

# Credit for Unsalable Alcohol



OFFICE OF THE STATE AUDITOR  
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Tax Expenditure Evaluation • November 2023 • 2023-TE16

Colorado levies an excise tax on alcoholic beverages that are meant for sale or consumption in the state. 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. **The Credit for Unsalable Alcohol allows taxpayers to claim a refund or credit for the amount of excise taxes paid on alcoholic beverages sold in Colorado when, after payment of the excise tax, the alcoholic beverages are rendered unsalable due to destruction or damage.** The credit was likely intended to provide taxpayers with a credit or refund for paying a tax that can no longer be passed on to the consumer since the alcohol has been rendered unsalable due to damage or destruction.

## We found:

- Taxpayers appear to use the credit for large volume losses when they occur; in 2021, 88 percent of the total credits were for claims of over \$1,000, which is at least 18,000 bottles of wine, 2,210 bottles of spirituous liquor, or 133,300 bottles of beer.
- The amount claimed by alcohol type is not proportionate to the amount of excise taxes paid by alcohol type. The Department of Revenue does not know why this occurred.
- Industry representatives reported that the credit is important, but some taxpayers reported not being aware of the credit.

## Policy Considerations

We did not identify any new policy considerations for this evaluation.

Tax Type:	<b>Liquor excise tax</b>	Year Enacted:	<b>1953</b>
Expenditure Type:	<b>Credit</b>	Repeal/Expiration date:	<b>None</b>
Statutory Citation:	<b>Section 44-3-503(9), C.R.S.</b>	Revenue Impact (2021):	<b>\$230,589</b>

Purpose given in statute or enacting legislation? **No**



# Credit for Unsalable Alcohol

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## Background

Colorado levies an excise tax on alcoholic beverages that are meant for sale or consumption in the state. 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. The tax is typically passed on to final consumers of the alcohol in the form of higher prices. Colorado imposes the following excise taxes on alcohol:

### Exhibit 1 Colorado Alcohol Excise Tax Rates

Alcohol Type	Tax Rate
Malt Liquor and Hard Cider	\$0.08 per gallon
Vinous Liquor (Excluding Hard Cider)	\$0.0733 per liter
Spirituous Liquor	\$0.6026 per liter

Source: Colorado Office of the State Auditor analysis of Section 44-3-503(1)(a), C.R.S.

**The Credit for Unsalable Alcohol allows taxpayers to claim a refund or credit for the amount of excise taxes paid on alcoholic beverages sold in Colorado when, after payment of the excise tax, the alcoholic beverages are rendered unsalable due to destruction or damage.**

The credit is not available for alcoholic beverages that are unsalable due to spoilage. Taxpayers are required to report and remit the alcohol excise taxes to the Department of Revenue (Department) on a monthly basis using the Monthly Report of Excise Tax for Alcohol Beverages (Form DR 0442). To claim the credit, taxpayers record the amount of alcohol destroyed or damaged on their monthly form, effectively offsetting their current tax liability by the amount of excise tax they previously paid on the alcoholic beverages (that were later damaged or destroyed). Alternatively, taxpayers may claim the credit as a refund using the Claim for Refund Form (Form DR 0137E). To qualify for the credit or refund, taxpayers must also submit evidence to the Department showing that the tax was paid and provide an affidavit (Form DR 0444) itemizing the products damaged or destroyed, along with the destruction date and an authorized agent's signature from the business that is filing the form. In cases where taxpayers plan the destruction in advance, Department guidance directs taxpayers to notify the Department of their intention to destroy the unsalable beverages at

least 4 weeks in advance; a Department representative may attend to witness the destruction, but, according to Department staff, rarely does so in practice.

**The credit was likely intended to provide taxpayers with a credit or refund for paying a tax that can no longer be passed onto the consumer since the alcohol has been rendered unsalable due to damage or destruction.** This type of credit also exists at the federal level [26 USC 5064] and is common among other states. However, the federal credit is restricted to losses where the excise tax paid totals \$250 or more, except when the President has declared a major disaster area. The \$250 minimum means taxpayers must have lost at least 18,000 bottles of wine or 5,000 bottles of beer to be able to claim the credit. Additionally, there are 32 other states with a similar expenditure for unsaleable alcohol. All of the other states provide a refund or credit for damaged products, but eligibility varies based on alcohol types and whether products lost due to theft, spoilage, or major disaster are eligible.

To determine whether the credit is meeting its purpose, we assessed the extent to which eligible taxpayers are aware of and using the credit.

## Evaluation Results

**In 2021, 122 taxpayers claimed \$230,589 in credits.** This is a relatively small amount (less than 0.5 percent) of the \$53.3 million in alcohol excise taxes collected that year. We lacked data on how many manufacturers or distributors in the state had damaged or destroyed alcohol, so we were unable to determine the proportion of eligible beneficiaries that claimed the credit. Most of the credit amounts were for large losses of product. In 2021, 88 percent of the total credits were for claims greater than \$1,000. As shown in Exhibit 2, this translates into a loss of more than 18,000 bottles of wine or 133,000 bottles of beer.

### Exhibit 2

#### Number of Bottles of Alcohol Required to be Damaged for Credits of \$100, \$500, and \$1000

	Vinous Liquor (750 ml Bottles)	Spirituos Liquor (750 ml Bottles)	Malt Liquor and Beer (12 oz Bottles)
<b>Greater than \$100 Credit</b>	> 1,800 bottles	> 220 bottles	> 13,300 bottles
<b>Greater than \$500 Credit</b>	> 9,000 bottles	> 1,100 bottles	> 66,600 bottles
<b>Greater than \$1,000 Credit</b>	> 18,000 bottles	> 2,210 bottles	> 133,300 bottles

Source: Office of the State Auditor analysis of Section 44-3-503(1)(a), C.R.S.

Most taxpayers claimed the credit three times or less in 2021, but 16 of the 122 taxpayers (13 percent) filed for the credit every month of 2021 and claimed \$166,000—or about 73 percent of all unsalable alcohol credits for that year. Most of these 16 taxpayers claimed relatively small amounts,

about \$65 per month on average, but a few of them claimed, on average, more than \$4,400 per month, which translates into a monthly loss of nearly 80,000 bottles of wine or 589,000 bottles of beer. The Department reported that without conducting an audit of these taxpayers—which it has not done—it does not have information or data to explain why these taxpayers claimed the credits each month. It noted that tax is collected largely on a voluntary compliance basis and it only audits a small portion of returns, especially when the risk to state revenue is low, such as with liquor excise taxes.

The amount claimed by alcohol type is not proportionate to the amount of excise taxes paid by alcohol type. As shown in Exhibit 3, credit claims related to malt liquor, which includes beer, accounted for 80 percent of the total claims in 2021, but malt liquor only accounts for 19 percent of the liquor tax revenue. In contrast, spirits made up more than 70 percent of the excise tax revenue, but only accounts for 15 percent of the unsaleable alcohol credit claims. The Department reported that it does not know why the amount of credits by alcohol type is not proportional to the amount of excise taxes paid.

**Exhibit 3  
Percentage of Excise Taxes Paid and Credits Claimed in 2021 by Alcohol Type**

Alcohol Type	Percent of Credits Claimed	Percent of Excise Taxes
Spirituos Liquor	15	71
Malt Liquor (includes beer)	80	19
Vinous Liquor (includes wine)	5	10
Hard Cider	< 1	< 1

Source: Office of the State Auditor analysis of Department of Revenue excise tax and credit claim data.

**Industry representatives reported the Credit for Unsaleable Alcohol is important, but some taxpayers reported not being aware of the credit.** Between our previous evaluation and this one, we spoke with eight liquor production industry professionals, and many expressed the importance of the Credit for Unsaleable Alcohol to their business. Multiple industry professionals said the credit is especially useful to businesses when there is a large quantity of product damaged or destroyed. According to industry stakeholders, insurance typically would not cover the costs of the excise tax paid on damaged or destroyed alcohol, so the credit allows the business to recover some of that loss. For example, one stakeholder reported that their company had lost half of a pallet of liquor during the transfer of product while the product was still in their possession. Their business was able to file for the Credit for Unsaleable Alcohol to recover some of that loss. However, two industry professionals reported that they were unaware that the Credit for Unsaleable Alcohol existed and stated that they did not believe that other industry associates were aware of the tax credit either, so some taxpayers might not be claiming the credit when they have significant losses.

## Policy Consideration

**We did not identify any new policy considerations for the credit.** In our previous evaluation of the Credit for Unsalable Alcohol, released in July 2019, we included a policy consideration for the General Assembly to consider clarifying whether it intended for taxpayers to be allowed to claim the credit for excise taxes paid on spoiled alcohol, which the Department has declared through rulemaking is not eligible. The General Assembly has not taken any legislative action in response to the policy consideration included in our 2019 evaluation.

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