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Section K

BUSINESS

The Mac Guy

Our Mac guru says you don't have to stick with Safari on a Mac because there are many other third-party browsers

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New margin tax sure to catch businesses off guard

Many companies, even some that were exempt under franchise tax, may see big bill.

By Aïssatou Sidimé
EXPRESS-NEWS BUSINESS WRITER

When the new Texas margin tax kicks in next year, many businesses will get hit with a surprise tax bill costing them several thousand dollars.

Under a new state law that replaces the franchise tax with a margin tax, businesses will pay taxes on gross revenues. The number of companies paying taxes will rise to 900,000 in May 2008 from 700,000 this year. The amount of state business taxes is expected to more than double to $11.9 billion during the next two years versus $5.7 billion for the last two-year period under the outgoing franchise tax, according to the Texas Comptroller's Office.

And a business could have to pay a margin tax even if it loses money according to federal tax calculations.

"A lot of taxpayers will be caught off guard by their new tax liability," said Clint Munsell, a certified public accountant at Sol Schwartz & Associates.

The margin tax replaces the franchise tax, which was levied on net income or capital. The franchise tax applied to just corporations and limited liability companies based in Texas. The franchise tax also allowed deductions for salaries, benefits, administrative costs and rents. As a result, less than 10 percent of all companies paid the tax.

The Texas Legislature created the margin tax during a special session in 2006 to close the loopholes and to generate more revenues to cover a school funding deficit.

Under the margin tax, most entities that were exempt before now will have to pay state taxes, including out-of-state limited partnerships, investment partnerships, law firms, doctor's groups and joint ventures. In addition, business losses no longer can be deducted.

Most of the $6.2 billion state tax increase will be coughed up by service firms. Businesses that use mostly independent contractors, such as trucking, logistics and home health-care companies, will see huge tax increases because they have no salaries or benefits to deduct.

Only oil and gas producers, distributors and larger retailers are expected to pay less in taxes.

That's because the margin tax is based on gross revenues generated in Texas — not profits or income after expenses — and allows deductions for just salaries and benefits or what it cost to buy or to produce goods, Bracewell & Giuliani tax attorney R. Joe Hull said.

The margin tax rate is 1 percent of gross revenues after deducting compensation, the cost of goods sold or a flat 30 percent of gross revenues. Retailers and distributors pay 0.5 percent. Other businesses with less than $10 million in revenues can opt to pay 0.575 percent of gross revenues.

Wanda Rohm expects a 300 percent in-

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COURTESY PHOTOS

ABOVE: A ReCyclone being installed in December 2005 at Fort Hood.

RIGHT: Granite ground into powder spews out of a chute at Sparling Recycling in Tavistock, England.

Pulverizing power

The world is turning to recycling equipment made in San Antonio.

By Adolfo Pesquera
EXPRESS-NEWS BUSINESS WRITER

In the town of Tavistock, 17 miles from the port of Plymouth by the English Channel, Roger Sparling has upgraded his waste recycling plant; it now uses a machine he examined firsthand at Fort Hood.

"This was the next step," Sparling said, in the evolution of recycling municipal solid waste. Sparling had the San Antonio-built machine installed the last week of October.

"When I first heard of it, I thought it was too good to be true," Sparling said. But after seeing a concrete crushing demonstration at the U.S. Army armored post, he added, "it satisfied me that it would do my job."

Akin to the inventions in Willy Wonka's chocolate factory, the PowerMaster ReCyclone suggests a childlike, magical solution. The big steel cylinder turns nearly anything it is fed into dry powder. Visualize a tornado without the rain, and you have the basic principle.

"This thing will grind any-

See RECYCLONE/4K

Buy several asset classes for diversity

Scott Burns

Craig Israelsen, an associate professor at Brigham Young University, wants us to know that it pays to build "Steady Eddy" portfolios for retirement. Having lots of asset classes, he says, is a good start. His recent article "The Benefits of Low Correlation" in the Journal of Indexes tells us a lot about a question that vexes most investors.

The question: If common stocks provide a 10 percent return over the long run, why can't I spend 7 percent a year and leave 3 percent to compensate for inflation? Why do all these planners tell me I can spend only 4 percent? Where does that lost 3 percent go?

For most people, it just doesn't seem right.

The statistical answer, which is less than illuminating, is that the lost return went down the variance sink. Another answer is that the 3 percent is the price of market volatility.

Build a more stable portfolio and you'll pay less for market volatility — the inevitable ups and downs of asset prices. You'll sleep better. You'll raise the odds you can spend more each year. And you'll be able to do it without going broke at some inconvenient time, like your 72nd birthday.

To demonstrate the idea, professor Israelsen tested the impact of increasing diversification on retirement portfolios. The portfolios were set for an initial withdrawal rate of 5 percent, with the original dollar withdrawal amount increasing by 3 percent each year thereafter.

Using the period 1970 to 2006, he examined both the statistical stuff (standard deviation and internal rate of return) and the scary stuff (worse single-year loss and frequency of one-, two- or three-year losses of 10 percent or more).

Guess what?

A portfolio with seven asset classes not only has a higher return than a simple domestic equity portfolio, it also has about half as much risk. More importantly, this Joseph's Coat portfolio had no periods with losses greater than 10 percent. The simple portfolio had worst-year losses three times larger, a daunting 30 percent.

In a telephone interview, professor Israelsen was quick to point out that some asset classes make better additions than others. Adding foreign stocks, for instance, didn't do much for your portfolio. Adding intermediate bonds and cash lowered risk, but it also lowered return.

"The real kicker came with the addition of REITs and commodities. Commodities were the seventh asset added, but it had the lowest correlation of any of the asset classes," he said. "You really need an asset class that moves in the opposite direction (from other asset classes). It's good to have something that goes up when everything else is tanking."

His two-asset portfolio — 50/50 U.S. large- and small-cap stocks — produced an an-

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ReCyclone turns almost anything to dust

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thing but case-hardened steel," said Lila York, owner of San Antonio-based PowerMaster Corp.

York unveiled a new line of ReCyclones earlier this year, but she doesn't expect much demand for it in the United States. Landfill costs here are still relatively cheap, and except for some highly populated regions on the East Coast, there's little urgency among American towns to revolutionize landfill operations.

Landfill fees for household and nontoxic commercial garbage range from $21 to $42 a ton in Bexar County. That's a bargain compared to the United Kingdom and much of Europe.

"Sixty pounds sterling a ton, that's what I pay to dispose in a landfill," Sparling said. "That's $124 a ton. And the cost is rising every year well over the rate of inflation."

York estimates that 25,000 ReCyclones distributed across the United States would make general waste landfills virtually obsolete. York's claims seem hard to believe, but the proof is in the dry, fluffy rubbish, or as Sparling puts it: "In this business, the way you make your money is by not spending it."

Almost everything processed through the ReCyclone would be reusable as compost, sand, other landscape covers or energy products such as diesel from plastic or coal substitutes from scrap wood.

"People want turnkey solutions," York said. "So we don't just sell them the ReCyclone. We custom-build systems tailored to a specific use. Someone might call and say, 'I want to turn chicken poop into fertilizer.' I had a call about turning glass into sand to put on beaches; we can grind it as fine as baby powder."

John Johnson is sales director for Global Advanced Recycling Technology Co., the U.K.-based distributor for the ReCyclone. He estimates the machine can recycle two-thirds of the garbage that otherwise would go to landfills.

The installation at Sparling Recycling attracted British media and industry experts. PowerMaster and Johnson are fielding inquiries from Europe and island states, including New Zealand, Malta and Sri Lanka.

Paul Dole, PowerMaster's special operations director, watches a worker at CCC Group Inc. in San Antonio attach a part to the top of a ReCyclone.

COURTESY PHOTOS

Mechanically, the ReCyclone is described as a durable — there's just one moving part — gyroscopic grinder with four chambers that spin air, making objects in the air crash into each other.

Depending on the size of the unit, ReCyclones are priced from $300,000 to $500,000. But sold as a turnkey system, with conveyor belts and other processing equipment, the average sales contracts are in the $1.5 million range. CCC Group Inc., a heavy-metal fabricating plant in San Antonio, is building them and has capacity to make 40 ReCyclones a month.

The ReCyclone is not a new invention, York said. Its slow entry into the market had to do with the inventor's vision. Ogden Bass, a mechanic in the mining industry, had only one application in mind: crushing rock.

If a prospective buyer wanted it for another use, that buyer often sought an exclusive-use contract. In other words, Bass agreed not to sell one to the buyer's competitors.

Bass invented the machine about 20 years ago, but sold only 15 units. He was happy to sell one every couple of years or so, York said. York is in the process of buying Bass out and has no intention of agreeing to future exclusive-use contracts, she said.

York has realized she doesn't know the full potential of the ReCyclone, and she's determined to keep her options open. A South American company has inquired about using it for e-waste; the theory being that if it can crush electrical components to dust, separating valuable elements such as gold and platinum would be much easier.

Perfect Blend, an organic fertilizer manufacturer in Bellevue, Wash., sees the ReCyclone as not only integral to its business but to the restoration of Earth's topsoils. Perfect Blend started its plant in 2000 with a Bass model ReCyclone and chicken manure from 2.2 million chickens on eastern Washington farms.

"If you ever buy organic foods in the United States, you're probably eating foods that have been grown with our fertilizers," said John Marler, founder and owner.

"PowerMaster allows us to bypass composting," Marler said. "Everything goes from intake to finished fertilizer at high-speed. We produce a ton every five to six minutes."

Marler is drawing up two, possibly three, contracts with Middle Eastern countries to replicate his plant in 2008. Another is planned for California.

"They will all be licensed plants, turnkey projects," Marler said. "I'll build them, charge them a royalty for the life of the plant."

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From its manufacture at CCC Group, a ReCyclone heads to Tavistock, England.

Number of companies paying taxes expected to rise by 200,000

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crease in state taxes for her printing company, Presto Printing, after deducting wages, 401(k) matches and insurance premiums for her 12 employees.

"When it first came out, I thought it would be great because so many businesses had not been paying the franchise taxes," Rohm said. "But if you are making a 1 to 2 percent net profit like I am and so many businesses are, a 300 percent increase is a lot."

Under the new law, there are a few ways a business entity is automatically exempt from paying the margin tax:

> *". . . If you are making a 1 to 2 percent net profit like I am and so many businesses are, a 300 percent increase is a lot."*
>
> **WANDA ROHM**
> owner of Presto Printing company

- It must be a sole proprietorship, general partnership of individuals, grantor trust, an estate or an investment partnership that gets at least 90 percent of its income from interest, dividends or capital gains.
- It must have gross revenues under $300,000.
- It must owe less than $1,000 in taxes.

However, businesses that meet either the $300,000 revenue or $1,000 tax exemption, still must file a return in May.

While the Legislature closed many loopholes with the new law, there are ways that other businesses owners can reduce their current and future tax liabilities, tax experts say.

First, company executives should itemize records to separate out all employee benefits, such as medical premiums, workers' compensation, parking, retirement contributions and free coffee, from other business expenses, said Steven Bankler, certified public accountant and personal financial specialist.

"In my instance, I pay for extra parking spaces for employees; and if I put it all on one check with the rent, then it is not deductible, unless the check says what part was for parking," Bankler said.

Second, rental income is subject to the state margin tax. Investment partnerships should remove or reduce rent payments so that at least 90 percent of their income comes from interest, dividends or capital gains, Munsell said.

"That way all the income is not subject to the margin tax," he said.

Third, business owners should avoid disbanding or breaking up companies into smaller entities to get under the $300,000 floor. A person must file a combined return for all businesses it owns, Hull said.

In addition, all companies that shut down operations during the last half of the year still will have to pay the margin tax.

Fourth, owners should convert limited liability companies to limited liability partnerships by year-end to qualify for exclusion in 2008, said R.J. DeSilva, spokesman for the state comptroller.

Last, business executives should test all four margin tax calculations before filing the return that is due May 15.

"You are allowed to change the method annually to take the lowest tax. But once you file, you cannot amend the return to change the method," Munsell said.

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Burns: Invest in seven classes of assets to improve diversity

CONTINUED FROM 1K

nualized internal rate of return of 10.74 percent. But it lost a deadly 30.8 percent in its worst year. His seven-asset portfolio — equal portions of U.S. large- and small-cap stocks, international stocks, U.S. intermediate fixed-income, cash, REITs and commodities — provided an 11.25 percent return. But the worst-year loss was only 10.2 percent.

When he observed that some portfolios appear more diversified than they are, I asked for an example.

"We can have a portfolio with U.S. large-cap and EAFE (international stocks), and it will look diversified. But it isn't in terms of timing — the timing of return is too similar. Diversification is really like an engine. Each asset class is a piston. It's important that they 'fire' at different times."

The Holy Grail of portfolio design would be a combination of asset classes that perfectly offset each other, providing a smooth return of 9 percent or 10 percent rather than a

> *"Diversification is really like an engine. Each asset class is a piston. It's important that they 'fire' at different times."*
>
> **CRAIG ISRAELSEN**
> Brigham Young University

bumpy one. Such a portfolio, if it could be built, would allow an annual inflation-adjusted spending rate starting at 6 percent or 7 percent instead of the frequently prescribed 4 percent.

The benefit to retirees would be massive. It would amount to a 50 percent to 75 percent increase in portfolio spending power for retirees. Many retirements would work a lot better if the safe withdrawal rate could be raised to 5 percent.

So here's an embarrassing question: How close are most investors to having the amount of diversification that Israelsen suggests is a good start?

Well, we have a long way to go. But the data is encouraging. Collectively, we're a lot more diversified than we were only a few years ago. The Hewitt 401(k) index, for instance, shows that we not only own the traditional large-cap domestic stocks (21 percent), but we also own small- and mid-cap domestic stocks (about 8 percent), as well as international stocks (10 percent) and emerging market stocks (1.55 percent). But we still have significant risk in our employers' stock (16.6 percent).

Basically, all that's missing is a REIT allocation and a commodities allocation. Unfortunately, those are the two asset classes that do the most to reduce portfolio risk.

Questions about personal finance and investments may be sent by e-mail to scott@scottburns.com or by fax to (505) 424-0938. Please visit my Web site at www.scottburns.com to comment on any of my articles, to find referenced Web links or to discuss personal finance topics on my forums. Questions of general interest will be answered in future columns and on my Web site.