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Federal Excise Tax Opportunity: Drawback for Use of Taxed Alcohol in Manufacture of Nonbeverage Products

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Manufacturers of nonbeverage products that use taxpaid alcohol in the production of certain products such as medicines, flavoring, and perfumes may qualify for a drawback from the Alcohol and Tobacco Tax and Trade Bureau (“TTB”). In some cases this TTB drawback may be a significant benefit, but the process for claiming it is complex and in many cases, potential claimants are unaware of the issue. With a statute of limitations of six years, there may be an opportunity to go back and claim the drawback for open past periods.

Background

Manufacturers of nonbeverage products (“MNBP”) that use taxpaid distilled spirits, such as ethyl alcohol, in the manufacture of nonbeverage products may claim a drawback from the TTB. The drawback is a payment from the federal government to a manufacturer in an amount equal to most of the taxes paid on those spirits. Nonbeverage products include medicines, medicinal preparations, food products, flavors, flavoring extracts, and perfume that are unfit for beverage use. One key requirement for the MNBP claim is that the products must be manufactured using a TTB-approved formula.

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Taxation of Distilled Spirits

A federal excise tax is imposed on distilled spirits produced or imported into the United States. Generally, the amount of tax imposed on distilled spirits is \$13.50 per proof gallon. For 2018-2019, the tax rates on some proof gallons may be reduced due to legislation originally known as the Tax Cuts and Jobs Act of 2017.¹ The tax is generally imposed on and paid by the distiller. The price paid by manufacturers for spirits for use in the production of nonbeverage products generally includes an amount representing the tax.

MNBP Drawbacks—General Information

Section 5111 of the Internal Revenue Code² provides any person using distilled spirits on which the tax has been determined, in the manufacture or production of medicines, medicinal preparations, food products, flavors, flavoring extracts, or perfume, which are unfit for beverage purposes shall be eligible for drawback at the time when the distilled spirits are used in the manufacture of such products.

The rate of the drawback is \$1.00 less than the rate at which the distilled spirits tax was paid or determined. Thus, generally the rate of a drawback is \$12.50 per proof gallon, unless the reduced tax rates of 2018-2019 were paid for the product.

Formulas

Manufacturers are required to file with TTB the formulas for each nonbeverage product produced with taxpaid spirits. Failure to do so in a timely manner may result in a penalty. The formulas are evaluated by the TTB Nonbeverage Products Laboratory to determine whether the products produced are unfit for beverage use. If the determination is made that the product is fit for beverage use, the manufacturer will not be paid the drawback and may not be allowed to sell its product.

MNBP Claim Requirements

There are a number of procedural requirements related to the MNBP claims. Drawback claims are generally filed quarterly, unless the claimant elects to file monthly drawback claims. In order to file monthly claims, the claimant may be required to obtain a bond.

To avoid a penalty, claims for drawback must be filed within six months of the end of the calendar quarter in which the distilled spirits covered by the claim were used. The statute of limitations for filing claims is six years from the end of the calendar quarter in which the taxpaid distilled spirits were used in the manufacture of nonbeverage products.

¹ Pub. L. No. 115-97 (“the Act”). The Act provides that the first 100,000 proof gallons per year are taxed at \$2.70 per proof gallon, the next 22,130,000 proof gallons are taxed at \$13.34 per proof gallon, and additional proof gallons taxed at \$13.50 per proof gallon.

² Unless otherwise indicated, section references are to the Internal Revenue Code of 1986, as amended (the “Code”) or the applicable regulations promulgated pursuant to the Code (the “regulations”).

If the claim rules are not followed, a penalty of \$1,000 per failure will likely be imposed. The penalties are generally netted against the amount of the drawback paid and cannot exceed the amount of the drawback claimed.

The MNBP claim for drawback consists of the TTB claim form and certain required supporting data. The required supporting data includes inventory information on spirits on hand at the beginning of the period, spirits received during the period, spirits used in manufacture of nonbeverage and intermediate products, spirits otherwise used, and other gains and losses.

Registration and Records

Any person claiming a MNBP drawback must register annually with the TTB and keep books and records to establish that distilled spirits on which tax was imposed were used in the manufacture or production of specified products that are unfit for use for beverage purposes. Claimants are deemed to be registered when they file the first drawback claim for the year with TTB.

Observations

MNBP drawback claims may be significant for eligible claimants; however, the compliance rules related to the claims are quite complicated. Moreover, to the extent the spirits may have been purchased at a price reflecting the reduced tax rates for 2018-2019, TTB requires additional information establishing the tax rate paid.

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