

EXCISE TAX CREDIT FOR UNALABLE ALCOHOLIC BEVERAGES

EVALUATION SUMMARY



JULY 2019
2019-TE25

THIS EVALUATION WILL BE INCLUDED IN COMPILATION REPORT SEPTEMBER 2019

YEAR ENACTED	1953
REPEAL/EXPIRATION DATE	None
REVENUE IMPACT	\$153,000 CALENDAR YEAR 2017
NUMBER OF TAXPAYERS	98
AVERAGE TAXPAYER BENEFIT	\$1,561
IS IT MEETING ITS PURPOSE?	Yes, but it appears to be underutilized

WHAT DOES THIS TAX EXPENDITURE DO?

The Excise Tax Credit for Unsalable Alcoholic Beverages [Section 44-3-503(9), C.R.S.] (Unsalable Alcoholic Beverages Credit) allows manufacturers and distributors of alcohol that have already paid state excise taxes on alcoholic beverages to receive a credit for the amount of the tax paid attributable to the alcoholic beverages that later become unfit for sale due to damage or destruction.

WHAT IS THE PURPOSE OF THIS TAX EXPENDITURE?

Statute does not explicitly state a purpose for this tax expenditure. We inferred that the purpose is to avoid taxing alcoholic beverage manufacturers and distributors for products that cannot be sold.

WHAT DID THE EVALUATION FIND?

We determined that the Unsalable Alcoholic Beverages Credit is likely meeting its purpose, but may be underutilized by the taxpayers eligible to claim it.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly may want to consider amending statute to clarify whether it intended to allow taxpayers to take the credit for alcoholic beverages rendered unsalable due to spoilage.

EXCISE TAX CREDIT FOR UNALABLE ALCOHOLIC BEVERAGES

EVALUATION RESULTS

WHAT IS THE TAX EXPENDITURE?

The Excise Tax Credit for Unsalable Alcoholic Beverages [Section 44-3-503(9), C.R.S.] (Unsalable Alcoholic Beverages Credit) allows manufacturers and distributors of alcoholic beverages to receive a credit or refund for the amount of excise taxes previously paid for alcoholic beverages that later become unfit for sale due to damage or destruction. This credit was enacted in 1953 and it has operated similarly since that time.

Colorado levies an excise tax on alcoholic beverages, which is calculated based on the volume of the beverages and the following tax rates, which vary based on the type of beverage:

- \$0.08 per gallon for malt liquor, beer, and hard cider
- \$0.0833 per liter for wine
- \$0.6026 per liter of spirituous liquor

Alcohol excise taxes are due from the seller the first time alcoholic beverages are sold, transferred, or otherwise disposed of within Colorado, which typically occurs when a manufacturer sells Colorado-made alcoholic beverages to a distributor or when a distributor sells alcoholic beverages shipped from outside the state to a Colorado wholesaler or retailer. However, for administrative convenience, some manufacturers and distributors pay the excise tax prior to the sale of the alcoholic beverages. Taxpayers are required to report and remit the alcohol excise taxes to the Department of Revenue on a monthly basis using the Department of Revenue's Monthly Report of Excise Tax for Alcohol Beverages (Form DR 0442).

To claim the credit, taxpayers record the amount of alcohol destroyed or damaged and the associated tax on Form DR 0442, effectively offsetting their current tax liability by the amount of excise tax they previously paid on the alcoholic beverages that were destroyed. Alternatively, taxpayers may also claim the credit as a refund using the Department of Revenue's Claim for Refund Form (Form DR 0137.) To qualify for the credit or refund, taxpayers must also submit evidence to the Department of Revenue showing that the tax was paid and provide an affidavit itemizing the products destroyed along with the date of destruction and an authorized signature. In cases where taxpayers plan the destruction in advance, Department of Revenue guidance directs taxpayers to notify the Department of Revenue of their intention to destroy the unsalable beverages at least 4 weeks in advance and a department representative may attend to witness the destruction. However, according to Department of Revenue staff, this does not typically occur in practice.

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURE?

Statute does not directly identify the intended beneficiaries of this tax expenditure. Based on the statutory language, we inferred that the intended beneficiaries are alcoholic beverage manufacturers and distributors because the Unsalable Alcoholic Beverages Credit lowers their overall tax liability when products are no longer salable due to destruction or damage. According to stakeholders, it is common for small amounts of alcoholic beverage products to become destroyed or damaged in the course of normal production, transportation, and storage. For example, bottles may be dropped and broken, underfilled, or mislabeled. Although less common, major accidents and natural disasters such as fires, flooding, and storms can also cause larger scale damage to alcoholic beverages.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute does not explicitly state the purpose for this tax expenditure. We inferred that the purpose is to avoid taxing alcoholic beverage

manufacturers and distributors for products that cannot be sold. Although manufacturers and distributors are typically required to pay the excise tax, alcoholic beverage excise taxes are generally intended to be passed through to consumers in the form of higher prices. Since damaged products are unsalable, the taxes already paid on such products cannot be passed through to consumers.

IS THE TAX EXPENDITURE MEETING ITS PURPOSE AND WHAT PERFORMANCE MEASURES WERE USED TO MAKE THIS DETERMINATION?

We determined that the Unsalable Alcoholic Beverages Credit is likely meeting its purpose, but may be underutilized by the taxpayers eligible to claim it. Statute does not provide quantifiable performance measures for this expenditure. Therefore, we created and applied the following performance measure to determine the extent to which the credit is meeting its inferred purpose:

PERFORMANCE MEASURE: *To what extent do eligible taxpayers claim the Unsalable Alcoholic Beverages Credit to avoid paying excise taxes on destroyed or damaged products?*

RESULT: Although the credit is regularly claimed by some taxpayers, especially larger manufacturers, we found that it is likely that many eligible taxpayers do not claim it. According to Department of Revenue data, 98 taxpayers took the credit during Calendar Year 2017. These 98 taxpayers represent 19 percent of the 525 alcoholic beverage manufacturers (402) and distributors (123) operating in the state. Although we did not have data showing how many manufacturers and distributors were eligible for the credit (i.e., they paid excise taxes on alcohol that was later unsalable), it is unlikely that only 19 percent of manufacturers and distributors would have had an eligible loss.

This low utilization rate may be due to the relatively small benefit the credit provides. Specifically, some stakeholders reported that the administrative cost of filing for the credit often exceeds its value. For example, the excise tax on beer is \$0.08 per gallon, so an accident

resulting in the loss of a single keg (about 15.5 gallons of beer) would only entitle the business to a refund of \$1.24. The loss of an entire pallet of 16 kegs would only result in a refund of \$19.84. Since filing for the expenditure requires tracking of losses and the completion of additional paperwork, some businesses may decide not to file for it and instead simply absorb the loss or only use it when large losses occur.

The low utilization rate may also be due to the credit having some overlap with the commercial property insurance maintained by businesses, which typically covers most loss of product at retail value. Since the retail price of the products generally passes the excise tax on to consumers, in some cases, an insurance claim might already cover the value of the excise taxes paid, making a refund from the state redundant. However, businesses typically only make insurance claims in cases of major disaster, so the credit would likely not overlap for the smaller incidents that stakeholders reported were most common.

WHAT ARE THE ECONOMIC COSTS AND BENEFITS OF THE TAX EXPENDITURE?

According to the Department of Revenue's 2018 *Tax Profile and Expenditure Report*, the Unsalable Alcoholic Beverages Credit reduced state revenue by \$153,000 in Calendar Year 2017. This figure was based on taxpayers who filed the Monthly Report of Excise Tax for Alcohol Beverages (Form DR 0442) to claim the credit. According to Department of Revenue data, of the 98 businesses that claimed the expenditure, 10 accounted for 95 percent of the total revenue impact. However, because the Department of Revenue's estimate does not include the amount that taxpayers claimed for a refund using Form DR 0137, the revenue impact it reported may understate the total impact.

Additionally, the revenue impact of this tax expenditure is subject to fluctuation over time. For example, the Department of Revenue reports that this expenditure reduced state revenue by \$708,000 in Calendar Year 2015. Major accidents and disasters, such as destructive weather events or fires that result in significant loss of product, are unpredictable and will vary from year-to-year.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURE HAVE ON BENEFICIARIES?

Eliminating the credit would likely have a small impact on most of the current beneficiaries. Specifically, the Department of Revenue reported that net collections under the alcoholic beverages excise tax totaled \$47 million in Fiscal Year 2018. In comparison, based on Department of Revenue Data, \$154,000 in additional excise taxes would have been owed in Fiscal Year 2018 if the credit was not available, which would represent less than a 1 percent increase in the total excise taxes owed on alcoholic beverages. Furthermore, a majority of the taxpayers who claimed the credit in Calendar Year 2017 received less than \$100 in credits, although several larger producers claimed over \$10,000. In our discussions with stakeholders, some reported that although the credit contributes to a favorable business climate for the industry, it is less significant due to Colorado's relatively low excise taxes.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

A tax expenditure for unsalable alcoholic beverages is available in 20 states (excluding Colorado) and the District of Columbia. While all of these tax expenditures allow taxpayers a tax credit for alcoholic beverages that are rendered unsalable due to damage, they differ in their treatment of other reasons for product loss. For example, 16 other states and the District of Columbia allow a similar credit for alcoholic beverages that cannot be sold due to spoilage. In addition, three other states and the District of Columbia offer a similar tax expenditure for products that have been lost due to theft. Finally, two states, Michigan and North Carolina, restrict the tax expenditure to apply only to major disasters that result in losses over a minimum threshold (e.g., over \$250).

ARE THERE OTHER TAX EXPENDITURES OR PROGRAMS WITH A SIMILAR PURPOSE AVAILABLE IN THE STATE?

There is a federal tax expenditure [26 USC 5064] that broadly exempts alcoholic beverages lost due to damage or destruction from federal alcohol excise taxes. However, the federal tax expenditure is restricted

to losses where the excise tax paid totals \$250 or more, except when the President has declared a major disaster area.

WHAT DATA CONSTRAINTS IMPACTED OUR ABILITY TO EVALUATE THE TAX EXPENDITURE?

The Department of Revenue was unable to provide data from its Claim for Refund Form (Form DR 0137), which some taxpayers may use to apply for refunds based on the credit instead of including it on their monthly excise tax form (Form DR 0442). DR 0137 combines refund requests related to many different tax provisions, and cannot be disaggregated for the purposes of determining the amount of the Unsalable Alcoholic Beverages Credit claimed as a refund. To collect this additional information, the Department of Revenue would need to add a reporting line specifically for the credit on the DR 0137, although this would require additional resources (see the Tax Expenditures Overview Section of the Office of the State Auditor's *September 2018 Tax Expenditures Compilation Report* for additional details on the limitations of Department of Revenue data and the potential costs of addressing the limitations).

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

THE GENERAL ASSEMBLY MAY WANT TO CONSIDER AMENDING STATUTE TO CLARIFY WHETHER IT INTENDED TO ALLOW TAXPAYERS TO TAKE THE CREDIT FOR ALCOHOLIC BEVERAGES RENDERED UNSALABLE DUE TO SPOILAGE. According to statute [Section 44-3-503(9), C.R.S.], the credit applies to alcoholic beverages "rendered unsalable by reason of destruction or damage." However, the terms "destruction" and "damage" are not further defined. Therefore, it is unclear whether the General Assembly intended to include spoiled alcoholic beverages within the meaning of these terms. The Department of Revenue has interpreted statute to disallow taxpayers from claiming the credit for beverages that cannot be sold due to spoilage and has issued clear guidance to taxpayers indicating that they should not claim the credit under these circumstances. However, an industry stakeholder reported

that some taxpayers may not make a distinction between different types of losses when claiming the credit and may include losses due to spoilage in the amount they claim. As discussed, 16 of the 20 states (excluding Colorado) and District of Columbia with a similar tax expenditure, include losses for spoilage as eligible for the credit.