Tax

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Take a Bite Out of Taxation: The Core Issues of the CIDER Act

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Interest in, and consumption of, hard cider is on an upswing in the United States. The hard cider market grew by 71 percent in 2014[1] with total cider sales jumping from just $78 million in 2011 to $470 million for the 52 weeks ending Jan. 3, 2015. By comparison, retail sales of spirits increased by only 2.4 percent, sales of table wine increased by only 3.3 percent, and beer sales actually decreased by 0.4 percent. Despite the apparent boom of cider consumption, the cider industry (particularly craft brewing) is presently handicapped by outdated laws that have not yet been modified to accommodate current trends and consumer demands. Two bills are currently awaiting action in Congress that would allow cider makers to produce cider using the natural ingredients without facing the possibility of increased tax liability.

Consumption of hard cider is not an entirely new trend. "Cider, pre-Prohibition, was one of the most common drinks in the United States…Everyone knows the famous Johnny Appleseed story, but he was actually going across the country planting cider apples to drink, not necessarily to eat. But that history is almost unknown because the explosion in the beer market after Prohibition replaced the cider market," said Wade Thompson, co-owner of Sociable Cider Werks. As hard cider is experiencing a renaissance, many states have begun to assimilate hard cider with craft beer for tax purposes and regulations. However the federal government continues to treat hard cider as a wine product, a definition derived from the product's classification before Prohibition.

In direct response to the steady growth of consumption, production of cider has likewise expanded. With this expansion, the appearance of organizations affiliated with cider, its production, regulation and growth, have also increased, evidenced by the formation of the United States Association of Cider Makers

[1] The *Cider Journal* article tracks off-premise (retail, not restaurant) sales of alcohol beverages.

("USACM") in 2013 at "CiderCon," now an annual conference in its fourth year devoted to discussing issues impacting the cider industry.

For Tax Purposes, Cider May be Classified as Champagne, Depending on the Percentages of Carbonation and Alcohol

The cider industry, like the rest of the alcoholic beverage industry, is presently hindered by outdated laws that have not been modified to accommodate current trends and consumer demands. Many cider consumers expect a moderate alcohol percentage (somewhere between 7 and 10 percent alcohol by volume) and a somewhat high level of carbonation, equivalent to that of most craft beer. Under current federal tax law, however, hard cider must contain less than 7 percent alcohol by volume before it is taxed at the higher wine rate, and only a certain level of carbonation[2] before it is taxed at the even higher champagne rate.[3]

The reality is that most hard ciders produced in the United States are carbonated. Under the current statutory framework, once the hard cider is carbonated, for tax purposes it is classified as either champagne or an artificially carbonated wine, resulting in a tax of either $3.30 or $3.40 per wine gallon. Further, because a large percentage of cider producers in the United States are small batch makers using natural raw materials, they often have little ability to control the carbonation and precise alcohol content of the cider. Since a variety of factors can lead to small changes in the composition of a cider's alcohol content and carbonation during the fermentation process, and because of hard cider's current definition in the tax code, these small variations can cause cider to be taxed at a rate fifteen times higher than what the statute clearly intended, creating a significant challenge for many craft brewers.

A Bipartisan Effort in Congress to Amend the Definition of "Hard Cider"

In 2013, in an effort to reform the tax structure for cider, U.S. Representative Earl Blumenauer (D-OR) introduced H.R. 2921 known as the Cider Industry Deserves Equal Regulations Act or "CIDER" Act. H.R. 2921 aimed to change the definition of "hard cider" into "any wine (1) the carbonation level of which does not exceed 6.4 grams per liter, (2) which is derived primarily from apples, apple juice concentrate and water, pears, or pear juice concentrate and water, (3) which contains no fruit product or fruit flavoring other than apple or pear, and (4) which contains at least one-half of 1 percent and less than 8.5 percent alcohol by volume." Similarly, in 2013 Senator Charles E. Schumer (D-NY) unveiled a plan to boost the sales for New York's existing hard apple cider producers and apple growers to expand their business through the sale of the hard cider, introducing S. 1531, known as the Cider Investment and Development Through Excise Tax Reduction CIDER Act (2013). The Senate bill was focused on the issue of cider taxation, but it largely mirrored H.R. 2921.

Both bills stalled without making much progress until being reintroduced during the 114th Congress. The CIDER Act (now H.R. 600) was reintroduced as a bipartisan measure by Representatives Earl Blumenauer and Chris Collins (R-NY) and the Senate version (S.1459) was again sponsored by Senator Charles Schumer.

If approved, these bills would amend the Internal Revenue Code 26 USC § 5041 and allow cider makers to produce cider using the natural products available without the possibility of facing increased tax liability. Specifically, the legislation would (1) increase the carbonation level for hard cider, thereby meeting

[2] 0.392 grams of carbon dioxide per hundred milliliters of product (26 USC § 5041(a))

[3] 26 USC § 5041(b)

customer expectations, (2) include pears in the definition of "hard cider," and (3) align the alcohol-content standard for hard cider with the natural sugar content of apples.

After being reintroduced, the CIDER Act passed the Senate Finance Committee in February 2015, but the bills are now awaiting action on the Senate floor. In a press release after the CIDER Act passed the Finance Committee, Senator Schumer noted, "The CIDER Act has now cleared a major hurdle, and I will not stop pushing until this legislation has come to a full floor vote and received the President's signature. Right now, federal tax laws make it extremely costly to produce, market and sell hard cider products, thereby preventing apple growers and cider producers in New York and across the country from fully benefiting from the stable income that comes with this product. There is incredible economic potential here that we must tap into. That is why I have not stopped fighting to pass the CIDER Act, which would finally update the definition of hard cider in the tax code by ensuring all products can be labeled and taxed for what they actually are, all while increasing growers' and producers' ability to compete both at home and overseas."[4]

In an effort to keep the CIDER Act on the forefront, the Board of Directors of USACM convened in Washington, D.C. during the last week of July 2015 to meet with Congressional members from across the country in support of the proposed legislation. Despite these efforts, only time will tell whether the CIDER Act will weather a final hurdle of approval on the Senate Floor, and be signed by the President.

Supporters of the CIDER Act were likely pleased to learn of two additional bills introduced during the 114th Congress. The Craft Beverage Modernization and Tax Reform Act (H.R. 2903) was introduced in the U.S. House of Representatives by Representative Erik Paulsen (R-MN). This comprehensive bill provides fair and equitable reform of the federal excise tax on beer, including cider, and other artisanal alcoholic beverages. If enacted, the Craft Beverage Modernization and Tax Reform Act will provide much needed tax relief. In the Senate, a companion bill, the Small Brewer Reinvestment and Expanding Workforce Act aka the Small BREW Act (S. 375), was introduced by Senators Benjamin Cardin (D-MD), Ron Wyden (D-OR) and others. Thus, although the CIDER Act fell flat once before, with the support of the related Craft Beverage Modernization and Tax Reform Act and Small BREW Act, this year may prove more sparkling and fruitful.

If you have any questions about the content of this alert please contact the Pillsbury attorney with whom you regularly work, or the authors below.

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[4] http://www.prweb.com/releases/2015/02/prweb12546931.htm

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