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SPEAKING OF DIVIDENDS

Happy Days, Gone Again

Under Democrats, low dividend tax likely would end

By **SHIRLEY A. LAZO**

WHAT DO INVESTORS EXPECT THE DIVIDEND TAX RATE to be in 2011, the year after the Bush tax cuts expire? For months, ISI Group financial analysts Tom Gallagher and Andy Laperriere asked that question of investors participating in ISI's informal lunch and dinner surveys. The duo wrote up their findings earlier in December in a piece entitled "Dividend Disconnect."


Most of the investors were remarkably consistent in their estimates, choosing a tax rate in the low 20s, versus the current 15%. Few thought the rate would revert to the pre-Bush 39.6%.

Gallagher and Laperriere, however, don't agree with them. "We believe the investor consensus is way too low." Here's why: Democrats are likely to maintain their majorities in both houses of Congress, they write, and will probably pick up seats in the Senate. "Therefore, even if the GOP wins the White House, a Republican president will probably be dealing with a Democratic Congress. The more likely scenario is an all-Democratic government."

Under current law, the dividend tax rate would return to 39.6% in 2011. So it would take an act of Congress to keep it where it is. And all the Democratic candidates, Gallagher and Laperriere note, have said that they would repeal the Bush tax cuts for those making more than \$200,000 annually. Furthermore, some have said the 15% dividend tax cut would be repealed. While Sen. Hillary Clinton (D-NY) hasn't given a precise answer, ISI is betting that she would let the top dividend rate match the top income-tax rate.

Week's Dividend Payments: [NYSE](#)¹ | [Nasdaq](#)² | [AMEX](#)³

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Week's Ex-Dividend Payments: [NYSE](#)⁴ | [Nasdaq](#)⁵ | [AMEX](#)⁶

Rep. Charles Rangel (D-NY), chairman of the tax-writing Ways and Means Committee, and other lawmakers have vowed to try to repeal the alternative minimum tax (AMT) permanently in 2008. Rangel recently proposed replacing the AMT with a 4.6% surtax on adjusted gross income over \$500,000. According to Gallagher and Laperriere, that would make the top income-tax rate and the top tax rate on dividends both 44.2%.

The pair also say that "it is possible that Democrats will decide to keep the dividend and capital-gains rate equal to each other, which would imply that both would increase to as low as 25% but more likely 28%," nearly double the current 15% rate. "But most Democrats think 28% is too low for dividends, and a few think it is too high for capital gains."

There is a wide range of potential outcomes under a Democratic government, "but even what in our view is the low end of the range would produce a higher dividend tax rate" than most investors envision.

Under a Republican president, the dividend tax rate is likely to be substantially higher than currently, observe the analysts. "The Democratic Congress will have the leverage because the default option is a 39.6% rate, so a Republican president will be forced to make major concessions to get a bill passed through a Democratic legislature."

IN ITS LATEST U.S. High Dividend Yielding Stocks Update screen, Bear Stearns surveyed issues in the Russell 3000, the Nasdaq 100 and the Standard & Poor's 1500 that yield around 20% but no less than 4%. All told, the firm's Global Equity Linked Strategy Team came up with 206 names. Many are real-estate investment trusts, including four of the top five Big Board-listed companies that follow.

The leader of the pack is **Newcastle Investment** (ticker: NCT), which puts its money into real-estate securities and other real-estate-related assets. It recently traded at 12.76, for a 22.57% yield.

Deerfield Capital (DFR) yields 21.99%. It invests in residential mortgage-backed securities, which account for nearly 90% of its portfolio. Recent price: 7.64.

RAIT Financial Trust (RAS), with a 21.15% return and priced at 8.70, specializes in providing commercial mezzanine and short-term bridge financing.

One of the largest publishers of locally based print and online media, **GateHouse Media** (GHS) changes hands close to 9 and returns 18% currently.

NorthStar Realty Finance's (NRF) forte is just about every kind of real-estate finance and investment. It is yielding 16.63% and is priced at 8.66.

E-mail comments to editors@barrons.com⁷

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