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Perspective

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Even Modest Growth At Risk

All around the world, economic activity has been slowing. Acknowledging the disappointing prospects for growth, the Federal Reserve extended its maturity-lengthening bond-purchase program, better known as Operation Twist. The Bank of Canada is likely to keep interest rates low for the rest of this year and central banks in Europe and Asia are poised to ease as well. The People's Bank of China cut rates for the first time since 2008. Clearly, the European debt crisis is taking its toll as the situation drags on with no clear end in sight. Indeed, increasingly, markets are expecting a Greek exit from the Eurozone and, even then, other weak-country finances remain in jeopardy.

Emerging market economies have softened as well, taking down commodity prices in their wake. This has weakened the Canadian dollar, tempered activity in Western Canada and raised the spectre of lower-than-expected tax revenues in the western provinces and Newfoundland.

U.S. unemployment is only inching downward, a negative fundamental for Mr. Obama, as voters are showing incumbent governments the exit sign in multiple elections over the past year. The Fed is doing what it can to boost interest-sensitive spending, but it is hard to imagine that at today's record-low bond yields, further downward pressure on long-term interest rates is going to do the trick. What's more, the year-end fiscal cliff, along with the tightening regulatory environment, is causing a great deal of uncertainty. In consequence, businesses are more reluctant to hire and U.S. banks are more reluctant to lend. Households have tightened their belts as well.

In a surprise move, the Canadian Government took action once again to tighten mortgage conditions—the fourth such move since 2008. The latest action reduces the maximum amortization on CMHC-insured loans from 30 years to 25 years. Minimum downpayments remain 5%, but the maximum refinancing (via a mortgage or home equity line of credit or HELOC, or a combination of the two) has been lowered from an 85% to 80% loan-to-value ratio. In addition, the Government has limited the gross debt service (GDS) ratio to 39% and the total debt service (TDS) ratio to 44%. The GDS ratio is the share of a borrower's gross household income that is needed to pay for home-related expenses, such as mortgage payments, property taxes and heating expenses. The TDS ratio is the share of income going to all such home-related expenses plus all other debt-servicing obligations. In addition, borrowers purchasing homes at or above $1,000,000 in price will no longer be eligible for a CMHC-insured loan, which means they must have a downpayment of at least 20% to qualify for an uninsured mortgage.

> "The combined mortgage and HELOC cannot exceed the new 80% refinancing limit, with the added proviso that the HELOC portion alone cannot exceed 65% of the home value."

In a separate move, the Office of the Superintendent of Financial Institutions (OSFI), the regulator of Canadian financial institutions, reduced the maximum amount of non-amortizing HELOCs (a hugely popular borrowing vehicle for homeowners) to 65% of a home's value from 80% previously. The combined mortgage and HELOC cannot exceed the new 80% refinancing limit, with the added proviso that the HELOC portion alone cannot exceed 65% of the home value.

A homebuyer can still procure an insured mortgage for up to 95% of the home's value, but would not be able to take out a HELOC until the mortgage was reduced to below 80% of the home's value. For example, if the mortgage was reduced to 70% of the home's value, the owner could take out a 10% HELOC. If the mortgage was reduced further to 15% of the home's value, the HELOC could increase to up to the 65% limit.

There's no doubt that some households will be constrained from borrowing by these new rules, though the impact should not be large. A recent survey by the Canadian Association of Accredited Mortgage Professionals found that, of households with both mortgages and HELOCs, average loan-to-value was just under 60%.

We believe these actions are prudent and responsible. "The new measures will support the long-term stability of the Canadian housing market," said Frank Techar, head of personal and commercial banking at BMO. "Minister Flaherty has tapped the brakes at precisely the right time and his actions should help ensure Canada's housing market experiences a soft landing."

Governor Mark Carney and Finance Minister Jim Flaherty have long been concerned about the record level of household debt relative to income in Canada. While the growth in household debt has slowed to 4% this year, compared to 6% earlier in the cycle, the slowdown in economic activity raises the prospects of job losses and increases the potential for mortgage delinquencies. These Government actions are intended to slow the housing market, particularly the condo markets in Toronto and Vancouver.

Bottom Line:

It is not surprising, with this global financial and economic backdrop, that stocks have sold off and commodity prices continue to fall. Long-term U.S. and Canadian bond yields are dropping like a rock from already record-low levels. While the Government efforts to prevent a Toronto and Vancouver housing bubble and to reduce household debt accumulation are commendable, the global slowdown and substantial political and financial risks might jeopardize even a modest 2% growth trajectory.

Gift Tax and US Citizens

As part of the US transfer tax regime (which includes US estate tax), US persons (US citizens, US resident or Greencard holders) may be subject to US gift tax on the lifetime "giving" of assets even if that US person lives in Canada.

The gift tax may apply when assets are transferred (ie. gifted) to another individual or, in some circumstances, to a Trust. US gift tax is based on the value of the gift, and the rates currently range from 18% to 35%.

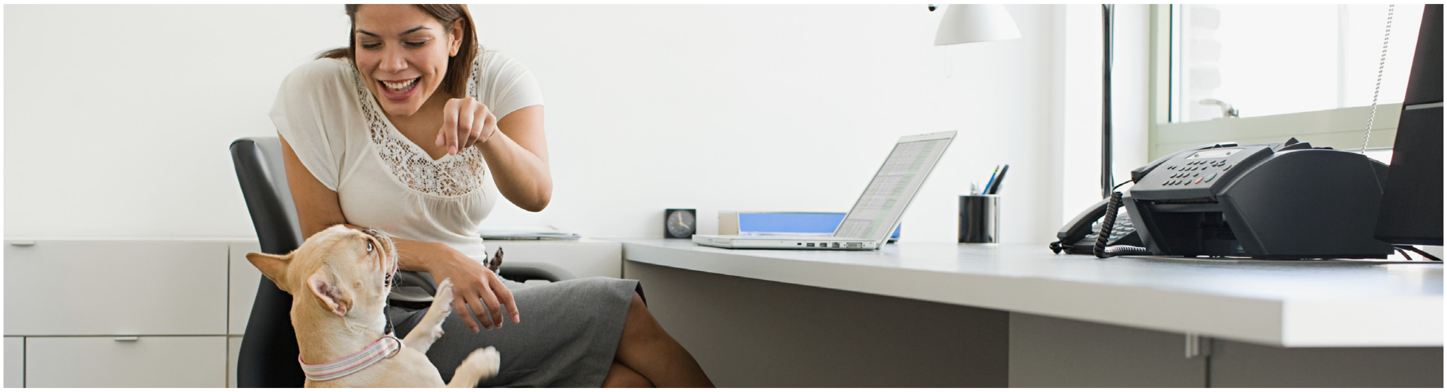
There are exclusions that may reduce or eliminate the US gift tax. A US person has annual gift tax exclusions of US$13,000 per recipient and US$139,000 (inflation adjusted amount for 2012) for gifts made to a non-US citizen spouse. In addition to these annual exclusions, a US citizen has a lifetime gift tax exclusion of US$5.12 million for gifts made in 2012 (as adjusted for inflation). However since the US gift tax and US estate tax regimes work in tandem, any amount of the lifetime gift tax exclusion applied toward gifts reduces the amount that can be used to offset US estate tax upon the individual's death. If there is no new US tax legislation, the future lifetime gift tax exclusion amount is scheduled to be reduced to US$1 million and the highest US gift tax rate will increase to 55% on January 1, 2013. Given the expected decrease of the lifetime gift tax exclusion applicable to US persons (from $5.12 million to $1 million), now may be the time to consider planning opportunities to take advantage of the current US$5.12 million exemption before the end of 2012.

As with any transaction, as a Canadian resident, you should also consider the Canadian income tax implications that may apply to any transfer of assets such as the potential application of the "attribution rules" or the possible recognition of capital gains or capital losses, (which may be denied) if assets other than cash are transferred to a family member. In addition, it will be important to consider the legal implications of a gift or transfer, such as the applicable family law considerations.

If you are contemplating the transfer of a significant amount of assets where US gift tax may be applicable, your BMO Nesbitt Burns Investment Advisor can introduce you to a qualified external cross-border tax professional, who can provide you with specific guidance in your particular situation.

For more information on potential US income tax issues for US citizens residing in Canada, ask your BMO Nesbitt Burns Investment Advisor for a copy of our publication "US Citizens Living in Canada – Income Tax Considerations".

The New Frontiers of Estate Planning: digital assets, parents, and pets



While the basics of estate planning have been the same for centuries, the traditional approach needs to be broadened to reflect changing realities that are transforming our society today: the rapid development of the use of online technology in our day-to-day lives, the surge in family caregivers, and the growing importance of pets.

The online world continues to reshape the way we interact with family and friends, acquire information, experience entertainment and manage financial accounts online, all from the comfort of our living room.

Canadians have embraced online technology in ever-increasing numbers. This accumulation of online property raises an important question: what happens to all of the digital assets we accumulated during our lifetime, such as social media accounts, online photo or music collections, and on-line stock trading accounts, in the event of our death or incapacity? It is important to incorporate these online assets into your estate plan to minimize leaving a daunting digital mess for your loved ones.

As our life expectancies rise, so do the chances of becoming a caregiver to a parent or older relative. In fact, nearly one in six Canadians aged 45 and over are already providing care for an aging parent, with more than half of caregivers providing both personal and financial support. Whether you are currently caring for an aging parent or relative, or if there is a significant chance that you will in the near future, estate planning today requires a broader view of the list of potential beneficiaries to ensure that a lasting legacy is left to all your loved ones – both young and old.

Almost half of Canadians own a pet. Studies show that pets are good for our health and help combat both loneliness and depression, particularly in the elderly. As seniors live increasingly longer, pet ownership is likely to rise, along with the emotional need to ensure pets are cared for after one passes away. In fact, three-quarters of pet owners feel that it is important to make arrangements for the ongoing care of their pet. However, only seven percent made a formal provision in their estate planning documents. To minimize the risk of your pet being abandoned and given up to a shelter, consider leaving a reasonable monetary legacy to a chosen pet caregiver who can use the funds to take care of your pet.

When updating your estate plan, consider whether it is appropriate for you to incorporate digital assets, aging parents and other relatives, and pets. Your BMO Nesbitt Burns Investment Advisor can suggest strategies on how to incorporate these trends into discussions with your legal professional. He or she can also review your financial plan and make necessary adjustments to reflect care-giving and financial obligations.

Time to review your estate plan

- Include your online digital accounts in your estate plan.
- Organize and track your online account names and passwords and keep an up-to-date list.
- If you are a caregiver to an aging parent or older relative, consider including them in your estate plan.
- If you are a pet owner, consider including your pet in your estate plan by designating a pet caregiver and leaving the pet caregiver a reasonable monetary legacy.

2012 Provincial Budgets: Impact on Top Marginal Tax Rates and Multiplier Factors

The recent provincial and territorial spring 2012 budgets introduced slight changes to the 2012 tax rates – specifically to eligible dividends in British Columbia and Manitoba and increases in Ontario tax rates for all types of income for individuals with incomes exceeding $500,000, as a result of the new proposed 'Deficit-Fighting Two Percent Ontario Surtax'.

The table below outlines the 2012 top marginal tax rates by the provinces and territories (including the impact of the recent spring provincial and territorial budgets). The rates apply to taxable incomes over $132,406 ($150,000 in Nova Scotia).

The 'multiplier' column calculates the additional amount of interest income that would have to be earned by an individual resident in each province or territory (who is subject to tax at the top marginal rates for 2012) to equate this after-tax interest income to the amount of after-tax income retained from earning an eligible dividend.

For example:

In 2012 for an individual resident in Alberta, eligible dividends are taxed at an effective top marginal rate of 19.29% whereas interest is taxed at the top individual rate of 39%. Accordingly, an Alberta investor would have to earn approximately **$1.32** of interest for each $1 of eligible dividends to be in the same after-tax position, as follows:

$1,323.10 interest income x 39% = $516.00 tax which leaves **$807.10** after tax (ie. $1,323.10 – 516.00)

$1,000 eligible dividends x 19.29% = $192.90 tax which leaves **$807.10** after tax (ie. $1,000 – 192.90).

	Interest & Ordinary Income	Capital Gains	Canadian Dividends		Multiplier
			(Eligible)	(Non-Eligible)	
Alberta	39.00%	19.50%	19.29%	27.71%	1.3231
British Columbia	43.70%	21.85%	25.78%	33.71%	1.3183
Manitoba	46.40%	23.20%	32.26%	39.15%	1.2638
New Brunswick	43.30%	21.65%	22.47%	30.83%	1.3674
Newfoundland and Labrador	42.30%	21.15%	22.47%	29.96%	1.3437
Northwest Territories	43.05%	21.53%	22.81%	29.65%	1.3554
Nova Scotia	50.00%	25.00%	36.06%	36.21%	1.2788
Nunavut	40.50%	20.25%	27.56%	28.96%	1.2175
Ontario [1]	46.41%	23.20%	29.54%	32.57%	1.3148
Prince Edward Island	47.37%	23.69%	28.70%	41.17%	1.3547
Quebec	48.22%	24.11%	32.81%	36.35%	1.2976
Saskatchewan	44.00%	22.00%	24.81%	33.33%	1.3427
Yukon	42.40%	21.20%	15.93% to 19.29%	30.41%	1.4595 to 1.4012

[1] The Ontario government's 2012 budget introduced a 2% surtax on taxable incomes exceeding $500,000. This new surtax takes effect July 1, 2012 but is scheduled to be eliminated once the budget is balanced (expected to be in 2017/2018). The impact of this 2% surtax on taxable incomes exceeding $500,000 is as follows:

Interest & Ordinary Income	Capital Gains	Canadian Dividends		Multiplier
		(Eligible)	(Non-Eligible)	
47.97%	23.98%	31.69%	34.52%	1.3129

Transfers to Overseas Pension Schemes – UK Updates

Immigrants to Canada may have considered transferring their UK pension to avoid foreign exchange fluctuations or differences in tax rules when receiving payments out of their UK pension plan. For former UK residents, they may be familiar with the Qualifying Recognized Overseas Pension Scheme (QROPS), which is a form of pension based outside the UK recognized by the British authorities as being eligible to receive transfers from registered UK pension funds. BMO Nesbitt Burns has been registered as a QROPS since 2007. In most cases, the individual may qualify for a tax-deferred rollover into an RRSP or registered pension plan.

However, as of April 6, 2012, new pension regulations in the UK around the transfer of pension funds to qualifying schemes overseas were introduced. These new regulations follow HM Revenue & Customs' (HMRC) earlier announcement that it would revise the rules to combat tax avoidance where pensions would be transferred to an overseas territory and subsequently paid out as a 100% lump sum amount, free of tax after the 5 year reporting requirement in certain local jurisdictions. In Canada, a withdrawal from an RRSP or registered pension plan would be subject to withholding tax. Highlights of the changes include:

1. Tighter tests to be satisfied as a recognized QROPS by HMRC
2. Increased reporting periods to HMRC from 5 to 10 years after the member transfers out of a UK pension scheme
3. Special reporting requirements when any distribution from a QROPS occurs within 10 years of the individual becoming a non-UK resident
4. Requirement for individuals to provide a signed acknowledgement of any potential adverse tax consequences with HMRC before they are allowed to transfer.
5. At least 70% of an individual's UK tax- relieved scheme funds are designated for the purpose of providing an "income for life".

If you are considering a UK transfer, please discuss with your tax advisor or speak with your BMO Nesbitt Burns Investment Advisor for further information.

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