

Sluggish Growth Continues p1

Federal Budget Review 2011 p2

Divergent Paths to Retirement p3

Transferring your Family
Vacation Property p4

Perspective



Sherry Cooper
Chief Economist and Executive
Vice-President, BMO Financial Group.

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Sluggish Growth Continues

As the global economy hit a new soft patch in recent weeks, stock markets around the world have sold off. In Canada, the recent correction wiped out all of this year's gains as the economy in both Canada and the U.S. slowed in the second quarter. The weakness in the U.S. has worsened Canada's trade balance which, combined with the strength in the Canadian dollar, has more than offset the effect that higher commodity prices had on our trade balance earlier this spring. Fiscal tightening is also dampening the growth outlook and central banks are poised to end some of their extraordinary monetary accommodation.

The rise in headline inflation has not been validated by a rise in real wages as excess labour supply and diminished union power keep downward pressure on labour costs. In the U.S., the large output gap and discouraged workers will keep downward pressure on real wages. In addition, the continued decline in home prices exacerbates the labour problems. The U.S. labour supply is historically quite mobile as workers would be willing to move to where jobs are more plentiful. With the continued housing crisis this cycle, people cannot

move because they cannot sell their homes, depressing household net worth and removing a mechanism for labour market equilibration. Labour and housing weakness, in combination with fiscal drag at the state and federal levels, has taken some of the steam out of the recovery. Some temporary setbacks have also been at play—the Japanese manufacturing woes associated with the earthquake and the extraordinary weather disruptions. These factors are dissipating, which should lead to at least a moderate rebound in the second half of this year.

The Fed will complete QE2 this month and is unlikely to change the stance of monetary policy anytime soon. Indeed, even the Bank of Canada is likely to remain on the sidelines for much of the rest of this year. While we are not forecasting a double dip, we do see continued sluggish growth for the near-term and a return to 2½%-to-3% growth next year. The political turmoil in Washington will weigh on markets for another month or two; but, ultimately, a budget compromise will alleviate the near-term pressure. The U.S. will not default on its debt, but the sovereign debt crisis in the EU will linger

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and ultimate willingness to restructure Greek debt is likely. Bearish sentiment in stock markets is likely overdone given the continued strength in corporate earnings. However, the underlying fiscal, housing and job market problems will not be corrected anytime soon.

Federal Budget Review 2011

On June 6, 2011, Finance Minister James Flaherty re-introduced the Federal Budget which was originally presented on March 22, 2011. As expected, there were no changes to the income tax measures outlined in the original budget and the effective dates of the tax measures announced remain consistent with those outlined on March 22, 2011.

The budget was defined by the government as the “Next Phase of Canada’s Economic Action Plan – A Low-Tax Plan for Jobs and Growth”. From a personal income tax perspective, the budget did not provide any broad-based measures, tax cuts or tax rate hikes. Instead, the budget proposes modest incentives to specific taxpayers. More notable proposals include several targeted measures that continue the theme of last year’s federal budget of improving tax fairness and closing perceived ‘tax loopholes’.

The most significant personal income tax measures are summarized below. Note that the measures introduced are only proposals at this stage and may not ultimately be enacted into law. Readers are cautioned to consult with their tax advisors for specific advice on how they may be affected by these proposals.

Summary of key personal income tax proposals

Tax Incentives

As noted above, the 2011 federal budget includes a number of smaller incentives for specific taxpayers including the introduction of several new tax credits and the increased access and flexibility in the administration of other existing tax incentives, the most notable of which are outlined below.

Children’s Arts Tax Credit

Beginning in 2011, parents will be able to claim a non-refundable 15% Children’s Arts Tax Credit on up to \$500 of expenses for children (under the age of 16 at the beginning of the year) enrolled in an eligible program of artistic, cultural, recreational or developmental activities.

Family Caregiver Tax Credit

Beginning in 2012, caregivers of dependents with a mental or physical infirmity will be able to claim a 15% non-refundable tax credit based on an amount of \$2,000.

RESPs – Asset Sharing Among Siblings

Measures were introduced to allow the transfer of assets after 2010 from an individual Registered Education Savings Plan (RESP) to another individual RESP for a sibling, without triggering tax penalties or the repayment of government grants.

RDSPs – Shortened Life Expectancy

The budget proposes to provide Registered Disability Savings Plan (RDSP) beneficiaries with a shortened life expectancy more flexibility to withdraw their RDSP assets without requiring the repayment of government grants or bonds.

Closing Tax Loopholes

Other budget proposals related to personal tax measures are designed to improve the integrity and fairness in the tax system by closing certain perceived ‘tax loopholes’, the most significant of which are outlined below.

RRSPs – Anti-Avoidance Rules

The budget proposes to enhance the existing anti-avoidance rules for RRSPs to further deter individuals from gaining inappropriate tax advantages through their RRSPs. The proposals are similar to the anti-avoidance rules that currently apply to Tax Free Savings Accounts (TFSA) and will include penalties on an “advantage” realized from inappropriate transactions such as “RRSP strips” and “swap transactions”, and income (or capital gains) from the modified “non-qualified” or “prohibited investments” rules.

Individual Pension Plans

Many business owners and incorporated professionals establish Individual Pension Plans (IPPs) to provide a source of retirement income. IPPs are defined benefit pension plans typically set up for one individual although they may include a spouse or another family member. The budget proposes that certain IPPs must now pay out a minimum amount beginning in the year the member turns 72 and introduces new rules for past service contributions.

Measures affecting the Charitable Sector – Donations of Publicly-Listed Flow-Through Shares

Consistent with the theme of maintaining the integrity and fairness of the tax system, several other budget initiatives are aimed at strengthening the confidence of Canadians in the charitable sector by enhancing the charitable regulatory regime and clarifying the effect of certain transactions involving charities. One of the most notable charitable sector proposals in the budget seeks to limit the incentive from donations of publicly-listed flow-through shares by restricting the exemption from capital gains tax on the donation of flow-through shares (issued on or after the March 22, 2011 budget day) to the excess of the (cumulative) capital gains over the original cost of acquiring the flow-through shares.

If you have any questions regarding these budget proposals, please consult with your tax advisor for further details.

Divergent paths to retirement: gender differences in the approaches taken by men and women

A paradox observed in retirement planning is that, despite the unique challenges that women encounter, they are finding retirement more enjoyable. The secret to this success may be their greater adaptability and strong social network.

A recent BMO Retirement Institute Report indicates that compared to men, women are generally less prepared financially for retirement. They tend to have accumulated a smaller retirement nest egg, as a result of a number of factors.



Despite the great strides made in recent years, women continue to earn less than men. A 2010 Statistics Canada report indicates that a woman currently earns 83 cents for every dollar earned by a man. A 2006 study also estimated that a typical college-educated woman in her mid-40s had already lost a total of \$440,743 in wages over her lifetime.

Women are also more likely to interrupt their careers to raise families or provide caregiving to family members. They take more leaves of absence, take up part-time work, or even quit their jobs altogether to fulfill these obligations, which translates financially into lower savings and pension benefits.

For further information about the BMO Retirement Institute visit us at www.bmo.com/retirementinstitute

If women face so many financial challenges, why are they happier in retirement?

- To start with, women generally have lower financial expectations. A recent survey indicated that one in three men thought they will need \$1 million for retirement, compared to only one in five women.
- Compared to men, women are more prepared to seek expert advice from financial professionals. They are also more likely to follow that advice. Guidance from professionals in navigating the often complex task of retirement planning may have helped women avoid costly financial mistakes.
- Last but not least, there is more to retirement than money. Women tend to be more accustomed to and hence more skilled at adapting to new life situations. While men's identities are typically tied to their jobs, women invest more time in building relationships with children, family and friends. Time spent on caregiving and nurturing the family may hurt the pocketbook, but it makes the transition to retirement easier for women.

To compound things further, that smaller retirement nest egg needs to stretch further, as a result of women's longer life expectancy. A woman who is already 65 years old can expect to live to 86, three years longer than a 65-year old man. The death of a spouse is often accompanied with a drop in income (as a result, for example, of a cut in government and employer pension benefits). Widowhood is not the only reason that more women live alone in retirement, either. Statistics Canada data in 2005 indicated that 40 per cent of women will divorce before their 30th wedding anniversary; and it has been estimated that a woman's standard of living drops an average of 45 per cent in the first year after a divorce.

Whether you are a man or a woman, you can profit from professional guidance in planning for your retirement. Contact your BMO Nesbitt Burns Investment Advisor to develop your tailor-made retirement plan today!



Transferring Your Family Vacation Property to the Next Generation

Many Canadians know the joys of owning a cottage, cabin or chalet and wish to pass the ownership and enjoyment of their family vacation property to the next generation. Parents, who wish to keep the vacation property in the family for as long as possible to provide their children and grandchildren “best of life” memories, must consider strategies to transfer the property efficiently.

Succession

Some of the issues to consider when planning for the succession of your vacation property include:

- Who uses the property, and, who would continue using it after your death? If not all of your children use the vacation property, consider addressing this in your Will. Should there be an option for any one of your children to acquire the property as part of his or her inheritance, and if so, by what process? Should you equalize the inheritance of the children who will not receive a share of the property with other gifts?

- Should the use of the property by your children be shared, and if so, should there be a co-ownership agreement?
- Should the property be held in a trust to allow for creditor protection and a reduction in probate tax?
- Can everyone who wants an interest in the vacation property afford to maintain it? If not, are there other assets to assist in this regard?

Taxes

Your vacation property may have increased in value significantly since it was purchased. Upon disposition of the property, capital gains tax will likely be payable. Therefore it is important to track and update the Adjusted Cost Base of your vacation property by keeping documents reflecting the original cost of construction or acquisition, and additional costs for betterment, improvement and renovation of the property, which can be deducted from the proceeds of sale. If you do not use the Principal Residence Exemption to reduce the capital



gains owing on your home, you can apply the Exemption to your vacation property. In addition, probate tax would apply to the fair market value of the vacation property upon death of the owner, unless the property is held in a trust, a corporation, or by way of joint tenancy with right of survivorship.

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.

Time of Transfer

When determining the timing and manner of transfer of ownership to the next generation, there are important factors to consider. For example, depending on the financial situation of the owner/parent (retirement needs, tax status), a gift or sale of the property to the children during the parent's lifetime may be advantageous. Alternatively, transfer upon death of the parent may be appropriate where it is intended that life insurance proceeds will fund capital gains and probate taxes, payable at death.

Other Tax Issues

Of the many Canadians who enjoy owning a vacation property, some use the property as a source of rental income, while others own a family vacation property south of the border. Both circumstances may give rise to tax implications in addition to the capital gains and probate taxes previously discussed.

For a more detailed discussion of the succession of the family vacation property, please ask your BMO Nesbitt Burns Investment Advisor for a copy of our publication *Your Plan for the Family Vacation Property*.

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