ST 18-0012-PLR 09/29/2018 LIQUOR TAX:

This letter discusses the taxability of flavored malt beverage under Article 8 of the Liquor Control Act. (235 ILCS 5/8-1) **NOTE: This letter supersedes ST 18-0007-PLR**. (This is a PLR.)

November 29, 2018

Re: Request for Private Letter Ruling by COMPANY

Dear Xxxxx:

This letter is in response to your letter dated August 29, 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:

Our client, COMPANY ("COMPANY" or the "Company"), requests the Illinois Department of Revenue (the "Department") to issue a Private Letter Ruling ("PLR"), pursuant to 2 Ill. Adm. Code 1200.110, confirming the correct excise tax rate to be applied to the Company's malt-based products, including, without limitation, its "PRODUCTS" branded products ("PRODUCTS") is $.0231 per gallon, applicable to all beer manufactured or distributed in Illinois, under the Illinois Liquor Control Act of 1934. The relevant facts are outlined below.

GENERAL INFORMATION

1. Enclosed please find two original Form IL-2848's, Power of Attorney, authorizing FIRM to represent the Company before the Department.
2. This PLR is not requested with respect to hypothetical or alternative proposed transactions. This PLR is requested to determine the tax consequences of the actual business practices of the Company.
3. The Company is not currently engaged in litigation with the Department in regard to this or any other tax matter.
4. The Company is not currently under audit by the Department in regard to this or any other tax matter.
5. To the best knowledge of the Company and its representatives, the Department has not previously ruled for the Company regarding this matter, nor has the Company previously submitted a ruling request to the Department regarding the same or a similar issue.
6. The Company requests that certain information be redacted from the PLR prior to dissemination to others. The Company requests that its name, address, other identifying information, financial information, proprietary information and trade secrets, all references to Exhibits, and the Exhibits themselves be redacted.
7. The Company knows of no authority contrary to the authorities referred to and cited below.

STATEMENT OF MATERIAL FACTS

1. General Company Overview

COMPANY is a Delaware limited liability company, headquartered in CITY and qualified to do business in Illinois. COMPANY manufactures and sells various malt-based alcohol beverages. The Company's products are sold in all 50 states and more than 40 countries worldwide. COMPANY is the ##th largest beer manufacturer in the United States and within the beer subcategory of flavored malt beverages ("FMBs"), the ##th largest manufacturer, selling more than ## million cans annually of its flagship FMB, PRODUCT. COMPANY has been manufacturing flavored malt beverages since 20XX and, more specifically, PRODUCT since 20XX.

COMPANY holds various federal and state licenses and permits to manufacture its FMBs. For example, at the federal level, COMPANY holds a Brewer's Notice issued by the Alcohol and Tobacco Tax and Trade Bureau ("TTB") to brew its malt-based products at BREWERY in CITY 1, STATE. The vast majority of the Company's FMBs, including all of its PRODUCTS, are brewed at this location and then shipped to COMPANY's more than ## beer distributors throughout the country. Additionally, regulators in each of the 50 States have authorized the Company to have its alcohol beverages sold in their respective States. In Illinois, COMPANY holds a Non-Resident Dealer permit issued by the Illinois Liquor Control Commission.

2. Brewing Process for PRODUCT Products and Flavored Malt Beverages

PRODUCTS are brewed using standard beer brewing methods combined with enhanced filtration and flavoring, which are commonly used in the beer industry to make FMBs. There are ten basic steps in the PRODUCT brewing process:[1]

1. Malting – Raw barley is steeped, germinated and dried to create malted barley.
2. Milling – Malted barley is milled to break apart the kernels.
3. Mashing – Milled, malted barley is steeped in brewing water to convert the starches into sugar to create "mash."
4. Lautering – Mash is filtered to separate spent grain from sugary liquid to create "wort."
5. Boiling and Hopping – Wort is boiled and hops are added for flavoring and aroma.
6. Fermentation – Yeast is added to the wort and fermented for 10-12 days. This is the process that creates fermented beer.
7. Primary Filtration – The fermented beer is filtered to remove excess yeast and other particles.
8. Secondary Filtration – The filtered beer undergoes additional filtration to neutralize the flavor and color of the beer.
9. Blending – The filtered beer is flavored and colored with proprietary ingredients.[2]
10. Carbonation & Canning – Carbonation is added to the flavored beer and the beer is canned for shipment.

Steps one through seven and step ten are identical to the steps involved in brewing and canning "traditional" beer (*e.g.*, PRODUCT 1, PRODUCT 2 and PRODUCT 3). Only steps eight and nine augment this brewing process – and those steps, as discussed below, are standard for brewing all beer products classified as FMBs.

3. Regulation, Classification, and Taxation of PRODUCT Products, and Other FMBs, by the Federal Government and Other States

Before addressing the Illinois statutory scheme below, it is important to understand that PRODUCTS are now and have always been categorized as beer (as well as malt beverages) by the federal government and taxed as such at the federal level.

For purposes of the federal excise tax imposed on beer under the Internal Revenue Code of 1986 ("IRC"), "beer" is defined in 26 U.S.C. § 5052(a) as "beer, ale, porter, stout, and other similar fermented beverages (including sake or similar products) of any name or description containing one-half of 1 percent or more of alcohol by volume, brewed or produced from malt, wholly or in part, or from any substitute therefor." PRODUCTS (and COMPANY's other FMB products) fall under this definition.

[1] Exhibit 1, PRODUCT Brewing Process Overview.

[2] The additional ingredients added in the ninth step are in the form of a liquid, which is added to the filtered beer to give it color and flavor.

TTB regulations further define "malt beverage" in 27 CFR 7.10 as a "beverage made by the alcoholic fermentation of an infusion or decoction, or combination of both, in potable brewing water, of malted barley with hops, or their parts, or their products, and with or without other malted cereals, and with or without the addition of unmalted or prepared cereals, other carbohydrates or products prepared therefrom, and with or without the addition of carbon dioxide, and with or without other wholesome products suitable for human food consumption." In short, a "malt beverage" is defined as an alcoholic product made from the fermentation of malted barley with hops.

TTB explained in a 2008 ruling that the IRC definition of "beer" is broader than that of "malt beverage" – in that "a fermented beverage that is brewed from a substitute for malt (such as rice or corn) but without any malted barley may constitute a 'beer' under the IRC but does not fall within the definition of a 'malt beverage' under the FAA Act… [and] a fermented beverage that is not brewed with hops may fall within the IRC definition of 'beer' but also falls outside of the definition of a 'malt beverage' under the FAA Act." TTB Ruling 2008–3 (https://www.ttb.gov/rulings/2008-3.pdf) at 4. The brewing process for PRODUCTS, described in Section 2 above, coupled with their TTB-approved formulas, provides clear evidence that the PRODUCTS are both a "beer" as defined by the IRC and a "malt beverage" as defined by TTB.

TTB has further defined "flavored malt beverages," which are a subcategory of "malt beverages." In 2005, the agency issued a final rule amending its regulations to clarify that malt beverages may include the addition of flavors and other nonbeverage ingredients containing certain levels of alcohol. Specifically, for those products at or below 6% alcohol by volume ("ABV"), "no more than 49% of their alcohol content may be derived from flavors and other nonbeverage materials" in order to remain classified as a "malt beverage." 27 CFR 7.11 ("Use of ingredients containing alcohol in malt beverages; processing of malt beverages."); *see also* and 27 CFR 25.15 ("Materials for the production of beer."). To ensure that the source of alcohol for products above 6% ABV – such as the PRODUCTS and many other FMBs – is malt-based, TTB established an even more stringent standard in order to meet the definition of "malt beverage": "[N]ot more than 1.5% of the volume of the finished product may consist of alcohol derived from flavors and other nonbeverage ingredients containing alcohol." *Id.*

COMPANY's PRODUCTS, as well as all other FMBs that it brews containing 6% ABV or more, meet this requirement, as evidenced by the attached TTB formula approvals. Therefore, these products are classified as "flavored malt beverages" by TTB.

Because the PRODUCTS qualify as "malt beverages," TTB is required to review the formula (*i.e.*, ingredients and method of production) and labeling of PRODUCT Products before the products are permitted to be sold. *See* 27 CFR 25.55(a)(1) ("Formulas for fermented beverages") and 27 CFR 7.41(a) ("Certificates of label approval"). Reviewing this information for numerous iterations of PRODUCTS over the past decade, TTB has classified *all* PRODUCTS as "malt beverages"; specifically, in the subcategory of "flavored malt beverages," which is noted in both (i) the Certificates of Label Approval ("COLAs") for these products as "Malt Beverages Specialties – Flavored"[3] and (ii) the TTB-approved formulas for the PRODUCTS.[4] As such, COMPANY must (and does)

[3] Exhibit 2, TTB-approved Certificates of Label Approval/Exemption ("COLAs") for PRODUCTS labels (evidencing TTB's approval of PRODUCTS' labels containing the description "Premium Malt Beverage," classifying each such product under the "Class/Type Description" heading as "Malt Beverages Specialties – Flavored").
[4] Exhibit 3.

pay federal excise taxes on the PRODUCTS at the rate applicable to beer. *See* 26 U.S.C. § 5051(a).[5]

Alcohol taxes in states where PRODUCTS [are] sold are paid either by COMPANY or by its distributors, depending on the state taxing structure. In every state (whether COMPANY or the distributor pays the taxes), PRODUCTS are taxed as beer.

4. Overview of Flavored Malt Beverage Subcategory of Beer

The general category of "beer" includes a number of subcategories recognized within the beer industry, such as "craft," "domestic," "import," and "flavored malt beverages" (*i.e.*, FMBs). The FMB subcategory includes the PRODUCTS, as well as hundreds of products made by some of the largest brewers in the United States, such as COMPANY 1, COMPANY 2, COMPANY 3, COMPANY 4., and COMPANY 5.[6,7]

PRODUCTS constitute only approximately #.#% of the total FMB market. As reported by IRI, between July 15, 2017 and July 15, 2018, FMB products were sold under approximately 920 different UPC codes in the United States, only approximately #.#% of which related to PRODUCTS.[8] Over that same period, FMB products totaled nearly $2.4 billion dollars of sales, of which PRODUCTS accounted for only approximately #.#%.[9]

Additionally, products that were known historically as "wine coolers" – due to the fact that in the 1980s "[w]ine coolers contain[ed] fruit juices with some wine added to achieve a lower alcoholic content than [was] possible from wine alone"[10] – have been reformulated and today are known primarily as "coolers" or "malt coolers." This is because these products are no longer manufactured using wine as the alcohol source, but rather are now manufactured using malt-based alcohol and are therefore also classified by the federal government as beer (or, more specifically, flavored malt beverages) and taxed as such. Similarly, many products that market themselves under the names of "cocktails" are actually FMBs that contain no spirits and likewise are taxed as beer.[11] In Illinois, to COMPANY's knowledge, "coolers" (also often referred to as "malt coolers") are also taxed as "beer."

RULING REQUESTED

---

[5] *See also* Exhibit 4, Exemplars of COMPANY's Excise Tax Returns (each of which evidences that 100% of the excise tax paid by COMPANY is at the rate applicable to beer) and Monthly "Brewer's Report of Operations" submitted to TTB.

[6] See Exhibit 5, Information Resources Inc. ("IRI") Sales Data for FMB UPCs from the Top 100 Manufacturers, for the rolling 52-week period ended July 15, 2018. IRI is a data analytics and consumer insights company that culls consumer point of sale (POS) data via partnerships with various chain and independent retail stores. IRI data cited herein was pulled from the "BEER" category database for nationwide stores, which includes grocery stores (*e.g.*, RETAIL STORE, RETAIL STORE 1), drug stores (*e.g.*, RETAIL STORE 2, RETAIL STORE 3), mass ("big-box") stores (*e.g.*, RETAIL STORE 4, RETAIL STORE 5), convenience stores (*e.g.*, CONVIENCE STORE , CONVIENCE STORE 1), club stores (*e.g.*, RETAIL STORE 6, RETAIL STORE 7), dollar stores (*e.g.*, RETAIL STORE 8, RETAIL STORE 9) and military stores (*e.g.*, RETAIL STORE 10, RETAIL STORE 11).

[7] *Id.*; *see also* Exhibit 6, TTB-approved labels for various top-selling FMBs.

[8] Exhibit 5. Note that IRI tracks the UPC codes of products sold, such that some small percentage of the 920 count represents the same product sold under different UPC codes at different times over that period.

[9] *Id.*

[10] *Federated Distributors, Inc. v. Johnson*, 125 Ill. 2d 1, 21 (1988).

[11] Exhibit 7, IRI Sales Data for Cooler UPCs, & Exhibit 8, TTB Approved COLAs for various "Cooler" FMBs (including PRODUCT 4," "PRODUCT 5" and "PRODUCT 6" products (all labeled "flavored malt cooler" and "flavored beer"); PRODUCT 7, "PRODUCT 8" and "PRODUCT 9" products (each labeled both "flavored beer" and "malt beverage"); and PRODUCT 10 and "PRODUCT 11" products (both labeled a "premium malt beverage")).

The Company respectfully requests the Department to rule that, under Article VIII of the Liquor Control Act of 1934, 235 ILCS 5/8-1 *et seq.*, the excise tax applicable to PRODUCTS is at the rate of $.0231 per gallon, applicable to all beer manufactured or distributed in Illinois.

RELEVANT AUTHORITIES

Article VIII of the Illinois Liquor Control Act of 1934

The Illinois Liquor Control Act of 1934 (the "Act") regulates the manufacture, sale and distribution of alcoholic liquors in Illinois. *See* 235 ILC 5/ *et seq.* Article VIII of the Act provides for the taxation of alcoholic liquors. *See* 235 ILC 5/8-1 *et seq.* Except for those duties imposed on the Department in Article VIII, the Illinois Liquor Control Commission is responsible for administering and enforcing the Act. The Department has adopted rules and regulations for administration of those duties vested in it by Article VIII. 86 Ill. Adm. Code § 420.1 *et seq*.

Definition of "Beer," "Wine" and "Spirits" Under Illinois Law

The Act defines beer, wine and spirits as follows:

- "'Beer' means 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 and the like." 235 ILCS 5/1-3.04.
- "'Wine' means any alcoholic beverage obtained by the fermentation of the natural contents of fruits or vegetables containing sugar, including those beverages when fortified by the addition of alcohol or spirits, as defined in this Section." 235 ILCS 5/1-3.03.
- "'Spirits' means any beverage that contains alcohol obtained by distillation, mixed with water or other substance in solution, and includes brandy, rum, whiskey, gin or other spirituous liquors, and those liquors when rectified, blended or otherwise mixed with alcohol or other substances." 235 ILCS 5/1-3.02.

The Department specifically incorporated each of these definitions into its regulations at 86 Ill. Adm. Code § 420.5.

Taxation of Various Classifications of Alcoholic Liquor Under Illinois Law

Under Article VIII of the Act, the General Assembly established a comprehensive taxation scheme, imposing excise taxes "upon the privilege of engaging in business as a manufacturer or as an importing distributor of alcoholic liquor." 235 ILCS 5/8-1. The applicable regulations can be found in 86 Ill. Adm. Code 420.10. For all periods after September 1, 2009, those taxes have been imposed at the following rates:

- $1.39 per gallon for wine containing less than 20% of alcohol by volume other than cider containing less than 7% alcohol by volume;
- 23.1¢ per gallon on beer;
- 23.1¢ per gallon for cider containing not less than 0.5% alcohol by volume nor more than 7% alcohol by volume; and
- $8.55 per gallon on alcoholic liquor containing 20% or more of alcohol by volume.

235 ILCS 5/8-1; 86 Ill. Adm. Code 420.10.

The statute and regulations thus impose tax at a single rate on all beer (23.1¢ per gallon), without regard to its alcohol by volume. This differs from the treatment of wine, cider and spirits, with each incurring differing rates of tax depending on their percentage of alcohol by volume.

DISCUSSION AND ANALYSIS

PRODUCTS and other FMBs are "beer" under Illinois law. As explained herein, they are brewed from malted barley, combined with hops, and fermented to create an alcohol by volume content greater than one-half of one percent. As such, they meet the definition of beer under Illinois law (86 Ill. Adm. Code § 420.5 (citing 235 ILCS 5/1-3.04) (defining "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 and the like")). PRODUCTS also meet the definition of "beer" under federal law (26 U.S.C. § 5052(a)).

The fact that the beer brewed to produce PRODUCTS – as well as other FMBs – is additionally filtered and then flavored in compliance with 27 CFR 7.11, does not cause these products to fall outside the statutory definition of "beer." On the contrary, the product fits squarely within that definition. As such, the Department must tax PRODUCTS as beer under the Act. *See Hartney Fuel Oil Co. v. Hamer*, 2013 IL 115130, ¶¶ 61, 66 (holding that the Department is without authority to "narrow or broaden the scope of intended taxation under a taxing statute," and that "an agency's powers are limited to those granted by statute, and acts of an agency beyond its statutory powers are void.") (internal citations omitted).

The Illinois Supreme Court has had at least two occasions to consider the taxation structure of the Act – determining in both cases that the General Assembly had defined the categories of alcoholic liquors and the taxation thereof in a reasonable manner that comported with the Illinois Constitution. In *Federated Distributors, Inc. v. Johnson*, 125 Ill. 2d 1 (1988), the Court considered a taxpayer challenge under the uniformity clause brought by distributors of so-called "New Products" to a decision by the Department to tax those products as spirits as opposed to wine. Notably, unlike the PRODUCTS[12], "New Products" did not fit into any established classification of alcoholic liquors under the Act. *Id.* at 6. Indeed, the parties stipulated that "New Products are not produced by either distillation or fermentation…They are produced from any combination of water, flavoring, fruit juices, vegetable juices, sugar, sugar syrup, preservatives and artificial carbonation, and are fortified by the addition of spirits." *Id.* at 6. The distributors argued that, given the inapplicability of the statutory classifications to New Products, if New Products were not taxed at the rate applicable to wine, they should not be taxed "at all." *Id.* at 7.

The Court held that the Department's decision to tax New Products as spirits was not reasonable, finding there to be "no 'real and substantial difference' between New

[12] As previously discussed, PRODUCTS clearly fall within the definition of "beer" under the Act and the Department's regulations.

Products and wine coolers" other than the method of production of the alcohol each product contained. *Id.* at 8-9. The Court also made clear, however, that it *was* appropriate to tax beer and wine coolers at different rates, regardless of their percentage alcohol by volume, because those products were substantially different. The Court wrote:

[B]eer and wine coolers are… ***very different products***: one is made from grains and hops, the other begins with fruits and/or vegetables. Although both contain alcohol formed through the process of fermentation, beer must begin with the grain malted and is thereafter heated in the brewing process. Wine coolers contain fruit juices with some wine added to achieve a lower alcoholic content than is possible from wine alone. ***The products are very different.***

Id. at 20-21 (emphasis added).

Parties filing amicus briefs in *Federated Distributors* argued that taxing New Products and wine coolers at the same rate would "destroy the entire statutory scheme because some imported beers may have the same alcoholic content as wine coolers and should also be taxed at the same rate." *Id.* at 20. Given the differences between beer and wine coolers, however, the Court rejected that argument, writing:

[T]he legislature has broad powers in the area of establishing classifications to define the subjects of taxation. Those broad powers, however, are limited in Illinois by the constitutional mandate of the uniformity clause. Uniformity need not necessarily dictate, however, that merely because two products have the same alcoholic content that they must be taxed at the same rate, *i.e.*, a 6% alcohol by volume beer and a 6% alcohol by volume wine cooler. A determination of real and substantial differences is not confined or limited to a review of only one aspect of a product, and in reaching our decision today we have not so limited our review to an examination of only the alcoholic level of the beverage, but have also looked to the overall similarity of the products.

Id. (internal citations omitted).

In concluding its opinion, the Court wrote that the "ultimate determination of taxation levels must be left to the legislature, to be determined within the constitutional limitations and to the end that they promote the purpose of the Act." *Id.* at 22. More than two decades later, the Court not only reiterated that proposition, but held that the tax classifications established in the Act (identical to those still in place today) met the standard of reasonableness required by the uniformity clause. In *Wirtz v. Quinn*, 2011 IL 111903, ¶¶ 81-89, the Court held that the circuit court correctly dismissed as a matter of law taxpayers' uniformity clause challenge to the disparity in tax rates under the Act for beer, wine and spirits, holding that "the tax classifications in [the Act] meet [the] standard [of reasonableness]" and "the legislature's judgment on this subject is not a matter that may be factually refuted." *Id.*, ¶¶ 88-89 (emphasis added). In other words, the Illinois Supreme Court reaffirmed in 2011 that the taxation scheme under the Act meets the standard of reasonableness under the uniformity clause of the Illinois Constitution and should be enforced as written.

The Department must enforce the tax as established by the Act. Doing otherwise, whether premised on purported uniformity clause considerations or otherwise, would amount to a finding by the Department that the Act is unconstitutional, at least as

applied to FMBs like the PRODUCTS. The Department does not have the authority to make such a finding.

CONCLUSION

For the reasons above, the Company respectfully requests the Department to issue a ruling that the Company's malt-based products, including the PRODUCTS, are "beer", under the provisions of Article VIII of the Liquor Control Act of 1934, 235 ILCS 5/8-1 *et seq.*, and, therefore, should be taxed at the excise tax rate applicable to beer manufactured or distributed in Illinois.

The Company appreciates the opportunity to provide detailed information regarding its products to the Department and will, of course, provide additional information or clarification if the Department so requests. If the Department tentatively determines to issue an adverse ruling, the Company respectfully requests a conference with the Department prior to the issuance thereof.

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.

A gallonage tax is imposed upon the privilege of engaging in business as a manufacturer or importing distributor of alcoholic liquor (235 ILCS 5/8-1). The Act contains four classifications of alcoholic liquor for tax purposes: beer, cider, wine and spirits. Beer is taxed at the rate of $0.231 per gallon. Cider containing not less than 0.5% alcohol by volume nor more than 7% alcohol by volume is taxed at the rate of $0.231 per gallon. Wine containing less than 20% of alcohol by volume, other than cider containing less than 7% alcohol by volume, is taxed at the rate of $1.39 per gallon. Alcohol and spirits containing 20% or more of alcohol by volume are taxed at the rate of $8.55 per gallon. See 86 Ill. Adm. Code 420.10(a)(1)(B).

The Act contains definitions for beer, cider, wine and spirits:

"Beer" means 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 and the like. (235 ILCS 5/1-3.04)

"Cider" means any alcoholic beverage obtained by the alcohol fermentation of the juice of apples or pears including, but not limited to, flavored, sparkling, or carbonated cider. (235 ILCS 5/8-1)

"Wine" means any alcoholic beverage obtained by the fermentation of the natural contents of fruits, or vegetables, containing sugar, including such beverages when fortified by the addition of alcohol or spirits, as above defined. (235 ILCS 5/1-3.03)

"Spirits" means any beverage which contains alcohol obtained by distillation, mixed with

> water or other substance in solution, and includes brandy, rum, whiskey, gin, or other spirituous liquors, and such liquors when rectified, blended or otherwise mixed with alcohol or other substances. (235 ILCS 5/1-3.02)

The Department, when faced with the question of the proper classification of a new product, must review the nature of the product and the intent of the Act. The Department must rely on the information provided by the person requesting the ruling. Generally, the ingredients and the manufacturing process for a beverage are proprietary, confidential and unavailable to the Department. Based on the information provided, the Department must place the product in one of the four classifications for tax purposes.

The Company has provided sufficient information of the PRODUCTS for the Department to determine that they should be classified as beer and taxed accordingly. This determination is limited to the PRODUCTS.

The Department's decision is consistent with the Illinois Supreme Court's holding in *Federated Distributors, Inc. v. Johnson*, 125 Ill.2d 1 (1988). In *Federated Distributors*, the court was faced with the question whether "new products" containing alcohol should be classified as wine or spirits for the purpose of taxation under the Act. The parties had stipulated that the new products were "produced from any combination of water, flavoring, fruit juices, vegetable juices, sugar, sugar syrup, preservatives and artificial carbonation, and are fortified by the addition of spirits." *Federated Distributors* at 6. The also court noted wine coolers and the new products were not "produced" by fermentation or distillation but were manufactured by adding wine or spirits to fruit juices. *Id*. at 20.

The court reviewed the new products and compared them to wine coolers, which were already being sold and taxed as wine. The court approached the issue as one of uniformity. 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 noted, however, that alcohol content alone is not necessarily the sole basis for classifying an alcoholic beverage for taxation purposes.

> "It is well settled that the legislature has broad powers in the area of establishing classifications to define the subjects of taxation. (*Klein v. Hulman* (1966), 34 Ill.2d 343) Those broad powers, however, are limited in Illinois by the constitutional mandate of the uniformity clause. Uniformity need not necessarily dictate, however, that merely because two products have the same alcoholic content that they must be taxed at the same rate, *i.e.,* a 6% alcohol by volume beer and a 6% alcohol by volume wine cooler. A determination of real and substantial differences is not confined or limited to a review of only one aspect of a product, and in reaching our decision today we have not so limited our review to an examination of only the alcoholic level of the beverage, but have also looked to the overall similarity of the products. To return to appellants argument, beer and wine coolers are, as our prior discussion indicates, very different products: one

> is made from grains and hops, the other begins with fruits and/or vegetables. Although both contain alcohol formed through the process of fermentation, beer must begin with the grain malted and is thereafter heated in the brewing process. Wine coolers contain fruit juices with some wine added to achieve a lower alcoholic content than is possible from wine alone. The products are very different. *Id.*, at 20-21.

The court determined that the only real difference between the two products was that the new products were essentially fruit juices fortified with the addition of spirits obtained through distillation and wine coolers were fruit juices fortified with the addition of wine obtained through fermentation. *Id.* at 6 & 15. The court concluded there was no real and substantial difference between the new products and wine coolers to justify taxing the new products at a different rate than wine coolers, and the new products should be taxed as wine containing less than 14% alcohol by volume. *Id*.

In the case at hand, information indicates that some of the PRODUCTS have alcohol content similar to other products such as wine, which is taxed at a higher rate than beer. However, the Department declines to tax PRODUCTS at this higher rate and finds that they are appropriately taxed as beer. In *Federated Distributors*, the court clearly ruled that the uniformity clause does not require the Department to consider only alcohol content in evaluating whether real and substantial differences exist between different products. Although the *Federated Distributors* court could find no real and substantial differences between new products and wine coolers, the Department finds a real and substantial difference between the PRODUCTS and other products containing similar alcohol content, such as wine The Department has reached its conclusion for a number of reasons.

First, PRODUCTS are manufactured by the process of fermentation of an infusion or concoction of barley, or other grain, malt, and hops in water, thus falling squarely within the definition of beer. Second, although some of the PRODUCTS contain an alcoholic content similar to some wines, the definition of beer does not contain any limitation on the amount of alcohol a beer may contain. Third, the PRODUCTS fall within the definition of beer contained in the Internal Revenue Code ("IRC"). See 26 U.S.C. 5502. The IRS definition of beer is consistent with the definition of beer in the Act. The PRODUCTS also fall within the definition of malt beverage established by the Alcohol and Tobacco Tax and Trade Bureau ("TTB"). 27 C.F.R. 7.10. The TTB definition of beer also is consistent with the definition of beer in the Act. Although the federal definitions are not controlling, they do provide important guidance to the Department. Fourth, although not determinative, classifying the PRODUCTS as beer has the practical effect of not disrupting the marketing of the products.

These factors, the Department believes, demonstrate that a real and substantial difference exists between PRODUCTS and other products, such as wine, that have a similar alcoholic content. Given these differences, the Department determines that PRODUCTS are taxable as beer at the rate of $0.231 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.

I hope this information is helpful. 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