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Perspective

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No Time To Panic

Once again, the world has been shaken by a highly improbable event. The worst earthquake and tsunami in Japanese history have devastated the population and wreaked havoc on financial markets and economic forecasting, at least temporarily. But, as we have seen so many times in the past, it never pays to panic in these situations. To be sure, the disruption and nuclear risk will dampen global growth over the near term and this has been reflected in the immediate decline in commodity prices. Over the medium term, however, lost output and reconstruction will boost the pace of economic activity. How long the disruption and volatility will last, however, is uncertain.

Japan is a key component in the global supply chain, especially for automobiles and electronics. It is also a relatively large consumer of oil, although far smaller than the U.S. or China. The Japanese government is already mired with the largest debt burden in the world and the devastation will only add to that debt. Nevertheless, Japan has a huge current account surplus and it can fund its rising debt burden domestically.

An immediate response to the quake was a flight to quality and liquidity as investors shunned risk and moved to the safest assets possible. This led to a rally in U.S. Treasuries, despite the ongoing stalemate in the U.S. Congress that appears to threaten a temporary shutdown in the U.S. government as the political debates regarding the debt ceiling will continue until the eleventh hour.

Stock markets sold off sharply and likely over-reacted, as always, in its broad-brushed decline. No doubt, some companies with significant reliance on Japan or on nuclear energy development warrant a sharp decline in valuation, but many with little or no direct exposure have been beaten up as well. This could be a buying opportunity as the dust clears down the road. Certainly, the natural disaster and nuclear crisis have caused incalculable loss of life and peace of mind. The ensuing post-traumatic stress will remain for an extended period, but markets will revive far before the human pain diminishes, returning our attention to rising oil and other commodity prices, the European sovereign debt problems and the global debate regarding inflation risk.

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We have cut our global economic forecast only modestly and expect Canada and the U.S. to grow at about a 3% pace this year with the Canadian dollar returning to its recent trading range above parity with the U.S. dollar. Inflation will remain moderate and interest rates will trend somewhat higher this year and next. In this environment, at least some of the recent selloff in stocks will be recovered, especially for companies with strong balance sheets and little exposure to Japan.

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Retirement income planning

As the first baby boomers reach 65 years of age in 2011, much attention around retirement planning will shift from saving for retirement to managing retirement income. This is a result of several trends:

- Volatile global markets over the past couple of years accentuates the perils of starting to draw down on assets during unfavorable market conditions;
- Steady improvement in life expectancy makes it necessary to ensure that one does not outlive one's retirement assets;
- The relentless decline of defined benefit pension plan coverage (notably in the private sector); and
- The ever-present threat of costly health care costs and other unforeseen expenses as one ages.

A recent survey of Canadians age 55 and over who are either retired or close to retirement, conducted for the BMO Retirement Institute, confirmed that the biggest fears of retirees and those approaching retirement are unexpected costs, outliving one's retirement assets, not keeping pace with inflation, health care costs and unpredictable investment returns.

> Unexpected costs viewed as biggest risk when planning for retirement.

Retirement income planning requires prioritizing goals and making some important decisions. For instance, while stability of income is desirable, one also needs to maintain purchasing power, since the retirement phase now accounts for about one-third of a person's lifespan. Moreover, solutions that emphasize stability and predictability often requires one to sacrifice control and flexibility, which hampers one's ability to deal with unexpected costs that may arise in later life.

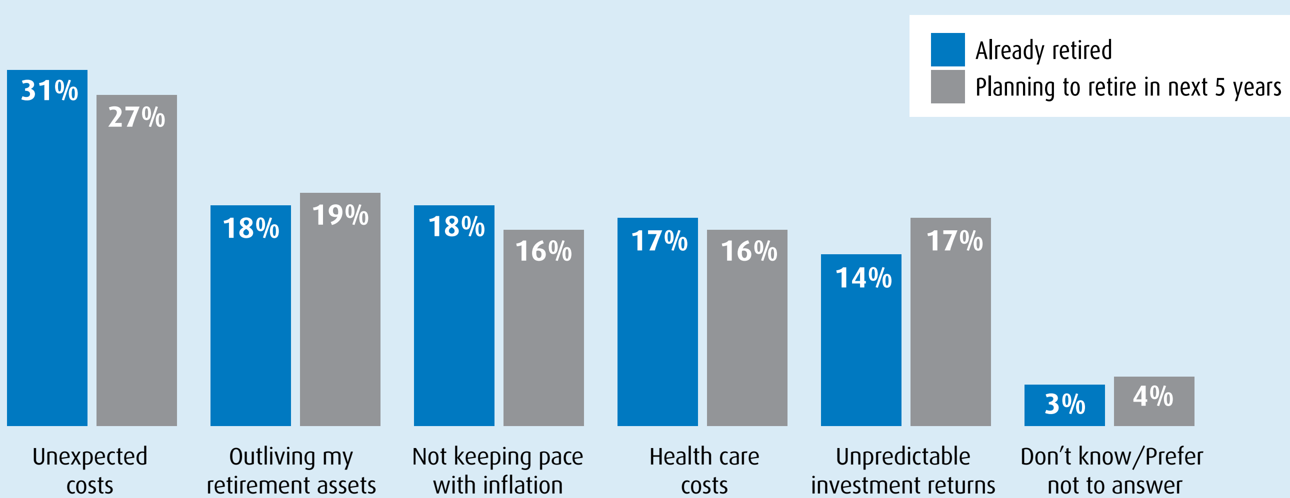
In light of all these considerations, what retirement income planning strategy should you take?

First of all, you need to have a good understanding of your own unique circumstances. If you are one of the lucky few who will benefit from a good-sized inflation-adjusted defined benefit pension that takes care of most or all of your retirement needs, you may prefer to take a growth-oriented approach for your investment portfolio. On the other hand, if you will be relying heavily on your retirement savings to finance your retirement lifestyle, it may be prudent to allocate at least a portion of your portfolio to products that mimic a pension income stream.

You also need to make an honest assessment of what you value most and what you are prepared to give up. Is having a guaranteed lifetime income stream more important to you than the potential for future growth of money? Or do you value the flexibility to deal with possible contingencies in future more than ensuring a predictable income for life?

If you are planning to retire in the next ten years, this is the time to start thinking about these important questions. Contact your BMO Nesbitt Burns Investment Advisor and begin developing your retirement income strategy today.

When asked, what do you consider to be the biggest risk when planning your retirement?



US citizens living in Canada. New information reporting requirements

Many US citizens have lived in Canada most of their lives and consider themselves to be Canadians. This may be true in terms of national pride and culture but their citizenship is a differentiator for US income tax filing requirements. US citizenship can be acquired by being born in the US or being born to US citizen parents but often the tax implications of being a US citizen are overlooked. The US imposes tax on US persons (US citizens, residents and green card holders) on their worldwide income regardless of where they live. Therefore US persons have annual US income tax filing and reporting requirements that exist regardless of where they call home and how little time they have spent in the US.

I am a US citizen or green card holder. What income tax filing and reporting requirements do I have?

A US person should be filing a US individual income tax return to report worldwide income on an annual basis. In addition to this, there are a number of information reporting requirements for US persons. One of the requirements is that you have to file a Report of Foreign Bank and Financial Account (FBAR) if you have a financial interest or signature authority in one or more accounts in a foreign country and the aggregate value of those accounts exceeds US$10,000.

As of tax year 2011, there are two additional disclosure requirements. First, US persons who have foreign accounts and assets with an aggregate value exceeding US$50,000 are required to disclose certain information about these accounts on an information return. To date, the IRS has not indicated which form should be used to make the disclosure. However, they have indicated that the disclosure would have to be attached to their US individual income tax return and the forms are expected to be available before the 2011 income tax filing season next spring. The new disclosure requirement is in addition to the FBAR previously mentioned.

The second new reporting requirement for tax year 2011 is that US persons who have shares in a passive foreign investment company (PFIC) must disclose certain information regarding their investment in the PFIC on an annual basis. In a nutshell, a PFIC is a non-US corporation that derives most of its gross income for the taxable year as passive income OR at least half of its assets produce passive income or are held for the production of passive income. In determining whether or not you have a reporting requirement for a PFIC, it is important to note that a Canadian mutual fund would be classified as a corporation regardless of the fact that it may be classified as a trust for Canadian income tax purposes. As such, if you hold shares in a Canadian mutual fund, you may be subject to the new PFIC reporting requirements. In previous years, there was only a reporting obligation with respect to PFICs if you were reporting a distribution from a PFIC, sold shares of a PFIC or you were making a certain election to treat the PFIC as a “qualified electing fund”. This new reporting obligation can arise solely from holding a Canadian mutual fund even if it is held in a registered account.

Other compliance and reporting obligations

There are significant penalties (in addition to possible criminal prosecution) associated with the failure to file individual income tax returns and complying with the FBAR. Beginning in 2013, under the new Foreign Account Tax Compliance Act (FATCA), non-US financial institutions will be required to identify and report on accounts held for US persons. Therefore, if you don’t identify yourself to the IRS, the IRS will likely find you. In order to encourage the reporting of offshore accounts, the IRS announced a voluntary disclosure program in early February that allows US persons with undisclosed offshore accounts until August 31, 2011 to file past due individual income tax returns and to disclose their offshore accounts. While there may be penalties associated with a voluntary disclosure, the IRS has provided some limited relief for US taxpayers who have reported and paid tax on all their taxable income but did not file FBARs. In many cases, U.S. citizens living in Canada would not have a U.S. tax liability as the foreign tax credits resulting from their Canadian taxes would offset any U.S. tax liability. Given the relief provided by the disclosure program, now may be the best time to come forward with any past-due filings.

Because of the complexity and the potential for significant penalties, consultation with a cross-border tax specialist is recommended. Your BMO Nesbitt Burns Investment Advisor can introduce you to an external qualified tax professional upon your request.

Disinheriting a Financially Independent Adult Child

Just as traditions, beliefs and values, pass from generation to generation, so does wealth. When it comes to succession of wealth, many parents go to great lengths to ensure that upon their death, the fruits of their lifelong labour – their accumulated assets and property - pass only to their children. On the other hand, in some cases parents wish to disinherit one, some, or all of their children. In these circumstances, a legal tug of war, so to speak, arises between the parent's right to testamentary freedom and the parent's moral obligation to his or her (financially independent adult) children.

To Give or Not to Give

The reasons underlying intentional disinheritance vary. For example, the disinheriting parent may have experienced estrangement or abandonment by a child, the parent may disapprove of the child's chosen lifestyle, or, the parent may believe that sufficient provisions had been made to that child already. When disinheritance is challenged by the excluded child (sometimes referred to as a "moral obligation claim" against an estate), the law asks: were the reasons for exclusion "valid and rational"? If the court is not convinced, on the evidence, that the reasons were valid and rational, the child may be successful in his or her moral obligation claim. That is, the court may determine that the parent did not meet his or her moral obligation to the child. In such a case, the court will likely alter the intended distribution expressed in the Will, ordering that the child receive any, some or all of the property to which he or she is not entitled, under the Will.

"Many parents go to great lengths to ensure that upon their death, the fruits of their lifelong labour – their accumulated assets and property - pass only to their children. On the other hand, in some cases parents wish to disinherit one, some, or all of their children"

Many moral obligation claims have been successfully defended (that is, the disappointed child does not succeed in his or her claim against the deceased parent's estate) where the court is convinced, based on the evidence, that the disinheriting parent's reasons were valid and rational. Examples of valid and rational reasons are:

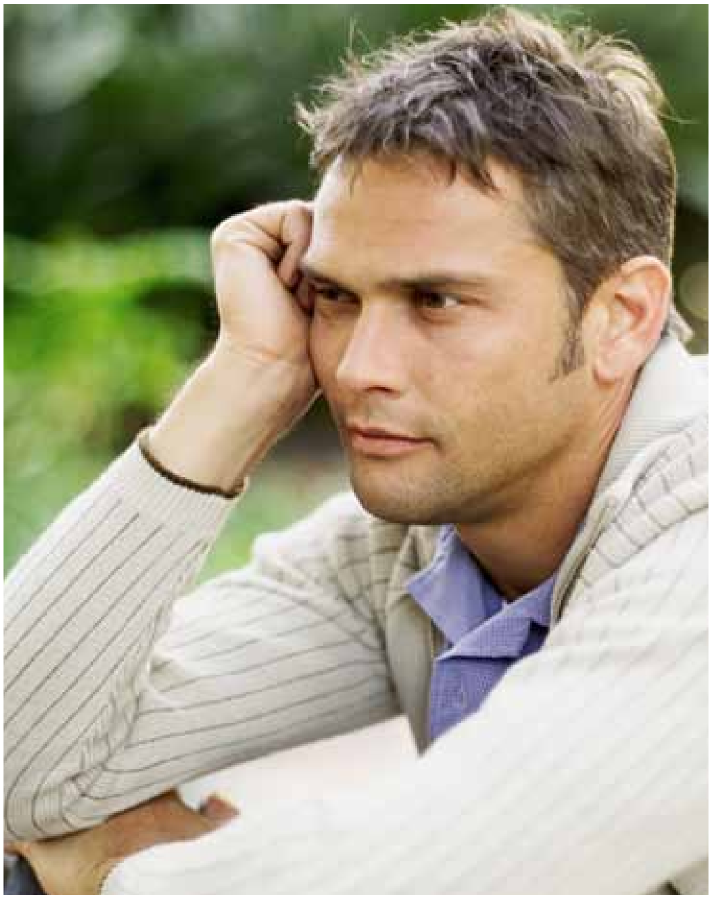
- Misconduct of the child towards the parent such as estrangement, abandonment or abuse, initiated by the child; and
- Transfer of significant property by the parent to the child (gifts), during the parent's lifetime.

In those cases, the courts have held that the parent had met his or her moral obligation towards the child, and was free to disinherit that child under the Will.

The Pendulum Swings

In a recent decision in British Columbia involving a claim against an estate by a disappointed (financially independent) child, the court held that the mother had not discharged her moral obligation to the child notwithstanding the transfer of significant amounts of money and real estate to that child during the mother's lifetime. The court varied the Will, awarding the child approximately 20% of the assets owned by her mother at date of death, as compared with the 1.4% of the assets to which the child was entitled under the mother's Will. The disappointed child who challenged the distribution under the Will received an additional $5.5 million. Although the B.C. decision is not binding on other (Common Law) provincial courts, it is persuasive. The importance of the decision is that it raises the bar for a parent's discharge of his or her moral obligation. That is, according to this decision, moral obligation of a parent towards a financially independent adult child is not necessarily negated, even if the parent had given that child significant gifts, prior to death.

> "This decision should give parents who wish to exclude a child cause to pause, to think twice, and consult with an estates lawyer, before making the decision."



Conclusion

This decision is a reminder that when it comes to succession of wealth, the rules of the game can change, tipping the scales in one direction or another, either in favour of the testamentary freedom argument, or, the moral obligation argument. The B.C. decision, perhaps, favours the moral obligation position, strengthens this position, allowing it to gain ground in the legal tug of war with its adversary, testamentary freedom. If so, this decision should give parents who wish to exclude a child cause to pause, to think twice, and consult with an estates lawyer, before making the decision.

"Succession law is a provincial matter. Succession laws in Quebec differ from succession laws in all other common-law jurisdictions in Canada. Quebec is not subject to common-law decisions in this area of the law, thus this discussion does not apply to Quebec."

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