THE DANA VIEWPOINT

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DEEP IN THE HEART OF TAXES

Yes, it's that time of year again, and with the *Infernal* Revenue Service adding 16,500 new employees, you had better make sure to dot all the i's and cross all the t's. Actually, they are probably gearing up for 2011 as there will be a myriad of changes coming, mostly due to the recently passed health care bill. Now, we confess to not having read all 2,407 pages of this bill, but there are several items that will alter your returns for 2011, so you should huddle with your investment advisor and accountant this year to prepare yourself. First and foremost, the tax cuts from the previous administration will likely expire at the end of this year. Other changes may not take effect until 2013, but it is best to prepare for them now. The biggest tax increase will be in Medicare payroll taxes. Singles earning more than $200,000 and couples earning more than $250,000 will pay 0.9% more on wages and self-employment income. All investment income will be taxed an additional 3.8%. This includes capital gains, dividends and interest. This is the first time in history that the Medicare tax is applied to them. This means that the Medicare tax on capital gains will be pushed to 23.8%. Dividends, currently taxed at the top rate of 15%, will be taxed as ordinary income, and, remember, the top rate will increase to 39.6% from 35%. Even the more generous "Cadillac" health programs intended to apply to high-income earners will also hit lower-income earners with these plans, starting in 2018; family insurance plans valued at more than $27,500 ($10,200 for individuals) will pay a new excise tax. Will you be selling real estate? The 3.8% Medicare surtax could catch you if you sell real estate for a big gain. Pharmaceutical firms will pay an annual fee, based on their market share starting next year. Health insurers will also have to pay an annual fee, based on market share starting in 2014. Both of these fees will, of course, be passed on to consumers. Then there is the 2.3% excise tax on the sale of medical devices starting in 2013. Beginning July 1 this year, tanning salons will be levied a 10% service charge. Finally, the VAT (value added tax) is looming large in the background. Many European countries have substituted a VAT for their income tax rationalizing that it is more equitable to have a consumption tax that would hit those that can afford to spend more. The fear by many in this country is that a VAT would be in addition to our income tax and could be increased over time. This opens the door to another 2,400 page document as to what would and would not be taxed. In Britain, food is exempt as that is the largest expense for the poor. After that it gets dicey. Is pet food considered food not subject to tax? Clothing presents another problem. In Britain, the guidelines for clothing state the article must have "form and

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function." Baby shawls are exempt, but not mother and baby shawls. Bras up to size 34B are exempt. You cannot make this stuff up. Let's hope Congress spends a lot more time studying before passing any form of a VAT.

In the investment business we deal with both reality and perception. Most things are reality, but occasionally we deal with how investors perceive reality. In the case of taxes we are dealing with reality. The investment landscape is changing, and we are spending many hours analyzing these changes to determine which investment areas will benefit from the tax changes and which will be hurt. Again, we advise that you start this year to review your investment objectives for the coming year or even decade.

Finally, some good news on the job front. The Labor Departments survey of businesses reported 162,000 new jobs in March and importantly included an increase in manufacturing employment of 17,000. Now, we know that one month does not mean that the unemployment issue has been solved. However, the trend has been improving for months and now we are in positive territory. The next several months will be critical to ascertaining the strength of the economic recovery. There are skeptics out there of course. They point out correctly that the March job gains included 48,000 temporary census workers for a total so far of 87,000 hires with several hundred thousand more in the months ahead (what are all these people doing?). A look inside the numbers shows that 82,000 new jobs were created in the service sector, 17,000 in manufacturing and 15,000 in construction. Remember that in January of 2009, lost jobs for that month totaled 779,000. We have come a long way. These new jobs create paychecks which result in consumer spending and inventory build up. Most economists are looking for 1st quarter GDP to come in around 2.5% down from 5.6% in 4th quarter of last year. We may see a pleasant surprise there also with GDP closer to 3.5%. Enjoy the ride.

Random Thought for April 2010:

"If you think health care is expensive now, wait until it's free."

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All data included in this letter was found in various articles in the *Wall Street Journal*, *Investors Business Daily* and *Casey's Daily Dispatch*.

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