Kentucky Tax Talk: What's Next For Bourbon Barrel Revenue

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There is no greater beast for many legislators and distillers alike than Kentucky's tax on bourbon.

Given bourbon manufacturing is the signature economic industry in the Commonwealth, as recently described by Kentucky Senate President Robert Stivers, there has consistently been a push and pull between the industry and the Kentucky General Assembly as to how it should be taxed.[1]

In June, the Kentucky General Assembly launched the Bourbon Barrel Taxation Task Force, which has already met twice.

Kentucky, unlike most other states, imposes a personal property tax on all inventory located in the state on Jan. 1 of the tax year; thus most finished bottles of bourbon are subject to annual property tax.

Additionally, and more pertinent, Kentucky imposes a property tax on the distilled spirit itself aging in barrels located within the state — aka the bourbon barrel tax.

Thus, bourbon is taxed at every level of manufacturing. As there are more than 10 million barrels of aging bourbon currently located in Kentucky, property tax hits this industry exceptionally hard. Reports indicate Kentucky is the only state to levy this type of tax on bourbon.[2]

In addition to multiple property taxes, alcohol manufacturers, wholesalers and retailers are also subject to various taxes such as the alcohol excise tax, wholesale sales tax, distilled spirits case sales tax, regular state-level sales and use tax, income tax, local occupational license taxes and alcohol license fees.

In order to keep the bourbon industry flourishing in Kentucky, the General Assembly has attempted several times over the years to make changes to the bourbon barrel tax that will lighten the burden for distillers.

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However, as the state and, more importantly, numerous local governments have come to rely on this income, most attempts to alter the tax have failed due to resistance from local governments, including county school districts.

One such attempt that came to fruition was the General Assembly's 2014 legislation that allowed taxpayers to apply property tax paid on bourbon barrels as a credit against their income tax burden under certain circumstances. On paper this development was a win-win — a reduced tax burden for distillers without any harm to local governments relying on the property tax revenue.

However, in practice, after Kentucky switched to a single-sales-factor income tax apportionment formula, many distillers' income tax burden reduced significantly making the credit practically unusable because the credit is nontransferable and nonrefundable, though a carryforward exists.[3]

This means that the taxpayer cannot monetize the credit if it does not have an income tax burden large enough for the given tax year.

While there were some whispers of potential bourbon barrel tax reform during the 2022 legislative session, the General Assembly instead focused its efforts on changes to the Kentucky individual income tax, and sales and use tax, with no changes made to the bourbon barrel tax.

However, the Kentucky General Assembly did recognize the need for reform and created the Bourbon Barrel Taxation Task Force.

The purpose of the task force is to consider the alcohol taxing scheme as a whole and collaborate to develop a solution for reforming the bourbon barrel tax in particular, as well as potentially several layers of alcohol taxation, to lessen its burden on distillers and keep the industry flourishing, without causing detrimental harm to local revenue.

The task force consists of a number of influential members of the General Assembly, which could suggest the General Assembly's level of commitment to this cause. The task force is chaired by Stivers and House Majority Whip Chad McCoy, R-Bardstown. Bardstown is the county seat of Nelson County, an epicenter of the

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state's of bourbon manufacturing.

Other key members include Senate Appropriations and Revenue Committee Chair Chris McDaniel, R-Taylor Mill; Sen. Jimmy Higdon, R-Lebanon, who is the representative for several bourbon hotspot counties; and former Jefferson County property valuation administrator and member of the state and local government committee, Sen. Denise Harper Angel, D-Louisville — to name a few.

Both Stivers and Higdon were instrumental in passing the 2014 legislation creating the barrel tax credit, which, Higdon expressed, they believed would eliminate the bourbon barrel tax.

The task force held its first meeting on June 24, at which staff from the Kentucky Legislative Research Commission gave a presentation on the background, history and administration of Kentucky regulation and taxation of alcohol manufacturing, distribution and retail sales.

In particular, the presentation highlighted the fact that the Kentucky tax code has not changed over time to meet the needs of this evolving industry.

The task force went tax by tax to understand how the tax is administered today, consider how the tax affects the distilling industry in Kentucky versus other states, and how the tax revenue is relied on by local governments and schools.

The task force considered the alcohol excise tax, which is a tax by volume on the wholesale of alcohol by the gallon. It also considered the wholesale sales tax, a tax imposed on the wholesaler — Kentucky is one of only two states that imposes such a tax.

Also considered was the distilled-spirits case sales tax — of which Kentucky is only one of three states that imposes such a tax — and the bourbon-barrel property tax on distilled spirits, discussed above, as well as local taxes and license fees.

After reviewing the administration and impact of each tax, the task force considered what removing the bourbon barrel tax would look like for local governments.

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The task force reviewed a chart that indicated that, of the 28 districts affected out of Kentucky's 120 counties, the total loss of local revenue from removing the barrel tax would be $18.5 million. Although, the state could partially reimburse the local jurisdictions through the Support Education Excellence in Kentucky education funding program, which would total $13 million. Thus, the total net loss for jurisdictions would be roughly $5.5 million.

The task force held its second meeting on July 22. This meeting was utilized to confirm the above numbers, reported as the net loss that would occur as a result of eliminating the bourbon barrel tax, were correct. Also considered were the Kentucky constitutional provisions affecting distilled spirits.

However, the bulk of the meeting included a presentation by the Kentucky Distillers Association on the state of the distilled spirits industry. The big takeaway from the KDA's presentation is the hindrance the barrel tax presents to new distillers in Kentucky, and the barrier it is creating for growth in the state.

As McCoy noted during the meeting, a new distiller that comes to Kentucky must begin paying tax on its bourbon aging in barrels before it makes any profit from selling the finished product. As Kentucky is the only jurisdiction with such a tax, it has given other states a competitive edge.

As noted by the KDA, Tennessee is now becoming a popular state for companies from which to buy already distilled bourbon, to put labels on and sell.

Considering all of these factors, the General Assembly seems to recognize the expediency of altering the taxing scheme, not only to keep existing distillers and continue attracting new distillers to the state, but also to ensure such changes do not negatively impact the locals.

One simple solution proposed by both the Legislative Research Commission and the KDA, which has been suggested by practitioners for years, is to make the barrel tax credit refundable. This would allow local governments to maintain revenue streams, while giving distillers a subsequent refund from the state.

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Although this seems like the quick and easy solution, Kentucky public policy generally disfavors refundable tax credits — thus, such a solution may open several cans of worms that the General Assembly may or may not be willing to face.

The task force will continue to meet monthly — although the August meeting was canceled — and many hope these meetings will not be a wasted effort.

As McCoy noted, based on the current Kentucky taxation of bourbon manufacturing, new distillers could go to "any other jurisdiction on planet earth" and receive more favorable tax treatment at the start of their manufacturing.[4]

Accordingly, given this increasing pressure from the industry and its importance to the future economic growth of Kentucky, we believe the refundable tax credit may be a viable option that the General Assembly may explore this January as a priority bill, along with a continuing examination of other taxes that make Kentucky an outlier.

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[1] See The Bourbon Barrel Taxation Task Force Meeting, June 24, 2022.
[2] See Paul Coomes & Barry Kornstein, Economic and Fiscal Impacts of the Distilling Industry in Kentucky, 2021, prepared for the Kentucky Distillers' Association (Jan. 19. 2022).
[3] The Kentucky Distillers Association reports that some distillers are only able to use 30% of their credit. https://kybourbon.com/industry-news/the-proof-is-here-more-than-10-million-barrels-of-bourbon-aging-in-kentucky-distillery-warehouses.
[4] https://www.state-journal.com/news/sj-digs-a-closer-look-at-distillery-taxes/article_ce039338-fe02-11ec-b705-1f20ed91f7b6.html.

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