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Charity remainder trusts, insurance trusts can take fangs out of capital gains bite

If you're a big winner in MCA Inc. stock or some other investment and hate the prospect of having to pay combined federal and California taxes of 35 percent on your capital gain, there is a way to avoid them.

The way involves establishing an *irrevocable charitable remainder annuity trust* and an *insurance trust* as well as doing certain other things, declares Morrie W. Reiff. The founder president of Encino-based Planned Asset Management Inc., which specializes in estate planning, explains the various steps.

Say, for example, you have \$3.4 million of MCA stock that cost you \$2.1 million. Your first step, Reiff says, is to contact a favorite tax-exempt charity and ask it to pay the cost of setting up a charitable remainder trust for you.

In exchange for the charity's paying the attorney and other set-up fees, he says, you agree to put \$2.6 million of your appreciated MCA stock into the trust and to name the charity as the trust's remainder beneficiary. If your favorite charity won't play ball, Reiff suggests, find another tax-exempt charitable organization that will satisfy your requirements.

Your charitable contribution of \$2.6 million of appreciated stock to the charitable remainder trust, he says:

Will get you a charitable tax deduction of \$372,000. You can use it to reduce up to 30 percent of your adjusted gross income, Reiff says, and any of the unused portion of the charitable tax deduction can be carried forward for five years.

Save you \$358,500 in capital gain tax.

Provide you with a lifetime income equal to a 10-percent return on the \$2.6 million of stock donated to the charity.

You have the trust stipulate that you and your spouse are to receive a lifetime income of \$260,000 a year from the trust, Reiff says, and that income is to continue until both you and your spouse die, regardless of who dies first. You also have yourself named as the self-trustee of the trust, he says, so you can control its assets.

Moreover, Reiff says, because what you establish is an irrevocable charitable remainder *annuity* trust, you may invade the trust's principal to pay your annual income amount should the trust fail to generate sufficient investment income.

After both you and your spouse die, the assets remaining in the trust are paid to the charity you named as the remainder beneficiary, Reiff says. To be sure, that may look as if you've diddled your children out of much of their inheritance, but there's more than the charitable trust to his overall gambit.

When you establish your charitable remainder trust, he says, you also create an irrevocable insurance trust with your three children named as beneficiaries. You and your spouse give money to the trust to buy a \$1.06 million whole life insurance policy that is a-joint policy, Reiff says, with you and your spouse named as the insureds.

That is, he says, upon the death of the second spouse to die, the insurance will pay \$1.06 million tax-free to the trust, which is the owner of the policy. The trust, in turn, pays the money to the trust's beneficiaries without any tax owing because the insurance policy is owned by the trust and, so, not part of your taxable estate, Reiff says.

You and your spouse fund the trust's purchase of the insurance policy by giving the trust \$16,250 a year for seven years to pay the policy's seven years of premiums, he says. Since you and your spouse are each entitled to an annual gift exclusion of \$10,000 per donee, and your three children, as beneficiaries of the trust, are the donees, Reiff says, no gift tax is payable on the \$16,250.

Unfortunately, he allows, the \$260,000 you receive each year from the charitable remainder trust is treated as ordinary income and taxed accordingly to you. Even if you have the trust invest in tax-exempt bonds, the income paid to you still is taxable to you because the capital gain tax you avoided

otherwise would be considered as applicable first, Reiff cautions.

Of course, you may shelter any income derived from the investment of the \$832,000 of MCA stock you kept and converted to cash, he says, rather than donating to the charity. He mentions two of his favorite tax-sheltered investments:

One is a 15-year, nonleveraged, limited partnership program that buys marine con steel boxes to shippers and some 250 steamship companies worldwide. The containers, which are bought for about \$3,400 in South Korea, actually are intermodal, Reiff says, meaning they go onto ships, trains, truck trailers and may be transshipped from one to another.

Such limited partnerships, which are managed by Intermodal Equipment Associates, the San Francisco-based general partner, have been paying out annual returns of about 10 percent the first year, he says. Of that, Reiff continues, about 80 percent has been tax-sheltered by depreciation, and the annual payouts in the second through the fifth years have averaged between 11 percent and 13 percent.

The other Reiff favorite for tax-sheltered investing currently relates to buying five to seven-year lease paper in the secondary market from manufacturers that have leased equipment to local governments. Proposition 13 has cramped the ability of local governments to afford the purchase of equipment, and it has grown harder to get voter approval for bond issues to buy equipment, he says; thus, local governments have turned to leasing.

Such intermediate-term lease paper, secured by such essential equipment as fire engines, has been affording investors a tax-exempt yield of about 6.9 percent a year, Reiff reports.