



Liquor Policy Review

by Dennis P. Coates

LRS Issues Arising from Separation of LP and LRS Licenses

Since LP and LRS licenses are now totally independent of each other they can be treated differently for tax or ownership purposes. Most importantly, LRSs must continue to not appear to be associated with another business - i.e. they cannot be internalized in a grocery store, gas station, or other business - and must be totally separated from an adjacent business and have their own entrance and exit.

There are many different situations that have evolved over the last few years - some LP owners continue to operate the associated LRS and some have retained the operation in a related company for tax and family ownership purposes. Others have entered into Third Party Use Agreements for the operation of the LRS and these again are on several different bases. Some are based on the LP owner receiving a percentage of gross or net revenue; some have had a lump sum paid for the use of the LRS license for a set number of years; and others have a formula for acquisition of the LRS in the event that separation of the licenses came about and set the stage for transfer of the LRS according to the buyout formula in the agreement.

It is very important, whatever your situation, to discuss the issues with an accountant. I have consulted Derek Schreurs of the Kamloops KPMG group with respect to some of my comments below.

If both licenses are still operated by the same company or owner, it will be necessary to do a valuation of both business entities. Currently, depending on geographic location, regional operating margins, and competition from both private and public stores, LRSs have most recently been valued at between five and six times defined net profit. LPs or pubs are valued on a different basis due to their large food component and the competition in many markets from casual dining style restaurants, which most often have their own dedicated lounge, many of which intrude into the traditional pub market. Pubs normally are valued

at a lesser multiple, on account of the lesser predictability of the income stream from the operations. Again, geographic location, size, competition, and track record are all factors in determining value at somewhere between three and five times net profit.

Some of the accounting considerations include whether the proceeds on disposition of the LRS, which would under most circumstances be a taxable event to the licensee, can be considered proceeds from the disposition of capital property. A value must be assigned on disposition, and the income therefore taxable to the licensee. If considered income from the sale of capital property, the licensee may be eligible to receive 50% of those proceeds tax free.

Valuation is the critical component in planning a separation of the operation of the two licenses. It should be done carefully and planned around fiscal year-ends.

The actual process for the transfer of the LRS licenses is on the LCLB website, including the forms. Just don't proceed without proper documentation and valuation, even if both are going to continue to be operated by the same family or group.

Those operators who have bank financing that covers both the LP and the LRS licenses need to separate out the primary debt between the two licenses. I believe the banking industry will be far more receptive to the financing of LRS operations now that the uncertainty of the operation of the LP licenses is no longer a factor. The banks were always concerned about the cost of preserving the LP operation in order to allow the LRS to continue operating. As you may know, there was an LRS license cancelled due to the default of the LP license.

There will be great opportunities ahead; just be careful in structuring your transactions.



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