ST 18-0007-PLR 07/12/2018 LIQUOR TAX

This letter discusses the applicability of the Uniformity Clause to the tax imposed by Article 8 of the Liquor Control Act (235 ILCS 5/8-1). See *Federated Distributors, Inc. v. Johnson*, 125 Ill.2d 1, 125 Ill. Dec. 343, 530 N.E.2d 501 (1988). **NOTE: This letter is superseded by ST 18-0012-PLR.** (This is a PLR)

July 12, 2018

Re: COMPANY's Request for a Private Letter Ruling

Dear Xxxxx:

This letter is in response to your letter dated May 15, 2018, in which you requested information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at www.tax.illinois.gov to review regulations, letter rulings and other types of information relevant to your inquiry.

Review of your request disclosed that all the information described in paragraphs 1 through 8 of Section 1200.110 appears to be contained in your request. This Private Letter Ruling will bind the Department only with respect to COMPANY, for the issue or issues presented in this ruling, and is subject to the provisions of subsection (e) of Section 1200.110 governing expiration of Private Letter Rulings. Issuance of this ruling is conditioned upon the understanding that neither COMPANY, nor a related taxpayer is currently under audit or involved in litigation concerning the issues that are the subject of this ruling request. In your letter you have stated and made inquiry as follows:

> Please find enclosed COMPANY's (the "Taxpayer") executed power of attorney form which identifies PERSON and PERSON 1 of the ABC Law Group as the Taxpayer's authorized representatives.
>
> The Taxpayer, through its authorized representatives from the ABC Law Group, respectfully requests that the Illinois Department of Revenue ("Department") issue a private letter ruling to the Taxpayer regarding the "excise" tax rate to apply to the beverage alcohol product known as "PRODUCT". Under the Illinois Liquor Control Act (the "Act"), the "excise" tax rate on beverage alcohol varies based upon the product's classification as wine, spirits, cider or beer. With regard to spirits, wine, and cider, and not beer, the tax rate also varies based upon the product's alcohol by volume

concertation [sic]. For example, Section 8-1 of the Act provides that malt beverage products (or beer) shall be taxed at the rate of $0.231 per gallon and wine, other than cider containing less than 7% alcohol by volume, shall be taxed at a rate of $1.39 per gallon.

On or about DATE, the Department's Alcohol & Tobacco Processing Section issued the attached email stating that its legal department is of the opinion that the "PRODUCT" products should be taxed at the same rate as wine for "excise" tax purposes ostensibly because it contains 14% alcohol by volume. The Taxpayer seeks the Department to issue private letter ruling which properly categorizes all of "PRODUCT's" brands as "beer" for purposes of the "excise" tax.

I. Statement of Facts

"PRODUCT" is a malt based beverage alcohol product which COMPANY 1 manufactures in CITY, Illinois[1]. In 2010, the Food and Drug Administration acknowledged that "PRODUCT" is a malt beverage[2] as it urged the manufactures of "PRODUCT" and three similar drinks to remove caffeine from its malt beverage based products because of safety concerns. While in December of 2010 COMPANY 1 removed caffeine, guarana and taurine from "PRODUCT," the product remains a malt beverage with food coloring. (See http://WEBSITE).

The Taxpayer imports and distributes "PRODUCT" products across the State of Illinois to retail outlets. Pursuant to Section 8-1 of the Act, the Taxpayer pays the "excise" tax on each gallon of "PRODUCT" it imports and distributes to State of Illinois retail outlets. On or about MONTH #, 2018, the Department indicated that it believes "PRODUCT" should be taxed at the rate of wine for "excise tax" purposes.

II. Relevant Contracts and Documents

There is not a contract or document relevant to this private letter ruling request.

III. Tax period at Issue

The Taxpayer seeks a ruling regarding the applicable tax rate on "PRODUCT" products moving forward as well as a refund of all tax periods in which the Taxpayer wrongly overpaid the "excise" tax pursuant to the Department's incorrect ruling that "PRODUCT" should be taxed as wine as opposed to a malt beverage product. The Taxpayer is not aware of audit or pending litigation with the Department about this issue.

IV. Prior Requests for Rulings

[1] http://WEBSITE
[2] https://www.fda/gov/Food/IngredientsPackagingLabeling/FoodAdditivesIngredients/ucm19036 6.htm

To the best of the Taxpayer's and its authorized representative's knowledge, the Department has not made a ruling on the applicable "excise" tax rate for "PRODUCT" products for the Taxpayer or Taxpayer's predecessor or otherwise made a formal ruling on this issue.

V. Analysis of Relevant Authorities

Section 8-1 of the Act provides that, "[a] tax is imposed upon the privilege of engaging in the business of manufacturing beer or as an importing distributor of beer at the rate of [ ] $0.231 per gallon." The Act does not provide differing "excise" tax rates for beer based upon alcohol by volume concentrations or any other differing characteristic – as it does for wine, spirits and cider. Further, Part 420.10 of the Illinois Department of Revenue Regulations summarizes the "excise" tax rates prescribed in the Act and also does not provide authority to tax beer at different rates.

The Act defines "beer" as "a beverage obtained by the alcoholic fermentation of an infusion or concoction of barley, or other grain, malt, and hops in water, and includes, among other things, beer, ale, stout, lager beer, porter the like." (235 ILCS 5/1-3.04).

As noted above in Section I, in 2010 the FDA acknowledged that "PRODUCT" meets the Act's definition of "beer" as it is a malt based beverage. "PRODUCT" also denotes on its webpage that it is a malt based product and there is no authority contradicting the fact that "PRODUCT" meets the Act's definition of beer.

While respectfully we do not believe there is any doubt that the legislature did not intend to tax beer differently based upon alcohol by volume concentrations, any doubt regarding the applicable statute's interpretation must "be construed most strongly against the government and in favor of the taxpayer." *Northwest Airlines, Inc., v. Department of Revenue of Ill.* 295 Ill.App.3d 889 (1st Dist. 1998) (citing *Van's Material Co. v. Department of Revenue*, 131 Ill.2d 196). If the underlying statute is unambiguous, the statute must be construed according to its terms. *Northwest Airlines, Inc*. 295 Ill. App. 3d 889.

Accordingly, the Department must rule that "excise" taxes for "PRODUCT" brand products shall be taxed at the rate of $0.231 per gallon.

VI. Statement of Authorities Contrary to the Taxpayer's view

The Taxpayer is not aware of any authority contrary to the Taxpayer's view.

VII. Trade Secrets to be deleted from the publicly disseminated version of the private letter ruling.

The Taxpayer requests that any information about the volume of alcoholic liquor distributed by the Taxpayer be removed from the Department's public version of the private letter ruling. Further, any information about the amount of taxes imposed as a

result of the Taxpayer's distribution of "PRODUCT' be removed from public dissemination.

DEPARTMENT'S RESPONSE:

The Illinois Liquor Control Act of 1934 ("Act") regulates the sale and distribution of alcoholic liquors in Illinois. 235 ILCS 5/. Article VIII of the Act provides for the taxation of alcoholic liquors. Except for the duties imposed on the Department of Revenue pursuant to Article VIII, the Illinois Liquor Control Commission is responsible for administering and enforcing the Act.

The Supreme Court of Illinois in *Federated Distributors, Inc. v. Johnson*, 125 Ill.2d 1, 125 Ill. Dec. 343, 530 N.E.2d 501 (1988), had occasion to review the history and purpose of the Act. The court was asked to determine the proper tax rate to apply to a new type of alcoholic beverage ("New Products"). New Products were very similar to wine coolers. They contained water, flavoring, fruit juices, vegetable juices, sugar, sugar syrup, preservatives, and artificial carbonation and contained less than 14% alcohol by volume. New Products were not produced by either fermentation or distillation. *Federated Distributors* at 6.

The Department of Revenue, in its initial letter to Federated Distributors, held that the New Products should be taxed in the same category as wine coolers, at the rate of 23 cents per gallon. In a subsequent letter to Federated Distributors, the Department changed its earlier position and concluded New Products should be taxed in the category of spirits, at the rate of $2 per gallon. *Id.* at 6-7. The trial court upheld the Department's classification of New Products as spirits, taxable at the rate $2 per gallon. The appellate court reversed the trial court and ordered New Products to be taxed at the same rate as wine and wine coolers, at the rate of 23 cents per gallon. *Federated Distributors, Inc. v. Johnson*, 163 Ill. App.3d 27 (1st Dist. 1987).

On appeal to the Illinois Supreme Court, the Department argued that the Act is entirely regulatory in nature, and the classifications of alcoholic liquor based on the method of production were not arbitrary and unreasonable for purposes of taxation. Federated Distributors argued that taxing New Products at the rate of $2 per gallon violated its constitutional guarantees of due process, equal protection and uniformity and frustrated the Act's stated purpose – fostering and promoting temperance in the consumption of alcoholic liquors. *Federated Distributors, Inc. v. Johnson*, 125 Ill.2d 1, 8 (1988).

The court reviewed the contents of New Products and wine coolers and determined that the only real difference between the two products was that New Products were fortified with the addition of spirits obtained through distillation and wine coolers were fortified with the addition of wine obtained through fermentation. *Id.* at 6 & 15. The court concluded there was no real and significant difference between New Products and wine coolers, and New Products should be taxed as wine containing less than 14% alcohol by volume. *Id.* at 21.

The court held "that, while the majority of the Liquor Control Act is regulatory in nature, article VIII of the Act is a tax for revenue purposes and is therefore subject to the uniformity clause of the Illinois Constitution of 1970." *Id*. at 8-9.

> "The validity of a tax classification under the uniformity clause is to be determined based on the "real and substantial differences" test and on whether the classification bears some reasonable relationship to the object of the legislation or to public policy."

Id. at 15. The court held there was no real and substantial difference between New Products and wine coolers to justify taxing New Products at a different rate than wine coolers. *Id*.

The court reviewed the history of making beer, wine and spirits and pointed out that all alcohol has one source – the fermentation of sugar. Distillation is the process of separating alcohol from water to obtain a drink with higher alcohol content.

> "Fermented cereal grains (as found in beer) may be distilled to whiskey, fermented fruits (as found in wine) may be distilled to brandy, and fermented sugar cane may be distilled to rum. The alcohol in spirits is thus *qualitatively* no different than the alcohol in wine—it has merely had some of its water content removed and is only *quantitatively* different. The process of distillation generally produces a product that is 40% to 50% alcohol by volume. (H. Hillman, The Gourmet Guide to Beer, at 166 (1983).) Is this quantitative difference enough to trigger the "real and substantial difference" test when the alcohol is mixed with fruit juices to create a product that is qualitatively no different than a wine cooler and which contains the same amount of alcohol by volume? The answer is no."

Id. at 18. Having determined the source for the added alcohol was not a sufficient basis to find a real and significant difference between New Products and wine coolers, the court examined whether placing New Products in the same category as wine with 14% or less alcohol by volume had a reasonable relationship to the purpose of the Act.

Section 1-2 of the Act states:

> "This Act shall be liberally construed, to the end that the health, safety, and welfare of the People of the State of Illinois shall be protected and temperance in the consumption of alcoholic liquors shall be fostered and promoted by sound and careful control and regulation of the manufacture, sale, and distribution of alcoholic liquors."

235 ILCS 5/1-2. "The Act has as a primary purpose the promotion of temperance in the consumption of alcoholic liquors." *Federated Distributors* at 20.

The appellate court's explanation of the purpose of the Act is most helpful.

> "The evil sought to be remedied by the Act is also not served by the Department's interpretation. The evil addressed by the Act is the abuse of alcohol. The Act seeks to alleviate that danger by making certain alcoholic beverages more expensive than others. The legislature determined that a greater danger of abuse is posed by these beverages, such as hard liquors which have a higher alcoholic content. As a means of discouraging their consumption, the Act places a higher tax on those beverages. By making hard liquor more costly, the public is discouraged from purchasing it and the evil of alcohol abuse is curtailed. Similarily, a lower tax is placed on beverages with a lower alcoholic content because they pose less danger of abuse when consumed."

Federated Distributors, Inc. v. Johnson, 163 Ill. App.3d 27, 33-34 (1st Dist. 1987). See also *Federated Distributors* at 20.

Taxpayer argues PRODUCT is a malt beverage and should be classified as beer and taxed at the rate of $0.231 per gallon. The Department has indicated to the Taxpayer that PRODUCT should be placed in the same category as wine having 14% or less alcohol and taxed at the rate of $1.39 per gallon.

PRODUCT has an alcohol content of 14% by volume. According to Taxpayer, PRODUCT is a malt beverage and contains natural and artificial flavors. Flavors listed on the Taxpayer's website include watermelon, sour apple, fruit punch, grape, and strawberry lemonade. Taxpayer provides no additional information regarding the products' ingredients.

Taxpayer's sole argument is that PRODUCT is a malt beverage, falls within the definition of "beer" and should be taxed as beer. The Department made a similar argument in *Federated Distributors,* arguing that the manner in which the alcohol is produced should determine the rate of tax. The court rejected the Department's position. *Federated Distributors* makes it clear that the process used to derive the alcohol contained in a beverage is not controlling.

The court held that New Products should be taxed in the same manner as wine with 14% or less alcohol, although no fermentation actually took place to make New Products. The court also raised no objection to wine coolers having been placed in the same category as wine with 14% or less alcohol. Generally, wine coolers are malt beverages with added flavors. Wine coolers have historically been taxed as wine with an alcohol content of 14% or less.

The court held that the issue was whether there was a real and substantial difference between wine coolers and New Products. The court in *Federated Distributors* did not find a real and substantial difference between wine coolers and New Products. The Department does not find a real and significant difference between New Products, wine coolers and PRODUCT. By taxing PRODUCT as wine with an alcohol content of 14% or less, the Department is treating and taxing all three of the products – New Products, wine coolers and PRODUCT – in a uniform manner.

Taxpayer is asking the Department to place its flavored malt beverage with an alcohol content similar to wine in the same classification as beer, a class of beverages that the legislature has determined to have less danger for abuse. As the court noted, the legislature saw a greater risk of alcohol abuse as the alcohol content of a beverage increased. By making liquor with higher alcohol content more expensive to purchase, consumers are discouraged from purchasing it. Beer has a lower tax placed on it because the legislature determined beer poses less of a danger of abuse than wine. Placing PRODUCT in the same category as beer runs counter to the purpose of the Act.

For the reasons set forth above, PRODUCT is to be taxed as wine with an alcohol content of 14% or less, at the rate of $1.39 per gallon.

The factual representations upon which this ruling is based are subject to review by the Department during the course of any audit, investigation, or hearing and this ruling shall bind the Department only if the factual representations recited in this ruling are correct and complete. This

Private Letter Ruling is revoked and will cease to bind the Department 10 years after the date of this letter under the provisions of 2 Ill. Adm. Code 1200.110(e) or earlier if there is a pertinent change in statutory law, case law, rules or in the factual representations recited in this ruling.

If you have further questions related to the Illinois sales tax laws, please visit our website at www.tax.illinois.gov or contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Richard S. Wolters
Chairman, Private Letter Ruling Committee

RSW:bkl