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Protect Yourself From Unknowns in the Future of Federal Estate Taxes

Dan Akers, Managing Principal

The future of the Federal Estate Tax system has never been murkier. Thanks to Steve Forbes and his bid for the presidency in 2000, more Americans became aware of the confiscatory nature of estate taxes. Recall that Steve Forbes' main issue was the abolishment of the Federal Estate Tax (understandable, given his family's fortune). What does the future hold for estate taxes and what are the two sides of the issue?

First, some fun facts:

From 1986 to 2001, the "exemption" from federal estate tax rose from $600,000 to $675,000 per person. Over that 15 year period, this represents an annual increase in the exemption of less than .80% per year during a time when the average annual return on a family's investments was about 12%.

The current "exemption" is $1,500,000 per person, scheduled to go to $2,000,000 in

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Prepare for Change

Kyle Boyd, Managing Principal

Would you like to know one of the most effective investment rules ever devised? Here goes. It is to remain open to change as new information becomes available. With that in mind, take a look at our assessment of today's investment landscape.

Chances are, you've heard that the personal savings rate is declining as the consumer debt rate rises in the United States. Both rates are at post-WWII records. Our country is also running a record trade deficit. The good news is that these conditions coexist with strong U.S. economic growth.

But as the economist Herb Stein once observed, "if things can't continue forever, they won't." High consumption, low savings and the lopsided ratio of imports to exports will reverse—because they must. Watch for adjustments in our economy over the next several quarters.

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Higher View quarterly

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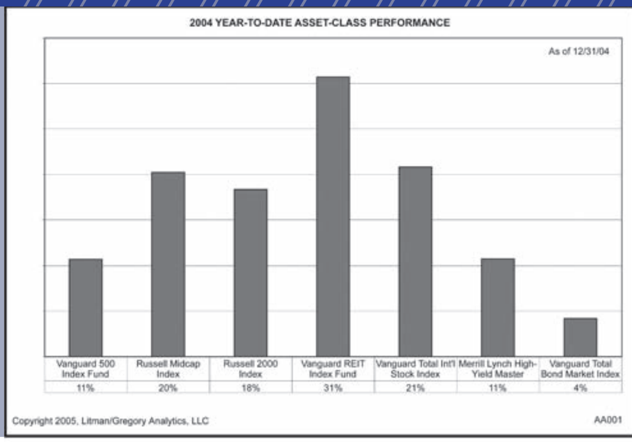

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Attractive considerations:

• Energy sector and stocks such as Exxon, ConocoPhillips, Houston Exploration and others

• Technology shares like Intel and Linear Technology

• Quality multinational firms such as G.E.

• Consumer Staples and food stocks such as Pepsi and Bunge

• Energy, agricultural products and industrial metals and commodities through professionally managed funds

• Shorter-term bonds

• Treasury Inflation Protected Securities (TIPS) for tax-deferred investments

Less attractive:

• Banking, due to rising cost of funds

• Longer-term bonds

(This is not specific investment advice, please note disclaimer on page 4.)

Prepare for Change

(continued from page 1)

The savings rate will rise as millions of baby boomers focus more on retirement, cooling off consumption. The growth of imports will chill as the dollar continues its decline, reducing the trade deficit.

Uncertainties abound. Although increased business investment is expected to take the sting out of the drop in consumer demand, such investment is by no means assured. Continued loss of life and hemorrhaging of dollars in Iraq could limit our government's ability to implement economic stimulus measures at home. And while a run on the dollar by foreign creditors is not expected, it's possible. This could drive rates higher and choke off economic growth.

Caution on stocks

While some stories and sectors remain attractive, market conditions are similar to those that preceded corrections in 1998 and 1999. This calls for more defensive positions and we expect to hold more cash than usual. If the market becomes significantly overheated, we will hedge market risk where authorized using mutual funds designed to trim net equity exposure.

Shorter bond maturities

Inflationary pressures are building, heralding a rise in bond rates. In general, we believe bond portfolios should be held at maturities shorter than the market. The price of Treasury Inflation Protected Securities (TIPS) resets with inflation, making them appropriate for tax-deferred investments.

Opportunities abroad

Compared to the U.S., foreign markets remain attractive. For one thing, investments in these markets hedge against a weaker dollar. We make these investments through the American Depository Receipts of certain firms, funds managed by Arnhold & S. Bleichroeder Advisors LLC and Artisan Partners, and certain index funds.

Real Estate & Alternatives

Growth in Real Estate Investment Trusts (REITs) have provided significant capital gains and income since 2000. They are the highest performing asset class over the past five years, besting the S&P by 24 percent. Although REITs are not the opportunity they were five years ago, they deserve consideration in a diversified portfolio.

For a complete 2005 Outlook from Altavista Wealth Management, please call 828.684.2600 or visit us online at www.altavistwealth.com. Kyle Boyd can be reached at kboyd@altavistawealth.com.

Information on estate tax returns filed in the year 2003:

Size of Individual Estate	# Returns with Tax Liability	Total Taxable Gross Estates	Total Estate Tax Liability Paid
$1 to $2.5 million	21,635	$33.8 billion	$3.8 billion
$2.5 to $5 million	5,505	$18.9 billion	$4.5 billion
$5 to $10 million	2,157	$14.7 billion	$4.2 billion
$10 to $20 million	824	$11.2 billion	$2.9 billion
Over $20 million	505	$31.3 billion	$5.2 billion
TOTAL	**30,626**	**$109.9 billion**	**$20.7 billion**

The total amount Americans pay attorneys, CPAs and other professionals trying to avoid paying estate taxes probably comes close to the total amount paid in estate taxes ($20.7 billion).

Protect Yourself From Unknowns in the Future of Federal Estate Taxes

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2006 and $3,500,000 in 2009. In 2010 the federal estate tax disappears and in 2011 the tax reappears with an exemption of only $1,000,000 per person.

A little known fact is that the concept of "carryover basis" appears in the year 2010. Under current law, if you own 100 shares of GE that you paid $1,000 for, and today it's worth $3,500 and you die, your heirs get a new cost basis of $3,500. In 2010, at the same time that the estate tax disappears, this "step up in basis" benefit goes away and your heirs will take your old cost basis of $1,000, thus incurring a capital gain tax on $2,500, should they wish to sell the stock.

There are some good reasons to get rid of the estate tax, or at least increase the exemptions significantly:

Small family farms and businesses sometimes have to be liquidated in order to pay the estate tax within nine months of date of death.

A disproportionate number of families have to sometimes spend in excess of $3,000 to create an estate plan that uses the exemptions in an appropriate way.

According the above chart, the amount of tax collected from over 2/3 of the total *taxable* estates represents only 18% of the already paltry amount of total estate taxes collected. The time, money and energy spent planning for the $3 million dollar estate, and the federal government's efforts to collect that "tiny" amount of tax is grossly inefficient.

Conversely there are good reasons to have an estate tax (with higher exemptions):

If the wealthiest individuals in the U.S. are able to pass massive fortunes down to future generations without any tax, in less than 100 years, 10 families could control over 90% of the country's wealth.

With a $5 million exemption, according to the above chart, only 4,500 returns would have been required, instead of 30,500, and $12.4 Billion in taxes would have been collected instead of $20.7 Billion.

With the coming transfer of wealth from baby boomers parents' to the baby boomers (about $20 trillion over the next 15 years), the federal government will have ample opportunity to collect a fair amount of estate tax and thus help in some small way to reduce the massive size of the federal debt, even with a $5 million exemption.

Planning with a changing exemption

Good estate planning attempts to pass property to heirs in an appropriate manner (outright or in trust) with efficient tax planning (using the exemption of each spouse). With the exemption amounts changing radically over the next five years, planners are beginning to use a technique called "disclaimer activated bypass trust planning." This planning technique allows a surviving spouse to choose how much exemption to use in the estate of the first spouse to die *after the death of that first spouse.*

Just two years ago, that exemption amount was fixed in the Will or Revocable Trust. As more and more estates become exempt from estate taxes, the need for bypass trust planning diminishes. But if we really do go back to a $1 million dollar exemption, those currently tax exempt estates could be in a world of tax trouble if there is not a provision in the document that sets up the tax plan.

The disclaimer technique gives us the flexibility to get through this transition period where we really don't know what the exemption will be in the year of death. If we get a permanent exemption of $4 to $6 million in the near future, we will be able to go back to the old method of forced exemption planning for our clients who still have taxable estates.

As an ending note, disclaimers have certain pitfalls that every client and financial planner need to understand. If you have not reviewed your financial and estate plan in the last few years, now is a good time to get up to date. You should discuss all options with your attorney, CPA or other professional advisor.

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Capitalize on the Value Altavista Brings to the Table

Greg Jones, Managing Principal

The Altavista client experience is unique in today's wealth management marketplace. We deliver high value by focusing on three basics: asset allocation, updated tax and estate planning, and individualized attention to the needs of each client.

We encourage all of our clients and prospective clients to examine our firm and its offerings from all angles to ensure that you gain maximum benefit from the services and experience our firm brings to the table.

At Altavista, it's not just about aiming for good returns on investments. We are concerned with after-tax investment performance and how your portfolio's performance is coordinated with estate and financial planning. We have extensive experience in customized asset class selection, enabling us to generate maximum performance at minimum risk.

Our open investment architecture allows us to serve each client's preferences and needs. Specifically, Altavista has no off-the-shelf investment products. We do not have proprietary or in-house products and services calling for our allegiance. We evaluate products and services soley on their marketplace merit and appropriateness to the client's situation. At the same time, each of us at Altavista brings a distinctive set of skills and experience to the firm, ensuring that your financial issues are examined from multiple perspectives.

Atlavista is not part of a large corporation. As such, we are insulated from the corporate mergers and consolidations so common with larger organizations. You receive full fee disclosure and cost control. Moreover, we are lean and efficient, enabling us to terminate and replace vendors when necessary with minimal disruption.

Lastly, we believe that any firm with wealth management in its name should offer trust administration and family office services, which we do.

Let's explore how Altavista can help you capitalize on our expertise and capabilities to the maximum degree. Give us a call any time to discuss the next steps we can help you take.

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