Calendar No. 1941

76TH CONGRESS } SENATE { REPORT
3d Session } { No. 1853

ELIMINATING THE TAX ON BRANDY AND WINE SPIRITS USED IN THE FORTIFICATION OF WINE; INCREASING THE TAX ON WINE

JUNE 13 (legislative day, MAY 28), 1940.—Ordered to be printed

Mr. GEORGE, from the Committee on Finance, submitted the following

REPORT

[To accompany H. R. 9117]

The Committee on Finance, to whom was referred the bill (H. R. 9117) to eliminate the tax on brandy and wine spirits used in the fortification of wine; to increase the tax on wine; to compensate for the loss of revenue occasioned by the elimination of the tax on brandy and wine spirits used in the fortification of wine; and for other purposes, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

The Treasury Department has no objection to the enactment of the bill. Its purposes are fully explained in the following excerpt from the report of the Committee on Ways and Means which accompanied the bill in the House of Representatives.

[Excerpt from H. Rept. No. 2395, 76th Cong., 3d sess.]

GENERAL STATEMENT

The purpose of this bill is to simplify procedure in the collection of taxes on wine. This simplification will benefit the Treasury Department, the wine producers, and the wine consumers alike.

At the present time the Federal excise taxes on wine are 5 cents per gallon on wine up to 14-percent alcohol by volume. 10 cents per gallon on wine 14 to 21 percent, and 20 cents on wine from 21 to 24 percent. These taxes are collected by the Government at the time the wine is withdrawn from bonded wineries or storerooms for sale.

In addition to these excise taxes, the Federal Government collects 10 cents per gallon tax on all brandy used for fortifying sweet wines—that is, practically all wines over 14 percent. One gallon of brandy takes care of the fortification of 3 gallons of sweet wine, so that, in fact, the fortification tax amounts to about 3⅓ cents per gallon on sweet wine. This is a hidden, production tax of 3⅓ cents in addition to the above excise taxes. As a matter of fact this fortification tax in its present form is a processing tax.

Now, the Government does not collect this tax at the time of fortification, but gives the producer 18 months to pay the tax. Because wine production is for the major part an underfinanced agricultural industry, the theory of this credit was to give the producers additional time to pay the tax and thus encourage them to hold their wines for aging.

But, in reality, this 18-month credit for payment for fortification tax has worked out to the disadvantage of everyone concerned. In many cases, the underfinanced producers failed to lay aside sufficient funds to meet the payment of the fortification tax due the Government 18 months after actual production. In many instances, they had sold the wine involved to other producers. In any event, when time came for payment of the fortification tax many were without sufficient funds and were forced to do the only thing possible under the circumstances—they were forced to sell wine on hand at whatever price was obtainable in order to raise funds with which to pay the Government and get their permits and bonds renewed.

Fortification usually starts in August, making the payments fall due around April of the second year following. While the bulk of the industry can and does meet its obligations through reserve funds set up for the purpose, there are others who cannot and these invariably resort to ruinous dumping of wine every year around April. The soundly financed wineries are forced to meet prices and, as a result, the whole industry suffers through the bad financial practices of a few wineries.

As for the Treasury Department, collection of the fortification tax has been a constant trouble. Six sizable wineries during the last few years permitted themselves to get into a position where they could neither pay the tax nor sell enough wine to meet their obligations and were forced out of business through bankruptcy proceedings and assignments for the benefit of creditors. Today, the Treasury Department says that delinquent fortification taxes amount to $3,500,000. There are 29 suits pending against various wineries for delinquent taxes. While there will probably not be any actual loss of taxes to the Government, because of the protection by surety bonds, the process of collection is costing the Government a considerable sum and extensive effort each year.

The consumer suffers through the dumping of improperly aged wines on the market to pay the fortification tax due. Under the proposed bill, the fortification tax will be repealed and the excise tax increased to cover the amount now collected by the fortification tax. The tax rate on light, unfortified wine will remain at 5 cents. The tax on sweet fortified wine 14 to 21 percent will be increased from 10 to 15 cents and the tax on fortified wine 21 to 24 percent, will be increased from 20 to 25 cents.

The new tax rates will actually produce to the Government additional revenue annually besides eliminating costly collection procedure. All of the new, combined tax will be paid as usual at the time wine is withdrawn from bonded wineries or storerooms for sale to the consumer.

To compensate those producers who have already paid the fortification tax, or against whom the tax has been assessed, the bill provides that the old rate of excise tax shall apply to all wine on hand as of the effective date of this bill, July 1, 1940. This appears to be the simplest manner of handling the situation without involving the Government in inventories of floor stocks or complicated credits, refunds, or abatements.

The Government will lose nothing on fortification taxes already assessed (but not collected) because all such levies are protected by surety bond. The Government will simply proceed to collect fortification taxes due for the next 18 months, and in the meantime, all new wine produced will pay the new excise tax of 5, 15, and 25 cents. The benefits to growers and producers through stabilization of the industry are obvious. In addition, the producer will be encouraged to age and mature his wine and the consumer will be able to purchase a finer, high-quality product.

The amendments to the bill contained in this report are pursuant to suggestions by the Treasury Department, as outlined in the letter printed below. Attention is called to the following statement contained in this letter:

"In view of all of the above, especially considering the advantage in sureness of tax collection and increased revenue, the Treasury Department offers no objection to the passage of the bill."

The letter from the Treasury Department is as follows:

TREASURY DEPARTMENT,
Washington, April 27, 1940.

Hon. ROBERT L. DOUGHTON,
Chairman, Committee on Ways and Means,
House of Representatives, Washington, D. C.

MY DEAR MR. CHAIRMAN: Further reference is made to your letter of April 6, 1940, in which you requested me to advise you of the recommendations or comments of the Treasury Department on a bill (H. R. 9117, 76th Cong., 3d sess.) introduced in the House of Representatives on March 27, 1940, by Mr. Buck and referred to your committee.

The preamble of the bill sets forth that the purpose thereof is "To eliminate the tax on brandy and wine spirits used in the fortification of wine; to increase the tax on wine; to compensate for the loss of revenue occasioned by the elimination of the tax on brandy and wine spirits used in the fortification of wine; and for other purposes."

To accomplish its purpose the bill proposes to amend three sections of the Internal Revenue Code and to enact an additional new section. It appears from the bill, and officials of the Bureau of Internal Revenue have been informed to like effect, that the purpose of the bill is to eliminate the tax of 10 cents per proof gallon on brandy and wine spirits withdrawn by wine makers and used in the fortification of wines on bonded winery premises, and to compensate therefor by placing an additional tax of 5 cents per wine gallon on wines containing more than 14 percent of absolute alcohol by volume but not more than 24 percent of absolute alcohol by volume. The existing tax of 5 cents per wine gallon on wines containing not more than 14 percent of absolute alcohol is not to be disturbed. Neither is the tax on wines containing more than 24 percent of absolute alcohol by volume to be disturbed. This latter group, under the law, is classed as distilled spirits and taxed accordingly.

The first section of the bill proposes the amendment of section 3030 (a) (1) (A) of the Internal Revenue Code so as to increase the tax on wines containing more than 14 percent and not exceeding 21 percent of absolute alcohol from 10 cents to 15 cents per wine gallon, and to increase the tax on wines containing more than 21 percent and not exceeding 24 percent of absolute alcohol from 20 cents to 25 cents per wine gallon. In all other respects section 3030 (a) (1) (A) of the Internal Revenue Code is not to be disturbed.

Section 2 of the bill proposes to amend section 3030 (a) (2) of the Internal Revenue Code to correct an error which was made in the printing of H. R. 9185 (Public, No. 814, 74th Cong.), being the Liquor Tax Administration Act, which was approved by the President on June 26, 1936. Section 319 (d) of the bill amended section 613 of the Revenue Act of 1918, as amended, to decrease the tax on each bottle or other container of artificially carbonated wine from 2½ cents on each "one-pint" or fraction thereof to 1¼ cents on each such bottle or other container. The quoted measure of content, i. e., "one-pint", was in error, for in the consideration of the bill, and in section 613 of the Revenue Act of 1918, the quantity was "one-half pint." Section 2 does not disturb section 3030 (a) (2) of the Internal Revenue Code in any other particular.

Section 3 of the bill proposes to amend section 3031 (a) of the Internal Revenue Code, which now authorizes the withdrawal by winemakers of brandy and wine spirits for the fortification of wines on the premises where such wines were made, and taxes the winemaker, upon proper use of the brandy and wine spirits in such fortification, at the rate of 10 cents per proof-gallon on all such brandy and wine spirits so used. Section 3031 (a) now provides that the 10-cent tax shall be levied and assessed against the producer who uses brandy or wine spirits in the fortification of wines, and provides that the assessment shall be paid by such producer and user within 18 months from the date of the notice of such assessment. The 10-cent tax now assessed is in lieu of the basic internal-revenue tax on the brandy and fruit spirits. Section 3 would so amend section 3031 (a) of the Internal Revenue Code as to remove the tax on the brandy and fruit spirits used in the fortification of wine, when such fortification is lawfully performed. Since it is proposed that there shall be no tax on the use of fortifying spirits as such, the provisions for the assessment, and payment of the assessment within 18 months from the date of the notice thereof, are likewise proposed to be removed.

Provision is made for charging to the winemaker withdrawing fortifying spirits the basic tax imposed thereon by law, with the proviso that whenever such spirits shall be lawfully used in the fortification of wines and accounted for in the manner provided by law and regulations, the producer shall be credited in the

amount of the internal-revenue tax on so much of such spirits so withdrawn as was so used. Provision is made, as in existing law, that every producer of wines who withdraws brandy or wine spirits for use in the fortification of wines shall give bond to fully cover at all times the payment of the internal-revenue tax at the rate imposed by law on the brandy or wine spirits, and that the bond shall be in such form as the Commissioner, with the approval of the Secretary, shall, by regulations, prescribe. Provision is also made, as is not now the case, that when brandy or wine spirits withdrawn for use in the fortification of such wines are not lawfully used in the fortification of wines, or when such brandy or wine spirits are not so accounted for in the manner provided by law and regulations as to warrant remission of the tax, the internal-revenue tax on such brandy or wine spirits, at the basic rate, shall be assessed against the wine producer who withdrew them. Section 3031 (a) now provides that when fortified wines are destroyed or sold or removed for the manufacture of vinegar or the production of dealcoholized wines containing less than one-half of 1 percent of alcohol by volume, the tax under the section on the brandy or wine spirits in such wines so destroyed, sold, removed, or used shall, under such regulations as the Secretary may prescribe, be abated or refunded. Since there will be no 10-cent tax if the bill is enacted, section 3 proposes to amend section 3031 (a) to delete the provision just referred to.

The net result of abandoning the 10-cent tax on fortifying spirits and imposing an additional 5-cent tax on the wines will be to increase the revenue of the United States and to provide eventually for quicker and more sure collection of the taxes on such wines. It is estimated that an average of one-third of a proof gallon of brandy or wine spirits is used to produce a standard gallon of fortified wine. The cost in tax of that one-third of a proof gallon of spirits is 3⅓ cents. The tax on the wine being raised 5 cents, it is apparent that on the average the Government will receive 1⅔ cents more on each gallon of fortified wine withdrawn on payment of tax. During the past 4 fiscal years the yearly average of brandy used in fortifying amounted to 14,710,501 proof gallons, and the yearly average of wine over 14 percent alcohol withdrawn tax-paid amounted to 39,367,155 wine gallons. Under the proposed bill, the yearly wine-tax collections would have been $497,308 greater than under the present wine and fortifying tax rates.

Under existing law the wine maker has 18 months within which to pay the fortification tax. Therefore, there may not be a default declared on the part of the wine maker on the payment of such tax until the 18-month period has expired. Hence, under the internal-revenue laws, there can be no lien against the wine maker's property until the 18-month period has expired and there has been a default. In the meantime, the wine may have been tax-paid and sold, and the Government must look for payment to the wine maker's assets other than the wine in which the spirits were used, and to his bond. If H. R. 9117 becomes law this will all be changed, and whenever fortified wine is removed from bond and the tax paid, the Government will receive its fortification tax which, as outlined above, is to be included in the wine tax. It seems to us that the entire tax situation will be clarified and there will be considerably less prospect of litigation and controversy with bonding companies concerning the fortification tax. We have been informed that the wine industry considers that the placing of the fortification tax on the wine itself and abandonment of the 18-month period of tax postponement will result in sounder business practices within the industry and thereby benefit the industry.

Section 4 of the bill is designed to take care of the situation which will result as of the effective date of the act which, we have been informed, is desired to be made July 1, 1940. If the 10-cent fortification tax is to continue in effect until and including June 30, 1940, and all wines which come out of bonded wineries and bonded storehouses on July 1 and thereafter are to be taxed at the higher rate, it will mean that as to all wines removed from bond on July 1, 1940, and thereafter, such wines will be paying not only the increased tax which is supposed to be a substitute for the present fortification tax, but they will be bearing the fortification tax also. This, of course, would be in effect double taxation, which is neither intended by the proponents of the bill nor desired by the Treasury Department. It appears to be good administrative procedure, therefore, to give to the proprietor of every bonded winery and bonded storeroom a credit of 5 cents for each gallon of wine on his premises which, when removed, will be subject to the higher tax. The fortification taxes accruing before July 1, 1940, will be payable as under existing law; that is to say, within 18 months from the date of the notice of the assessment thereof. It is obvious that if the new law is to be effective as of July 1, 1940, on the basis of an inventory as of June 30, 1940, a

proprietor who tax-pays wine of an alcoholic content from 14 to 24 percent of absolute alcohol by volume on or after July 1, 1940, will necessarily have to pay the tax at the new rate, even though the fortification tax on the spirits in such wine has been or will be paid. Under section 4 the credit given to the proprietor will be usable by him in the purchase of wine stamps. In the view of the Treasury Department it is immaterial whether he uses 5 cents' worth of credit and 10 cents of his own money in paying a 15-cent wine tax, or if he uses 15 cents' worth of credit in payment of the 15-cent wine tax. The purpose of the credit being to compensate for the fortification tax which has been, or may be, paid, it is immaterial to the Treasury Department how the proprietor uses it, or even if he should transfer his credit to another proprietor.

In view of all of the above, especially considering the advantage in sureness of tax collection and increased revenue, the Treasury Department offers no objection to the passage of the bill. However, we do offer the following suggestions for changes in the bill.

Section 3030 (a) (1) (A) of the Internal Revenue Code, which is proposed to be amended by section 1 of the bill, at the present time imposes taxes upon all still wines, including vermouth, and all artificial or imitation wines or compounds sold as still wine, produced in or imported into the United States after "February 24, 1919, or which on February 25, 1919," were on any winery premises or other bonded premises or in transit thereto, or at any customhouse. The Revenue Act of 1918 was approved on February 24, 1919. In that act taxes on still wines, etc., were imposed by section 611. Legislation subsequent to February 24, 1919, in respect to these taxes always proceeded by way of amendment of section 611, and when the code was enacted the old dates were retained. It is suggested that in lieu of the dates "February 24, 1919," and "February 25, 1919," appearing in lines 8 and 9 on page 1 of the bill there be inserted the dates "June 30, 1940," and "July 1, 1940," so that that portion of the section will read "after June 30, 1940, or which on July 1, 1940."

The language in lines 1, 2, and 3 on page 2 of the bill indicates that the taxes we have been discussing are to be levied, collected, and paid when the objects of the taxation are sold or removed for consumption or sale. It appears obvious that if the dates which have just been suggested are inserted in the bill there will actually be little change in the net result if the new tax is effective on July 1, because it is the date on which the wines are removed for consumption or sale which governs the rate of tax to be paid. If there should be on bonded winery premises after June 30, 1940, that is to say, on July 1, 1940, or thereafter, or in transit from one bonded place of storage to another bonded place of storage on July 1 wines which were in bonded storage after February 24, 1919, or in transit to a place of bonded storage on February 25, 1919, no attention would be paid to the various rates of tax which had been imposed between 1919 and 1940, for the reason that it is the tax imposed by law on the date of removal which governs.

In the present section 3030 (a) (2) of the Internal Revenue Code, and in that section of the code as it is proposed to be amended by section 2 of the bill (in line 11, p. 3) appears the date "June 26, 1936." This date is traceable to the effective date of the Liquor Tax Administration Act, which was approved on June 26, 1936. Section 319 (d) of that act amended section 613 (a) of the Revenue Act of 1918 in respect of the tax on champagne, sparkling wine, artificially carbonated wine, etc. It is suggested that this date, and the immediately following language reading "or which on the day after such date" be eliminated and that there be substituted therefor "June 30, 1940, or which on July 1, 1940." This will harmonize section 3030 (a) (1) (A) and section 3030 (a) (2) of the Internal Revenue Code in respect of the effective dates of the tax.

Section 3031 (a) of the Internal Revenue Code, as proposed to be amended by section 3 of the bill, does not contain an effective date. Such effective date must, of course, under the policy and the theory of the bill, be July 1, 1940. It is suggested that on line 23, page 4 of the bill, following the designation of the section (sec. 3) there be inserted the words "Effective July 1, 1940," so that the language of lines 23 and 24 will read as follows: "Sec. 3. Effective July 1, 1940, section 3031 (a), Internal Revenue Code, is amended to read as follows:" If that change be made, there should be a change in line 6, page 6. The words "the effective date of this Act" in that line should be replaced by "July 1, 1940."

In lines 5, 6, and 7 on page 7 of the bill (in sec. 4) appears this language: "and containing 14 per centum *or more* of absolute alcohol by volume, but not more than 24 per centum *or more*." Since the quoted language is intended to be descriptive of the lower and upper limits of the two classes of wines with which the bill deals, i. e., wine containing "*more than* 14 per centum and not exceeding 21 per centum, and wine containing more than 21 per centum and *not exceeding*

24 per centum," it is obvious that such limits have not been properly described. The lower limit should have been described as "more than" 14 per centum, and the words "or more" in line 7 should be eliminated from the description of the higher limit. It is suggested that there be substituted for the language quoted from lines 5, 6, and 7 the words and figures "and containing more than 14 per centum of absolute alcohol by volume, and not exceeding 24 per centum."

It is suggested that an additional section, to be numbered 5, be inserted in the bill to guard against the possibility that there is not sufficient authority in existing law and in the bill for the issuance of all necessary regulations. We suggest that the added section read as follows:

"SEC. 5. The Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe and publish all needful rules and regulations for the enforcement of this Act."

In view of the urgency of this report, it has not been possible to secure advice from the Bureau of the Budget as to the relationship of H. R. 9117 to the program of the President.

Very truly yours,

HERBERT E. GASTON,
Acting Secretary of the Treasury.