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# Perspective



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## TSX Underperforms For Now

The global stock rally since late last year reflects a marked improvement in the U.S. economy as stronger U.S. employment boosts income growth and confidence. The U.S. housing market is bottoming and will be a positive contributor to economic activity this year for the first time since 2007. Earnings growth is strong and businesses continue to invest in capital equipment and technology. The U.S. will likely be the strongest economy in the G-7 over the next two years. Adding to the positive sentiment, concerns about the credit crisis in Europe have dissipated, at least for now, as long-term loans by the ECB to banks in the eurozone appear to have mitigated risks. Nevertheless, the eurozone economy is likely to contract in the first part of this year.

Chinese growth, though slowing, is still relatively strong as business and government investment in fixed assets has been better than expected. Rising oil prices are the biggest risk to global growth this year, although Canada suffers from domestic risks as well. Most notably, Canadian household debt levels remain unusually high, largely due to record-low mortgage and home-equity loan rates. Governments are cutting spending and raising taxes. Corporate earnings growth has slowed, leading some businesses to cut payrolls. Hence, not only is the Canadian economy underperforming, but the stock market is as well.

The TSX underperformance versus the S&P 500 over the past year was the largest since 1999. RIM has been a glaring sore spot, while Apple has contributed hugely to the U.S. stock market performance.

As well, the Canadian materials sector has underperformed as gold and precious metals prices have declined. Canada's energy sector has been trumped by its U.S. counterparts. The discount in Western Canada Select crude prices to WTI has widened significantly amid pipeline bottlenecks, while surging shale oil production in Texas and North Dakota has been a boon to the U.S. sector. Also, most Canadian oil companies produce natural gas where earnings have been depressed by the plunge in prices. While this could persist with limited pipeline capacity in the near term, Canada is still the go-to market as a long-term energy play.

**“This respite in TSX performance comes on the heels of 7 consecutive years of stellar outperformance.”**

U.S. banks have also outperformed. Having been clobbered since the financial crisis, many U.S. banks can now resume dividend payments. Credit growth has picked up following years of household deleveraging. And, since mid-2011, the U.S. economy has shown decidedly more momentum than Canada's, where employment has gone nowhere for the past 8 months. Consumer stocks have outperformed in the U.S., reflecting pent-up demand for consumer goods and services, notably for automobiles.

This respite in TSX performance comes on the heels of 7 consecutive years of stellar outperformance. Taking a breather has improved relative valuation levels. But, recent experience highlights the prudence of portfolio diversification. Canadians must invest outside of Canada to get exposure to the red-hot technology and health-care sectors.

In addition, the rebound in economic prospects south of the border has led to a sell-off in bonds, steepening the yield curve and driving U.S. 10-year Treasury yields up more than 60 basis points since September. While interest rates are not likely to skyrocket, prospects for capital losses in bonds have increased, making equities all the more attractive.

# Tax Planning for the Family Farm – The Intergenerational Rollover

In the Winter 2012 issue of *Perspective*, we discussed the Capital Gains Deduction, which is one of the two key tax planning strategies that can be used when transferring a Canadian farm property. In this article, we will outline another strategy, the *Intergenerational Rollover*, which can defer the realization of capital gains or recapture of capital cost allowance (i.e. tax depreciation) on farm property when transferred to a child or grandchild. The eligibility requirements are not identical for both strategies, although in many situations both are available to decrease or defer tax on transfers of qualifying farm property.

## Using the Intergenerational Farm Property Rollover

In addition to the ability to shelter up to \$750,000 of capital gains on a qualified farm property through the use of the Capital Gains Deduction, Canadian farm property (including shares of a family farm corporation or an interest in a family farm partnership) may also qualify for an additional tax benefit in the form of a tax deferral. More specifically, a farmer may be able to transfer the interest in the family farm to a Canadian resident child(ren) on a tax-deferred basis either during his/her lifetime or at death.

In general, the child will inherit the parent's tax cost base, so the deferred gain could be taxable when the child subsequently disposes of the property. However, (active) farms that are passed down from generation to generation could theoretically escape capital gains tax indefinitely. The requirements for farm property for this rule are different from the Capital Gains Deduction requirements and as such this tax deferral may not be available even where the farm property otherwise qualifies for the Capital Gains Deduction.

## Incorporating Tax Planning Strategies for Farm Property into Your Estate Plan

Ideally, the use of the Capital Gains Deduction and Intergenerational Rollover tax planning strategies for farm properties should be orchestrated to achieve the maximum benefit, where available. This can be particularly tricky where some family members will inherit the farm property or carry on the farming business and others will not. Conflicts can arise between the competing interests of these beneficiaries. What benefits one beneficiary from a tax perspective may reduce the value of another beneficiary's inheritance. It is important that your estate plan take into consideration whether these tax strategies will be available and their effect on all beneficiaries



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and your estate as a whole. For example, the Intergenerational Rollover can save estate taxes, but ultimately the tax on the unrealized gain may be payable by the child who receives or inherits the farm property because the tax cost base will not be increased. Conversely, the tax cost base of other property inherited by the other children will generally be the fair market value at the time of death and additional tax will only be payable on further increases in value after the transfer to them.

Tax and estate planning involving the family farm requires consultation with professional advisors as the rules are extremely technical and complex. In addition, each individual's situation will be unique in many respects requiring the expertise of a professional to customize the appropriate plan or solution which fits your particular circumstances and personal objectives. For more information regarding these tax strategies involving the family farm, please ask your BMO Nesbitt Burns Investment Advisor for a copy of our publication *Tax Planning for the Family Farm*. Your BMO Nesbitt Burns Investment Advisor can also help you to identify your needs and refer you to the appropriate professional(s) for further assistance in your particular situation.

# Make your workplace DC pension plan work harder for you!



In Canada, the main sources of retirement income are government pensions (Old Age Security and Canada/Québec Pension Plan), employer-sponsored plans and personal savings.

Registered pension plans (RPPs) form the bulk of employer-sponsored plans: according to Statistics Canada, about six million Canadians are members of RPPs.<sup>1</sup>

The two main types of RPPs are defined benefit (DB) plans and defined contribution (DC) plans. With a DB plan, the employer is responsible for making lifetime fixed pension payments to a retired employee. With a DC plan, on the other hand, how much retirement income a retired employee gets depends on the amount of contributions that went into the plan and how the investments perform.

Over the past 20 years, a noticeable trend in the private sector workplace is the shift from DB to DC plans. The principal reason behind this phenomenon is the reluctance of employers to assume the risk of being their employees' retirement income guarantor. However, demographic changes also favour the growth of DC plans: few people now spend their entire career with one employer; instead, job mobility is the norm. So it is hardly surprising that a recent report of the BMO Retirement Institute found that attractive salaries and flexibility as to time and location of work are valued much more highly than a good retirement pension when people evaluate competing job opportunities.

An issue that arises with the increased prevalence of DC plans is investor behaviour. Many research studies have

found that the average investor has a tendency to make sub-optimal decisions. In the context of a DC plan, some common mistakes that people make are:

- Not enrolling in the plan
- Not increasing contributions to the plan as earnings increase
- Not selecting the right investment mix

In an attempt to counteract these human tendencies, many DC plans have introduced “auto-features” to “nudge” plan participants in the right direction. These features include:

- Automatically enrolling employees in a plan as soon as they meet eligibility requirements (typically with the choice of opting out)
- Automatically increasing employee contributions in tandem with earnings increase
- Providing a default investment option where the plan participant does not actively select his/her own asset mix

While these mechanisms are useful, there is also evidence that over-automation can make plan participants over-reliant and complacently assume everything is already taken care of.

If you are a member of a DC plan that has auto-features, do not just rely on them. After all, it is your own retirement, and everyone's circumstances are different. Do not assume that there is a one-size-fits-all solution that works for everyone. Instead, remain fully engaged, take charge and view your DC plan as an integral component of your overall retirement savings.

## Tips on making your DC plan work harder for you:

- Enrol as soon as you are eligible.
- Take full advantage of employer matching contributions and additional voluntary contributions (if applicable).
- Review your investments on a regular basis to ensure they are appropriate for your retirement objectives, time horizon and risk tolerance profile.
- Consult your BMO Nesbitt Burns investment advisor to develop a financial plan to serve as your long-term financial roadmap.

For further information about the BMO Retirement Institute visit us at [www.bmo.com/retirementinstitute](http://www.bmo.com/retirementinstitute)

<sup>1</sup> Statistics Canada. The Daily, Pension Plans in Canada. May 9, 2011.

# Protecting Seniors from Financial Abuse

The concern of many individuals across Canada regarding the increase in abuse of the elderly in general, and specifically, financial abuse, has been heard by our politicians. As a result, most provincial governments have amended existing laws in an attempt to provide greater protection for seniors.

Often the abuse is subtle, silent and invisible. Who is there to protect the elderly, fragile parent when an adult child unduly influences that parent to transfer assets to him/her, or if that adult child abuses a Power of Attorney for Property to defraud his/her parent of assets?

Several provincial governments have introduced (or proposed) new legislation which creates a reporting obligation on members of the community who provide services to the elderly, with accompanying penalties for not reporting suspected financial abuse.

For example, proposed new laws in Ontario place an obligation on non-professionals who provide services to a Retirement Home resident (“Resident”) and those who provide financial services to a client Resident, to report any suspected financial abuse conducted on the Resident. The proposed offence provision for failure to report may result in a fine. The British Columbia Law Institute has also published a guide for lawyers and notaries to assist them to recognize potential undue influence when taking Will instructions from an elderly client.

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If your province has not yet done so, it is likely only a matter of time before the issue of financial abuse of the elderly is addressed by way of new legislation which creates reporting requirements by certain third parties. The implications of such legislation for investment advisors and financial institutions may be that there would be a due diligence standard of care and an obligation on the part of investment advisors and financial institutions to report any suspected financial abuse of elderly, vulnerable clients.

The comments included in this publication are not intended to be a definitive analysis of tax law or trust and estate law. The comments contained herein are general in nature and professional advice regarding an individual’s particular tax position should be obtained in respect of any person’s specific circumstances.

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