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# Transferring Winery Permits and Licenses

*Preparing for the inevitable*

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It's nearly impossible to page through any wine trade publication these days without encountering a story announcing a winery sale. Whether it's the latest in a long line of acquisitions by one of the mega-winery conglomerates, or the late blooming of a wine lover's lifelong dream, these outwardly different transactions trigger a similar set of esoteric regulatory requirements.

The compliance part of the story doesn't make the news, but it is important—perhaps more important to you—than a lot of what does make headlines. "Paperwork happens!" In fact, like death and taxes, winery transfers are virtually inevitable at least once in every winery's history. Your winery may not be for sale, but an unsolicited "offer you can't refuse" or an unplanned change in family circumstances may require you to become a sudden expert on the regulatory requirements of transferring your winery to new ownership. Or maybe you'll find yourself on the other side of the negotiation, when it's time to expand and you discover that it's easier to buy another production facility than it is to increase the use permit on your current one.

Even the use of common estate planning tools such as trusts or family partnerships requires that you know the basics of winery transfers and changes of control. Changes of ownership or control can happen even though the winery stays in the family. The most common scenario of this type occurs when the stock of a corporate-owned winery is placed into a trust or gifted to the owner's children while implementing an estate plan. A change in control also occurs when some type of asset protection entity such as a family LLC or limited partnership is created to hold the stock of the winery entity. Even incremental stock transfers, as little as 5% a year, will someday add up to a change in control, when the majority of ownership finally shifts. These types of entirely "internal" transactions, while not typical sales, frequently create technical transfers that need to be reported much like a sale to a third party.

### SHORT COURSE

- Prepare for the inevitable: know the basics of transferring permits and licenses.
- Advance planning and good compliance housekeeping can save stress, time, and taxes.
- How you handle the permits and licenses depends on the type of transaction.
- Report changes of ownership or control to TTB within 30 days for unbroken operations.
- Processes and timing differ from state to state so do your homework early.

## GOOD HOUSEKEEPING

Any realtor will tell you that tidying up your house is one of the most effective ways to make your property more appealing to a buyer. Well, good compliance housekeeping is also important when selling your winery. Potential buyers will often do their "due diligence" on your licenses and permits, either before making an offer or at least before closing the transaction, so it is prudent to check whether your ownership records are up-to-date with the regulatory agencies before putting your winery on the market. In a surprisingly high percentage of the winery transactions we handle, we find that past changes in key personnel or ownership interests of the selling winery had not been reported to the regulatory agencies. These types of unreported changes will probably add significant stress and delay your transaction because the regulatory agencies are likely to want the overlooked changes reported and approved before approving the transfer.

Another good housekeeping tip is to make sure all of your production reports and excise tax returns have been filed. Before issuing a new permit to your winery's buyer, TTB will want to close out and discontinue your permits. But first, TTB will review your records to make sure there are no deficiencies. While TTB has made great strides in catching up on its workload, you might be unpleasantly surprised to hear about a missing return or report that had not previously been noted or requested, although the error occurred several years ago.

If you are thinking of selling, you may wish to contact your winery's specialist at TTB's National Revenue Center to find out if they are up to date in reviewing your records, and if not, to specifically ask them to determine whether there are any outstanding items that you need to address. A tax deficiency is much easier to resolve without the pressures of a transaction creating an emergency situation.

## SMALL PRODUCER CREDIT ISSUES

Another kind of good housekeeping is essential for wineries in the "small producer" category. Your reduced tax rate is dependent upon producing at your winery each calendar year. If you sell your winery before crush—which is easy to do, since crush doesn't occur until the middle or end of the third quarter each year—you may end up not producing at your winery the last year you operate the winery. That can have serious tax consequences. In that case, TTB will be forced, under its own regulations, to retroactively recalculate your taxes for the entire calendar year, and assess you at the full tax rate, disallowing all the small producer credit claimed.

This risk exists for any type of change of ownership that eventuates in the issuance of a new permit, including changes in business structure for asset protection or estate planning purposes, as mentioned earlier. It can also happen through the untimely death of a general partner or dissolution of a marriage—an event that may be impossible to predict.

Fortunately, there is a routine form of "cheap insurance" that can perfectly protect your tax advantages under all conditions. We recommend to all wineries in the small producer category that you keep at least one tank or a few barrels undeclared each harvest, and declare them in January each year. That way, you start the year with production, and don't have to wait till the grapes ripen to ensure that you qualify for your small producer credit. It's so simple, there's no good excuse not to do it!

## NOT ALL TRANSACTIONS ARE CREATED EQUAL

Wineries change hands in a number of different ways. Sometimes the buyer or seller has a clear choice of method; other times, the parties discover in the process of their negotiations that one or another method has mutual advantages.



The most common method is the sale of the assets of the winery to a new owner. This is called an "asset purchase." In this case, the buyer does not purchase the entity owning the winery; it simply purchases the land, improvements, equipment, inventory, brands, etc. The seller prefers this method when the entity plans to keep other assets or businesses not included in the sale; the buyer prefers it when the owning entity may have undetermined liabilities that the buyer does not want to assume.

Instead of buying the winery's assets, a buyer can buy the company. The buyer acquires the winery by buying the stock or ownership interests in the entity that owns the winery. Then the entity on the permit does not change, but the people behind it do. This is called a "stock purchase" or "change of control." If your winery permit is held by a corporation, the buyer would buy the shares of stock of the corporation. If your winery is owned by an LLC or a limited partnership, the buyer would buy the memberships of the LLC or partnership interests. By this method, the buyer automatically acquires the winery's assets, including the permits and licenses, and simply takes over leases, receivables, etc., in the absence of special provisions to the contrary.

There are numerous variations on these types of transactions, many of which may affect your licenses and permits. For example, let's assume your winery has outgrown its present facility and is building a new one. After moving into the new quarters, you plan to sell your existing facility. One way to orchestrate the transition is to apply well in advance for new permits and licenses at your new facility. This allows the regulatory approvals to issue before you start to move, and gives you the greatest flexibility in the moving process. In this scenario, you can have inventory and even winemaking operations happening at both new and old locations simultaneously.

This approach also has advantages to the buyer of your outgrown winery. Since it leaves your old licenses and permits in place at your existing winery, you can transfer them to the buyer at the time of sale. Then the buyer may be able to start up operations immediately using your permits and licenses, rather than wait for their new ones to issue (more about this below).

In most circumstances, the best option is to license the new facility with new permits and licenses before you are ready to move in. But sometimes moving existing licenses and permits to the new location is the better choice; for example, to protect small producer credit if you haven't implemented our "cheap insurance" advice (given above) and there are a lot of tax dollars at stake. However, there are geographic limits to transferring licenses, so consult with your compliance advisor before assuming you can transfer the permits and licenses. Also, the timing can be tricky in this situation. It is much easier to orchestrate with a non-producing type of license than with a winery.

(A discussion of all the types of winery transactions affecting your licenses and permits is beyond the scope of this column. For more information on the many types of changes to winery permits, and how to handle them, see the authors' article entitled Business Changes That Affect Your Winery License, available at www.csacompliance.com/html/Articles/BusinessChanges.html).

## THE OPTION OF SELLING THE WINERY BUT KEEPING THE PERMIT AND LICENSES

Sometimes, the selling winery will need to keep its permits and licenses, because it will not immediately cease operations and has inventory it wants to continue to sell. In this situation, the purchase agreement should state that the selling winery will not transfer its permits and licenses to the buyer and the buyer must obtain its own permits and licenses. There are a couple of challenges involved in this unconventional approach. One drawback is the extra time required for the buyer to get its permits and licenses issued. Your winery's new owner will not want to close the sale until its regulatory approvals are issued. Additionally, the selling winery will need to find a new facility where it can continue its operations, and transfer its permits and licenses there. A very convenient solution for the seller is to have the buyer become a "host winery" in an alternating proprietor arrangement, and allow the selling winery to become a "tenant

## A Word About ESCROWS IN CALIFORNIA

ONE OF THE MOST CONFUSING ISSUES in a transfer of a California winery is whether an escrow is required.

The buyer of any California business may elect to use a "bulk sale escrow" for protection from the debts of the seller. By giving the notices specified in the California Uniform Commercial Code, a buyer is relieved of any responsibility for the seller's unpaid debts. This type of escrow is optional when a California winery is sold.

In some California liquor license transactions, another type of escrow is mandatory. The California ABC Code requires that all retail licenses be transferred through an escrow. The winery license (Type 02) does not require an escrow because it is not a retail license. But California wineries often hold additional retail licenses, for example, to permit the sale of wines not produced by the winery, or to operate an associated restaurant or B&B. Under the ABC Code, these retail licenses must be transferred through a liquor license escrow. When retail businesses are bought and sold, a bulk sale escrow is often conducted concurrently with a liquor license escrow, so they are often confused.

Even when a liquor license escrow is required because the winery has a retail license, there is no reason to include the winery license or any winery equipment and wholesale inventory in that escrow. You can avoid delaying your transaction by allocating a portion of the purchase price to the value of the retail license and any inventory and furnishings, fixtures and equipment (FF&E) specifically associated with the retail license, in your purchase agreement. The liquor license escrow can then be conducted in accordance with its own statutorily mandated timeline, which can take up 90 days, allowing the rest of the transaction to proceed on a quicker timeline.

winery" at the facility it just sold to the buyer.

Sometimes the seller wants to retain some or all of the inventory of the winery for later sale, but has no plans to continue to produce wine. Without continuing production, the seller cannot legally retain its winery permits and licenses. This scenario requires that the seller apply for and obtain different regulatory approvals on the wholesale or retail level before taking possession of the inventory at the new location. Providing in the purchase agreement for a delayed "purchase" of the retained wine can permit the winery transaction to close without waiting for the seller's new licensing to issue.

### THE OPTION OF SELLING A BRAND BUT KEEPING THE WINERY

Recently it has been popular to purchase a successful brand of wine, but not the producing winery. The selling brand owner could be a winery or even negociant licensed as a wholesaler. Sales of just a brand may include the existing branded inventory but rarely involve the transfer of a winery's other assets, including its permits and licenses. Merely the brand name and its trademark or other rights are sold to the buyer.

Often in these transactions, there is a request that the Certificates of Label Approvals (COLA's) for the brand be "assigned." COLA's do not create property rights and are not assignable. A COLA is simply a regulatory approval to bottle wine with a certain label, and the approved COLAs are part of the production records of the bottling winery. If the new brand owner is concerned that the winery that formerly produced the wine will continue to use the brand name, the new owner should simply insist that the producing winery remove the bottling trade name from its permit and surrender the existing COLA's for labels containing the brand name. Appropriate paperwork should be filed to notify TTB of the new ownership of the trade name involved. Ideally, even the brand name itself should be added to the new brand owner's TTB permit as a trade name.

### WHAT ABOUT LABEL APPROVALS?

In a complete sale of the winery assets, the buyer should request that it be able to keep the winery's registry number. TTB routinely grants this request and it is helpful to ensure continuity, especially in labeling. The existing COLA's of the winery may be valuable to the buyer.

Although in the past, buyers of wineries would routinely request and be granted "adoption" of the seller's COLA's, TTB has started to time limit these adopted COLA's, posing a problem for older labels that are no longer approvable under current labeling policies—for example, a brand name based on either varietal type or geographic name. A time-limited adoption would cause the current COLA's, which could otherwise be used indefinitely, to lapse. Fortunately, there is a way for a winery buyer to simply inherit the predecessor's COLA's without a formal adoption process. If the buyer maintains the winery's trade name, registry number, and address, TTB has taken the position that no label adoption is necessary. We recommend avoiding label adoption if possible so as not to lose or sunset [SD1]any valuable "grandfathered" labels.

### HOW TTB HANDLES A CHANGE IN OWNERSHIP OF A WINERY

Strictly speaking, TTB does not "transfer" winery permits from one owner to another, but provides a process for the buyer to use the seller's permit while the buyer's new permits are being approved. This user-friendly procedure allows for a smooth transition of unbroken operations in any winery transfer, whether it is an asset purchase or stock purchase.

In order to take advantage of this procedure, TTB requires that applications for the new permits be filed within thirty days of the change of ownership or control of the winery. The thirty-day rule is not a mere policy; Federal law provides that if an application is not filed within thirty days of a change of control, the seller's permits terminate automatically. But if applications for new permits are filed within the thirty days, then the seller's permits continues in effect until the buyer's application is acted upon. With enough advance planning there is no reason the buyer's TTB applications cannot be filed upon closing the sale or even before, but even if the parties delay finalizing certain aspects of the transaction until the close, thirty days should be long enough to complete and file the TTB applications—if you're diligent.

TTB implicitly recognizes that the new owner is operating under the seller's permits during the transition. Excise tax returns and monthly reports of operations are filed under the seller's name and tax I.D. number. To facilitate the preparation of paperwork it is common for the seller to give the buyer or its representative power of attorney to sign returns and reports during this transition period.

The seller will also request that TTB discontinue its permits upon issuance of the buyer's new permits. This is where your good compliance housekeeping will facilitate the transaction. Otherwise, TTB will prolong the transition period—and the seller's period of legal responsibility for its buyer's operations—while any outstanding issues or deficiencies are addressed.

### HOW STATE AGENCIES HANDLE A CHANGE IN OWNERSHIP OF A WINERY

In California, the ABC will issue a temporary license to a buyer who takes over operations of an existing winery at its current location, upon the filing of an application to transfer the license. This transfer application needs to be filed in advance of the closing of the transaction so that the temporary license can be issued effective as of the date of closing. Even though TTB does not require the filing of applications for new permits for thirty days after the change, as discussed above, the California ABC often requires a copy of your TTB applications when applying for a temporary license,