



February 10, 2009 10

VIA FACSIMILE (613) 941-2293

WITHOUT PREJUDICE

Mr. John Shipley
General Counsel
Tax Law Services
Department of Justice
234 Wellington Street
Ottawa, ON
K1A 0H8

Dear Sir:

**Re: SHAAE (2001) Master Limited Partnership v. The Queen (the "2001 Appeal");
Investors in Sentinel Hill 1998 Master Limited Partnership (the "1998 Appeals")**

Further to our meeting of January 27, 2010 and our telephone conversation of February 8, 2010 with Mr. John Crowley, we write to outline a full settlement proposal for the 2001 Appeal and the 1998 Appeals. This offer is made on a "without prejudice" basis and applies only if and to the extent that your client accepts the terms outlined herein for both groups of appeals.

Background

The Sentinel Hill group structured a number of film transactions over a four year period from 1998 to 2001. All were challenged by the CRA to a greater or lesser extent. We have, however, successfully resolved the 1999 and 2000 Sentinel Hill transactions without litigation.

In light of the Rulings issued for the 1998, 2000 and 2001 transactions, we, and the 1998 and 2001 investors, view the 2000 Sentinel Hill settlement as the benchmark for the resolution of the 1998 and 2001 Sentinel Hill transactions.

The terms on which the 2000 Sentinel Hill transaction – Sentinel Hill Alliance Atlantis Equicap Millennium Limited Partnership – was resolved was to reassess by agreement to deny 12.43% of the losses claimed in the first two years (amounting to \$54,250,000 of denied losses out of \$436,482,000 reported losses) and to defer the deduction of a further \$55,808,000 of Studio Fees over seven years on a 20-20-15-15-15-5-5-5 basis. The negotiated settlement was reached after a number of proposals were exchanged and resulted in a denial of approximately 40% of the deductions challenged by CRA. The allocation of the denied losses among various categories was made by agreement between the parties to the settlement and resulted solely from a "numbers based" negotiation.

Settlement Proposal: 2001 Appeal

In order for a settlement to be palatable to the 2500+ investors in the 2001 Sentinel Hill transaction, we believe the 2001 Appeal must be resolved generally within the parameters of the negotiated settlement of the 2000 Sentinel Hill transaction (wherein 12.43% of reported losses were denied over the first two years).

The reported losses over the first two years of the 2001 Sentinel Hill transaction were \$392,000,000. For settlement purposes, the partnership would accept the disallowance of \$50,000,000 of the deductions comprising those losses (12.76%). In addition, the partnership would agree to treat the Studio Fees as the acquisition cost of a class 14 depreciable asset, fully depreciable at the same rate as in the 2000 settlement over seven years. Under this offer, the percentage of disallowed losses is slightly higher than under the 2000 Sentinel Hill settlement (12.74% versus 12.43%), but within a tolerance that we believe would be acceptable to the investors. Further, the settlement proposal, expressed as a percentage of challenged losses, compares favorably to the 2000 Sentinel Hill settlement.

The denied deductions would be applied proportionately across the 2001 and 2002 taxation years in the same proportion as the losses were reported.

From the CRA's perspective, settling the 2001 Sentinel Hill transaction now has the added benefit of ensuring that a capital gain is reported by investors in their 2011 taxation year. We could agree, as part of the settlement, to allow the CRA to review the draft partnership dissolution documents. This way, the CRA can ensure that the capital gains are satisfactorily realized.

Settlement Proposal: 1998 Appeals

The 1998 Sentinel Hill transaction also had a Ruling, and thus we believe also ought to be resolved by reference to the 2000 Sentinel Hill settlement. Furthermore, the basis of the CRA's challenge to the 1998 losses is different than for the subsequent years' transactions. There were no fees or expenses in the 1998 Sentinel Hill transaction that the CRA viewed as "circular" – all such fees and expenses were paid in cash.

We believe that the 1998 investors could be persuaded to agree to a settlement determined by reference to the same percentage disallowance as in the 2000 Sentinel Hill settlement (12.43%). On that theory, of the \$28,991,890 in aggregate reported losses in the 1998 transaction, losses of \$3,603,692 would be disallowed pro rata among the 1998 investors.

Mr. Strother is an investor in 1998. Mr. Strother's father was also a 1998 investor, and Mr. Strother is the executor of his father's estate. Mr. Strother would agree on his own behalf and on behalf of his father's estate to this settlement. If the CRA agrees to this settlement, Mr. Strother would also recommend the settlement to the other 1998 investors.

In addition, we would correspond with the other 1998 investors who choose to accept the settlement in order to advise them of their recomputed capital gain on the dissolution of the 1998 partnership in 2008. If investors do not refile their 2008 returns to report the revised capital gain, the CRA still has the power to reassess the investors' 2008 taxation year either within the

“normal reassessment period” for 2008 or under the consequential reassessment rule in subsection 152(4.3) of the *Income Tax Act*.


Other Matters

As part of the settlements, the CRA would also agree to favourably consider an interest waiver application to be submitted pursuant to subsection 220(3.1) of the *Income Tax Act* for a reasonable period of time (say 60 months) for both transactions.

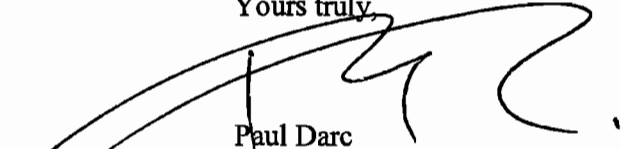
We would also agree to keep the terms of any settlement confidential, on the same terms as the general partner was bound with respect to the settlement of the 1999 Sentinel Hill transaction.

Next Steps

We will contact Mr. Crowley during the first week of March, 2010 to receive a response to our proposal. We reiterate our desire to resolve the aforesaid matters by negotiation.

Yours truly,

Robert Strother

Director, Sentinel Hill Ventures Corp. &
Sentinel Entertainment Corp
Limited Partner, Sentinel Hill 1998

Yours truly,


Paul Darc
Director, Sentinel Hill Ventures Corp. &
Sentinel Hill Entertainment Corp.

cc: Mr. John Crowley by fax 1-613-941-8088

cc: Mr. Robert Carvalho, Department of Justice (Vancouver) by fax 604-666-2214

cc: Thorsteinssons LLP – David Davies by fax 604-688-4711