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COORS BREWING COMPANY

COMMENTS

TO

TTB NOTICE NO. 4

FLAVORED MALT BEVERAGES

AND RELATED PROPOSALS

OCTOBER 17, 2003

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Coors Brewing Company

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October 21, 2003

Chief William H. Foster
Regulations and Procedures Division
Alcohol and Tobacco Tax and Trade Bureau
P.O. Box 50221
Washington, DC 20091-0221

Re: TTB Notice No. 4, Flavored Malt Beverages
Dear Chief Foster:

Coors Brewing Company appreciates the opportunity to comment on the proposed standard for flavored malt beverages as published by the Alcohol and Tobacco Tax and Trade Bureau (TTB) on March 24, 2003. Coors supports the TTB's proposed rule. The rule classifies flavored malt beverages in accordance with longstanding federal law and regulation; rightly respects the role of the states; is based on sound public policy; and provides predictability in response to marketplace uncertainty. Our comments summarize the rule's key propositions and then evaluates those propositions.

Beverages containing 0.5%, or more,
alcohol obtained from distillation
are distiiled spirits products.

The proposed rule correctly addresses an important question:

• What is the appropriate classification of an alcoholic beverage that combines malt beverage and distilled spirits?

Answer: Distilled Spirits.1 The TTB's proposal addresses a pressing question in today's marketplace: what is a "distilled spirit," as compared with a "malt beverage"? Sensibly, the answer set forth in the TTB's proposed rule is functional: alcohol in malt beverages should be the product of fermentation, not distillation.2 That approach is onsonant with the approach of the federal government and most states, which define distilled
spirits to include mixtures or dilutions of distilled spirits. This is important

1 26 U.s.c. 5002 (8). "The terms "distilled spirits", "alcoholic spirits", and "spirits" mean that substance known as ethyl alcohol, ethanol, or spirits of wine in any form (including all dilutions and mixtures thereof from whatever source or by whatever process produced)." The Federal Alcohol Administration Act similarly defines distilled spirits to include all dilutions and mixtures thereof.

2 The 1998 Edition of the Brewers Adjunct Reference Manual provides for the addition of "Ethyl Alcohol" to beer for "Flavors". The issue framed by the TTB proposed regulation is not whether malt beverages are allowed to contain distilled spirits. Rather, the issue is "how much" distilled spirits can exist in a malt beverage before the malt beverage falls-within the parameters applicable to "distilled spirits" beverage?

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because federal laws, like the laws of most states, regulate and tax beer, or malt beverages, different than mixtures and dilutions of distilled spirits.

Specifically, the Internal Revenue Code (IRC) and the Federal Alcohol Administration Act (FAA Act) tax and regulate beer and distilled spirits differently. These differences predate the founding of our Nation and have been in force ever since. Each alcoholic beverage classification has its own history, character and distinctiveness not shared or enjoyed by the other. Perhaps the most pervasive distinction between these two alcoholic beverages is the different processes required to make each alcoholic beverage, i.e., beer is fermented, and spirits are distilled. This distinction remains as one of the primary underpinnings of federal and state regulatory, production, distribution, labeling, advertising and taxation since the Congress passed and President George Washington signed a law establishing different duties for beer than for spirits.3

Unlike colonial times, however, brewers and others now commonly combine flavors with their products to produce “flavored malt beverages”. It is just as common for flavor manufacturers to combine distilled spirits with other ingredients and additives to make the flavors purchased by the brewers. As such, there are many products in the marketplace that have both alcohol from fermentation and alcohol from distillation in combination.

During the past few years the TTB discovered production practices that combined so much distilled spirits with malt beverages that as much as 99% of the alcohol content of the finished “flavored malt beverage” products was, in fact, distilled spirits.4 State regulators within the last year learned of and responded to the TTB’s alarming findings.5

Response from the states has been overwhelming, requesting the TTI3 to mandate a standard for “flavored malt beverages” that will correctly classify “flavored malt beverages” in a manner consistent with the laws of their state.6 The TTh proposed regulation solves the current problems facing state governments, and the industry, by restricting the amount of distilled spirits to less than 0.5% of the total alcohol content in a

3 July 4, 1789.
4 See Notice No. 4, Part m.
5 See Appendix “A”. TTB recognizes that less than 0.5% distilled spirits content is not significant to a malt beverage since it is permissible to have soft drinks manufactured with a “de minimus” amount of alcohol from the flavor. Presentation by Theresa Glasscock, Chief of Staff, TTB, before the Northern Region of the Conference of State Liquor Administrators, Rehoboth Beach, Delaware, Oct 30, 2002.
See also Appendix “B”. June 1, 1992 Internal ATE Memorandum To: Chief, Wine and Beer Branch, From Charles N. Bacon. Subject “Non-Traditional Malt Beverage Products Production and Regulatory Requirements.
See also Appendix “C”. William H. Foster, Deputy Chief, Regulations Division, ATE, “Flavored Malt Beverages” presentation to National Alcohol Beverage Control Association, an organization of state government officials, on October 25. 2002, at Philadelphia, Pennsylvania.
6 See Appendix “D” for state definitions of distilled spirits that are similar to the federal definition.

**flavored malt beverage. The proposed regulation maintains the integrity of beer and malt beverages combined with distilled spirits.**

**The proposed regulation also safeguards the interests of the federal and state governments in regulating mixtures and dilutions of distilled spirits.7 The TTB proposed regulation is consistent with past rulings and applications allowing malt beverages in combination with flavors, flavor extracts and wholesome food fit for human consumption. Sensibly, the proposed regulation evaluates the finished "flavored malt beverage" product and determines the relative amounts of distilled spirits in combination with the malt beverage. Although the TTB expressed some question in Notice No. 4 about what are wholesome foods fit for human consumption, those concerns are not paramount to the conclusion that they are limited in the amount of distilled spirits that they contribute to a flavored malt beverage.**

**0.5% is the correct standard for "flavored malt beverages"**

**Although recent "flavored malt beverage" products have been approved by the TTB, the TTB proposed regulation is not surprising because, as recently as 1996, the TTB gave notice to the industry that rulemaking in this area was likely.8 The TTB proposed regulation ends any confusion that may otherwise linger from the past or that may arise from alternative proposals. At the same time, the proposed regulation does not displace reasonable commercial expectations.**

**Some comments likely will argue that there is a difference between products made by combining distilled spirits "directly" with a malt base, and products made by combining distilled spirits "indirectly" with a malt base through the addition of tax drawback flavors. Coors believes that this is a distinction without a difference. Congress clearly intended to classifed any alcoholic beverage that contains a mixture or dilution of distilled spirits as "distilled spirits".9 Either way, the TTB proposed regulation prevents a finished alcoholic beverage product from being anything other than a "flavored malt beverage".**

**7 lbid,at 1.**
**8 ATF Industry Circular 1996-1. Also, ATE intentions to begin rulemaking were announced during an open conference call to all members of the alcoholic beverage industry in July 2002. During the conference call, the ATF stated the results of its investigation of the flavored malt beverages in the marketplace, stated that the investigation supports a 0.5% standard, and that a projected timetable for rulemaking may result in an effective date during the summer of 2004.**
**26 U.S.C. 5002 (8). The terms "distilled spirits", "alcoholic spirits", and "spirits" mean that substance known as ethyl alcohol, ethanol, or spirits of wine in any form (including all dilutions and mixtures thereof from whatever source or by whatever process produced). Note the Federal Alcohol Administration Act similarly defines distilled spirits to include all dilutions and mixtures thereof.**

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Congress created three separate and distinct classifications of alcoholic beverages: beer, wine, and distilled spirits. The 0.5% standard in the TTB proposed regulation is the best standard to deal with the issues before the TTB because only the 0.5% standard in the proposed regulation assures strict compliance with the IRC and FAA Act and obeys the Congressional conunand to tax beer differently than wine or distilled spirits. As between the two processes, “fermentation” or “distillation,” only distilled spirits are given special tax status and credits by Congress. Congress provides incentives for flavor manufacturers to use distilled spirits when producing flavors by providing special tax claims for distilled spirits diverted into qualified flavors (tax drawback flavors).10

Congress also provides a special tax treatment for distilled spirits contained in a tax drawback flavor. These flavors are often combined with original distilled spirits products. Consider flavored vodka, for example. Flavored vodka is produced by combining tax drawback flavors with original vodka. A distiller can benefit by adding as much distilled spirits from the tax drawback flavor as allowable because the distilled spirits diverted to the tax drawback flavor received a special drawback of 100% of the previously paid excise tax. This process replaces taxable distilled spirits with “drawback” distilled spirits. The combination of distilled spirits with other distilled spirits from tax drawback flavors allows a distiller to reduce the net tax on the finished “flavored” product by almost half of the tax paid on the same amount of original vodka.”

Such elaborate tax, claims and credits leave no doubt that Congress acted with full knowledge of. and reliance upon, the differences between “fermentation” and “distillation”. Congress included mixtures and dilutions of distilled spirits under the definition of “distilled spirits” knowing the plain meaning of the terms. Producers who combine distilled spirits from tax drawback flavors with malt beverages are mixing and diluting distilled spirits. The example for “Flavored Vodka” illustrates that distilled spirits in “tax drawback flavors” are always “distilled spirits,” even when they enjoy the benefit of a tax drawback,

Because distilled spirits added to tax drawback flavors indirectly combine with malt beverages when producing “flavored malt beverages,” the TTB proposed regulation will end recent struggles to deal with the appropriate classification of alcoholic

10 26 U.S.C. 5131 –5134. Subpart F – Nonbeverage Domestic Drawback Claimants

Sec. 5131. Eligibility and Rate of Tax. (a) ELIGIBILITY FOR DRAWBACK. – 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, on payment of a special tax per annum, shall be eligible for drawback at the time when such distilled spirits are used in the manufacture of such products as provided for in this subpart.

Sec. 5134. Drawback. (a) RATE OF DRAWBACK. – In the case of distilled spirits on which the tax has been paid or determined, and which have been used as provided in this subpart, a drawback shall be allowed on each proof gallon at a rate of $1 less than the rate at which the distilled spirits tax has been paid or determined
26 U.S.C. 5010.

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beverages that include mixtures or dilutions of distilled spirits. The Federal interest in correct taxation is significant because some producers employ “designer” tax drawback flavors that add as much as 80% or more of the total alcohol content to the finished “flavored malt beverage” product, e.g. “citric acid blenders.” 12

By limiting the amount of distilled spirits mixed or diluted with malt beverage to 0.5% alcohol by volume of the finished product, the TTB’s proposed standard prevents a significant amount of’ distilled spirits from being diverted to other than “distilled spirits” beverages. The proposed standard is also fair to brewers because it does not prohibit brewers from using most flavors that contain relatively trace amounts of distilled spirits for the sole purpose of acting as a solvent and preserving the flavor.13

Distilled spirits products should be
taxed as distilled spirits.
The proposed regulation answers questions that arise from the IRC and FAA Act

concerning combinations of malt beverages and tax drawback flavors.
• Should “flavored malt beverages” be reclassified and taxed as “distilled spirits specialties” under the Internal Revenue Code?

Answer: Yes. If the malt beverage contains any flavor resulting in a dilution or mixture of at least 0.5% alcohol by volume of “distilled spirits,” “alcoholic spirits,” or “spirits,” then it should be classified as a distilled spirit beverage.14

• Does it matter if the distilled spirits present in a “flavored malt beverage” results from using flavors unfit for human consumption?

12 See Appendix “E” for an example of how citrus blenders are added via a statement of process approved by TTB to make “flavored malt beverage”. During the past year TTB began requiring disclosure of contribution to total alcohol content from “flavors”, the most common being “citric acid blender” since the trick is to make as much grain neutral spirits (GNS) unfit for human consumption, as possible. This is best accomplished by blending the GNS with citric acid. Citric acid is easily diluted by water thereby freeing the distilled spirits and making the beverage fit for human consumption.
See also Appendix “B”. June 1, 1992 Internal ATF Memorandum To: Chief, Wine and Beer Branch, From Charles N. Bacon. Subject “Non-Traditional Malt Beverage Products Production and Regulatory Requirements.
See also Appendix “C”. pages 8&9. William H. Foster, Deputy Chief, Regulations Division, ATF,

13 “Flavored Malt Beverages” presentation to National Alcohol Beverage Control Association, an organization of state government officials, on October 25, 2002, at Philadelphia, Pennsylvania. “See Appendix “A” slides 67-70.

14 Ibid, at 4.

**Answer: No. To quaify for a tax drawback the distilled spirits must be part of a flavor "unfit for human consumption".15 The distilled spirits contained in a flavor unfit for human consumption is always distilled spirits. Tax drawback flavors can be mixed or diluted when combined with liquids to make a beverage. Common examples include using small amounts of these flavors in soda water or soft drinks.**

**• Are tax drawback flavors subject to additional excise taxes applicable to regular distilled spirits if the flavors are mixed or diluted with a non-alcoholic beverage?**

**Answer: Yes, if the resulting beverage contains at least 0.5% alcohol by volume of "distilled spirits", "alcoholic spirits" or "spirits".**

**For example, mixing or diluting tax drawback flavors with soda water and sugar results in a beverage fit for human consumption that is taxable as an alcoholic beverage whenever the alcohol content is greater than 0.5% alcohol by volume.'6**

**• Are there any special tax credits for regular distilled spirits that are mixed or diluted with tax drawback flavors?**

**Answer: Yes. 17**

**• Are there any special tax credits for regular distilled spirits that are mixed or diluted with malt beverages?**

**Answer: No.**

**• Should malt beverages be classified as "flavored malt beverages" if they contain tax drawback flavors that do not add more than 0.5% alcohol by volume to the finished product?**

**Answer: Yes. Although the alcohol in a malt beverage must be the product of brewing, it is reasonable to allow malt beverages the use of tax drawback flavors to the same extent allowable for non-alcoholic beverages, e.g., soda pop, juice, flavored water.18**

**15 26 U.S.C.5131-5134.**
**16 26 U.S.C. 5001.**
**17 26 U.S.C. 5010**
**18 See Appendix "A", slides 67-70.**

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a Should malt beverages be classified as “flavored malt beverages” if they contain tax drawback flavors that add between 0.5% and 49.999% alcohol by volume to the finished product?
Answer: No. Any beverage containing a dilution or mixture of at least 0.5% alcohol by volume of “distilled spirits”, “alcoholic spirits” or “spirits” is a distilled spirits alcoholic beverage. 19

Alcohol in a malt beverage should be the product of fermentation in a brewery.

TTB should confront issues about the amount of alcohol content in a malt beverage product resulting from the use of flavors or other ingredients containing alcohol. Traditional TTB interpretations on this matter follow the practical and correct conclusion that Congress intended the alcohol in malt beverages to be a product of fermentation at a brewery. Such interpretations arc consistent with the IRC and FAA Act and they maintain beer integrity.

The proposed regulation is the logical consequence of TTB’s interpretations and sets a stable course for flavored malt beverages in the future. It rightly answers the Q question posed by so many states and others, establishing a threshold standard over which a malt beverage becomes “distilled spirits” as the result of combining excessive amounts of tax drawback flavors with a malt beverage.

The proposed rule is also fair because it does not prohibit any current product. Just because many of the current “flavored malt beverages” may need to be reclassified as distilled spirits does not mean that the TTB proposed regulation will “kill the category,” as some might claim. These products will continue to be available to satisfy the tastes of American consumers. Actually, the proposed regulation cures the category, without destroying any product. Indeed, a distiller could make the very same “flavored malt beverage” products some brewers are making today. The proposed regulation requires the alcohol in a flavored malt beverage to be the product of fermentation and establishes 0.5% as the correct standard limiting any presence of distilled spirits in combination with a flavored malt beverage. Products tested by the ATF in 2002 that contained at least 0.5% distilled spirits in the finished product can still be produced, but they are subject to reclassification by the TTB as a “distilled spirit” product. Under current TTB policies, a brewer can qualify for a Distilled Spirits Permit at their current brewing facility and alternate their premises to produce identical “distilled spirits products”.

19 26 U.s.c. 5002 (8). The terms “distilled spirits”, “alcoholic spirits”, and “spirits” mean that substance known as ethyl alcohol, ethanol, or spirits of wine in any form (including all dilutions and mixtures thereof from whatever source or by whatever process produced). The Federal Alcohol Administration Act similarly defines distilled spirits to include all dilutions and mixtures thereof.

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Another positive effect of the proposed regulation is the natural limitation of the alcohol content in malt beverages. The TTB noted that in 1995 a brewer developed an 18% alcohol fermented beer. The TTB proposed regulation would allow that brewer to flavor the 18% alc/vol beer, but not allow more than an additional 0.5% ale/vol of distilled spirits through tax drawback flavors in the finished product. The TTB noted in its Notice of Proposed Rulemaking [Notice No. 4] that one alternative approach to the proposed regulation is to allow up to 50% of the alcohol in the finished product to come from flavors that contain distilled spirits, e.g., “blenders,” as noted hereinabove. Any fair and consistent application of the alternative approach would allow the brewer that made an 18% alcohol by volume fermented beer to add tax drawback flavors to the beer and jump its alcohol content to more than 35% alcohol by volume in the finished product. Certainly, the 1996-1 TTB ruling clearly presented TTB’s intention to take action necessary to assure that the laws passed by Congress requiring fermentation, and not fortification, are met.

A de minimus 0.5% is the correct dividing point between flavored malt beverages and distilled spirits.

C In contrast to the current tax treatment of flavored malt beverages, Notice No. 4 is consistent with the IRC’s rules for other mixed alcohol products. The IRC makes clear that unless Congress creates a specific exception to the contrary, the inclusion of any amount of distilled spirits in a product will cause the tax rate for distilled spirits to apply. I.R.C. § 5001(a). Flavored malt beverages containing distilled spirits, however, do not fall within any of these limited exceptions. Accordingly, they should be taxed at the rate for distilled spirits.

The text of the exceptions to the general rule confirms this view. For example, § 5131 of the IRC allows a manufacturer who uses distilled spirits in “medicines, medicinal preparations, food products, flavors, flavoring extracts, or perf limes” to receive a rebate on the distilled spirits taxes it has paid. This provision only makes sense if one interprets the IRC to automatically impose the distilled spirits tax on any good containing distilled spirits. Similarly, § 5010(c) creates a special exception for beverages that combine wine and distilled spirits, which allows a producer to pay the lower, wine tax on the wine portion of the beverage. And § 5001(a)(6) creates an exception for fruit-flavor concentrates that contain less that 0.5% percent alcohol by volume, allowing these products to escape the “distilled spirits and wine” taxes that would other wise apply.

The presumption underlying these statutory exceptions is clear: Had Congress not acted, the tax rate for distilled spirits would have applied. In the case of flavored malt beverages, Congress has not acted. Further, given that Congress has on numerous occasions indicated that when it wishes a different rate to apply, it will legislate that rate,

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there is no reason to believe that Congress' silence on flavored malt beverages was a matter of oversight. Accordingly, the TTB should, consistent with the IRC, tax these products at the rate for distilled spirits.

Notice No. 4 presents an additional proposal to establish a de minimus exception for the inclusion of distilled spirits. Coors Brewing Company suggests that to the extent the TTB decides to crafi a de minimus exception, the exception should in fact be de minimus. Notice No. 4 floats a proposal that would allow distilled spirits to constitute as much as 49% of the total alcohol volume of a flavored malt beverage and still be deemed de minimus. See Notice No. 4, Part VI.B. This contradicts both the common sense understanding of de minimus as well as the IRC's and Regulations' treatments of the term. Instead, Coors Brewing Company urges the TTB to adopt § 7.11 's proposed 5% de minimus rate, which is consistent with the IRC's and Regulations' typical definition of de minimus as 5% 20 or 10% 21 of total volume.

Proper classification of alcoholic beverages is good public policy.

The rulemaking effort by the TTB to ensure "flavored malt beverages" are properly classified consistent with Internal Revenue Code of 1986 is important and should be commended. Proper classification is vital to determine appropriate product composition, production, control over production facilities, tax rate and the system of distribution.

20 See, e.g. I.R.C. § 40(d)(4) (five percent de minimus exception for denaturants used in alcohol-based fuels); Treas. Reg. § 1.162-28(g) (five percent de minimus exception for inclusion of lobbying work in calculation of total labor hours); Treas. Reg. § l.263A-1(b)(1 1)(iii) (five percent de minimus exception for inclusion in inventory costs of certain expenses related to the creation or acquisition of certain property); IR.C. § 31 8(a)(3)(B) (five percent de minimus exception for certain trusts from the constructive ownership rules for stock); Treas. Reg. § I .444-2T(c) (five percent de minimus exception for determining whether a partnership, S corporation, or personal service corporation is a "member of a tiered structure"); Treas. Reg. § 1.5 14(c)-2(k)(2)(i) (five percent de minimus exception for debt-financed acquisition or improvement of real property by tax exempt organizations); L.R.C. § 673(a) (five percent de minimus exception for the grantor trust rules); I.R.C. § 954(b)(3) (five percent de minimis exception for the calculation of foreign base company income).

21 See, e.g. Treas. Reg. § 1 .43-4(a)(2) (ten percent de minimus exception for certain qualified enhanced oil recovery costs); Treas. Reg. § 1.263A-3(a)(2)(iii) (ten percent de minimus exception for certain property acquired for resale); I.R.C. § 460(b)(6) (ten percent de minimis exception relating to the application of certain special accounting rules for long-term contracts); Treas. Reg. § 1.752-2(d)(1) (ten percent de minimus exception to the rule regarding a partner's economic risk for nonrecourse loans); Treas. Reg. § I .865-2(b)(1)(ii) (ten percent de minimus exception regarding the allocation of certain losses with respect to stock); I.R.C. § 95 1(b) (de minimus exception for certain U.S. holders of foreign stock); I.R.C. § 902(a) (ten percent de minimus exception for purposes of receiving the "deemed paid credit"); Treas. Reg. § K 1.1362-8(b)(3) (ten percent de minimus exception to the passive investment income rules applicable to dividends received by an S corporation from stock it holds in a C corporation).

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To some observers the TTB's effort may seem as easy as reading the expressed language of the IRC and the FAA Act, but to others it may seem a bit like trying to put a genie back into a bottle. During the past year many industry members, including Coors Brewing Company, have debated the best resolve of the plethora of issues concerning "flavored malt beverages".

The debates often center on the issues of competition and taxes. However, competition among industry members, and taxes established by Congress are issues that will always be part of a healthy public debate on alcoholic beverages of every class or type. Neither the issues nor the debate should distort or change the role of the TTB. The TTI3 needs to provide a regulation that guides the production, labeling, advertising and taxation of "flavored malt beverages" that is consistent with the IRC and FAA Act. In this matter, the TTB cannot allow distilled spirits to combine with malt beverages as a "flavored malt beverage" at any level inconsistent with the definition Congress gave "distilled spirits".22

Allowing industry and Congress to perform in their traditional roles is not as central to TTB's role as is the need for TTB to determine the amount of distilled spirits that can be combined with malt beverage without changing the classification. Coors Brewing Company believes that the integrity of malt beverages is at risk if the TTB takes any action other than adopting the TIB proposed regulation.

Just as the integrity of malt beverages is at risk for brewers, the integrity of laws of various states is similarly at risk. The proposed rule is consistent with states' interests in the regulation of these products. This is a matter of constitutional significance: the 21st Amendment of the Constitution of the United States requires Congress and the TTB to withhold any law or regulation that interferes or interrupts the best interest of the states.23 The TTB proposed regulation is the only approach or proposal that is consistent with the vast majority of the different states' laws defining and regulating distilled spirits.24 The TTB proposed regulation thus fulfills TTB's role as a leader of the states regulatory and tax collecting organizations.25 Coors Brewing Company supports the TTB proposed regulation because it is the right thing to do under the IRC and FAA Act, and the right thing to do to help states regulate distilled spirits.

22 Ibid.

23 Letters of comment on Notice No. 4 have been filed by 29 individual state governmental agencies responsible for the regulation and I or tax of alcoholic beverages, including: Arkansas, Arizona, California, Colorado, Florida, Georgia, Hawaii, Idaho, Kansas, Kentucky. Louisiana, Maryland, Maine, Missouri, Mississippi, Montana, North Carolina, Nebraska, New Mexico, Oklahoma, Oregon, Pennsylvania, South Carolina, South Dakota, Tennessee, Virginia, Wisconsin, West Virginia, and Wyoming.
24 See Appendix "D".
25 Federal laws and the Constitution provisions were enacted for the purpose of assisting the states:

(a) The "Wilson Original Packages Act" of August 8, 1890 provides that liquors, on arrival in any state or territory, shall be subject to the laws of the state or territory as though produced therein, not withstanding their introduction in original packages.

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Unfortunately there is a history of adding alcohol to malt beverages that has been, until recently, unknown to most of the alcohol beverage industry and state regulatory officials.26 “The ATF policy adopted in 1970 was never publicized, nor were later changes to that policy; no rulings, circulars or memorandums ever conveyed this policy to the industry or public. This is problematic since many industry members remain unaware of ATF policy in this area.”27 The proposed regulation corrects this situation consistent with federal law and state law. For some it may not seem easy, but for everyone it is the right way to correct a practice that resulted in distilled spirit products being approved and labeled as “flavored malt beverages”.

Shortly before 1996, the TTB recognized the need to propose regulations to address a practice desired by some manufactures that added tax drawback flavors to malt beverages.28 Only as recently as 2002, the TTB acknowledged to the benefit of state liquor control officials the presence of more than a significant amount of distilled spirits in “flavored malt beverages”.29 Without the TTB’s initiative, as exemplified by the proposed rule, the state liquor control administrators would have continued to be unaware of issues that must be reconciled with their individual state laws and regulations. The TTB effort to deal with this matter included advising state liquor control administrators about a limited federal statutory framework governing the labeling and taxation of alcohol beverages. But, like the TTh, most states plainly distinguish beer from wine and distilled spirits for regulatory and tax purposes. And, like the TTB, the limited statutory framework changed little since the repeal of Prohibition more than 70 years ago. Perhaps the pertinent differences in the matter before the TTB are the differences between federal and state laws that find federal laws that give special treatment to taxation of distilled spirit products containing wine or flavored with tax drawback flavors.

(b) The “Webb-Kenyon Act” of March 1, 1913 prohibits the shipment or transportation into a state, territory, district, or area subject to the jurisdiction of the United States of liquors intended to be received, possessed, sold, or used, either in the original package or otherwise, in violation of any law of such state, territory, district, or area; reenacted at Sec. 202(b), Liquor Law Repeal and Enforcement Act of August 27, 1935.

(c) The Twenty-First Amendment prohibits the transportation or importation into any state, territory, or possession of the United States of liquors in violation of the laws of such state, territory, or possession.

(d) The Federal Alcohol Administration Act, Sec. 4(d) provides that a basic permit shall be conditioned on compliance with, among other things, “the Twenty-First Amendment and laws relating to the enforcement thereof, and with all other Federal laws relating to distilled spirits, wines and malt beverages”.

26See Appendix “B”. June 1, 1992 Internal ATF Memorandum To: Chief, Wine and Beer Branch, From Charles N. Bacon. Subject “Non-traditional Malt Beverage Products Production and Regulatory Requirements.

27 Ibid, page 4.

28 See Appendix “B” for 1992 memo from Charles Bacon

29 See Appendixes “A” and “C”.

The TTB proposed regulation helps solve issues unique to the individual states that, like the federal government, define distilled spirits to include any beverage containing alcohol obtained by distilation, notwithstanding the mixture or dilution of malt beverage.30 While over half of the states have commented to the TTB, only one state, Georgia, has indicated that the proposed regulation does not save the state from having to change its current law.31 The compatibility and consistency of the TTB proposed regulation with the laws and regulations of the various states is lost under the alternative proposal that allows up to 50% of the total alcohol content to come from distilled spirits.

Because the states have only recently been informed of the issues that arise from “flavored malt beverages”, Coors Brewing Company expects that it, and most of the alcoholic beverage industry will face a patchwork of state rulings and entbrcement absent adoption of the TTB proposed regulation. The TTB proposed regulation is consistent with the 21st Amendment to the United States Constitution and the power it gives each state to define and regulate beer, wine and spirits, differently.

Examples of differences in the regulation of malt beverages at the state level do exist. For instance, some states regulate “3.2% Beer” differently than beer with higher alcohol content. Some states prohibit the sale of any alcoholic beverage that contains distilled spirits on Sunday. One state requires separate retail and wholesale licenses for malt beverages over 4% by weight. But a great number of states have advised the TTB that only the 0.5% standard will work under their laws, and one state has already given notice to the industry that any “flavored malt beverage” over the 0.5% standard is a spirit and will be regulated and taxed as such beginning January 1,2004.32 Leadership and consistency are important, and only the TTB proposed regulation provides comity to the states and a marketplace free from disruption and threats to production, distribution. labeling, retailing, tax and sales regulations at the state level. The TTB proposed regulation truly protects the integrity of malt beverages in every state.

The TTB has given state liquor administrators assurance that it will act directly and promptly to the issues shared with the states. Coors Brewing Company recommends that TTB give top priority to the timing of adopting the TTB proposed regulation. including an early compliance date. Expedited action by the TTB meets the needs of the various states and relieves states from having to take independent action to require special labels, distribution licenses, retail licenses or taxes during the interim.

30 See Appendix “D” for state definitions of distilled spirits that are similar to the federal definition.
31 Georgia’s comment to TTB noted that both the proposed regulation and the “majority” alternative proposal failed to satisfy the law in Georgia.
32 See Appendix “F” for letter to Coors Brewing Company from the State of Nebraska advising of its interpretation of Nebraska law that places current “flavored malt beverages” in the “distilled spirits” classification. Coors Brewing Company strongly believes that other states are holding off taking similar action because they believe the TTB proposed regulation will be swiftly adopted, thus avoiding disruption within the marketplace in their state and allowing a coordinated transition for the entire alcoholic beverage industry.

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The TTB proposed regulation minimizes turmoil that threatens the marketplace.

The TTB proposed regulation also addresses issues about alcohol content of malt beverages. The TTB proposed regulation is an appropriate response to concerns it clearly noted in Industry Circular “1996-1” and the proposed regulation fulfills the intent and deihitions crafted by Congress over 60 years ago.

ATF Ruling 96-1 provided notice to alcohol beverage industry members that the use of flavors in malt beverages should be limited. The circular was prompted by new distiller branded products that were being identified as flavored malt beverages. Neither the ruling nor the corresponding Industry Circular directly limited combinations of tax drawback flavors containing distilled spirits with beer provided the final product was below 6% alcohol by volume.33 The basis for that determination is unclear because it clearly contradicts a holding in the decision which states, ~‘a malt beverage under the FAA Act may only contain alcohol which is the result of alcoholic fermentation at the brewery.

Since 1996 the TTB concerned itself with limiting alcohol content resulting from tax drawback flavors by focusing mainly on products that might be 6% alcohol by volume, or more. The initial focus of TTB was with notice to the industry that it would consider rulemaking for products under 6% alcohol by volume. However, during the first few years after 1996, the TTB reviewed and approved many statements of processes for brewers desiring to add blenders made primarily of distilled spirits and citric acid at about 1 80~ proof Although the TTB gave the industry notice that these products may need to undergo additional restrictions, after rulemaking, it did not rush to put a halt to the practice until state regulatory and taxing authorities began asking about the amount of alcohol in these products resulting from the use of flavors containing distilled spirits.

The TTB proposed regulation ends confusion that exists with consumers who do not know that there are distilled spirits in these products because the label only declares the product to be “flavored malt beverage”. The labels caused similar confusion with most state regulatory and taxing organizations that only recently became aware of the amount of distilled spirits in these products. In many instances this new awareness triggered concerns about legal definitions and gave rise to questions about tax diversion at the state level.

33 ATF Industry Circular 96-1, The Circular allowed disproportionate combinations of tax drawback flavors to flavored malt beverages. A flavored malt beverage under 6% alcohol by volume could derive up to 5.9% alcohol by volume from tax drawback flavors. Meanwhile, a flavored malt beverage containing 6% alcohol by volume is restricted to only 1,5% alcohol by volume from tax drawback flavors. Thus the addition of 0.1% alcohol by volume could cause a reduction of 4.4% alcohol by volume from tax drawback flavors in a finished product.

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Another struggle for the TTB involves issues arising from concerns over high alcohol blenders used to fortify malt beverages more than to flavor the beverage. There are no provisions in the IRC that authorize the direct addition of distilled spirits in the production of beer. Coors Brewing Company believes that the TTB should not continue to allow the indirect addition of distilled spirits in the production of beer. The TTB proposed regulation stops brewers from doing indirectly through blenders that which they are prohibited from doing directly under the IRC.

The TTB proposed regulation likely will require a few manufacturers to choose between reformulating products using different flavors and without using high alcohol blenders or, in the alternative, transfer production to a distilled spirits plant and change the label. Changing only the label is not a foolish suggestion because the proposed regulation does not prohibit brewers currently making these products from establishing an alternating preniise with a distilled spirits plant permit. This would allow use of the same method of manufacturing process, use of the exact same ingredients, result in the exact same product that exists in the marketplace today, and maintain all consumer taste expectations for current flavored based products made with at least 0.5% distilled spirits.

Technology and brewing processes exist which help produce competitive products without the use of high alcohol blenders. These technologies and processes should not conli.ise the basic purpose of the proposed regulation, je., determine the classification of malt beverages combined with distilled spirits derived from the use of tax drawback flavors.

These processes and technological applications are noted because they represent good alternatives that assure consumers their demand for innovative alcohol beverage products will continue to be met under the TTB proposed regulation. These scenarios are tomorrow’s success stories and they can emulate only from the TTB proposed regulation and not be from the alternative, “majority” proposal.

In conclusion, the TTB proposed regulation constitutes good public policy and corrects errors evident in the marketplace. The proposed regulation does not kill the category of flavored malt beverages and will neither jeopardize jobs nor limit consumer choice. Coors Brewing Company asks the TTB to increase the level of urgency to effectuate the proposed regulation at the earliest possible date.

For Coors Brewing Company

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