



This Obscure Canadian Tax Law Could Pay for Your Retirement

Description

The *National Post* calls these “the most unusual land packages in the country”. Thanks to an obscure Federal tax law, this small but highly profitable company pays absolutely no government resource royalties. The result: this cash-gushing firm is a dividend machine. And the best part is that these safe and steady distributions are paid out every month... so you don't have to wait to start cashing in.

Let me explain.

Do you own any real estate? If so, you probably thought you owned your property entirely. But in actuality, all you likely have is the limited privilege to live on the surface of your land.

In fact, everything beneath your feet is owned by the crown. So if your house happens to be sitting on an oil field or a gold mine, those resources belong to Her Majesty Queen Elizabeth II. That's why companies pay enormous royalties to the government on any resources they extract from the earth.

But there are a few exceptions. One small company called **PrairieSky Royalty Ltd** ([TSX: PSK](#)) owns approximately 6.3 million acres of fee-simple mineral title land throughout Western Canada. This is some of the most valuable real estate in the country because the landowner, not the crown, has full claim to any minerals discovered on the property.

The obscure tax situation dates back to a land deal in the 1880s. In order to encourage the construction of the TransCanada railway, the Federal government granted **Canadian Pacific Railway Limited** 25 million acres of land across the Prairies. To sweeten the offer, the Feds also gave up all of its sub-surface mineral rights.

This land would become immensely valuable after oil was discovered underneath it decades later. In 2002, CP spun off these properties in a company that would eventually become **Encana Corporation** (TSX: ECA)(NYSE: ECA). And in May, Encana created PrairieSky in an initial public offering where the natural gas giant sold off a 46% stake in the new entity.

And PrairieSky's tax advantage is just the start. The company is unique in that it doesn't extract any of the oil and gas from the land itself. Rather, the company leases drilling rights to other companies.

It works like this: Leasing companies pay an upfront fee that grants them the right to explore the property for a fixed period of time. If the lessee finds oil and gas and starts production, it pays royalties to PrairieSky. In other words, PrairieSky gets all the upside potential from oil exploration on its land, but without any of the downside drilling risk.

For shareholders, this all means that the company is a cash-gushing machine. After PrairieSky leases its property, its cost of revenue is virtually zero. This business model allows the firm to generate enormous operating profit margins of 80% to 90%... a heck of a lot better than your typical oil stock.

That's great news for investors because the company returns most of these profits to shareholders. Since the firm's initial public offering, PrairieSky has paid out two distributions of 10.58¢ per share. Given that management expects to pay shareholders monthly, that comes out to a hearty 3.3% annual yield.

PrairieSky gives you an ownership stake in some of the most valuable land in Canada. You won't find another portfolio of assets quite like this anywhere else. That's why this stock is a great addition to any income portfolio.

CATEGORY

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