

Bond Basics



By Sara Schorske

EVERY BONDED winery has a bond, and usually once a winery starts up, you pretty much forget about it.

That is, until you get the unexpected wake up call of a certified letter from ATF informing you that bond increases are needed promptly. Even if you exceeded your bond coverage only temporarily, and feel reasonably sure you will not do so again, at that point it's usually too late to avoid the requested changes. Once a bond problem has come to ATF's attention, the specialists are quite insistent that proper steps be taken to increase the amount of coverage.

Rather than getting a crash course when your bond suddenly needs to be changed, take a few minutes now to learn what every winery owner and manager should know about this important winery asset. You might also clip out this article to keep it for reference, chances are you'll need it one day. Then, when you see a need for change coming, or catch a bond problem before ATF does, you may be able to preserve important options. This is especially important if bond coverage is difficult for your company to obtain or increase. Then, flexibility in dealing with your bond can be absolutely crucial to the health of your business.

Bonds come in two "flavors," operating bonds and deferral bonds. This article will explain both kinds of bond coverage, and tell you everything you

Compliance Watch is written by Sara Schorske, founding member of CSA—Compliance Service of America, LLC (www.csa-compliance.com). CSA specializes in licensing and compliance for the wine and beer industries. To reach the author—E-mail: csa@csa-compliance.com; Tel.: (800) 400-1353.

need to keep your winery bond coverage in compliance.

Every Winery Needs an Operating Bond

Every winery must have an operating bond in order to stay open for business. Your operating bond covers the tax value of the 'in bond' wine either on hand in your winery or on route to your winery. In calculating the size of the bond, you should exclude any wine in a taxpaid area such as your tasting room, any wine in off bond areas such as a wine library or other storage outside of your bonded premises, and any wine stored for you at commercial warehouses or other bonded wineries.

The bond is calculated by multiplying your winery's tax rate times your maximum storage capacity (or the maximum quantity of wine you expect to store at any one time). Make sure you properly allocate your inventory among the various tax classes of wine you produce. For example, still wine 14% and under is taxed at \$1.07/gallon; still wine over 14% but not over 21% is taxed at \$1.57/gallon; sparkling wine is taxed at \$3.40/gallon.

You can easily plan for table wine and sparkling wine quantities, but sometimes Mother Nature (or normal processes of evaporation) can surprise you with unexpected inventories of over 14% wine. If you produce red wines or do extended barrel aging, leave yourself some headroom in your bond for this common occurrence.

Your operating bond must meet or exceed the tax value of your in bond wine, up to \$50,000. Once you hit that magic figure, however, you need not increase your bond again until the tax value of your in bond inventory reaches \$250,000. At that point, it's time to buy a maximum bond of \$100,000, which covers all tax liabilities of \$250,000 and above.

Advanced Math for Small Producers

If the winery qualifies for the full small producer credit of \$0.90/gallon, you may be able to use the reduced tax rates on still wine for your bond calculations. However, be careful! The small producer credit applies only to the first 100,000 gallons (approximately 42,000 cases) removed from bond each year. If you will be taxpaying larger quantities of wine each year, your taxes will jump to the full rate once that threshold is crossed. If you know this will be the case for your winery, your bond needs to be calculated at the full rate, NOT the reduced one.

How to Keep Your Bond Small Even If Your Shipments Are Not

For a small winery, calculating your bond at the full rate is a scary thought, because that yields a bond amount almost six times larger than the same bond calculated at the small producer rate! Some small wineries may have difficulty qualifying for such a large jump in bond size. Sureties are notorious for requiring extensive financial data, personal guarantees, and even collateral before writing a bond. If jumping up to the full tax rate on part of your removals each year will make it difficult or impossible to get the size of bond you will need, here's a helpful hint: Make sure not to remove all of the allowable 100,000 gallons from your own winery. Instead, when you get close to the magic mark, start shipping your wine in bond to a commercial warehouse. That way, the warehouse will remove the wine from bond at its bonded premises, not yours. By arranging for off-site bonded storage and removals, you can keep the taxable removals from your own winery under 100,000 gallons. If you follow this plan, you will not avoid eventually hav-

ing to pay taxes at the full tax rate, but you will avoid having to increase your bond.

The Uncertainties of Taxation on a Sliding Scale

Another mathematical challenge for small producers comes when a small winery's wine production reaches 151,000 gallons a year. (We're talking now about production, not about removals, as we did in the previous section.) At that point, the small producer tax credit starts to go down on a sliding scale, from the full credit of \$0.90 at 150,999 gallons to nothing at 250,000 gallons. The reduction is one percent for each 1,000 gallons of wine in excess of 150,000 gallons produced during the calendar year. And the total amount of your production fixes your tax rate, retroactively, for all your removals for the entire calendar year.

Some examples will help clarify the way the reduced credit works. A winery that produces 200,000 gallons (50,000 gallons above the 150,000 mark) must reduce its credit by 50%, to \$0.45. Its tax rate on the first 100,000 gallons removed would be \$0.62/gallon. A winery that produces

225,000 gallons must reduce its credit by 75%, to \$0.225. Its tax rate on the first 100,000 gallons removed would be \$0.845/gallon. Unfortunately, you won't know the exact amount of your credit until you are finished declaring your production for the year.

Protecting Your Bond When Production Unexpectedly Increases

If you know your winery production is likely to fall within that sliding scale range this year, calculate your bond needs using your best estimate of your tax rate. It's safest to estimate high. But if it looks like increased grape yields or custom crush contracts will push your tax rate high enough to make a bond hard to get, here are two solutions to try.

First, be a custom crush customer, not a custom crush service provider. Your allowable tax credit is based on wine actually produced at your winery each year, whether it belongs to you or not. And your tax credit calculations exclude any wine fermented for you at another winery, even if that wine does belong to you.

Second, as a stopgap measure when

your vineyards produce a bumper crop, delay declaring some of the wine until after the first of the year. Although this simply pushes the extra production into next year, when you could face a similar problem again, at least you have nine to twelve months to plan for outsourcing some production or getting a bigger bond. Remember, a difference as small as six tons at crush can change the amount of your production by 1,000 gallons. A jump from a production of 150,000 to production of 169,000 doubles your effective tax rate from \$0.17 to \$0.34!

Mysteries of Deferral Bonds

In addition to operating bond coverage, all wineries need deferral bond coverage also. A winery deferral bond covers the amount of tax the winery owes ATF between the time when the wine is removed from bond and the time when the tax is paid. Since each tax period is two weeks long, and taxes are due 14 days after the end of the period, the payment of tax is normally deferred from two to four weeks. (For example, the tax on wine removed June 2 is due by June 29, a deferral of 27 days. The tax on wine removed June 29 is due by July 14, a deferral of 15 days).

Your ATF operating bond form automatically gives you a "free" \$500 in deferral coverage or a free \$1,000, if the total amount for operations coverage is at least \$2,000 and the box on the bond increasing the automatic deferral coverage to \$1,000 was checked). For many wineries, the automatic coverage handles their needs.

To calculate the deferral coverage your winery needs, you should figure the maximum wine gallonage at each tax class which you will be taxpaying in any two week period. This includes wine removed for use in a taxpaid tasting room, shipped to customers, or removed from bond for storage elsewhere in a taxpaid status.

For example, if you will remove a maximum of 8,000 cases of table wine in your peak two week period, that would be 19,020.24 gallons. At \$0.17/gallon, the tax on that would be \$3,233.44. At \$1.07/gallon, the tax would be \$20,351.66. Assuming \$1,000 automatic deferral coverage, you would need either additional coverage of \$2,500 or \$19,500 (depending on your tax rate) to cover your needs in this example.

The bond amount for deferral coverage must match or exceed the actual dollar amount of your maximum

COMPLIANCE SERVICE *of* AMERICA

Providing Compliance Solutions
and Licensing Assistance
to Wineries Across the Nation

Please visit our NEW website for past articles
and current compliance information

www.csa-compliance.com



800-400-1353

period's tax deferral, up to \$250,000, the maximum deferral bond.

Reduce or Eliminate Deferral Coverage Needs

You can reduce or eliminate your need for deferral coverage if you ship in bond to off site storage places, or if you prepay your taxes. Prepayment is a good option if the winery's normal deferral needs are fairly low, and has only a few peak removals during the year. If you will frequently need extra deferral coverage, however, it is worth the small additional premium to have sufficient coverage and not have to prepay.

If you choose to use the prepayment method, you will need to keep a running total of the taxes owed on wine removed from bond each tax period. A computer spreadsheet, which can do the math for you of converting cases to gallons and gallons to dollars, reduces this job to the single challenge of remembering to do it! Set up your spreadsheet to keep a running total of taxes deferred to date.

Prepayment Options

When the running total gets close to your deferral coverage and you know you will have more removals

before your next tax return is due, it is time to make a tax prepayment. Whatever amount you choose to prepay reduces your current debt to ATF, and gives you room to make more removals without exceeding your deferral bond.

You use the standard ATF excise tax return for this purpose. Here's how to fill out the form as a prepayment return:


- A separate set of serial numbers applies to returns filed with prepayments (i.e., PP-1, PP-2, etc.).
- Mark the box for prepayment in item 4 of the form, and fill in the anticipated date or date range of remaining removals for this tax period in item 5.
- Enter the amount of payment in items 3 and 24 and on lines 17, 19, and 21.
- Sign the return and mail it immediately.
- When your regular tax return is due, fill it out as normal, showing the total tax owing for the period in item 24.
- Enter the prepaid amount at the bottom of the form, in the section entitled Schedule B—Adjustments Decreasing Amount Due, in items 30(b), 33(b), and 34(c).
- Then write the amount in on line

20 also, and subtract it from the period's tax total to figure the balance due with the return.

Increasing your bond

If you do have to increase your bond someday, you can either replace it with a larger "superceding" bond, or simply add onto it with a "strengthening" additional bond. You also have the choice of obtaining a surety bond, submitting federal securities in lieu of a surety bond, or depositing cash collateral in the form of a certified check. If bond increases become necessary, contact your compliance advisor, your ATF specialist, or an ATF inspector for instructions.

In any case, remember that it might take some time to get the bond coverage increased, so it's best to plan ahead and start early when you see the problem coming. (ATF does not recommend cash collateral or federal securities bonds because of the extra time and hassle it takes to get the Treasury Department and the Federal Reserve Bank to approve them.)

You can never afford to forget about your bond. And now that you have the bond basics under your belt, you know what to remember! 

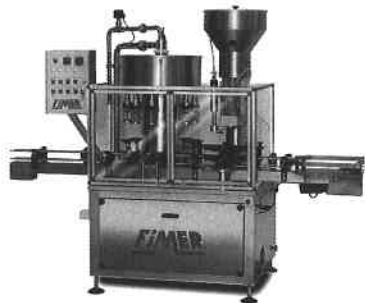


CRIVELLER COMPANY

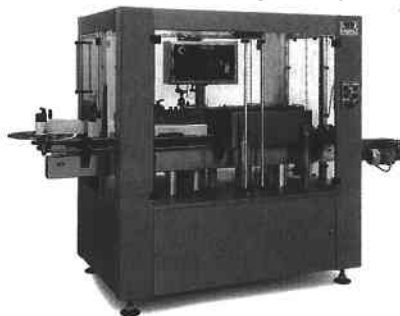
The Right Alternative For Your Winery Equipment.

CRIVELLER COMPANY, suppliers of destemming, crushing, pressing, filtration and bottling equipment for the wine industry. With over 20 years of world-wide and hands-on experience, it's a name you can trust.

NEW FOR 2000: CRIVELLER CALIFORNIA CORP. Our new office & manufacturing facility in Santa Rosa.



Compact MONOBLOCS by FIMER



Vacuum LABELLER by MEB LABELLING

NEW LOCATION!

West Coast U.S.A.:

1540-A Petaluma Hill Rd.
SANTA ROSA, CA
95404
PH: (707) 526-2930
FAX: (707) 526-2931
E-mail: crivca@sonic.net

Canada:

6935 Oakwood Drive
NIAGARA FALLS, ON
L2E 6S5
(905) 357-2930
(905) 374-2930
E-mail: cri@crivellerbrew.com

East Coast U.S.A.:

P.O. Box 162
LEWISTON, N.Y.
14092
(905) 358-5202

Web Site: www.crivellerbrew.com