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What Happens If I Break the Rules

The Top Ten Common Compliance Errors

Committing any one of these 10 common compliance errors can lead to stiff fines. Some may result in suspension or even revocation of your Federal Basic Permit. Save money and grief by learning to steer clear of these pitfalls the easy way—read about them here.

1. Bottling and Transferring Unlabeled Wine Without A Label Approval

[The U.S. Department of Treasury's Bureau of Alcohol and Tobacco Tax and Trade \(TTB\)](#) requires that wineries obtain Certificate of Label Approval (COLA) for all bottled wine meant for sale in the U.S. This does not mean that wineries are required to actually affix a label to each bottle at the time of bottling, however. In fact, bottling “shiners” (without label) is increasingly common. Winemakers don't finalize the composition of a wine blend until just prior to bottling. Printing specific information on a wine label, including the components of a particular blend and the percentages of varieties used, is also a common trend, so winemakers often put off designing their labels until after the wine is bottled and affix the label at a later date.

A common compliance error results when the winery doesn't obtain a [COLA](#) until after the wine is bottled and sometimes transferred in bond to a storage facility. Federal regulations require wineries to obtain a COLA prior to bottling, and all unlabeled wine that is transferred in bond be accompanied by a COLA. The label being submitted for approval must contain the mandatory information about the wine, including but not limited to brand, variety or class, percent alcohol by volume, net contents, the bottler's name and address, the sulfite declaration and the health warning statement. This generic label need not be the label that is eventually affixed to the bottle as long as the bottler obtains another COLA for the final label design.

2. Failing to Obtain New Federal Label Approvals When Product Specifications Change

Many winery owners and their staffs are unclear about when they are required to apply for a new Certificate of Label Approval or COLA from the TTB. As many winery personnel know, you are not required to obtain a new approval for every new vintage of the wine that you have a COLA for from its previous year. The rule of compliance is that there is an exception to every rule. If the wine in question has a different alcohol content as a percentage by volume from the previous year, then you may need a new COLA. If an existing COLA shows the alcohol content within 1% of the new vintage's alcohol test and the wine is 14.1% or greater than no COLA is needed. The same is true when the wine is within 1.5% of what is printed on the previous vintage label when the wine is 14% or lower.

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The problem arises when the tax class of the wine changes altogether. Even if the new vintage is within the 1% or 1.5% allowed tolerance but the tax class changes you must apply for a new COLA. Make sure you are paying the correct tax rate based on the alcohol test and not the previous year's COLA. Another common error in alcohol labeling is failure to obtain a correct alcohol test that differs from your label statement and your COLA, and then your inventory can be frozen until a new COLA has been approved. In this case, the most prudent course of action is to request permission to "Use Up" the incorrect label. This is as simple as applying for a new COLA except that you provide an explanation of errors and receive permission to use the label for a period of time. The back of the COLA form has a table, which shows the conditions under which a winery operator must apply for a new COLA. This is a great quick reference if you are unsure about whether you need to reapply or if you can skip it for a vintage.

3. Making Quarterly Excise Tax Payments Without Adequate Tax Deferral Bond Coverage

As of January 1, 2006, a winery owner may make quarterly tax payments if the expected tax liability for the calendar year is less than \$50,000 and was not more than \$50,000 the previous calendar year. This is a very convenient regulatory change for California wineries that are filing state excise tax returns each quarter. Sufficient tax deferral coverage is required before deferring taxes until the end of the quarter. Tax deferral bond coverage can be added to a [winery's operating bond](#) to cover the tax liability on wine that has been removed from bond when the tax liability has been determined but not yet paid. According to the TTB's Wine Tax Group, if the taxpayer has bond coverage they have certain amount of deferral coverage also. A bond that is for \$1,000 has \$500 of deferral coverage already included. A bond that is \$2,000 or more has \$1,000 deferral coverage already built in. However, often wineries don't have enough deferral coverage in their bond coverage for an entire quarter's worth tax-paid removals.

The TTB Investigated Office in California has not tolerance for wineries without adequate bond coverage. If deferral coverage is not adequate and the taxpayer does not get correct bond coverage, the winery can be forced to pre-pay taxes on wine removed and file period-returns in addition to the pre-payment returns. The easiest way to calculate the amount of deferral coverage needed is to carefully estimate the largest number of gallons that may be removed in a tax period and multiply those gallons by the expected tax rate, which is determined by the alcohol content and the small producer's eligibility for tax credit. It is also a safe bet to double your operating bond coverage, because most wineries have two vintages in bond at some point.

For instructions on calculating Wine Bond Coverage go to www.ttb.gov. Click on the "wine" tab by the top of the page. Click on "wine forms" located under "quick links" along the right-hand margin. The Wine Bond Form Worksheet is the last form on the list: TTB F 5120.36w.

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4. Filing Late Excise Tax Returns To TTB

Most wineries are still required to pay excise taxes semi-monthly either because they don't have sufficient tax deferral coverage or they have annual tax liability greater than \$50,000. TTB publishes the semi-monthly payment schedule at the end of each year on their website at TTB.gov for the upcoming year. Semi-monthly payments are due around the 14th and 29th of each month but if those dates fall on weekends or holidays, the due dates are moved forward. —To the 13th and the 28th or even earlier. Taxpayers don't always check that payment schedule prior to filing a return, and it is easy to miss a due date, since most of us are conditioned to paying on the 15th of the month to other agencies. Penalties for failure to pay tax at the time required, categorized as willful refusal to pay the tax, are all too common. According to the [Code of Federal Regulations](#), late filing can result in a penalty of "five percent for each month or fraction thereof of the delinquency, not exceeding 25 percent in the aggregate, unless it is shown that the delinquency is due to reasonable cause and not to willful neglect." In addition, interest on the principal amount will accrue until it is paid.

5. Destroying Wine Without TTB Permission

Federal regulations state that "wine on bonded wine premises may be destroyed on or off wine premises by the proprietor without payment of tax. A proprietor who wants to destroy wine on or off wine premises must file with the appropriate TTB officer an application stating the kind, alcohol content, and approximate volume of wine to be destroyed, where the wine is to be destroyed, and the reason for destruction."

If wine is unmarketable due to spoilage, you may ask permission to destroy wine without the inspection by a TTB investigator. A simple letter to your area field office requesting permission to destroy wine is usually all that is required to legally destroy the wine. Wine that is destroyed without permission from TTB carries tax liability, and you still prove that it was destroyed. Wineries that destroy wine and account for the destroyed wine as inventory losses due to evaporation or other reasons may be found to be defrauding the government. If a large quantity of wine is destroyed, causing the winery to exceed the typical 6% annual gallonage loss expected from evaporation, an audit could ensue.

6. Transferring The Small Producer's Tax Credit On Purchased Wine

Small wineries that produce between one and 250,000 gallons of wine in a calendar year are eligible for up to \$0.90 of credit per gallon for the first 100,000 gallons they remove from bond in a calendar year. Under certain circumstances, an eligible small producer who holds title to the wine at the time of removal can transfer the credit to another bonded facility. The credit transfer is often used by small producers who store and ship from an off-site warehouse location. For accounting reasons, these small proprietors only want to pay taxes on wine that

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is being sold while keeping the remaining wine in bond. The problem occurs when not all of the wine is actually fermented by the small producer. If a portion of the wine being removed from bond was purchased by the small producer and blended into the wine they did actually ferment, the tax credit on the purchased wine cannot be transferred. The small proprietor can either notify the transferee that a portion of the wine should be paid at the full rate, or the small proprietor can pay the tax and take the \$0.90 credit per gallon on all the wine that is removed prior to shipping it to the storage facility.

7. Doing Business With Unlicensed Customers

It is important to know your customers. In the wine industry, that means that you should know whether or not they are licensed to hold title to and sell wine. Many small wineries are engaged in some sort of custom crush business in addition to producing their own brands; they should be certain that all their customers are licensed. In California, you can easily check the license status of potential custom crush client by visiting the California ABC's website www.abc.ca.gov. The ABC's license query system allows you to check for licenses based on an individual's name, a business name, a trade name, or address. Custom crush clients should hold a Type 17 Wholesaler's license or they should be a licensed winery with a Type 02 Winegrowers license. Both of these types of businesses are first required to obtain a [Federal Basic Permit](#), but you can rest assured that those have been issued because most states will not issue a license until a Federal Basic Permit has already been obtained. The bottom line is you should not sell wine to any unlicensed entity other than a consumer who will not resell the wine.

8. Failing To Update TTB And State agencies Of Ownership and Premises Changes

Federal and state regulations require winery applicants to provide details regarding who will own and operate the winery and information about the physical premises and equipment that make up the bonded area at a winery. It is all too common for small incremental changes in these details to go unreported to the agencies that license and regulate wineries. If a winery owner converts his business from a sole proprietorship to a Limited Liability Company (LLC), for example, state and federal agencies consider this a change in ownership, which must be reported (and in some cases new applications filed), even if the sole proprietor is now the sole member of the newly formed LLC. Even small changes to corporate boards of directors or other officers or seemingly insignificant stock changes should be reported to TTB and to your state. Additionally, if a winery adds onto its building, builds an additional building, or simply adds an outdoor crush pad, the description of the physical premises should also be updated.

As a winery owner, in order to ensure that your license information is current, review your application files at least once annually to make sure they are in compliance. Updates are dated and numbered sequentially on TTB forms, so it

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is easy to check your most recent update. State agencies deal with ownership and premises changes differently, so it is wise to call your state ABC office for guidance on how to update your state licenses with these changes.

9. Failing To Properly Report Exports

Wine produced in the U.S. and sold to buyers in other countries is considered exempt from the per-gallon excise tax changes at the federal and state levels. Exports often include sales to airlines and cruise ships. For wineries shipping outside the U.S., the savings can add up. Wineries are required to report any bonded wine that is exported outside the U.S. on their [Monthly Report of Wine Premises Operations, report # 702](#). Most winery operators do not realize that there are other documents that must be filed in order to secure the tax exemption or to obtain a refund if the exported products have been removed from the bond and taxes paid prior to export.

For wineries shipped directly from bond, you should complete and file TTB F 5100.11 [Withdrawals of Spirits, Specially Denatured Spirits, or Wines for Exportation](#). To request a refund or credit for taxes paid on exported wine you should file TTB F 5120.24 [Drawback on Wine Exported](#). Both forms are simple to complete and should be filed at the time of export. Proof of exportation should be kept on file and TTB will typically accept a signed bill of lading showing with the foreign destination at the point of delivery.

10. Shipping To Consumers In Other States Without Proper Licensing

A guest in your tasting room asks you to ship wine to Alabama. When you let them know it's illegal to ship to Alabama, they respond with "but the winery down the road does..." It's hard to compete with a neighboring winery that doesn't follow the rules of the law. It's even harder to keep up with the myriad of changing rules and regulations. But for the sake of your business, it's important to stay compliant when it comes to shipping to consumers in other states. With the dwindling number of reciprocal states, most states have transitioned to a permit system, requiring your winery to be licensed in that state before you ship to consumers. Shipping without a license can come with heavy state penalties and legal actions. In most cases, the shipping winery owes sales and/or excise taxes when making consumer sales in other states, and the state and federal agencies take their revenue very seriously.

Shipping without a license could also potentially affect your federal basic permit. [TTB ruling 2000-1](#) indicates that "TTB could under appropriate circumstances take administrative action against a (winery) where the (winery) ships alcoholic beverages into a state in violation of the laws that "state".

What Happens If I Break The Rules?

Without exception, all of the common compliance errors listed above can carry stiff penalties with the TTB, and TTB staff members have discretion when determining penalties for all of these violations. They consider the compliance history of the violating winery and whether the violations were willful or not. First-time offenders with no history of compliance problems may receive a simple warning, and as long as corrective action is taken to avoid future violations, there are no monetary penalties. In more extreme cases, monetary penalties may range from \$5,000 to several hundred thousands of dollars can be imposed.

If monetary penalties are imposed, the winery may settle with TTB with an offer to compromise. If the violations are more serious, then a two- to 45-day suspension may be imposed, and in the worst cases, the Federal Basic Permit can be revoked. TTB will consider prior suspensions and revocations when reviewing new permit applications, so a negative history will follow the offender.

The good news is that, in most cases TTB staff will work to educate first-time offenders and help them avoid these common mistakes in the future. Remember, TTB staff are here to help you!

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ABOUT COMPLI

Established in 1997, Compli is the recognized leader in alcoholic beverage compliance services. Over 600 wineries, breweries, distilleries, importers and wholesalers have chosen them for this reason. Compli manages everything from Federal permits with TTB to direct shipper licenses, price posting, product registration and more. Compli offers training and consulting services based on your company needs. They also specialize in large national licensing projects for new businesses and those resulting from mergers and acquisitions. In addition to full service compliance administration, Compli offers the only comprehensive help-yourself software and web-based solutions like *eCompli and Licensing On Demand*.