

MKF
 MOTTO, KRYLA & FISHER
 Wine Industry
 Accountants and Consultants



The
**Family
 Wine Business**
 Journal

Welcome!

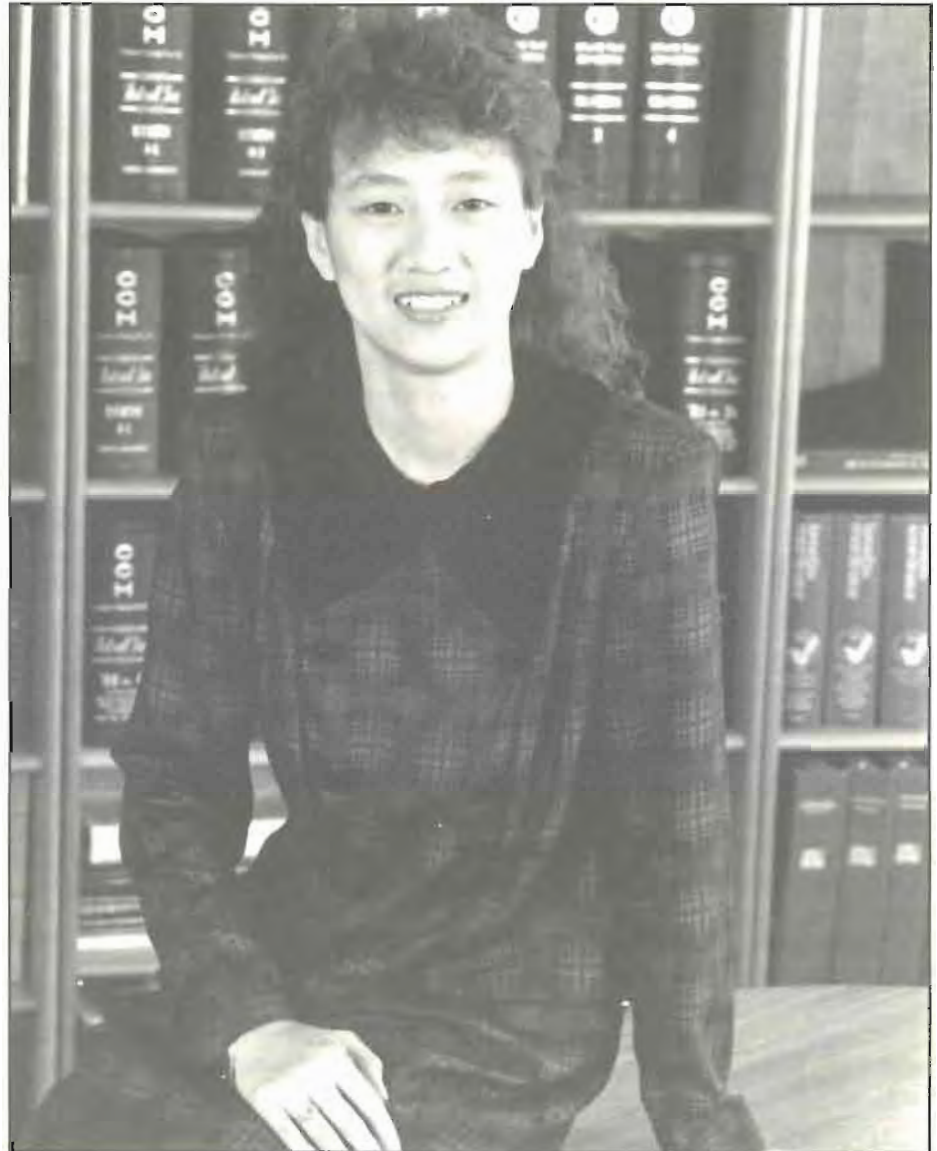
Our goal in bringing this Journal to you is to raise and discuss issues facing families in the wine business and owners of closely-held wine businesses. The types of issues that we will address deal not only with current topics relating to the operations of your business, but also with succession planning and estate planning.

What are "succession planning" and "estate planning?" Basically, "succession planning" is planning for the smooth transfer of ownership and operational control of your business to those who are willing and able, at the appropriate time, and in the appropriate manner. "Estate planning" is planning to achieve your succession plan in a manner which minimizes any potential tax costs.

... you need to set a plan in motion now to keep your business going later.

Those are the short answers. But these issues really deal with much more. These two areas involve the following additional issues:

- Business continuation planning
- Management succession
- Identification and separation of family goals and business goals
- Retirement planning
- Financing and funding issues



Welcome to the first issue of The Family Wine Business Journal!

Elaine Chan

In this issue of the Journal, we will preview the above topics by

identifying some of the concerns associated with these topics.

Business Continuation Planning

It takes a great deal of time and hard work to build and maintain a successful winery. On the other hand, it takes very little to create a business failure. How concerned are you about the future and long-term existence of your winery? Do you want the winery to be continued on into the future within the image that you have established? Do you have the same enthusiasm and excitement about the future as you had when you were just dreaming about starting a winery and watching it grow?

Right now, you are the business.

If the future of your winery is important to you, then you need to set a plan in motion now to keep your business going later. A family-owned business is different from a public company that organizes itself based on a **hired** professional management team and **hired** replacements. Once a public company is established, the departure of one or more key people usually does not stop the business from operating. Even the departure of the chief executive will not cause the business to shut down.

Contrast this with the family-owned or closely-held wine business. Right now, **you** are the business. You have the reputation and skills needed to run the business. You have the understanding to keep it going. Without you, what is the business worth? Is it worth only what you could get if you sold its assets? Maybe. Without you, could the business survive? Maybe not. To make sure that your business does survive, you need to make sure that a plan exists to keep the momentum going.

Management Succession

A major part of the business continuation plan will address management succession. Management succession involves (1) choosing a successor, and (2) transitioning the leadership role to the designated successor. A family business must have an heir. A closely-held business needs a successor. The responsibility for choosing the heir or successor is up to you as the leader of the business.

Who is your successor going to be? Who would you like to see running the show? Sometimes the answer is very obvious. Perhaps your son or daughter has been practically running the winery for some time and knows the business as well as you do. Many times, the answer is not at all obvious. You may have several children; some in the business and others not. How do you choose a successor? On the other hand, none of your children or close relatives may have been involved in the winery, and perhaps they have no desire to be. You may, however, have a faithful

How do you decide in favor of one person over another?

nonfamily right hand person who has been with you for a long time who could do an excellent job of continuing your winery in the way that you envision.

How do you resolve this potential conflict? How do you decide in favor of one person over another? Emotions often play a large part. The **desire** to make sure that your winery continues is based on your dreams and your vision, and not necessarily on logic and reasoning. Perhaps you want the person you select to have the same dreams

and vision. The decision is an important and difficult one. You must decide which qualifications are important to you. It simplifies things if a well-prepared and motivated successor is available, but the choices that are available usually involve some complications. In addition, your successor must agree to succeed.

Although the selection process can and probably will be emotional, the transitioning process should **not** be. Assuming that the person that you have selected is willing, it is your responsibility to make sure that he is able. If he does not have the requisite knowledge and experience, you must make sure that he acquires them. Help him to gain the reputation and skills that he needs. Give him the benefit of your experience. Give him your guidance.

Once the transitioning is complete, then you must step aside. Let the new leader lead and show you what he can do. It is time to enjoy the fruits of your labor.

Identification and Separation of Family Goals and Business Goals

When you are dealing with your business, it is often difficult to separate your role as the owner and/or employee of the company from your family relationships.

... you need to set some goals and make some choices.

However, it is important that, at any given moment, you know which hat you are wearing.

When you are selecting a **successor** to manage your business, you are an owner looking out for

the future of your business. Although you may consider a family member as your potential successor, a nonfamily manager may be acceptable because of his profit-making abilities and his overall skills. In any event, you must ultimately do what is best for your family as well as your business.

When you consider the future **ownership** of the business, the distinction between doing the best for your family versus your business becomes more blurred. Most of you probably want to keep your business in the family, so the question really becomes who amongst your family members should **own** your company. Who will be the best owner? Who deserves the most to be the owner? Remember that ownership usually means operational control, or at least the ability to determine who will have operational control. Will the selected owner undo your management succession plans?

As the distinctions become more and more blurred, it becomes more important that everyone who is potentially involved understands (and hopefully, accepts) the plan. The greater the understanding, the more comfortable everyone feels and the more likely that your plans and dreams will be fulfilled.

Estate Planning

As we mentioned earlier, estate planning helps to minimize the tax costs associated with the transfer of your business. The transfer that we are referring to is the transfer of the ownership of the business.

When you transfer your assets, you are subject to a tax with a current rate as high as 55 percent (for certain amounts exceeding \$10 million, the top rate is 60 percent). This tax is imposed on the *value* of the property that you transfer. For example, if you own a winery

which is worth \$10 million, a transfer of that winery will cost you \$5.5 million in taxes.

*... you need to decide
what you would like
to happen.*

The potential tax bill can be very threatening for individuals whose main (or sole) asset is their business. The amount of cash required to pay the tax is probably not available from the winery. Exceptions and deferrals are available to help minimize the tax. By planning, you can make the most of those exceptions and deferrals.

Before you work on minimizing your potential tax cost, however, you need to set some goals and make some choices. You need to develop at least a general plan that you are comfortable with and does what you want. Will your assets be distributed according to your wishes? Are your business continuity and management and ownership succession plans in order? Before the tax cost can be dealt with, you need to decide what you would like to happen.

Retirement Planning

Before you give away your most valuable and/or only asset, make sure you have taken into account the type of lifestyle you would like to have after the transfer. Will you have sufficient cash flow to take care of your needs and dreams? Expect to need more than you can possibly estimate right now. Make sure that you will be financially comfortable.

Financing and Funding Issues

Once you come up with a plan to transfer the management and

ownership of your business, how are you going to finance this transfer? Do you have the cash to pay for the transactional costs, including the tax bill? If you do not have the cash right now, do you have a means of getting it? If you cannot afford to accomplish your plan, you have two alternatives: the first alternative is to delay or even forego implementing the plan. The second is to find a different way; to come up with a better and achievable way to accomplish your goals.

Summary

Those are some of the subjects we plan to talk about. They are difficult subjects, because they bring up many questions that most of us would prefer to avoid. In fact, it may seem like there is an overwhelming number of difficult questions and issues that you must deal with.

Planning is not an easy process, but only you can decide what should happen. We pose the questions so that you see the types of decisions that you need to make. As you can imagine, there are an unlimited number of ways that these questions can be answered. We will help you to get through the questions by taking one step at a time. Just keep in mind that planning takes time. It takes time to formulate the ideas, determine whether they are feasible, formalize the plan, and to implement the plan. Future issues will address specific topics and questions, and serve as a reminder for you to get your plan in order. And if your plan is already in order, the future issues will introduce new ideas, and remind you to reassess your plan for new situations and circumstances.

We would like to hear from you on these subjects. Which questions or issues are most important to you? What is your perspective on the issues? Let us know. ♦

Approaching the Planning Process

How should you approach succession planning and estate planning? What specific steps are involved?

The first thing that you might do is to see your advisor and ask him what your approach should be. Generally that is a good idea, because your advisor can give you some direction. To get you started, your advisor will probably suggest that you think about certain questions, such as the ones we posed in the accompanying article. Think about what you would like to happen. Succession planning deals with the transfer of the ownership and control of your winery and other assets. Ask yourself who should inherit which assets.

Once you have a general idea about what you would like to happen, you need to determine whether you have a tax problem. Will you be able to transfer all of your assets intact, or will some of your assets be sold to pay taxes? The tax starts to apply once your net worth exceeds \$600,000, and can take 55 percent or more of your assets.

How do you determine whether you will owe taxes? Since we know that the tax applies if your net worth exceeds \$600,000, we need to determine your net worth. To do that, you need to make a rough estimate of the value of your assets. Then reduce the value of your total assets by the amount of your liabilities. The resulting figure is your net worth. If your net worth is over \$600,000, you may not be able to transfer everything you want unless you can plan around the tax or come up with the cash to pay the tax.

If you are sure that you do not have a tax problem, then collect your ideas and have your attorney

draft your will. However, if there is even a slight possibility that you will owe taxes, then you need to bring your ideas to your advisor and see what he can do for you. Your advisor should do the following for you:

- (1) Review your ideas with you;
- (2) Ask you additional questions which are specific to your particular situation;
- (3) Give you a picture of how your plan actually works; this will show you who gets how much and when;
- (4) Determine your tax cost and reveal any tax benefits;
- (5) Give you comments and suggestions regarding your plan; show you how to accomplish your goals in different ways in order to minimize your tax;
- (6) Discuss liquidity and cash flow; determine the cash requirements and discuss how they will be met; and
- (7) Make sure that you are satisfied with your plan and that you understand it.

After your plan is set up, then you need to act on your plan. You need to make sure that all of the necessary documents are drafted and executed and that you have taken care of all of the details.

When all of this is completed, you should remember to review your plan periodically. Make sure that your plan continues to do what you want. Determine whether changes in personal situations affect your plan. Inquire whether there have been any law changes which may affect your plan. Think of succession planning and estate planning as tools that can always be fine-tuned. ♦



Elaine Chan is Senior Tax Manager with Motto, Kryla & Fisher, Wine Industry Accountants and Consultants, specializing in

family succession and estate planning.

Elaine is a tax attorney and CPA, and was formerly with Arthur Andersen & Co. where she worked with closely-held business owners and high net worth individuals. She is a graduate of Hastings College of the Law and U.C. Berkeley.

MKF

The
FAMILY WINE BUSINESS
Journal

AGENDA

Business Continuation Planning
Management Succession
Ownership Succession
Identification and Separation of
Family and Business Goals
Estate Planning
Estate Taxes
Retirement Planning
Financing and Funding Issues
Business Valuations

MOTTO, KRYLA & FISHER
Wine Industry
Accountants and Consultants

NAPA VALLEY:

999 Adams Street
St. Helena, CA 94574
(707) 963-9222

SONOMA COUNTY:

North & Vine, P.O. Box 1524
Healdsburg, CA 95448
(707) 431-2200