

2009 TTB Expo Presentation

Alternating Brewery Proprietorship – Do You Qualify?

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Overview

- What is an alternating brewery proprietorship?
- What is a contract brewing arrangement?
- What distinguishes one from the other?

Overview (Continued)

- What are the responsibilities of an alternating proprietorship?
- What are the responsibilities of a contract brewer?
- What are TTB's concerns regarding alternating proprietorships?

Overview (Continued)

- Guidelines
- Conditions
- Contractual Provisions

Alternating Brewery Proprietorship

- Alternating proprietorship — term TTB uses to describe arrangement in which two or more people take turns using the physical premises of a brewery
- Generally, the proprietor of an existing brewery, the **host brewer**, agrees to rent space and equipment to a new **tenant brewer**

Contract Brewery Arrangement

- Contract brewing arrangement is a business relationship in which one person (wholesale or retail dealer or brewer) pays brewing company (contract brewer) to produce beer for him or her

Responsibilities

Let's review the responsibilities of both the alternator and the contractor.

Alternating Brewer Proprietorship Responsibilities

- Tenant qualifies as brewer under part 25 by filing appropriate documents with TTB
- Tenant produces beer, keeps appropriate brewery records, labels beer with its own name and address, obtains necessary Certificates of Label Approval (COLAs), and pays tax at appropriate rate upon removal of its beer from brewery
- Tenant brewer has title to beer at all stages of brewing process

Contract Brewer Responsibilities

- Contract brewer is responsible for producing beer, keeping appropriate brewery records, labeling beer with its name and address, obtaining necessary COLAs, and paying tax at the appropriate rate upon removal of beer from brewery

Contract Brewer Responsibilities (Continued)

- Contract brewer retains title to beer at least until beer is taxpaid or removed from brewery
- TTB considers contract brewing arrangements to be ordinary commercial arrangements

Differences

What distinguishes an alternating brewery proprietorship from a contract brewing arrangement?

Differences between Alternating and Contract Brewing

- Title
- Records
- Taxpayment
- Qualification and Permit Status

Title

- **TITLE** — As defined in 26 U.S.C. 5092, a brewer is a person who brews beer or produces beer for sale
- In order to brew or produce beer, a person must first have title to the ingredients or raw materials, including unfermented wort

Title (Continued)

- In an alternating arrangement, host and tenant brewer hold title separately to ingredients or raw materials that are used to produce beer

Title (Continued)

- Holding title to ingredients or raw materials is essential in order for either tenant or host brewer to brew or produce his or her own beer (per definition of a brewer under section 5092)
- Title to certain raw materials must be established prior to production

Raw Materials

- Materials needed to produce beer: malt, grains, yeast, hops, and other brewing ingredients
- Term “raw materials” does not include packaging materials like bottles, cans, closures/bottle caps, and the like

Records and Reports

- In an alternating arrangement, host and tenant brewer must keep separate records of their respective beer production and removals and each must provide operational reports to TTB
- In a contract brewing arrangement, contract brewer is responsible for keeping records of beer production and removal and for providing operational reports to TTB

Taxpayment

- In an alternating arrangement, host and tenant brewer individually pay tax, at rate of tax applicable to each, upon removal of their own beer from brewery
- In a contract brewing arrangement, contract brewer is responsible for paying tax at appropriate rate of tax on beer removed from brewery

Qualification and Permit Status

- In an alternating arrangement, both host and tenant brewer act as brewers and each must be qualified under part 25
- In a contract brewing arrangement, only one person (contract brewer) must qualify as brewer under part 25

Concerns

What are TTB's concerns about alternating brewery proprietor arrangements?

Concerns

- Tenant brewer is in fact acting as brewer and is producing beer
- Tenant brewer is operating in manner independent from host brewer with respect to such issues as operations, production decisions, marketing, and beer produced

Concerns (Continued)

- Tenant brewer is merely contracting production of beer to host brewer or vice versa

Concerns (Continued)

- Alternating proprietorship arrangement that is designed to split production of large company into additional smaller companies to qualify for reduced rate of tax on beer or to enable payment of reduced rate of tax on larger quantity of beer than would otherwise be possible

Concerns (Continued)

- Use of identical or substantially similar labels, brand names, trademarks, or trade names by tenant brewer and host brewer at the host brewery premises may be evidence of a contractual agreement wherein tenant brewer is producing beer for host brewer

Guidelines for Alternating Brewery Proprietorships

Additional standards that TTB applies in assessing the qualification and operation of alternating brewery premises.

Alternating Agreement

- A clear indicator of an alternation arrangement is when there is an agreement between host brewer and tenant brewer providing for rental or lease of brewery premises and equipment with which a tenant intends to produce beer for sale

Alternating Agreement (Continued)

- The agreement must not provide for pass-through payments to cover Federal excise taxes (FET)
- A pass-through is payment provided in some agreements wherein one of the brewers reimburses the other for amount of FET payment

Access to Host Premises

- TTB does not approve alternating brewery arrangements that include as part of the agreement a condition that prohibits access to brewery premises by tenant brewer or its employees

Business Plan

- In determining whether an applicant is an alternating brewer or is instead entering into a contract brewing agreement, TTB considers the tenant brewer's business history, plans for development of future brewery assets, and level of commitment to the business; that is, investment in the business

Separation and Identification of Beer

- Each tenant brewer's beer must be separate and identifiable from the beer of all other tenants and host brewer at all stages, including prior to fermentation, during fermentation, during cellar storage, and as finished beer after production and before removal from the brewery

Additional Alternating Brewery Arrangement Conditions

Representation

- If TTB conducts a conference with tenant brewer, we require presence of that tenant brewer
- TTB does not allow host brewer or its representative to appear at conference on behalf of tenant brewer
- TTB does not object to representative of host brewer being present and giving advice to tenant brewer at such a conference

Prepayment Status

- Because of potential jeopardy to the revenue, TTB does not approve any new alternating brewery arrangements when the NRC has placed the host brewer in prepayment status
- TTB does not require that existing tenant brewers terminate agreements at such host breweries

Prepayment Status (Continued)

- If TTB places tenant brewer on prepayment status at any of its locations, we revoke any approved authorizations granted to tenant, since we consider involuntary prepayment status to jeopardize the revenue

Limit on Tenant Brewers

- So as not to hinder the administration of 27 CFR part 25 or jeopardize the revenue, TTB reserves the right to limit the number of tenant brewers operating at the premises of a single host brewery

Use of Host Brewery Employees

- Host brewery employees may engage in production of beer at brewery on behalf of tenant
- TTB recognizes that tenant brewer may not find it practical or desirable to provide his or her own employees or brewmaster at host brewery and does not expect use of tenant employees for beer production when this function is part of the agreement with host

Brewing Services Agreement

- May be used in an alternation arrangement when tenant is paying host for certain services relating to tenant's production of beer
- Tenant may pay host for its employees' services on a per-unit or per-time basis, and tenant may purchase raw materials from host prior to brewing

Brewing Services Agreement (Continued)

- Exact terms and compensation must be specified in agreement
- Hourly compensation or monthly rental may be provided, or employees' cost may be part of broader provision in agreement that specifies terms between host and tenant

Contractual Provisions

Let's take a look at some of the "ordinary and usual" contractual provisions between the host and the tenant that come into play what TTB's position is on them.

Manufacturing Fees

- TTB will not approve an alternating agreement which includes provision for host to charge tenant manufacturing fee for access to, possession of, and utilization of the premises

Invoicing

- Invoicing for raw materials showing ownership by tenant, even if payment hasn't actually occurred yet, must take place prior to production
- As sufficient proof of ownership, we will rely on tenant brewer's commercial records and financial records that show these materials as asset of tenant

Exclusivity of Contracts

- It is TTB's position that contracting parties enter into agreements by their own free will and can include restrictions that they mutually agree upon
- However, an escape clause that leaves one party with too much of a hardship if the clause is exercised would raise questions upon TTB review

Security Interest

- Hosts have similarly tried to protect debts accrued when providing contractual services to tenant by security interest clauses
- Since this is an acceptable practice under the Uniform Commercial Code in most business situations, TTB will approve an alternating agreement which contains a provision addressing a security interest

Right of Rejection

- Beer deemed unacceptable by tenant may not be returned to host; beer belongs to tenant; it is unlawful to transfer beer to a brewery of different ownership (see 26 U.S.C. 5414)
- It is the position of TTB that tenant must hold title to raw materials and to beer at all stages of production and is ultimately responsible for producing and packaging beer

Right of Rejection (Continued)

- A “right of refusal” scenario allows tenant the right to reject any batch, before or after bottling, which would require host to assume all costs for dumping or destroying product
- However, there is no reason to preclude the parties from agreeing to provide financial compensation to cover manufacturing services fees

Withholding Delivery

- We will approve an alternating agreement which contains a provision for host to withhold delivery to tenant if host hasn't been paid for manufacturing fees
- This is private contractual matter that does not affect validity of an alternation agreement

Insurance

- Fire and Casualty and Product Liability:
 - We will allow for tenant to have either no liability/insurance or share liability/insurance coverage for products with host brewer provided that tenant has clear and exclusive title to raw materials and ingredients

Insurance (Continued)

- Fire and Casualty and Product Liability:
 - Some alternating agreements include a provision whereby host and tenant include each other as a rider to product liability insurance policies
 - TTB will interpret such a rider to be consistent with contract brewing, and we will not approve an alternating agreement which contains this provision

Summary

- Differences between **Alternating Brewery Proprietorships** and **Contract Brewing Arrangements**
- Responsibilities of each
- TTB's concerns
- Guidelines
- Conditions
- Contractual provisions

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