WineAmerica Newsletter – November 2008

From The President's Desk

Here in Washington we have been consumed by the upcoming elections which will have a big influence on Federal issues for the next years, both positive and negative. On the eve of the election it appears that Democrats will be comfortably in control of both houses of Congress and the Presidency, an unprecedented situation. Even during the first two years of the Clinton administration, when Democrats controlled Congress, they did so with many conservative Southern Democrats as part of their majority. The new Democrat majority will be much less restrained. This situation certainly poses challenges for both American wineries and the business community as a whole. WineAmerica will have its work cut out to build good relationships and to find ways to protect the interests of our membership.

We can already sense that there will be new and difficult challenges in 2009. There is no question that there will be greater regulation of food safety and we will have to work hard to ensure that any fees associated with these new regulations do not impose a heavy and unreasonable burden on wineries. Rumblings that alcohol excise taxes may go up are stronger now than they have been since 1989 and it will be important to look out for our interests. With Democrats firmly in control, AgJobs may have a better chance of passage, but it is likely that the compromises behind that legislation will be renegotiated with much stronger union input.

Additional research for grape growing and wine making has long been a very strong priority for WineAmerica and we have made great progress with the Farm Bill. But the financial chaos gripping the country poses a great threat to research funding even though our champions are mainly Democrats. We just don’t know how the Federal government will address needed investments like research in an environment of trillion dollar deficits and financial bailouts driven by an economic meltdown.

That’s all pretty dour but there are actually some good things to report. With strong support and some initial funding from APHIS, part of USDA, the Clean Plant Network is moving forward, solving organizational problems and positioning to be able to provide virus free and possibly crown gall free grapevines, of interest to all parts of the grape growing community in the United States. This has been a long term project promoted by WineAmerica because of its importance to grapegrowers. It has gained traction both within the USDA and in Congress, which included $20 million in funding for the network as part of the Farm Bill. It now appears that there will be both an Eastern and Western grape community section for the network to ensure responsiveness to growers with very different needs. Within these sections there will be grower, nursery, extension, state regulatory and research representatives. More details about the organization of the Clean Plant Network should emerge in the next few months. More information can be found at the Clean Plant Network website: http://groups.ucanr.org/ncpn/

An important development, which should be enormously helpful to grape growers, is a new website for the National Grape Registry: http://ngr.ucdavis.edu/ This site, created with funding from the Viticulture Consortium and the American Vineyard Foundation, provides a comprehensive listing of all grape plant material available within the United States. It contains useful information about

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From the President's Desk, continued

grape varieties listing all synonyms, clones, and many of the commercial nurseries where particular varieties may be purchased. It also has a useful glossary of many terms associated with grapes, and a comprehensive list of commercial nurseries throughout the country.

Two other early developments emanating from the new Farm Bill are the results of the first round of funding for the Specialty Crop Research Initiative (SCRI) ($28 million) and a recent announcement of state grants from Specialty Crop Block Grants (SCBG) ($10 million).

There was considerably disappointment regarding SCRI grants directly related to grapes and wine. Several large proposals did not get funded. This may be because of inadequate preparation time since there were only 30 days to prepare complex grant applications where normally one would expect 90 days. A couple of grants that directly referenced grapes were approved: a $3.2 million four year grant to study water and nitrogen use for perennial crops (U.C. Davis) and an $80,000 planning grant to prepare a proposal for optimizing white wine quality through plant nutrient management (Washington State University). Several other grants do not explicitly address grapes but could also be useful. The most important of these are two grants that went to Carnegie Mellon University to study automation for specialty crops (total $10 million). Only about 8% of the actual (as opposed to planning) research proposals submitted were funded. The National Grape and Wine Initiative is reviewing the process for submitting and endorsing grants and it appears that grape and wine proposals will be improved for the next funding cycle which is expected to be announced in January 2009 and which will allow a full 90 days for responses.

The Farm Bill SCBG allotment of $10 million for Fiscal Year 2008 has been processed by the states and the results have been announced: http://www.ams.usda.gov/AMSv1.0/getfile?dDocName=STELPRDC5072701. Nine states funded projects referring directly to grapes or wine (CA, CT, FL KS, OH, OR, TX, VT, & WV). That is a pretty good result. It is expected that there will be $49 million available for Fiscal Year 2009 so all member and state organizations are advised to work closely with their state agriculture departments to maximize their opportunities to receive funding.

In 2007 SCBG awards also went to many grape and wine projects (CA, CO, CT, GA, IN, KS, MO, NB, OH, SD, VT, WV, and WY). You can examine the results at: http://www.ams.usda.gov/AMSv1.0/getfile?dDocName=STELPRDC5069113.

Direct Shipping Litigation Turning Into a Pandora's Box

by Cary Greene

In an unwelcome turn, there have been a number of recent court decisions, in Tennessee, Michigan and New Jersey, among others, that could threaten the legal environment for wineries in some states. These decisions emanate from cases filed to expand direct shipping rights for either wineries or retailers. While the decisions tend to be of limited effect so far – the Michigan and New Jersey opinions can still be appealed, and the Tennessee case is likely to face further proceedings – they prove the adage that when you litigate, anything can happen. The bigger fear is that they represent the leading edge of a disturbing pattern that could erode basic winery rights by court edict.

The Tennessee and New Jersey cases began when out-of-state wineries and local consumers filed complaints in federal District Court looking to open up the Tennessee and New Jersey markets to interstate direct-to-consumer shipment. Because neither Tennessee nor New Jersey allowed even local wineries to ship wine directly to consumers, the plaintiffs looked to other allegedly "discriminatory" privileges

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Direct Shipping Litigation, continued

afforded to local wineries and argued that allowing interstate direct-to-consumer shipment was the appropriate remedy. In their decisions, the courts instead decided to pick away at these other allegedly "discriminatory" privileges, including: (1) differences between in-state and out-of-state licensing fees; (2) availability of satellite tasting rooms; (3) minimum local fruit requirements; (4) licensing residency requirements; and (5) personal transportation limits (*i.e.*, how much wine a customer may take home). In each instance, the court perceived state favoritism toward local interests, and federal constitutional infirmity.

In the Tennessee decision, the Sixth Circuit Court of Appeals identified at least three problems with the Tennessee Grape & Wine Law. *First*, the court indicated that requiring wineries to use a minimum amount of local fruit in order to qualify for tasting room and other privileges unfairly favored local interests. *Second*, the court indicated that requiring wineries to be Tennessee residents for at least two years merely to qualify for a winery license also unfairly favored local interests. *Third*, the court raised concerns about the legality of restrictions on the amount of wine an individual may personally transport across Tennessee state lines where no similar restrictions are imposed on intrastate personal transportation. The court sent the case back to a federal District Court in Tennessee for further proceedings. The decision gives the state of Tennessee an opportunity to justify the challenged laws, and local wineries an opportunity to intervene to defend their rights.

In the New Jersey decision, a federal District Court identified at least two problems with New Jersey's winery licensing scheme. *First*, the court held that in-state and out-of-state wineries must be allowed to open an identical number of satellite tasting rooms. *Second*, the court held that licensing fees for in-state and out-of-state wineries need to be identical. The decision may be appealed to the Third Circuit Court of Appeals.

The Michigan lawsuit was filed by out-of-state retailers alleging discrimination because Michigan law allows only local retailers to ship wine direct-to-consumers. A federal District Court agreed and held that under the dormant Commerce Clause, Michigan could not prohibit out-of-state retailers from shipping to local consumers if the state was going to allow local retailers to make such shipments. The decision may be appealed to the Sixth Circuit Court of Appeals. While the Michigan opinion deals squarely with only retailer direct-to-consumer shipping rights, it is important to recognize that the decision could have indirect consequences for wineries. For state legislators and regulators already skeptical of the wine industry, such court opinions could hardly be comforting.

If more of these opinions trickle out, winery rights may be slowly and unevenly eroded. This, in turn, could make legislators less willing to work to ensure a favorable marketing climate for in-state wineries. Should this erode winery opportunities, wineries will face an uphill battle for survival in some states.

Our best option, at this point, appears to be to stay on top of the lawsuits as they happen and make sure that winery interests are protected. With respect to the Tennessee, Michigan and New Jersey suits, this means following the proceedings and looking for opportunities to elucidate the issues, make clear the potential adverse consequences, and advocate for a favorable outcome. In the future, however, we believe that it may be more judicious to use legislative remedies to solve problems rather than expect success through litigation. As the adage goes, anything can happen in the context of litigation.

Tips & Tools – Using Pay.gov

by Michael Kaiser

To streamline the reporting process, TTB introduced Pay.gov, a website that allows wineries to process and file their excise tax returns and excise tax payments, as well as to file winery operations reports electronically. Pay.gov does not support Mac users.

What are the advantages to Pay.gov?

There are several advantages to using Pay.gov. First, it saves time. If you use the electronic forms you substantially increase your chances of consistently filling out the forms correctly. The system does not allow you to move forward on processing the form until you have all of the required information filled out. In addition, you can amend a Pay.gov form by copying a prior record, clicking the amend button, changing the data and submitting it. Second, it allows you to save draft forms to your hard drive. If more than one person handles different aspects of winery operations, the draft form can be emailed and filled out by the appropriate individual. Third, using Pay,gov also reduces postage and ensures that filing deadlines are out of the hands of the post office. Finally, TTB policy only requires you to keep electronic copies of documents filed on Pay.gov.

How do you sign up for Pay.gov?

TTB tries to make their electronic filing formats as user friendly as possible. To sign up for Pay.gov, go to the TTB website (www.ttb.gov) and fill out the registration form. It is important to make sure that whoever signs the form has signing authority through an approved "power of attorney" (TTB form 5000.8). Mail the form to NRC in Cincinnati, Ohio, there is no filing fee, and within two weeks Pay.gov will email you a user identification number.

Using Pay.gov

You can find help for using Pay.gov on TTB's website. There are numerous tutorials which tend to be straight forward and user-friendly summarizing the basics for completing various TTB forms. These tutorials also discuss other avenues for seeking help when using Pay.gov.

Recordkeeping & Reporting Reminder

by Cary Greene

As we approach the season for sending in quarterly and annual Reports of Wine Premises Operations (TTB form 5120.17) and TTB Excise Tax Returns (TTB form 5000.24), it seems a good time to talk about TTB's recordkeeping and reporting requirements. As a bit of background, TTB, as an arm of the Treasury Department, functions principally to protect and collect federal revenue. Recordkeeping and reporting are their primary tools for carrying out this function.

TTB welcomes being contacted by phone and email. They want to work with wineries to ensure they have the tools to comply with agency recordkeeping and reporting requirements. This is important in that over the past few years, TTB has begun auditing wineries with greater frequency. The audit teams seem to have become more aggressive, in recent years, in identifying errors in recordkeeping and reporting. Things that might have gone unnoticed in past audits have now become the source of fines and penalties. This can be frustrating, especially for wineries that have operated relatively incident free for many years. While TTB's recent acceptance of a $3 million offer-in-compromise from Archer Daniels Midland ("ADM") for alleged regulatory violations should be balanced against ADM's sheer production volumes, compromises between $10,000 and $50,000 are no longer uncommon for smaller wineries.

Bearing this in mind, it might be advantageous to take a look at your TTB compliance practices, particularly with respect to TTB recordkeeping and reporting.

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Recordkeeping, continued

What are the basic small winery reporting requirements?

Wineries must file both Reports of Wine Premises Operations (TTB form 5120.17) and Excise Tax Returns (TTB form 5000.24).

Operations reports (5120.17s) must be filed either monthly, quarterly, or annually, depending on your expected production and excise tax liability. In accordance with TTB regulations, the default position is that wineries must file *monthly* reports. Wineries that have less than 60,000 gallons of wine on hand at any given time (bulk and bottled), and who pay less than $50,000 in excise tax annually are eligible to file *quarterly* operations reports. Wineries that have less than 20,000 gallons of wine on hand at any given time (bulk and bottled), and who pay less than $1,000 in excise tax annually are eligible to file *annual* operations reports. "Eligibility" does not mean that you can automatically file quarterly or annual reports. Wineries are obligated to explicitly notify TTB of whether they intend to file operations reports by calendar quarter or calendar year. Wineries can do so either by using a letter notice before commencing operations for a given year, or by indicating their intent in the Remarks section of form 5120.17 (Section X). According to form 5120.17, operations reports are due "by the [15th] day after the end of the report period," *i.e.*, after the end of the calendar quarter or calendar year.

The operations report is not particularly difficult to fill out but you must do so carefully and ascertain that you have good justifications for each and every entry. You must report every drop that comes into your bond: either through bond to bond transfers, through production of wine, or even through volume increases resulting from sweetening or fining. You must justify that you have that volume of wine in inventory (bulk or bottled), or that you removed it from bond (as a taxpaid removal or bond to bond transfer). There are some allowances for evaporation or other losses, but ordinarily bulk and bottled losses must be recorded. *You must be able to trace back all of your entries to winery records.* Remember that the auditor does not spend every day in your winery and does not understand shortcuts you might take. So make your recordkeeping as transparent and direct as possible.

Excise tax returns (5000.24s) are generally filed either semi-monthly (twice-monthly except September when three returns are filed) or quarterly depending on the winery's expected and previous annual tax liability. In accordance with TTB regulations, the default position is that wineries must file *semi-monthly* returns. Wineries that are eligible to file quarterly 5120.17s (less than $50,000 in excise tax) *and* that were eligible to file quarterly 5120.17s the preceding year (less than $50,000 in excise tax) may choose to file quarterly 5000.24s. Under certain conditions, wineries eligible to file annual 5120.17s (who pay less than $1,000 in excise tax) may also be permitted to file annual 5000.24s. For further information about eligibility for annual excise tax filing, contact TTB's National Revenue Center ("NRC"). If you choose to file on a quarterly basis, the last day for paying excise tax and filing returns is the 14th day after the end of the calendar quarter.

The TTB website has a page that summarizes all filing due dates for both operations reports and excise tax returns: http://www.ttb.gov/tax_audit/fed_ex_tax_due.shtml. This is particularly helpful for semi-monthly excise tax filers given the complexity of filing deadlines. Remember, to avoid fines and penalties it is critical that reports have an original signature from a winery representative with appropriate signing authority (approved TTB form 5000.8), and that reports are filed prior to mandatory deadlines.

What are the basic small winery recordkeeping requirements?

TTB regulations require wineries to retain all excise tax returns, operations reports, and records for *not less than three years*. Winery records mandated by TTB include all "wine transaction records" (recorded in either wine gallons or liters) – a broad term that covers essentially any record that verifies any operation or production

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Recordkeeping, continued

activity on the winery premises. These records include: (1) bottling operations records; (2) taxable and non-taxable removal records; (3) label information records (varietal, vintage, appellation of origin, analytical data, date of harvest); and (4) records of any material or operation appearing on 5120.17s (including date of receipt, quantity received, name of party received from, date of use). In each case, records should be clear and complete enough that TTB auditors can verify every activity on the winery premises for the past three years upon examination.

Remember, TTB auditors have only a few days to conduct a review and make an assessment. Clarity and thoroughness make their job easier. While no doubt a chore to maintain, transparent records and reports are items TTB is likely to remember.

MARK YOUR CALENDAR!

2009 Wine & Grape Policy Conference
Washington DC

March 22 - March 25 at the Grand Hyatt Washington.

With a new President and new Congress it is a critical time for WineAmerica members to make their voices heard! For the 2009 Wine & Grape Policy Conference we will be spending two days getting to know people and visiting old friends on Capital Hill, and one day discussing policy. We will also be working with officials of the Department of Agriculture to get acquainted and get a sense of the direction of the agency under the new Administration.

Call the hotel at 202-582-1234 or toll free 800-233-1234 and reference the Wine & Grape Policy Conference to reserve your room.

The rates are $275 for single occupancy and $300 for double occupancy.

Rooms fill up quickly in Washington, so please make your reservations as soon as possible!

More details will follow soon.