

BOURBON BARREL TAXATION TASK FORCE

Minutes of the 1st Meeting of the 2022 Interim

June 24, 2022

Call to Order and Roll Call

The 1st meeting of the Bourbon Barrel Taxation Task Force was held on Friday, June 24, 2022, at 10:00 AM, in Room 169 of the Capitol Annex. Representative Chad McCoy, Chair, called the meeting to order, and the secretary called the roll.

Present were:

Members: Senator Robert Stivers, Co-Chair; Representative Chad McCoy, Co-Chair; Senator Jimmy Higdon; Representatives Jennifer Decker and Thomas Huff.

Guests: Eric Gregory, President, Kentucky Distillers Association, and John Brent, Judge Executive, Henry County.

LRC Staff: Jennifer Hays, Cynthia Brown, Sarah Watts, and Ashton Thompson

Alcohol Taxation

Jennifer Hays, Committee Staff Administrator, Appropriations and Revenue, Legislative Research Commission, presented an overview of alcohol taxation in Kentucky.

Ms. Hays testified that the distribution and sale of alcohol in Kentucky is controlled by a three-tier system: manufacture, wholesaler, and retailer. While the industry has grown to include microbreweries, small-farm wineries, and direct-to-consumer sales, the tax system has not changed much.

Wholesalers in Kentucky are responsible for three types of taxes: alcohol excise tax, wholesale sales tax, and distilled spirits case sales tax.

The alcohol excise tax is levied upon the use, sale, or distribution by sale or gift and is based on the total volume of products sold. Distilled spirits are taxed at a rate of \$1.92 per wine gallon and \$0.25 on each gallon when the volume within a retail container is six percent or less. Wine is taxed at a rate of \$0.50 on each gallon of wine and no less than \$0.04 on the sale or distribution of any retail container of wine. Malt beverages are taxed at a rate of \$2.50 on each barrel of 31 gallons, and one percent of the tax collected is deposited to the Malt Beverage Educational Fund. Alcohol used solely for sacramental purposes or is unfit for beverage purposes is exempt from the alcohol excise tax.

In response to a question from Representative McCoy, Ms. Hays said her interpretation is that a product only needs to contain distilled spirits for the excise tax rate to apply. In response to another question from Representative McCoy, Ms. Hays said distilled spirits are defined in Kentucky statute.

Responding to questions from Representative Decker, Ms. Hays agreed that the federal excise tax on distilled spirits is taxes on a proof gallon and that there is no reference to proof gallons in Kentucky taxation laws.

The wholesale sales tax is for the privilege of making wholesale sales of beer, wine, or distilled spirits and is based upon the value of the product sold. The taxable base is gross receipts from the wholesale sale. Prior to July 1, 2015, the rate was 11 percent. Today, it is 11 percent for distilled spirits and 10 percent for wine and beer. Beginning March 12, 2021, the same rates will apply to direct shippers. One percent of the tax due is reimbursed for the collection and reporting of the tax, except for microbreweries and distilleries.

In response to a question from Representative Decker, Ms. Hays said staff would contact the Department of Revenue for information regarding how many taxpayers are in each category of distilled spirits, beer, and wine.

The distilled spirits case sales tax requires each wholesaler to pay \$0.05 per case sold in Kentucky.

In response to a question from Representative McCoy, Ms. Hays confirmed that the tax is based on the volume of cases sold.

Ms. Hays directed members' attention to the information in their meeting materials that reviewed the different state tax rates on distilled spirits, beer, and wine.

In response to a question from Representative McCoy, Ms. Hays said that she was not sure if other states tax on a proof gallon, but many states list the rate based on a specific percent of alcohol and that may mean that when the percentage of alcohol reaches that percentage level, the alcohol is taxed at a lower rate.

In response to a question from Senator Stivers, Ms. Hays said the taxes on wholesalers are all general fund receipts, except for the 1 percent that goes to Malt Beverage Educational Fund.

Ms. Hays explained that House Bill 249 of the 2021 Regular Session expanded the definition of "machinery for new and expanded industry" to include machinery directly used for manufacturing distilled spirits, wine, or malt beverages at a plant facility that includes a retail establishment. This created a Sales and Use Tax exemption for that equipment.

The Supreme Court ruled in *South Dakota v. Wayfair* (2018) that states may impose a sales tax on purchases made from out-of-state retailers even if the retailer does not maintain a physical presence in the state. This case also makes it easier for states to adopt a streamlined sale tax approach which relieves the burden on interstate commerce and creates a more uniform approach among states for imposing sales and use taxes on retailers outside of the taxing state.

Ms. Hays covered the property tax on distilled spirits in bonded warehouses which is imposed on every owner, proprietor, or custodian of a bonded warehouse in which distilled spirits are stored. The value of the tax is assessed by the Department of Revenue and then the certified valuation is returned to the applicable county clerks for local taxation. The distilled spirits are subject to a reduced tangible personal property state tax rate of \$0.05 per \$100 of assessed value, and the tax is due on September 15th following the assessment by the Department of Revenue on January 1st.

In response to questions from Senator Stivers, Eric Gregory, President, Kentucky Distillers Association, said that the value of distilled spirits is determined by a formula that calculates the volume and age of the barrel. Barrels that have aged longer are worth more in value.

In response to a question from Representative Decker, Mr. Gregory said that the Department of Revenue does not distinguish between distilleries when calculating the value of barrels. In response to another question from Representative Decker, Mr. Gregory said it would be difficult to determine the true market value based solely on the brand of the barrel.

Ms. Hays said that the distilled spirits tax credit allows taxpayers who pay Kentucky property taxes on distilled spirits to claim a nonrefundable and nontransferable credit on their income tax return. The income tax credit is equal to the distilled spirits, total property tax assessed and paid, and must only be used for capital improvements at the premises of the distiller.

In response to a question from Representative Decker, Ms. Hays said that you can accumulate the income tax credit over years, but once it is taken on the tax return there is no carry forward of the credit.

Ms. Hays directed members' attention to the information provided by the Kentucky Distillers Association that listed the net loss in revenue in each county if the property tax on distilled spirits was repealed. School districts would be impacted by a total of \$18.5 million but would be able to recoup \$13 million through the Support Education Excellence in Kentucky (SEEK) funding program. A total of \$1.2 million would be lost if cities were to impose a tax on distilled spirits, and there would be no way to recover the lost revenue

through any other formula. County fiscal courts would also be impacted by a loss of \$3.5 million. Total countywide net loss is \$15.6 million in revenue.

In response to a question from Representative McCoy, Ms. Hays said the property tax estimates in the chart were calculated using the most current data available, and therefore, are based upon assessed values from one year and property tax rates of another year, due to the timing of the assessment and collection of the tax under the property tax calendar.

In response to questions from Representative Decker, Ms. Hays said that the amounts on the chart are county revenues that are not collected by the state. The tax revenues are collected and distributed at the local level.

In response to questions from Senator Stivers, Ms. Hays confirmed the amounts of state and local taxes paid in relation to distilled spirits.

Ms. Hays explained that there are two alcohol license fees that are assessed at the local level. In accordance with KRS 243.060, a county or consolidated local government in which traffic in alcoholic beverages is permitted may impose a license fee that is based on business activity. Per KRS 243.070, a city or consolidated local government may impose a license fee on any person holding a city license. KRS 243.075 permits a regulatory license fee of up to 5% to be imposed by cities and counties based on population requirements, but the use of the revenues from the fee is limited.

At the local level, regulatory fees can be imposed on a city or a county without a city with a population of less than 20,000. This fee applies to gross receipts of the sale of alcoholic beverages at each licensed establishment. The local jurisdiction must use the funds specifically for any policing, regulatory, or administrative expenses related to the sale of alcohol.

In response to a question from Representative Decker, Ms. Hays said that the number of license fees per county varies depending on the jurisdiction.

In response to comments made by Senator Higdon, Ms. Hays said there is a simple change that could be made to make the income tax credit refundable and remove the requirements in place to claim the credit. It would cost money, but is a simple solution.

In response to a question from Senator Stivers, Mr. Gregory said that a moist county is a county in which alcoholic beverage sales are permitted in certain parts of the county, like at golf courses. A wet county is a county in which alcohol is sold countywide. In response to other questions from Senator Stivers, Ms. Hays responded that Department for Local Government has Uniform Financial Information Report (UFIR) data, but it is not consistent. John Brent, Judge Executive, Henry County, said the fees associated with retail

sales can only be used to run the administration of the program. In his county, the fees generate \$100,000 in revenues a year. His county has a population of about 16,000 people and has a couple of restaurants and convenience stores selling beer.

With there being no further business, the meeting was adjourned at 11:36 p.m.