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ESTATE PLANNING + PRACTICE PROFILE

Liquid Assets

If your client invests in wine, you must be prepared to handle this special asset with care in financial and estate plans. By Elizabeth Wine



THROUGH A LONG, HOT SUMMER, jittery investors fretted about the fragile economic recovery. Meanwhile, the other economy—the one filled with luxury goods like fine wines—sailed serenely along. The Liv-ex 100 Fine Wine Index, a leading industry benchmark of the most highly prized tipples—mostly French—was up 26.8% for the year through Aug. 31 and 33.4% over the past 12 months.

For wealthy clients with substantial wine cellars, that's a big boost to their net worth. Regardless of whether they are legitimate investors or merely collectors—a distinction the IRS will be sure to make for you—investing in wine can deliver serious value to your clients.

SPECIAL HANDLING

Wine like other luxury goods, requires special treatment by advisors. Estate attorney Matthew Erskine, a partner in Erskine & Erskine in Worcester, Mass., says most advisors and clients tend to treat large stores of wine wealth as “an afterthought” in financial and estate plans. Erskine, who specializes in tangible personal property, including such illiquid and tricky-to-value items as wine, art, classic cars and antiques, has seen that mistake result in big tax consequences time and time again.

Accounting for a serious wine collection when doing financial and estate planning requires some thought. It does not mean simply

tacking it on to the end of the wealth statement or lumping it with other tangible personal property that does not appreciate in value, like non-antique furniture or cars.

It means planning for it just like for a portfolio of stocks. The cellar should have a complete inventory, and the valuation should be updated at least once a year, estate attorneys say. It should be insured, and there should be a plan for disposing of it after the client dies—assuming the heirs don't opt simply to drink it.

How does an advisor make sure all of this is properly done? You don't have to be an oenophile. You just need to have a good crew with the right expertise.

This group should include a wine investment expert. These professionals are much like the freelance curators who manage the art collections of wealthy investors. “The market is too fragmented and inefficient to go in without help,” Erskine says.

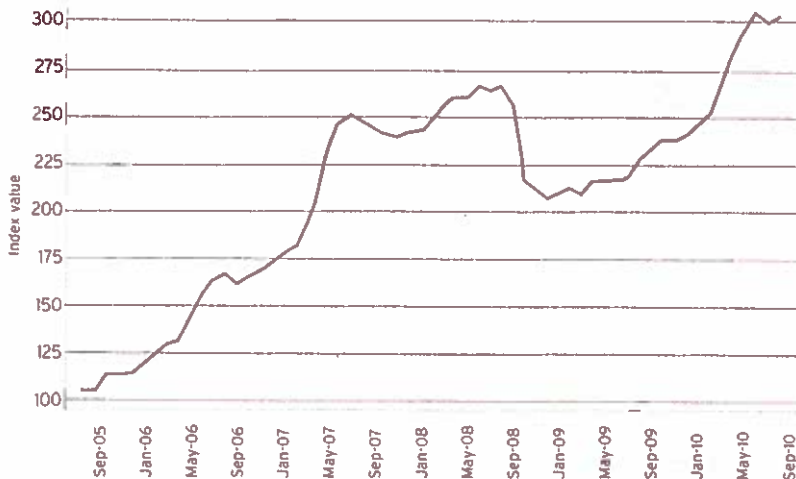
Financially managing a wine cellar also calls for an estate attorney knowledgeable in tangible personal property law. An accountant with specialized knowledge is nice, but not necessary.

COLLECTOR OR INVESTOR?

With the crew assembled, the first thing an advisor needs to know is whether the IRS characterizes the client as a collector or an investor. Everyone who has a wine cellar is, by definition, a collector. Investor may

BEST BOTTLES

The Liv-ex 100 Fine Wine Index, a leading industry benchmark of the most prized fine wines, has been rising since the beginning of 2009.



Source: Liv-ex.com

sound pedestrian, but it's a more desirable designation; investors pay much lower taxes.

If collectors do sell anything out of their cellars, they will pay a 28% capital gains tax rate, because the wine will be considered a personal asset. And they can't take any deductions for the expensive measures they take to maintain their cellars.

Investors, on the other hand, will pay a 15% long-term capital gains tax for commercial property, because their cellars are considered business inventory. (Unless Congress takes action, that rate will eventually climb back to 20%.) Investors can also offset gains on wine purchases with losses from other wine purchases. Collectors cannot.

Estate attorney Mike Whitty at Vedder Price in Chicago cautions, though, that "most casual hobbyists" won't rise to the level of investor. "You can't just buy it and say, 'I'm holding the stuff for an investment,'" Erskine says. He notes that most collectors buy and buy, and only occasionally let the odd bottle go.

There are several ways to prove

investor status, and shrewd clients will use most if not all of them. Meticulous recordkeeping is necessary to establish a pattern that a client is buying and selling wine to make a profit.

One key is having a tracking system of some sort—usually a spreadsheet detailing at what prices clients bought and sold the wine. Keeping receipts is also wise. Clients must show they are realizing a return on their investment.

Further, they must show that they have a procedure for selling the wine. An example might be selling when a bottle has met two times cost basis. "Just like an investment policy for a portfolio, you need an investment policy for your wine collection," Erskine says.

MAKING A PLAN

The wine expert can help clients set up the investment policy. For example, the management plan might concentrate only on certain vineyards, only on Bordeaux or only on Burgundy from a certain region, say, if clients want to have a strong

position in a certain market. Other parameters might be buying wines only under a certain cost, say \$35 per bottle—analogue to buying only stocks under a certain P/E ratio.

Still other parameters might be only buying red wines, or only whites that are one to three years old, which must be sold between five and eight years of age—because otherwise the risk of their going bad is too high. The plan might exclude Lebanese wine, but keep an eye out for other emerging markets so that clients can get in on the ground floor. Of course, there might be the occasional foray into spirits, perhaps a diversification into whiskey.

The advisor should know the plan requirements and give them a comprehensive review with the wine expert at least once a year to ensure compliance. "Do not assume the client's CPA will be doing this," Erskine says. Also, be sure to check with the expert to make sure the client is keeping up with inventory and complying with contracts, taxes, export licenses and so on.

The advisor also checks in with the curator to make sure cash flow is running smoothly for the collection. If the expert knows he or she will be bidding on futures in February and will need \$250,000, for example, the advisor makes sure it's available. Figure out if any foreign exchange should be purchased ahead of time, like buying euros early if the dollar is looking weak.

Erskine notes that savvy wine investors are not taken in by the romance of the grand old French chateaux names. Rothschilds and Moutons hold no appeal because they are already richly valued. "The investing client is not buying the prestige bottles of wines at retail—that's for collectors," he says.

Erskine advises wily wine buyers to buy the futures of wines with a great future. Hold until they mature,

then sell promptly. No hanging on to it for decades.

PASSING IT ON

When it comes time to plan for passing the cellar on to the next generation or to friends, clients should categorize their holdings just like portfolios. Erskine suggests a simple “good, better, best” system.

The best stuff gets sold immediately, because it’s closest to its peak and realizing its top value. The better stuff should take as long as 12 to 18 months to place in private sales or at auction. The good stuff is likely futures of what’s expected to be a really fine vintage. They will fetch a premium if the heirs can wait for maturity—which could be a decade away—to sell.

The biggest issue for the collection at a client’s death is valuation. The IRS will go by fair

to charity for an auction, or as part of the supplies for a fund-raising reception, thereby earning a charitable income tax deduction.

However, if clients give the wine to a charitable institution for something other than its charitable purpose, they only get to write off what they paid for it, not the current fair market value. So clients should only donate wine to charities whose mission involves food and wine education. So, for example, the Culinary Institute of America would be an acceptable charitable choice, but not, say, the Girl Scouts, Doctors Without Borders or Locks for Love.

Alternatively, clients could put the wine up for sale and donate the actual sale price to the charity, according to Whitty. Clients will pay the capital gains tax, but they will get to write off the full cash amount of the donation.

tion insurance costs about \$40 per \$10,000 of coverage or \$400 a year for a \$100,000 cellar.

These carriers all cover wine collections on a blanket basis, meaning any unspecified wine is covered, with a per-bottle maximum of \$2,500 to \$10,000, depending on the carrier. Bottles with higher values are itemized on a schedule, similar to what clients do for jewelry coverage. The coverage is worldwide, and it covers wine stored at a client’s residence, off site in a wine storage facility and at the office or in transit after it has been purchased.

Policies are generally “all-risk,” meaning everything is covered unless specifically excluded. “If you own it, it’s covered,” Glunt says. So that means if a client’s Martha’s Vineyard home is damaged by a hurricane, and the power goes out, stopping the chiller motor in the cellar, spoiling

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market value, which may well be higher than the client thought the bottles were worth.

If the client built a unique collection, the taxes on a higher valuation may be tricky to fight unless the client kept great records. In that case, for example, if the IRS said a particular bottle was worth \$1,500, the executor could argue back, “I’ve been trying to sell these things for five years and all I’ve been able to get is \$500 a bottle.”

Whitty says that some clients may want to wind down their collection before their death, or just give away some cases that are reaching the end of their optimum quality. In this case, they can start using the wine as part of an annual gifting program for family and close friends, using the annual gift-tax exclusion. Clients can also contribute their wine collection

INSURING IT

As with other valuable assets, wine should be insured. Kenneth Gott, a financial advisor and wine enthusiast with Aspiriant in San Francisco, recalls a time when a client was glad he had coverage. The client made a claim when someone mistakenly opened a very expensive bottle. The insurance paid off.

Dan Glunt, founder and CEO of Fort Point Insurance in San Francisco, a private client personal insurance agency, works with boutique wealth management firms across the country that have clients with substantial cellars. He says the four primary insurers of wine collections are also the four top personal insurers: Chubb, Ace Private Risk Services, Chartis Private Client Group (formerly AIG Private Client Group) and Fireman’s Fund. Wine collec-

the wine, it’s covered.

In California, however, some carriers charge a 10% deductible for earthquake coverage. So a \$1 million cellar in California may have a \$100,000 earthquake deduction. All other claims have no deductible, Glunt says; earthquake is typically the only exception.

This may all seem like a lot of trouble to take over a few bottles of wine, but wealthy clients in this category may view it as well worth the time and expense. Cai Palmer, wine expert and owner of the Wine at Five shop in well-heeled Rye, N.Y., says he sees prices for many bottles going down. But he notes, “The ultra-wealthy are an economy unto themselves.” FF

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