

2009 TTB Expo Presentation

Section 5010 Tax Credits for Distilled Spirits

Presented by
Jeffrey Ammann, Karen Welch
Dave Bateman, and Chris Torello



Overview

- Laboratory Analysis
 - Submitting Samples
- Calculating the Standard Effective Tax Rate for Imported Products
- Qualifications
- Practical Examples

**5010 Tax Credit:
Laboratory Analysis of
Imported Products**

Objective

To analytically verify the use rate of an eligible flavor (including sugar syrups, blenders, intermediates or mergers) and/or eligible wine in a finished distilled spirits product to confirm the effective tax rate computation as described in 27 CFR 27.41, Computation of Effective Tax Rate.

Meaning of Terms

- **Use Rate:**
 - The percent eligible flavor/wine in a finished product on a proof gallon basis
- **Proof:**
 - The ethyl alcohol content of a liquid at 60° F, stated as twice the percent of the ethyl alcohol by volume
- **Proof Gallon:**
 - A gallon of liquid at 60° F which contains 50 percent by volume of ethyl alcohol having a specific gravity of 0.7939 at 60° F referred to water at 60° F as unity, or the alcoholic equivalent thereof
 - Also equal to wine gallon multiplied by proof/100

Eligibility Requirements

- A flavor which:
 - Is unfit for beverage purposes according to 26 U.S.C. 5134
 - Was not manufactured on the premises of a DSP
 - Was not subjected to distillation on a distilled spirits premises such that the flavor does not remain in the distillate
- A sugar syrup:
 - Is unfit for beverage purposes according to 27 CFR 17.133(a)
 - Contains at least 60 g/100 mL solids
 - Not more than 12% alcohol by volume

Eligibility Requirements (Continued)

- A wine which:
 - Does not contain more than 0.392 grams of carbon dioxide per 100 milliliters
 - Was not subjected to distillation at a DSP after receipt in bond
 - Must contain at least 20 ppm total fusel oil

Sample Submission

- Include calculation of standard effective tax rate
- Send the finished product (750 mL) and at least 8 oz of eligible flavor, eligible wine, blenders, mergers, intermediates, sugar syrups and the distilled spirit base used in the production of the finished product to:

**TTB – Beverage Alcohol Laboratory
National Laboratory Center
6000 Ammendale Rd
Beltsville, MD 20705**

Analyses Considerations

- Confirm if flavor has been evaluated by Nonbeverage Products Laboratory
- Analyze flavor for suitable target analyte
 - Use gas chromatography (GC), high pressure liquid chromatography (HPLC), or tandem mass spectrometry to determine the presence of an appropriate analyte common in both flavor and finished product
 - Propylene glycol
 - Vanillin
 - Quinine

Analyses Considerations (Continued)

- Analyze flavor for suitable target analyte:
 - Must analyze each component to ensure that only flavor and finished product contain analyte
 - Concentration of analyte is much greater in flavor, usually dilute in ethanol/water mixture
 - Certain analytes are not amenable for use rate determination
 - Analytes that may be found in every component
 - e.g., acetic acid, ethyl acetate, fusel oils
 - Determine the proof of the flavor, base, and finished product

Use Rate Calculation

$$\frac{\text{Concentration of target analyte in finished product}}{\text{Concentration of target analyte in flavor}} \times \frac{\text{Proof of flavor}}{\text{Proof of finished product}} \times 100 = \text{Use rate (\% on a proof gallon basis)}$$

Lab Report to RRD

- Laboratory forwards laboratory analysis of each component in a submission to the Regulations and Rulings Division (RRD)
- Include a narrative for each component:
 - Identify the analyte selected to confirm use rate
 - For eligible wines, determine if contains > 20 ppm fusel oils
 - If the Laboratory determined that the use rate is within +/- 10% of claimed use rate, RRD will use proprietor's calculated effective tax rate
 - If the Laboratory determined that the use rate is more than +/- 10% of claimed use rate, RRD will use Laboratory's findings to calculate effective tax rate

Lab Report to RRD (Continued)

- Laboratory will alert RRD if a component lacks a suitable target analyte and its addition cannot be verified
 - If there is no reason to believe the flavor/wine was not added, then Laboratory will recommend to use proprietor's calculated tax rate

5010 Tax Credit: Imported Products

**Karen Welch
Regulations and Rulings Division**

Approval and Certification of Wine and Flavors Content

- (a) Any person who...imports into the United States distilled spirits on which the tax is to be paid or determined at an effective tax rate based...on the alcohol content derived from eligible flavors...request and receive a statement of eligibility for each wine or flavor to be used in the computation of the effective tax rate.

27 CFR 27.76

Approval and Certification of Wine and Flavors Content

- (b) To receive a statement of eligibility, the importer shall cause to be submitted to the TTB Beverage Alcohol Laboratory, 6000 Ammendale Road, Ammendale, MD 20705, the following:
- (1) An 8-ounce sample of each distilled spirits, wine, and flavor contained in the product; and

Approval and Certification of Wine and Flavors Content

- (2) A statement of composition for each ingredient
- (i) **For wine**, the kind (class and type) and percentage of alcohol by volume; and
 - (ii) **For flavors**, the name and percentage of alcohol by volume, and the name and quantity of each ingredient used in the manufacture of the flavor.

Approval and Certification of Wine and Flavors Content

- (c) Each time distilled spirits containing eligible wine or eligible flavors are imported into the United States, the importer shall prepare a certificate of effective tax rate computation showing the following:
- (1) Name, address, and permit number of the importer;
 - (2) Kind (class and type) of product;

Approval and Certification of Wine and Flavors Content

- (3) Elements necessary to compute the effective tax rate in accordance with § 27.41 are:
- (i) Proof gallons of distilled spirits (exclusive of distilled spirits derived from eligible flavors);
 - (ii) Wine gallons of each eligible wine and the percentage of alcohol by volume of each; and
 - (iii) Proof gallons on distilled spirits derived from eligible flavors.

Approval and Certification of Wine and Flavors Content

- (4) Date of the statement of eligibility of wines/flavors
- (5) Effective tax rate applied to the product
- (6) Signature

Approval and Certification of Wine and Flavors Content

- (d) Importer files certificate of Effective Tax Rate computation with Customs at the port of entry (if products imported in bottles). If imported in bulk, certificate furnished to proprietor of DSP to which the spirits are transferred.

Standard Effective Tax Rate

- (a) In lieu of preparing a certificate of effective tax rate computation each time distilled spirits containing eligible wine or eligible flavors are imported as prescribed in § 27.76(c), an importer may have a standard effective tax rate established based on the least quantity and lowest alcohol content of eligible wine or eligible flavors used in the manufacture of the product.

Standard Effective Tax Rate (Continued)

- Summary of the subsections (b) and (c):
 - Need the same flavor/wine samples and information as for the Statement of Eligibility;
 - Requires a sample of the finished product, and a statement of the composition of the finished product; and
 - Standard Effective Tax Rate for the product computed in accordance with § 27.41(a) (Same as § 19.34).

27 CFR 27.77

Approval Process

- Standard Effective Tax Rate Approval Process:
 - Beverage Alcohol Laboratory evaluates samples and confirms declared use rate.
 - Beverage Alcohol Laboratory sends results of analysis to the Regulations and Rulings Division.
 - Regulations and Rulings Division confirms standard effective tax rate requested and issues letter to importer approving or disapproving request.

Turnaround Time

- Allow a 2-month turnaround time from the time you submit samples to the Beverage Alcohol Laboratory to receipt of approval (or disapproval) from the Regulations and Rulings Division.

Common Mistakes

- Incorrect calculation of Standard Effective Tax Rate – must be computed in accordance with 27 CFR 27.41.
- Employing Standard Effective Tax Rate prior to approval being granted – Importers must have authorization from TTB prior to employing a standard effective tax rate.

5010 Tax Credit Qualification

Dave Bateman
Distilled Spirits Industry Analyst

Qualifying for 5010 Credits

- Have a Federal Alcohol Administration Act (FAA Act) permit as a distilled spirits plant (DSP) or importer
- Have a formula using wine and alcoholic flavorings
- Keep a batch record of spirits made with wine and alcoholic flavorings

Flavorings

- **Manufacture of nonbeverage products, intermediate products, or eligible flavors:**
 - Distilled spirits and wine may be used for the manufacture of flavors or flavoring extracts of a nonbeverage nature as intermediate products to be used exclusively in the manufacture of other distilled spirits products on bonded premises
 - Nonbeverage products on which drawback will be claimed, as provided in 26 U.S.C. 5131 – 5134, may not be manufactured on bonded premises

27 CFR 19.374

Flavorings (Continued)

- Premises used for the manufacture of nonbeverage products on which drawback will be claimed must be separated from bonded premises.
- For purposes of computing an effective tax rate, flavors manufactured on either the bonded or general premises of a distilled spirits plant are not eligible flavors.

Alternating Premises

- Curtailment and extension of plant premises for the manufacture of eligible flavors:
 - General – The premises of a DSP may be alternately curtailed and extended, as provided in this section, to permit the use of the facilities for the manufacture of eligible flavors

Alternating Premises (Continued)

- **Qualifying documents** — When a portion of the DSP premises is first to be curtailed or extended as provided in this section, the proprietor shall file with the appropriate TTB officer:
 - An application for registration, TTB F 5110.41, to cover alternate extension and curtailment of the premises, and
 - A special diagram, in duplicate, delineating the premises as they will exist, both during extension and curtailment, and clearly depicting all buildings, floors, rooms, areas, equipment and spirits lines (identified individually by letter or number) which are to be subject to alternation, in their relative operating sequence.

Alternating Premises (Continued)

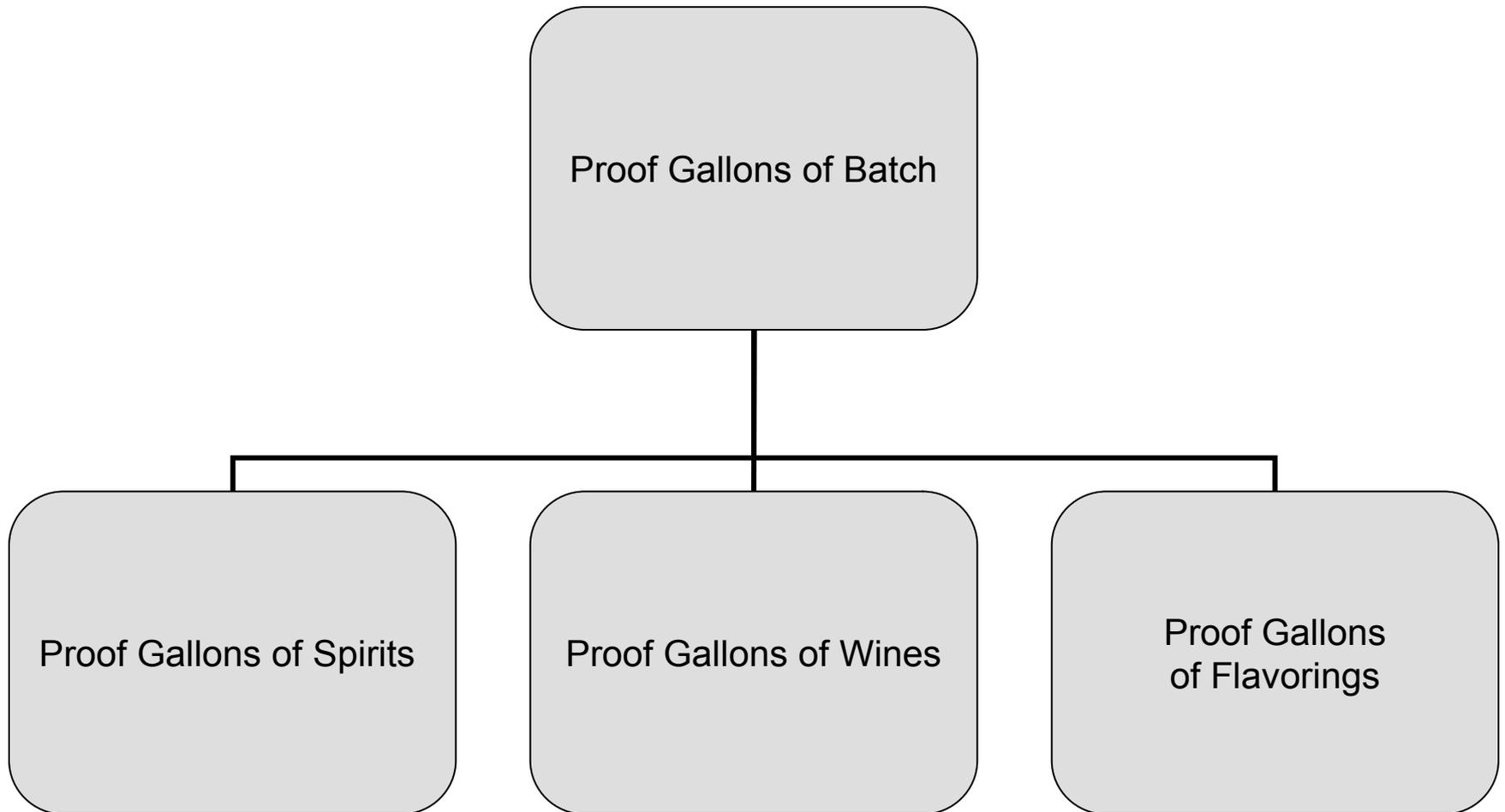
- **Proprietor's responsibility** — Once such qualifying documents have been approved, the designated premises and equipment may be alternately curtailed or extended pursuant to notice on TTB F 5110.34:
 - Bonded spirits on portions of bonded premises that are to be curtailed need not be removed if the spirits are taxpaid concurrent with the filing of TTB F 5110.34 to effect curtailment; and
 - Taxpaid spirits which are on portions of premises to be included by extension of bonded premises and which have not been used in the manufacture of a nonbeverage product need not be removed if the spirits are to be dumped immediately and returned to bond under the provisions of subpart U of this part.

5010 Credit Computation

5010 Tax Credit

- Credit for eligible flavors used in approved formulas and/or wines in the processing of distilled spirits

Composition of Approved Formula



5010 Credit Computation

Excise Tax Liabilities (\$)

Proof Gallons of Alcohol in Batch

5010 Credit Computation (Continued)

**Distilled Spirits + Wines (Listed by Class)
+ Flavorings (Exceeding 2.5%)**

**$(\text{W.G. Spirits} * \text{Proof}) + ((\text{W.G. Wine} * \% \text{ alcohol}) * 2)$
 $+ (\text{W.G. Flavors [2.5\% limit does not apply]} * \text{Proof})$**

Tax Advantage

- Allows for alcohol content of 2.5% of batch to be tax exempt
- Taxes alcohol content of wine at the lower wine tax rate
- Can be listed in proprietor's records as a total credit of a reduction from the tax rate:
 - $\$13.50 - \text{flavoring credit of } \$.34 = \$13.16$ effective tax rate
 - $\$.34$ flavoring credit + $.\$36$ wine tax difference = $\$.70$ credit

Batch

• Distilled Spirits	2,249.1 pg
• Eligible wine (14% ABV)	2,265.0 wg
• Eligible Wine (19% ABV)	1,020.0 wg
• Eligible Flavors	100.9 pg

Determine 2.5% of Batch

- Distilled Spirits 2,249.1 pg
- Wine
 - 14% & Under: $(2,265 * (.28))$ 634.2 pg 21% &
 - Under: $(1,020 * (.38))$ 387.6 pg
- Flavors 100.9 pg
- Total 3,371.8 pg

$3,371.8 * (.025) = 84.3$ pg tax exempt flavors

$100.9 - 84.3 = 16.6$ pg flavors that are taxed

Distilled Spirits	2,249.1 pg
Eligible Wine 14% alc vol	2,265.0 wg
Eligible Wine 19% alc vol	1,020.0 wg
Eligible Flavors	100.9 pg

$$\frac{2,249.1 (\$13.50) + 2,265.0 (\$1.07) + 1,020 (\$1.57) + 16.6 (\$13.50)}{2,249.1 + 100.9 + (2,265 * .28) + (1,020 * .38)} =$$

$$\frac{\$30,362.85 + \$2,423,55 + \$1,601.4 + \$224.10}{2,350.0 + 634.2 + 387.6} =$$

$$\frac{\$34,611.90}{3,371.8} =$$

\$10.27 effective tax rate

Taking 5010 Credit

- Credit can be taken by:
 - Effective tax rate per each batch of distilled spirits (27 CFR 19.35)
 - Standard effective tax rate for each product based on the least quantity and lowest alcohol content of the wine and/or alcohol flavoring ingredients that may be used in product (27 CFR 19.36)
 - Average effective tax rate based on proof gallons in all batches of a product produced during the most recent 6 months (27 CFR 19.37)
 - Inventory reserve account based on establishment of an account for each product then proceeding on a first in, first out method (27 CFR 19.38)

5010 Credits

- Reduction of tax due per batch produced
- Based on flavorings (maximum \$.34 pg)
- Reduction taken on removal from bond
- Actual – Average – Standard
- Withdrawal FIFO or actual

5010 Tax Credits: Practical Examples

Chris Torello, CPA,
Senior Excise Tax Auditor

5010 Credit Formula

**PG Spirits (\$13.50) + WG Wine Under 14% (\$1.07) +
WG Wine 14-21% (\$1.57) + WG Wine Over 21% (\$3.15)
+ PG Flavorings over 2.5% (\$13.50)**

**PG Spirits + PG Wine (all tax classes) +
PG Flavorings (eligible and ineligible)**

Practical Example 1

The Perfect Distillery, Inc.
550 Main Street
Cincinnati, Ohio 45202

DUMP AND BATCH RECORD

SERIAL #: 100-001
FORMULA #: F-12

SPIRITS, WINES AND ALCOHOLIC INGREDIENTS DUMPED

PROCESSING

PRODUCT: Perfect Mix Vodka - 100 Proof PROOF: 100 TANK #: 100

INGREDIENT	TYPE	TRANSFERRED FROM TANK #	DATE	WINE GALLONS	PROOF	PROOF GALLONS		
						DISTILLED SPIRITS	WINE	ELIGIBLE FLAVORS
Neutral Grain Spirits	Spirits	121	6/26/2009	1,960.00	100.0	1,960.00		
Vodka Additive - Formula B3TC	Flavor	241	6/26/2009	33.33	120.0		40.00	
Water	Water	-	6/26/2009	6.67	-			
TOTALS				2,000.00		1,960.00	40.00	0.00

Example 1 Solution

Distilled Spirits	1,960.00 pg
Eligible Flavors	33.30 pg
Eligible Flavors > 2.5%	0.00 pg <small>(1,960.0+33.3)*2.5% = 49.83</small>

$$\begin{array}{r}
 1,960.00 (\$13.50) + 0.00 (\$13.50) \\
 \hline
 1,960.00 + 33.30 \qquad = \\
 \\
 \$26,460.00 \\
 \hline
 1,960.00 + 33.30 \qquad = \\
 \\
 \$26,460.00 \\
 \hline
 1,993.30 \qquad =
 \end{array}$$

\$13.27 effective tax rate

credit earned = \$0.23 (\$13.50 - \$13.27)

Practical Example 2

The Perfect Distillery, Inc.
550 Main Street
Cincinnati, Ohio 45202

DUMP AND BATCH RECORD

SERIAL #: 100-002
FORMULA #: F-18

SPIRITS, WINES AND ALCOHOLIC INGREDIENTS DUMPED

PROCESSING
TANK #: 104

PRODUCT: Perfect Mix Blended Whiskey

PROOF: 80

INGREDIENT	TYPE	TRANSFERRED FROM TANK #	DATE	WINE GALLONS	PROOF	PROOF GALLONS		
						DISTILLED SPIRITS	WINE	ELIGIBLE FLAVORS
Bulk Whiskey (4+ years)	Spirits	221	6/26/2009	2,320.50	160.9	3,733.68		
OTS Orange Wine	Wine	141	6/26/2009	63.00	41.8		26.33	
Water	Water	-	6/26/2009	2,316.50	-			
TOTALS								
				4,700.00		3,733.68	26.33	0.00

Example 2 Solution

Distilled Spirits	3,733.68 pg
Eligible Wine (20.9% ABV)	63.00 wg

$$3,733.58 (\$13.50) + 63.00 (\$1.57)$$

$$3,733.68 + (63.00 * (.418)) \quad =$$

$$\$50,404.68 + \$98.91$$

$$3,733.68 + 26.33 \quad =$$

$$\$50,503.59$$

$$3,760.01 \quad =$$

\$13.43 effective tax rate

credit earned = \$0.07 (\$13.50 - \$13.43)

Example 3 Solution

Distilled Spirits	2,922.70 pg
Eligible Wine (20.9% ABV)	83.77 wg
Eligible Flavors	241.34 pg
Eligible Flavors > 2.5%	161.36 pg <small>$(2,922.7+35.02+241.34)*2.5\% = 79.98$</small>

$$2,922.70 (\$13.50) + 83.77 (\$1.57) + 161.36 (\$13.50)$$

$$2,922.70 + (83.77 * (.418)) + 241.34 =$$

$$\$39,456.45 + \$131.52 + \$2,178.36$$

$$2,922.70 + 35.02 + 241.34 =$$

$$\$41,766.33$$

$$3,199.06 =$$

\$13.06 effective tax rate

credit earned = \$0.44 (\$13.50 - \$13.06)

5010 Tax Credits:
Claiming on your Form 5000.24
Excise Tax Return

5010 Credit Formula

How do I claim 5010 credits?

- Two approaches are commonly used:
 - Use the effective tax rate(s) to determine the gross tax due.
 - Use the credits earned per proof gallon to claim a decreasing tax adjustment.

Gross Tax Due

CALCULATION OF TAX DUE		<i>(Before Making Entries 18-21, Complete Schedules A and B)</i>	
(a) PRODUCT	(b) TAX CLASS	(c) AMOUNT OF TAX	
9. DISTILLED SPIRITS	23	118,815.74	
			
17. TOTAL TAX LIABILITY <i>(Total of lines 9 - 16)</i>		118,815.74	
18. ADJUSTMENTS INCREASING AMOUNT DUE <i>(from line 29)</i>			
19. GROSS AMOUNT DUE <i>(Line 17 plus line 18)</i>		118,815.74	
20. ADJUSTMENTS DECREASING AMOUNT DUE <i>(from line 34)</i>			
21. AMOUNT TO BE PAID WITH THIS RETURN <i>(line 19 minus line 20)</i>		118,815.74	

Perfect Mix Vodka (Example 1) 2,000 pg x \$13.27 = \$ 26,540.00

Perfect Mix Blended Whiskey (Example 2) 3,760 pg x \$13.43 = \$ 50,496.80

Perfect Mix Spice Rum (Example 3) 3,199 pg x \$13.06 = \$ 41,778.94

TOTAL 8,959 pg \$118,815.74

Decreasing Adjustments

SCHEDULE B - ADJUSTMENTS DECREASING AMOUNT DUE		
EXPLANATION OF INDIVIDUAL ERRORS OR TRANSACTIONS (a)	AMOUNT OF ADJUSTMENTS	
	(b) TAX	(c) INTEREST
30. Perfect Mix Vodka - 5010 Tax Credit	460.00	
31. Perfect Mix Blended Whiskey - 5010 Tax Credit	263.20	
32. Perfect Mix Spice Rum - 5010 Tax Credit	1,407.56	
33. SUBTOTALS OF COLUMNS (b) and (c)	2,130.76	0.00
34. TOTAL ADJUSTMENTS DECREASING AMOUNT DUE <i>(Line 33, Col. (b) + (c)) Enter here and on line 20</i>		2,130.76

Perfect Mix Vodka *(Example 1)* 2,000 pg x \$0.23 = \$ 460.00

Perfect Mix Blended Whiskey *(Example 2)* 3,760 pg x \$0.07 = \$ 263.20

Perfect Mix Spice Rum *(Example 3)* 3,199 pg x \$0.44 = \$ 1,407.56

TOTAL 8,959 pg \$ 2,130.76

Decreasing Adjustments (Continued)

CALCULATION OF TAX DUE <i>(Before Making Entries 18-21, Complete Schedules A and B)</i>		
(a) PRODUCT	(b) TAX CLASS	(c) AMOUNT OF TAX
9. DISTILLED SPIRITS	23	120,946.50
		
17. TOTAL TAX LIABILITY <i>(Total of lines 9 - 16)</i>		120,946.50
18. ADJUSTMENTS INCREASING AMOUNT DUE <i>(from line 29)</i>		
19. GROSS AMOUNT DUE <i>(Line 17 plus line 18)</i>		120,946.50
20. ADJUSTMENTS DECREASING AMOUNT DUE <i>(from line 34)</i>		2,130.76
21. AMOUNT TO BE PAID WITH THIS RETURN <i>(line 19 minus line 20)</i>		118,815.74

Perfect Mix Vodka *(Example 1)* 2,000 pg x \$0.23 = \$ 460.00

Perfect Mix Blended Whiskey *(Example 2)* 3,760 pg x \$0.07 = \$ 263.20

Perfect Mix Spice Rum *(Example 3)* 3,199 pg x \$0.44 = \$ 1,407.56

TOTAL 8,959 pg \$ 2,130.76

8,959 pg * \$13.50 = \$120,946.50

5010 Tax Credits: Common Problems

Common Problems

- Common Problems Discovered on Audits:
 - Simple mathematical errors.
 - Improper application of the 5010 credit formula.
 - Incorrect 6-month period used to determine the average effective tax rates.
 - Changes made to product formulas affecting the standard effective tax rates that are not revised.
 - Approved standard effective tax rates improperly applied (prior rate still in the system).
 - Using effective tax rates to claim 5010 credits from gross tax due while also deducting credits earned per proof gallon as decreasing tax adjustments.

Contact Information

- Jeff Ammann, Chief, Beverage Alcohol Laboratory
 - [REDACTED]
 - 240-264-1596
- Karen Welch, Regulations and Rulings Division
 - [REDACTED]
 - 202/453-2046
- Dave Bateman, Distilled Spirits Industry Analyst
 - [REDACTED]
 - 202-302-3859
- Chris Torello, Tax Audit Division
 - [REDACTED]
 - 513-898-0740