BETTERINVESTING™ Rocky Mountain Chapter

OCTOBER 2011 e-NEWSLETTER

COMING EVENTS

>StockTalk: November 12th at Southglenn Library**.**
> Intro to Investing & Value Line: October 8th, Bear Valley Library
> Intro to the Stock Selection Guide (SSG): October 15th , Indian Tree
> Beginning Toolkit: October 29th in the morning and **Supercharge Your SSG with Sound Judgment:** in the afternoon, both classes at the Colorado Christian University, Beckman Center
> Portfolio Centered Decision Making & Lab: November 19th in the morning and **Secrets to Club Success** in the afternoon, both at Colorado Christian University, Beckman Center

AAII SPECIAL: OCTOBER 24TH

Popular speaker SAUL SEINBERG presents: "Why Everyone Should Use Options for Added Income" AND "Technical Analysis: An Essential Tool", October 24th.
Program starts early @ 6:30 PM to allow coverage of two subjects!
Good Shepherd Episcopal Church, 8545 East Dry Creek Rd., Centennial, 1/2 mi west of I-25; north side of street. Park free behind bldg.

REGISTER TODAY!

TALES FROM THE BRIGHT SIDE

Does Warren Buffett's secretary really pay income taxes at a higher rate than he does, i.e. 17%? That's what he says. Let's see…

Assume his secretary is paid $50,000/yr plus 25% in benefits for a total compensation package valued at $62,500. Average secretarial pay is around $35,000, but we can assume Buffett pays his secretary well. Only the $50,000 cash portion is taxed.

Subtract the standard deduction of $5,800 and the exemption of $3,650 leaves only $40,550 that is actually taxed. Using the 2011 tax table below, you can figure that the secretary will pay $6,262.50 to the federal gov't in taxes. That works out to be a real tax rate on total compensation of 10.02%. Buffett's secretary is taxed at a **lower** rate than Buffett. Hooray! Buffett isn't the curmudgeon he thought.

Taxable Income	Marginal Tax Rate:
$0-$8,500	10%
$8,500-$34,500	15%
$34,500-$83,600	25%
$83,600-$174,400	28%
$174,400-$379,150	33%
$379,150+	35%

FIND-A-CLUB

We now have 15 clubs listed in our Find-A-Club program who are open to visits by those looking for an investment club to join or just curious about the investment club experience and want to learn more. Nine of those clubs are "women only" while the remainder are mixed (men and women). To increase the success of this program, we need to have as many clubs as possible to open their doors to visitors. We need more men and mixed clubs, **so register your club today.**

DIVIDENDS AND TAXES

Today, dividends and capital gains are taxed at a 15% marginal rate at the Federal level. Many want to tax at ordinary rates "to be fair". Cap gains taxes can get really complex, but dividend taxes are more straightforward. Let's take a look at dividend taxes.

Suppose a company has revenue of $1,000,000, and a pre-tax profit margin of 10%. The board plans to pay 2% or $20,000 as a dividend to the company owners (stock holders). Out of that $1,000,000, expenses, workers, management, and bond holders are paid leaving $100,000. Quite properly, the income earned by workers, management, and bond holders is then taxed at their personal ordinary income rate. Note that at this point, everyone is paid but the stock holders.

That leaves $80,000 to be re-invested in the company and $20,000 for the owners. But the $20,000 dividend isn't paid yet. In fact, the dividend isn't paid until the corporation pays a corporate tax of 35% on it. The company isn't required to pay the corporate tax on workers or management pay, but it must pay that tax on the dividends to the owners. That reduces the dividend from $20,000 down to $13,000. That $13,000 is then sent to the company owners as their dividend income which is then **additionally taxed at 15%.** So the after tax income to the owners is only $11,050 for an astounding **actual total tax rate of 44.75%.** Ordinary, qualified dividends are **taxed twice**. Worker pay, management pay, and bond interest isn't taxed twice. Why are dividends taxed twice?

Master Limited Partnerships (MLP) and Real Estate Investment Trusts (REIT) are not required to pay taxes on earnings at the corporate level. So their distributions (dividends) are sent to partners and quite appropriately taxed as personal income at ordinary rates just like the workers and management.

All of this was discussed and thrashed out in detail many years ago when the gov't realized that dividends were double taxed. In those days, the dividend was taxed 35% at the corporate level and then taxed again at the personal income rate resulting in a total tax north of 60% in most cases. Al Gore was part of a reform team that resulted in lowering the personal tax rate on dividends to 15% resulting in a total tax rate of 45% which was a little fairer than 60+%. The reform was totally bipartisan. **Today, people act like they never heard of the any of this.**

Taxing dividends at a 45% rate discourages investors who buy stock in a company hoping to share in the wealth creation of business activity. These people are not speculators but true investors. Investors are the very people we should be encouraging. Australia for example understands this and has no personal tax on dividends at all. Why do we???

WORDS OF WISDOM

"As a *market* timer your cash balance is a function of what you think the market is about to do. However, the *stock* timer's cash balance is a by-product of investment opportunities you see in the market. If you can't find good companies (quality and growth requirement being met) to own at the right price (valuation commensurate with quality, growth, and projected return), cash or short-term bonds are good alternatives until a new opportunity presents itself. Again, this is not about market timing, but you should not be buying stocks just for the sake of being fully invested" – Vitaliy Katsenelson, *"Active Value Investing – How to Make Money in a Range Bound Market"*