Barrel of SALT Benefits & Incentives for the Bourbon, Beer and Other Alcoholic Beverages Industry

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Being from Kentucky, there are few things we know (or do) better than bourbon. Virtually from birth, you are ingrained with the most important facts of life, such as knowing the difference between bourbon and whiskey, that bourbon originates from Bourbon County, Kentucky, and that Kentucky bourbon is world renown due to its abundance of iron-free, limestone water used to filter and distill the bourbon. Bourbon is big business in the Bluegrass State, representing a $8.6 billion industry which generates over 21,000 local jobs, and produces ninety-five percent (95%) of the world's bourbon.[i]

On a national scale, the production, distribution and sale of all types of alcohol has always been big business, and according to one 2018 study, the direct economic impact of America's beer, wine and spirits retail industry is more than $122.63 billion annually, with the total economic impact of the alcohol industry being $363.33 billion annually[ii] – and these numbers have only continued to grow. Over the past few years, not just bourbon, but several other distilled and craft spirits have reached unprecedented heights of popularity and demand, resulting in hundreds of new production, warehousing, distribution and bottling facilities popping up all over the country. States have definitely taken notice as the tax dollars and local jobs continue to pour in, and have become increasingly active in finding new ways to incentivize these industries to stay, locate or expand in a respective jurisdiction. But which states serve up the most state and local tax (SALT) benefits and incentives to entice this booming industry to their jurisdictions?

This article will provide an overview of how states are finding ways to "tap into" the bourbon and craft alcohol boom through targeted statutory SALT exemptions, credits and other relief, and the application of broad manufacturing and production-related benefits that most states already have on the books to encompass

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these operations.

Straight Up – Sales/Use Tax Often Provides the Most Substantial SALT Savings

Most states have broad statutory exemptions, credits and other forms of relief enacted decades ago for traditional manufacturers and industrial processors for sales/use tax, income tax and property tax purposes – the three main ingredients for substantial tax savings for these operations. Those engaged in the manufacture, storage, bottling and distribution of alcohol products can often qualify for these same manufacturing-based benefits – with many states making that abundantly clear to the industry through legislation or administrative guidance.

First, we start with available sales/use tax benefits. Given the significant cost to the build the necessary facilities and purchase the machinery, equipment and infrastructure for the production of alcohol products, and a combined state and local sales tax rate of over 9% in some places[iii], the sales tax bill on many of these purchases can be substantial. And remember, just because you purchase certain items sales tax free from overseas or states in which there is no sales tax obligation, does not mean use tax (the back stop for sales tax) would not apply instead in the state in which you operate.

Many states have some form of a sales/use tax exemption for tangible property purchased and used, stored or consumed in a "manufacturing" or production process. Some states like Kentucky and Indiana explicitly recognize that the production of distilled spirits and other alcohol products is considered manufacturing for sales/use tax (and other tax purposes) given the importance of these operations to their state and local economies. North Carolina is the most recent example of a state specifically enacting a sales/use tax exemption for the alcohol industry; as effective October 1, 2021, all machinery, equipment, parts and accessories for breweries, distilleries and wineries will be exempt when used in the manufacture of their products, along with all supplies and ingredients used or consumed in the process.[iv]

Although another state may not specifically tailor its tax code to the alcohol industry, most states statutorily recognize that

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"manufacturing" includes any process through which material having little or no commercial value before processing has appreciable commercial value after processing – i.e., the production of alcohol from raw materials. Moreover, many state taxing agencies generally agree through administrative guidance, practice or policy that the distilling, brewing and production of alcoholic beverages is considered manufacturing eligible for available sales/use tax exemptions, rebates or refunds. This recognition may also extend to a company's alcohol warehousing, storage, bottling and distribution facilities and operations too depending on the state.

While each state has its own quirks and caveats (e.g., spare, repair and replacement items may be taxable), to the benefit of manufacturers, states generally exempt the purchase of materials consumed in the process or that become part of the final product, [v] the machinery, equipment, tools and supplies used to create the finished product, and often the equipment necessary to move the products throughout the process until it is packaged and ready for distribution. But just because the production of alcohol may be considered manufacturing, a company must also ensure that the potentially exempt item is used within the "integrated" process (typically from the moment raw materials enter the facility until it is packaged and ready to be shipped), "directly used" in that process (e.g., actually making contact with the material/product) and/or at least "primarily" used for manufacturing purposes (e.g., at least 51% of the time; not a forklift used only 10% of the time to move in-process materials).

Despite this fine print, these exemptions for the machinery, equipment and other items used to manufacture a product are very generous and can amount to substantial sales/use tax savings for a distiller or brewer. Therefore, most items that are used at the point a raw material is loaded into the facility until it is at the dock or on the rack ready to be shipped to customers are considered to be within the "integrated" process and potentially eligible for the applicable sales/use tax saving measure.

For example, as mentioned, Indiana explicitly recognizes in its administrative regulation that the integrated manufacturing process for distilled spirits starts at the point of grinding/fermentation of

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grain, through the aging and blending process, and then to the bottling, labeling and packaging component of the operations. Therefore, any tangible property directly used during this integrated process may be exempt from sales and use tax, including pumps used to circulate cooling water through condensers in the distillery, chemicals used to treat the water used in the production of whiskey to ensure purity or prevent buildup in the boilers/pipes, equipment used to crush coal prior to being fed into a boiler used to generate steam in the distillation process, the bottling and packaging process (e.g., case and bottle conveyors used during the filling operations, equipment to fill the bottles with product and to place labels on the bottles, and case filling equipment and case palletizers), transportation equipment for movement of in-process materials in the facility (but generally not between other plants/facilities), and equipment required for environmental, safety or other regulatorily/legally required reasons.[vi]

But the sales/use tax fun doesn't end there, as many states also exempt from sales tax the utility/energy costs of the process, the labor required to install machinery and equipment (e.g., for those states that have begun taxing services[vii]), and machinery and equipment used for recycling operations which can be part, or a byproduct, of the manufactured product (e.g., dried distilled grains processed or resold or further processed by the distiller). A whole menu of options.

Chaser Needed – Property and Income Tax Benefits Also Pair Well

While sales/use tax savings are often the most common area that states offer substantial tax benefits for manufacturers, just as important of a consideration may be a state's property tax and income tax structure given the substantial capital expenditure for such operations.

Many states likewise don't have distilling-specific property tax exemptions; however, several states do provide exemptions from ad valorem taxation for manufacturing equipment, manufacturing material and supplies[viii], and environmentally conscious equipment and supplies, or at least impose a greatly reduced property tax rates at the state and local level.[ix] Examples of more

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targeted property tax exemptions for the alcohol industry include Tennessee which has held that its farm produce exemption can include aged whiskey barrels when held for the production of whiskey.[x] But as mentioned, several states also offer various property tax abatements and reductions that are broad enough to be utilized by the distilling industry.[xi]

While the above property tax relief generally relates to the real property, improvements and the tangible personal property used in the alcohol production process, one property tax issue often overlooked is property tax on inventory which is especially important for the bourbon industry that requires several years for the product to age before it can legally be sold, or until the company decides it is the correct year to be sold from a proof, quality or market standpoint (e.g., 12 and 15 year bourbons). States that do not tax inventory are strong contenders for bringing and growing the distilled spirits industry. Conversely, states that tax inventory, only provide exemptions for interstate commerce/freeport type products (only held in-state for a limited time before being shipped out of state), or provide credits for other state taxes to offset the inventory tax (e.g., Kentucky, West Virginia) put themselves at an immediate disadvantage that many in the industry are starting to notice given the unprecedented, and continually growing, amount of barreled spirits currently warehoused and aging throughout the country.[xii]

In addition to critical real and personal property tax costs that those in the alcohol industry must consider, as mentioned, some states authorize statutory income tax credits for machinery and equipment purchases, and for other taxes paid, by distillers as another way to attract the industry. Kentucky is a primary example of this structure, as it provides one of the most generous income tax credits in the country against corporate income tax for machinery and equipment primarily used for recycling purposes equal to 50% of the installed cost of the property, the credit never expires, and can apply to recycling occurring at a distillery, brewery or other alcohol production facility. Also, as indicated above, Kentucky is a state that does tax inventory for property tax purposes, but has two corporate income tax credits that can be used by the distilled spirits industry to offset the inventory tax – (i)

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the bourbon barrel reinvestment credit (a nonrefundable and nontransferable credit available to each taxpayer paying Kentucky's "barrel tax", but the credit must be used for capital improvements at the premises of the licensed distiller) and (ii) a credit to offset its general ad valorem tax on inventory (may apply the credit against the taxpayer's Kentucky individual or corporate income tax liability, but the credits are nonrefundable, nontransferable, and subject to certain other limits).[xiii]

Another income tax consideration for those in the alcohol industry is a state's income tax structure overall, including states that don't impose a typical corporate income tax (although beware of states like Nevada, Ohio, Texas and Washington the impose gross receipts taxes which are often considered to be more economically harmful than corporate income taxes[xiv]). Likewise, looking at a state's income tax apportionment formula is critical as 29 states currently use the popular single sales factor apportionment[xv] which typically provides a substantial reduction in income tax for manufacturers with large facilities, property and employees in a state but sales largely outside of that state, versus the remaining states which still factor in a company's property and payroll for its income tax liability.

And while not as often factored into a company's tax-related considerations for entering into or growing operations in a state, one must also be vigilant of the state's unemployment insurance tax rates and reserves, especially after the recent COVID-19 pandemic put many states' trust funds into unprecedented deficits which required them to borrow from the Federal governments and/or hike up unemployment insurance rates for existing employers.[xvi]

Good Bourbon Takes Time – Moving Too Fast Also a Problem for Incentives

While the above sections highlighted many of the common, statutory-based SALT benefits available to the distilled spirits industry as a matter of right (if statutory criteria are met), there are also a plethora of state and local incentive programs specifically designed to bring in new business to a jurisdiction through a variety of methods. However, many companies foot-fault and leave these incentives/free cash free on the table simply by moving too fast as

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many states require the company to first contact the applicable economic incentive agency prior to deciding or taking steps to come to or expand in the state (*e.g.*, before entering into a land contract, hiring contractors, issuing press releases or even social media posts about coming to a state, etc.). This is often referred to as the "but for" test – if a company can't show that "but for" the incentives it would have gone to another state, then the company is disqualified from many available incentives as a matter of law.

Most states have a variety of tools in their toolbelt to help entice new and expanding business to its state, particularly for the manufacturing industry as it not only brings substantial capex spend (and tax revenue from same), but also critical infrastructure (needed roads, highways, etc.) and new, skilled and higher paying jobs to areas that desperately need it. These common incentives include corporate income tax credits, sales/use tax rebates, wage assessments, skilled training credits, and property tax abatements. However, these incentives programs often have very lofty new job and/or minimum investment thresholds before a company is eligible for the incentives (and continuing compliance requirements to prevent the "clawback" of any incentives given). And although many economic development agencies are able to completely take real and personal property off the books as part of an incentive package, some states like Kentucky are constitutionally prohibited from doing so and instead must use other options to effectively get to the same spot.[xvii]

And don't forget about the locals, as cities, counties, parishes and other local jurisdictions are often critical to the location and expansion of distilling and other production, warehousing, distribution and related facilities in a state not only for needed support before a company can receive larger, state-level benefits and incentives, but also through separate local economic packages, abatements, funding and other inducements available to attract developments.[xviii]

States may also offer tourism-based incentive programs too given the increase in out-of-state visitors coming to an area just to visit distilleries, breweries, wineries and other alcohol facilities. These type of incentives often come from a separate pot of funds,

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administered by a different agency, and are based on different metrics, such as the number of non-resident visitors anticipated to come to the venue, the types of entertainment and lodging options that will be part of the planned facility, etc., such as in Kentucky which just recently offered a $30 million tax incentive package to lure away an Ohio-based distillery to the Bluegrass under its Tourism Development Act.[xix]

These are but a few examples of the incentives-based opportunities and groundbreakings popping up all over the country, and this trend does not appear to be running dry any time soon.

Distilled Down – The Proof is in the Product

There are a lot of tax-related benefits and issues to pour over before deciding whether to locate or expand an alcohol production, storage, or distribution facility in a state. Hopefully this article has provided a taste of many of the opportunities available to the industry, but it is always important to work with your local economic development agencies and tax professionals knowledgeable in a particular jurisdiction, as each state has its own recipe. So, mash it all together, and figure out what works best for your company, and most importantly, your product. Cheers!

**Note: This article was originally published in the November/December 2021 edition of Multistate Taxation and Incentives, a Thompson Reuters publication.*

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[i] "The Bourbon Effect, Kentucky's Greatest Asset," Kentucky Distiller's Association, (last visited Sep. 10, 2021).

[ii]"America's Beer, Wine, & Spirits Retailers Create 2.03 Million Jobs & $122.63 Billion in Direct Economic Impact," America's Beer, Wine & Spirits Retailers Association. *See also*, John Sperry, "Cheers to the Alcohol Industry!", United States Census Bureau (Sep. 17, 2019).

[iii] *See* Janelle Cammenga, "Sales and Local Sales Tax Rates, Midyear 2021," Tax Foundation (Jul. 8, 2021) (noting that approximately 38 states also have a local sales tax, and several states with a combined sales tax rate near or above 9%).

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[iv] North Carolina H.B. 890, enacted as Session Law 2021-50 (approved Sep. 10, 2021).

[v] For example, California provides sales tax exemptions for food products (such as grains, corn, yeast, etc. that can be used as ingredients), raw materials incorporated in the finished product, and manufacturing aids that assist in distilling process, and has a dedicated website to explain this and how such operations are treated for California state and local tax purposes. *See* "Tax Guide for Distillers and Distributors of Distilled Spirits", California Department of tax and Fee Administration, (last visited Sep. 15, 2021). Kentucky also recently amended its sales tax statutes to make clear that its manufacturing exemptions for machinery, equipment, and material, tools and supplies applies to those directly used or consumed at a plant facility processing distilled spirits, wine, malt beverage, and on the premise of a distiller, rectifier, winery or small farm winery that includes retail establishment on the premise. KRS 139.010(19)(a) & KRS 139.470(9)(a).

[vi] *See* 45 IAC § 2.2-5-10(c).

[vii] *See* KRS 139.470(22) (exempting "[g]ross receipts derived from charges for labor or services to apply, install, repair, or maintain tangible personal property directly used in manufacturing or industrial processing process of:....

(b) Distilled spirits or wine at a plant facility or on the premises of a distiller, rectifier, winery, or small farm winery licensed under KRS 243.030; or (c) Malt beverages at a plant facility or on the premises of a brewer or microbrewery licensed under KRS 243.040 that is not otherwise exempt under subsection (9) of this section or KRS 139.480(10), if the charges for labor or services are separately stated on the invoice, bill of sale, or similar document given to purchaser").

[viii] *See e.g.*, N.Y. Real Prop. Tax Law § 102(12); N.Y. Real Prop. Tax Law § 300; Ohio Rev. Code Ann. § 5711.22(F); Ohio Rev. Code Ann. § 5711.22(I); Ohio Admin. Code § 5703-3-03; Cal. Rev. & Tax. Code § 129; Cal. Rev. & Tax. Code § 219; FL: Fla. Stat. § 193.621, Fla. Stat. § 192.011; Fla. Stat. § 196.185.

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[ix] For example, tangible property "actually engaged in manufacturing" is subject to Kentucky's reduced state ad valorem tax rate of $0.15/$100 and exempt from all local property taxes, whereas most non-manufacturing tangible personal property is subject to the normal state rate of $0.45/$100 plus full local property taxes (which can be well over $1.00/$100 alone). KRS 132.020. Other states likewise have preferential property tax rates for manufacturing property. *See e.g.*, Jared Walczak, 'Location Matters: Effective Tax Rates on Manufacturers by State," Tax Foundation (Sep. 1, 2015) (providing detailed maps on tax effect for manufacturers by state, and in regard to property taxes specifically, asserting that "Thirty-nine states offer some degree of property tax abatement for new capital-intensive manufacturers, a few of which all but wipe out overall tax liability" for manufacturers), Garrett Watson, "States Should Continue to Reform Taxes on Tangible Personal Property," Tax Foundation (Aug. 6, 2019) (providing several examples of the exemption and preferential treatment for tangible personal property used by manufacturing and industrial processing industries), "50-State Property Tax Comparison Study for Taxes Paid in 2019," Lincoln Institute of Land Policy (Jun. 2020) (analyzing average effective tax rate of real and personal property for manufacturing and industrial properties in several cities across the nation).

[x] IN RE: Brown-Forman Corp. d/b/a Jack Daniels Distillery Docket Nos. 117543; 117544; 120742 (TN State Bd. Of Equalization Sep. 13, 2019).

[xi] *See* prior articles and studies on multistate property tax treatment and abatements for manufacturers discussed and cited *supra*, n. 9.

[xii] In Kentucky alone, distillers are filling over two million barrels a year (the highest production rate in modern history and highest of any state) and have approximately 10 million aging barrels of bourbon and other spirits (equating to more than two barrels for every person living in Kentucky). *See* "The Bourbon Effect," *supra* at n. 1.

[xiii] *See* KRS 132.130, KRS 141.389 & KRS 141.408. Note that Kentucky does also have an in-transit inventory (i.e., freeport) exemption for

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both state and local property taxes for products shipped outside the state within six months. KRS 132.097 & KRS 132.099.

[xiv] *See* Janelle Cammenga, "State Corporate Income Tax Rates and Brackets for 2021," Tax Foundation (Feb. 3, 2021).

[xv] Janelle Cammenga, "State and Local tax Structure has a Critical Impact on Corporate Tax Burdens," Tax Foundation (Jul 1. 2021).

[xvi] Joe Sonka, "Kentucky approved for $865 million federal loan to shore up unemployment insurance fund," Louisville Courier Journal (June 26, 2020). Although note that Kentucky's General Assembly enacted legislation during the 2021 legislative session to prohibit the increase in unemployment insurance rates, clarify that benefits payable from the emergency would not be charged to an employer's reserve account, and that there would be no unemployment administrative account surcharge all for 2021 to help employers in the Commonwealth. *See* 2021 H.B. 413, amending KRS 341.030(7), KRS 341.270(3-4), KRS 341.530 & KRS 341.614.

[xvii] *See e.g.*, KRS 103.020, KRS 103.200 & KRS 103.210 (authorizing the issuance of industrial revenue bonds (IRBs) to finance certain facilities and allow the property to be eligible for substantially reduced [nearly exempting] property taxes for property within the IRB).

[xviii] For example, as indicated in n. 16, *supra*, Kentucky local jurisdictions can authorize substantial property tax reduction via local industrial revenue bonds, but their support (and PILOT payments to the local school jurisdictions) is required before a company can get the larger, state-level property tax incentives. It is also not uncommon for there to be multi-million-dollar tax credit deals by cities to land and keep breweries and distilleries as seen previously with California and North Carolina in their respective cities. *See e.g.*, Kelsey Snell, "Craft beer: tastes great, fewer taxes," Politico (Aug. 13, 2014).

[xix] *See* KRS 148.851-148.860 (Kentucky Tourism Development Act provisions administered by the Kentucky Tourism Development Finance Authority and the Tourism, Arts and Heritage Cabinet, rather than the Cabinet for Economic Development); Steve Rogers, "

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Horse Soldier Bourbon tourism brings nearly $200 million investment to Pulaski," WTVQ (Sep. 23, 2021).

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