Loyal BCE investors are getting a raw deal

Jul 05, 2007 04:30 AM

JAMES DAW

The bidding war for BCE Inc. won shareholders a big bump in their languishing share value. For many, though, it's a mixed blessing.

Those who bought shares outside a retirement savings plan before 2000 could lose a quarter to three-quarters of the proposed price premium to taxes.

Taxes could apply even to those who originally paid close to the $42.75 price the Ontario Teachers' Pension Plan and its partners will soon offer for each share. A buyer who paid $41 could be taxed on half of a $30 gain.

Depending on the tax bracket, that will cost between about $3.25 and $7 a share. Those who bought shares before 1972 could pay $4.35 and $9.36 in taxes.

This strange situation is a hangover from the tech-stock bubble. In May of 2000, BCE shrewdly decided to give its shareholders most of the company's holding in the gravity-defying Nortel Networks Corp., which was then trading at more than $80 a share. The result was that someone who paid $41 would be treated as if he or she paid only $12.62 for a BCE share, and the rest for 1.57 Nortel shares.

Recipients of the Nortel shares could have sold within a few months for a big profit, and tax bill. Those who held on after prices crashed may now be in a position to claim a capital loss, but generally the loss would not be enough to offset the entire capital gain on BCE shares.

Meanwhile, long-time BCE shareholders will probably suffer a decline in their after-tax income, or in the security of that income.

BCE's quarterly dividend of 36.5 cents a share provides an annual yield of about 3.5 per cent at the company's recent, elevated share price. Those who bought years or decades ago would enjoy a percentage yield many times higher, based on the original purchase price.

A couple of banks are paying a higher yield, but most that pay more than BCE are not large enterprises. And BCE shareholders will have less money after taxes to buy replacement shares.

What's more, BCE shareholders will lose the chance to share in happier days ahead if Teachers succeeds with its takeover offer, argues Patrick McKeough, a stock analyst and publisher of the Canadian Wealth Advisor newsletter.

They will have a vote on whether to accept the Teachers offer, but those focusing on short-term gains and performance bonuses could carry the vote.

Long-time shareholders, many of them senior citizens and retired employees of Bell Canada, have held on through five years of lousy returns. Before the rumours of the takeover surfaced in late March, and going back to early 2002, BCE shares have seldom traded above $30. They had reached $46.30 in early 2000, during the Internet bubble.

Over five years, BCE has barely increased its dividend, while the average annual gain for 30 of Canada's top dividend-paying stocks was 17 per cent.

The problem, McKeough points out, is that BCE has been fighting to adapt to changes in regulation, increased competition and an assault on the traditional land line telephone business from cellular, Internet and cable rivals. But he says that erosion has tapered off.

Others are speculating Ottawa might now look favourably on a merger with Telus Corp. that would bring BCE efficiencies and opportunities. And, McKeough says, infant technology could give copper phone lines a new lease on life, delivering broadband television and energy-saving technology to homeowners.

Then, along come the opportunists with deep pockets and a line of credit to scoop up that more promising future and leave the small, loyal shareholders with a tax bill.

"Basically, it stinks," McKeough says.

James Daw, CFP, can be reached by phone at 416-945-8633 or by email at jdaw@thestar.ca.