to determine the 1999 MLP income at nil and summarized into four categories, nine issues that CCRA had concerning the 1999 MLP. In response to CCRA’s proposal the 1999 MLP engaged the services of the law firms of Goodmans LLP, Thorsteinssons, a national law firm specializing in taxation, and the international law firm of Torys LLP. As well, the 1999 MLP engaged the services of the Capital Hill Group, Canada’s largest government relations firm.

Since February 7, Sentinel Hill and its counsel have devoted considerable time and resources with respect to the issues raised in the CCRA letter. These efforts culminated in numerous meetings with CCRA at both the Vancouver level and the senior levels of the Rulings & Audit Directorates in Ottawa. Within the audit procedure framework of CCRA, we have favorably resolved six of the nine issues raised by CCRA. We objected strenuously to the remaining positions taken by CCRA and the advice of our counsel is that the bases of our objections have a solid foundation.

On March 27, 2003 CCRA issued a Notice of Determination to the 1999 MLP dealing with the remaining three issues and we filed a Notice of Objection to the Notice of Determination. The filing of that notice ended the involvement of the Audit Directorate and allows the issues to be reviewed by the Appeals Branch of CCRA, with continued dialogue with the Rulings Directorate. To this end, we expect to commence a series of meetings with the Appeals Branch and the Rulings Directorate on May 26, 2003. We plan, at those meetings to discuss the remaining issues, and hopefully reach a favorable resolution. If the issues are not resolved, the final avenue of review would be litigation.

Specifically, the remaining three issues in respect of the 1999 MLP are as follows:

Compensation to the Motion Picture Studio CCRA’s Notice of Determination declares compensation to the Studio to be a “matchable expenditure”, the practical effect of which is to move the business deduction for these amounts from the 1999 MLP’s first year of operation to its tenth. We are astonished at this determination as the advance rulings obtained by Sentinel Hill for 2000 and 2001 clearly implied that these amounts were not matchable expenditures.

Unit Loan Lender Not At Arm's Length The Audit Directorate of CCRA has taken the position that the unit loan amount (the loan extended to limited partners by Veritus II Trust) should be deducted from the 1999 MLP's limited partner's "at risk" amount because in the opinion of CCRA the lender does not deal at arm's length with the 1999 MLP. This issue was not ruled upon by CCRA and was treated in the advance ruling received by Sentinel Hill as an assumption of fact. Since there is no cross ownership or control between the lender and Sentinel Hill or its principals or to our knowledge, any of the limited partners, CCRA is presumably relying on a perception that the lender and the 1999 MLP are "acting in concert" with respect to the loans. We believe this is an incorrect perception and we hope to resolve this issue favorably through further dialogue with CCRA at the Appeals and Rulings level.

PLP Class B Limited Partnership Units Purchase Option The PLP Class B Limited Partnership Units were acquired indirectly by the Studio in the 1999 MLP transaction. CCRA has determined that the exercise of the purchase option constituted a benefit to investors. This issue was specifically caveated in the advance ruling in that CCRA assumed that the option price was at fair market value and that the option exercise could not be compelled by the 1999 MLP or the PLPs. CCRA appears to take issue with the option price and the early and consistent exercise of the options, notwithstanding that the exercise of the options could not be compelled by the 1999 MLP or the PLPs. We hope to deal favorably with this issue at the Appeals level of CCRA.

### **Proposed Re-Assessment for Limited Partners in 1998 MLP**

Unlike the mechanism being followed by CCRA for the 1999 MLP (a notice of determination of income at the partnership level), for 1998, CCRA is proposing to re-assess each individual investor separately. Procedurally, this will require each investor to file a separate Notice of Objection to permit an appeal of the re-assessments. Depending upon the outcome of our upcoming discussions concerning the 1999 MLP, if Notices of Objection are required, we propose to utilize the services of Thorsteinssons to prepare a common form of Notice of Objection to be used by each investor.

Generally speaking, the proposed re-assessments seem to follow the approach taken by CCRA with respect to the 1999 MLP and appear to be limited to the three issues presently under discussion for 1999. (We have, however, not had formal confirmation of this by CCRA.) For this reason, we expect that any progress made with CCRA with respect to the 1999 MLP should be of assistance in resolving issues with respect to the 1998 MLP. As 1998 MLP investors delivered post-dated cheques payable in 1999 most, if not all, of the 1998 loss would be denied with losses permitted for 1999 when an at risk amount was established at the time the post-dated cheques were payable.

We are surprised and disappointed that CCRA has proposed the re-assessments for 1998, particularly in light of the fact that waivers had been provided by the 1998 investors and that CCRA had agreed that there was no reason to take action until the remaining three issues for 1999 had been determined at the Appeals level of CCRA.

Nevertheless, the Audit Directorate has seen fit to take this step and we will work with you in coordinating and formulating a response, including the preparation of a Notice of Objection.

### **Recommended Investor Action**

We recommend that 1998 MLP investors take the following two actions:

1. We believe that CCRA has had adequate time to complete their work. To commence bringing matters to a close on the 1998 MLP we recommend that you revoke your time compliance waiver, if you originally provided one to them. This action will still provide CCRA six (6) months to complete any work under way and to issue reassessments. You may complete this action by completing the enclosed form T652, attaching a copy of the original waiver and either (a) mailing the form to the CCRA office where the original waiver was sent, or (b) faxing the completed form and copy of the original waiver to Sentinel Hill Ventures Corporation, c/o Eau-Vive Rivest at 604-669-9485. Enclosed is a fax cover page for your convenience. We will fax you a receipt for your completed form and forward the package to CCRA on your behalf.
2. We do not know when, or depending upon the outcome of our discussions with CCRA regarding the 1999 MLP, if, your Notice Of Reassessment will arrive. However, when you do receive it, we will coordinate the filing of a Notice Of Objection for you. Please complete the enclosed Letter Of Authorization, attach the Notice Of Reassessment to it and fax the complete package to Eau-Vive Rivest at 604-669-9485. Again, we have enclosed a fax cover page for your convenience. We will fax you a receipt for your completed package and issue a Notice Of Reassessment to CCRA on your behalf within the statutory period allowed. You may, of course, complete and file your own Notice Of Objection should you so desire.

You should be aware that depending upon the timing of your receipt of the Notice Of Reassessment and the corresponding filing of a Notice Of Objection, a tax refund you may have due to you for the 2002 year may be used by CCRA to offset tax due. This is not something within our control. If a refund is used in this manner, you may apply to have it refunded once 120 days have elapsed from the date that the objection is filed.

Your Notice Of Reassessment will state an amount of tax to be paid by you to CCRA. As you will be objecting to the reassessment (or more correctly we will be objecting on your behalf) you may pay as much or as little of the assessed amount as you like. If you under pay, based upon the final amount owing (as determined by a Court or upon settlement) then interest accrues against you at the "overdue taxes" rate under the Income Tax Act. This rate is the average 3-month Treasury bill rate for the first month of previous quarter plus 4%.

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If you overpay, then interest accrues to your benefit at the refund rate, which is the 3-month Treasury bill rate plus 2%. These rates are adjusted quarterly and for the second quarter of 2003 they are 7% and 5% respectively.

Should you make a payment of tax to CCRA, please be sure that you specify the appropriate year against which it should be applied.

### **Summary**

We hope the discussion above answers all your questions as to the current status of your investment in Sentinel Hill 1998 Master Limited Partnership. To recap:

- Sentinel Hill is continuing work on behalf of the 1998 MLP and 1999 MLP with respect to the CCRA audits, appeals and proposed reassessments. We are taking all actions, which, on the advice of counsel, we believe, are in the best interests of the limited partners. We will continue to keep you up to date as events unfold over the next several months.
- We recommend that 1998 MLP investors revoke their time compliance waivers at this time.
- We do not know when, or if, you will receive a reassessment notice from CCRA, however when you do receive it, we will assist you in filing a Notice Of Objection. The costs of the objection process and the costs of the appeal process for the 1999 MLP will continue, for now, to be borne by Sentinel Hill.

If you have any questions in connection with the foregoing, please do not hesitate to contact Kenneth Gordon and Bradley Sherman in Toronto (416-515-2933) or Robert Strother and Paul Darc in Vancouver (604-669-9454).

Yours truly,

**SENTINEL HILL VENTURES CORPORATION**



Robert C. Strother  
Chairman

RCS/dt