

## Tax and Estate Planning Considerations for Manitoba Mineral Rights Owners

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This article is intended to provide basic information about mineral rights and the taxation issues surrounding ownership and the use of a corporation for tax and estate planning purposes.

A corporation can be used as a vehicle to accommodate estate planning and possibly income splitting on revenues derived from the ownership of mineral rights.

When an individual passes away, there may be a tax deferred transfer of the mineral rights to their spouse provided their spouse is named as the beneficiary of these assets in the will of the deceased. Should a person die without a spouse, or if the mineral rights are left to someone other than the spouse, the fair market value of the mineral rights must be reported in the final tax return of the deceased as income. This income is fully taxed at the rate that applies to the individual taxpayer. It is important that due diligence be undertaken to ensure that the appropriate value is used to report the disposition since this is one area that can be challenged by Canada Revenue Agency resulting in additional tax, interest and potential penalties.

When an individual transfers their mineral rights to a corporation, this transaction must take place at fair market value. In exchange for their mineral rights, the individual is issued shares of the corporation equal to the value of the mineral rights that were transferred. When a person dies owning shares of a corporation, the same tax deferred transfer to a spouse may apply in respect of those shares. Should there be no spouse or if the shares are left to someone other than the spouse, the fair market value of those shares must be reported in the final tax return of the deceased. However, shares are taxed as capital gains. Currently in Canada, the capital gains inclusion rate is 50% so the estate would pay tax on only 50% of the value of the shares as opposed to 100% of the value of the mineral rights should the individual die owning the minerals rather than shares of the corporation which owns the minerals.

Meighen Haddad LLP works closely with an accredited firm of petroleum engineers out of Calgary to provide valuation of mineral rights whether for estate reporting or incorporation purposes.

The creation of a corporation can also accommodate an "estate freeze". Minerals are transferred to the corporation at the value determined by the valuation process and the individual transferring minerals to their corporation would receive, as consideration for the transfer, preferred shares equal to the value at which the minerals were transferred. Preferred shares normally have a fixed value that does not change.

Other family members could be issued common shares of the corporation and those shares would reflect the growth in value of the corporation.

Preferred shares can be redeemed by the corporation which means that the corporation has the right to buy them out for the redemption amount. Over the course of time, it is possible for the corporation to redeem those shares as it accumulates cash from royalties on its oil resources. In a perfect world, those shares are fully redeemed prior to the death of the mineral owner which means that upon death, there are neither mineral rights or shares to attract tax.

Shareholders who own voting shares elect directors and make decisions on behalf of the corporation. The mineral owners could be issued a class of shares which carry voting rights, thus entitling them to control the activities of the corporation.

Issuance of shares to children or other family members can allow for income splitting. Dividends can be declared on the shares and income derived from the corporation's oil resources can be paid out by way of dividends on the shares. There are other mechanisms to have money paid out of the corporation. The corporation's accountants would assist in determining the most tax-effective way of having the money paid from the corporation to its shareholders and directors.

Corporate ownership of mines and minerals also solves a frequently encountered problem regarding fractional ownership of mines and minerals. The Real Property Act (Manitoba) prohibits the issuance of a Certificate of Title for a fractional interest in minerals smaller than a 1/16 share. Eventually, the family of the mineral owner will run up against this problem as ownership is transferred from generation to generation. Transferring the minerals to a corporation alleviates this problem. So long as the corporation maintains its existence, its ownership of minerals does not change when any shareholder passes away. Legal ownership of minerals remains with the corporation while the shares of the deceased shareholder can be passed on to the next generation.

A decision about incorporating should be taken only with the guidance and advice of legal and accounting professionals. The incorporation process can be expensive, and a cost/benefit analysis should be done before the process is undertaken. Meighen Haddad LLP works closely with accountants well-versed in mineral taxation issues and has a team of lawyers who can provide sound guidance and advice on the process.

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