EXCISE TAX EXEMPTION FOR ALCOHOLIC BEVERAGES ORIGINATING OUTSIDE THE U.S.

EVALUATION SUMMARY

APRIL 2020
2020-TE13

THIS EVALUATION WILL BE INCLUDED IN COMPILATION REPORT SEPTEMBER 2020

YEAR ENACTED	1969
REPEAL/EXPIRATION DATE	None
REVENUE IMPACT	Could not determine
NUMBER OF TAXPAYERS	Could not determine
AVERAGE TAXPAYER BENEFIT	Could not determine
IS IT MEETING ITS PURPOSE?	Yes

WHAT DOES THIS TAX EXPENDITURE DO?

The Excise Tax Exemption for Alcoholic Beverages Originating Outside the U.S. (Foreign Alcohol Exemption) exempts individuals from paying excise tax on up to 1 gallon (or 4 liters) of alcoholic beverages in their possession when they arrive in Colorado airports on flights originating outside the United States.

WHAT IS THE PURPOSE OF THIS TAX EXPENDITURE?

Statute does not explicitly state the purpose of this exemption. We inferred that its purpose is to simplify taxpayer compliance and decrease state administrative and enforcement costs associated with collecting the excise tax.

WHAT DID THE EVALUATION FIND?

We determined that the expenditure is meeting its purpose because it is likely being used.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly may want to consider modifying this exemption to align it with Department of Revenue practice, which is to allow the exemption for up to 1 gallon (4 liters) of alcoholic beverages brought into the state, regardless of where they were obtained or how they were brought into Colorado.

EXCISE TAX EXEMPTION FOR ALCOHOLIC BEVERAGES ORIGINATING OUTSIDE THE U.S.

EVALUATION RESULTS

WHAT IS THE TAX EXPENDITURE?

According to statute [Section 44-3-503(1), C.R.S.], alcoholic beverages sold, offered for sale, or used in the state are subject to an excise tax as provided in EXHIBIT 1.1.

EXHIBIT 1.1.
EXCISE TAX RATES BY ALCOHOLIC BEVERAGE TYPE
CALENDAR YEAR 2019

BEVERAGE TYPE	TAX RATE
Beer, malt liquors, fermented malt beverages, and hard cider	$0.08 per gallon
Wine	$0.0733 per liter
Spirits	$0.6026 per liter

SOURCE: Section 44-3-503(1), C.R.S.

The Excise Tax Exemption for Alcoholic Beverages Originating Outside of the U.S. (Foreign Alcohol Exemption) [Section 44-3-106(4), C.R.S.] exempts individuals from paying Colorado excise tax on up to 1 gallon (or 4 liters) of alcoholic beverages in their possession when they arrive at any Colorado airport on a flight originating outside the United States. This expenditure has remained functionally unchanged since it was enacted in 1969 by House Bill 69-1081, with the exception of House Bill 77-1176, which raised the volume limit from the original 1 quart to the current 1 gallon (or 4 liters) in 1977.

The Department of Revenue does not require individuals to take any administrative steps to claim this tax expenditure, as long as they do not possess more than 1 gallon (or 4 liters) of alcoholic beverages when they arrive in the state. Any individual who brings more than this amount must report and pay excise tax on the volume in excess of the exempt amount using the Department of Revenue's Personal Excise Tax Return for Alcoholic Beverages (Form DR 0449), which is also used to report beverages shipped into Colorado via mail and beverages brought into Colorado from other states.

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURE?

Statute does not explicitly identify the intended beneficiaries of this tax expenditure. Based on statutory language, we inferred that the intended beneficiaries are adults arriving at any airport in Colorado on a flight originating in a foreign country who possess small quantities of alcoholic beverages. In addition, the State appears to benefit from this exemption, since the amount of excise tax that would otherwise be collected, a maximum of $2.41 per person, may not be sufficient to cover the administrative and enforcement costs associated with collecting the tax.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute does not explicitly state a purpose for this tax expenditure. Therefore, based on its operation, we inferred that the purpose of the Foreign Alcohol Exemption is to simplify taxpayer compliance and decrease state administrative costs. According to the *Tax Policy Handbook for State Legislators, 3rd Edition,* published by the National Conference of State Legislatures, "A quality tax system facilitates taxpayer compliance by minimizing the time and effort necessary to comply with the law. It also minimizes the cost of the state administrative apparatus necessary to collect revenue, enforce the law, and audit to ensure compliance with the law." Imposing an excise tax on small quantities of alcohol, which are intended for personal use, would likely be difficult to enforce and could increase the State's administrative costs without a significant enough corresponding increase in tax revenue. Thus, we inferred that the exemption is a structural provision intended to increase the efficiency of the State's tax system.

IS THE TAX EXPENDITURE MEETING ITS PURPOSE AND WHAT PERFORMANCE MEASURES WERE USED TO MAKE THIS DETERMINATION?

We determined that the Foreign Alcohol Exemption is likely meeting its purpose, but it is unclear to what extent it is used because we were unable to determine the number of taxpayers claiming the exemption or the quantity of alcohol that was exempt.

Statute does not provide quantifiable performance measures for this tax expenditure. Therefore, we created and applied the following performance measure to determine if the expenditure is meeting its inferred purpose:

PERFORMANCE MEASURE: *To what extent are eligible individuals utilizing the Foreign Alcohol Exemption?*

RESULT: Individuals who bring in less than 1 gallon (4 liters) of alcoholic beverages are not required to take any action to receive the exemption, so it is likely that nearly all eligible individuals are able to avoid paying excise taxes, as intended. However, because these individuals are not required to report to the Department of Revenue regarding the alcoholic beverages they bring into the state under the exemption, we were unable to determine how many used the exemption or the volume of alcohol they brought into the state.

Additionally, taxpayers who bring in more than 1 gallon (or 4 liters) of alcoholic beverages and file the Personal Excise Tax Return for Alcoholic Beverages (Form DR 0449), as required, are likely to benefit from the exemption because the form instructs them to only report and pay excise tax on the amount in excess of 1 gallon (or 4 liters). However, as shown in EXHIBIT 1.2, it appears that a relatively small number of taxpayers filed this form during Calendar Years 2015 through 2019.

EXHIBIT 1.2. NUMBER OF PERSONAL EXCISE TAX RETURN FOR ALCOHOLIC BEVERAGES FORMS FILED CALENDAR YEARS 2015 THROUGH 2019	
YEAR	FORMS FILED
2015	126
2016	117
2017	125
2018	144
2019	111
Average (2015-2019)	125
SOURCE: Department of Revenue.	

WHAT ARE THE ECONOMIC COSTS AND BENEFITS OF THE TAX EXPENDITURE?

We lacked information necessary to estimate the Foreign Alcohol Exemption's revenue impact to the State. However, because the State's excise tax rates are relatively low, the exemption likely reduces state revenue by only a small amount (and saves taxpayers a corresponding amount). For example, although we did not have data on the percentage of international travelers who have brought alcohol into the state, if 5 percent of the 1.1 million inbound international passengers who travelled through Denver International Airport during Calendar Year 2019 possessed the maximum amount of alcohol allowed under the exemption, the exemption would have reduced state revenue by a maximum of $133,000. This hypothetical is based on 55,000 passengers (5 percent of the 1.1 million inbound international travelers above) each receiving the maximum potential value of the exemption, $2.41. However, because it would be difficult for the State to enforce the excise tax for alcohol brought into the state for personal use and many passengers likely bring in less than the maximum amount, the amount of tax that the State would have actually collected under this scenario would likely be substantially less than this amount. Further, the exemption's revenue impact to the State is likely offset by a reduction in administrative and enforcement costs that would otherwise be necessary to collect the tax.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURE HAVE ON BENEFICIARIES?

If this expenditure were eliminated and the excise tax was enforced on small quantities of alcohol brought into the state, the State would see increased administrative and enforcement costs. In addition, every person bringing alcoholic beverages into Colorado by air from a foreign country would be required to file the Personal Excise Tax Return for Alcoholic Beverages (Form DR 0449) and pay the applicable excise tax. These taxpayers, however, would only incur a small excise tax liability. For example, a taxpayer bringing 1 liter of wine into Colorado from a foreign country would be required to pay $0.07. As discussed, the highest tax rate on alcoholic beverages is on spirits, at $0.6026 per liter, which equates to a tax of $2.41 per person for the maximum amount that qualifies for the exemption.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

Every state in the U.S. and the District of Columbia levies a tax on alcoholic beverages. We identified 10 states with tax expenditures similar to Colorado's Foreign Alcohol Exemption, as shown in EXHIBIT 1.3. In addition, it is possible that other states that lack an explicit exemption, also provide a similar exemption in practice, because of the difficulty in enforcing an excise tax for small amounts of alcohol for personal use and because some states only apply their excise tax to sales of alcohol that occur in the state.

EXHIBIT 1.3. STATES WITH FOREIGN ALCOHOL EXCISE TAX EXEMPTIONS	
STATE	VOLUME OF FOREIGN-ORIGINATING ALCOHOL EXEMPT FROM STATE TAX
Alaska	Any volume (no tax on personal alcohol importation)
Colorado	1 gallon (beer) or 4 liters (wine/spirits)
Hawaii	6 gallons (beer) and 1 gallon (wine/spirits)
Kansas	1 gallon
Maryland	1 quart
Minnesota	2.5 gallons (beer) or 4 liters (wine/spirits)
New York	1 quart
Oklahoma	1 liter
South Carolina	$20 value
Washington	Amount equal to that prescribed to be duty free by federal law: currently 1 liter
Wyoming	5 gallons (beer) or 9 liters (wine) or 3 liters (spirits)
SOURCE: Office of the State Auditor analysis of other states' tax codes and regulations.	

ARE THERE OTHER TAX EXPENDITURES OR PROGRAMS WITH A SIMILAR PURPOSE AVAILABLE IN THE STATE?

The federal government levies an excise tax on all alcoholic beverages produced, imported, or sold in the United States [26 USC 5001, 5041, and 5051]. According to the Code of Federal Regulations [Title 19, Section 148.33(d)(3)], up to 1 liter of alcoholic beverages may be brought back to the U.S. from a foreign country by a U.S. resident without paying the federal excise tax.

WHAT DATA CONSTRAINTS IMPACTED OUR ABILITY TO EVALUATE THE TAX EXPENDITURE?

The Department of Revenue does not collect data on this expenditure, and we were unable to locate data sufficient to estimate its state revenue impact or the number of individuals who claim it. Individuals who bring in 1 gallon (4 liters) or less of alcoholic beverages are not required to report their use of the exemption. In addition, the Department of Revenue does not require individuals who bring in more than the exempt amount and file the Personal Excise Tax Return for Alcoholic Beverages (Form DR 0449) to indicate the volume or type of alcohol that was exempt. Because the excise tax varies based on the type of alcoholic beverage brought in, without this information we were not able to calculate the revenue impact of the exemption for individuals who submitted Form DR 0449.

In order to collect this information, the Department of Revenue would have to require taxpayers to report the amount and type of alcohol that qualified for the Foreign Alcohol Exemption, and would likely have to modify the Personal Excise Tax Return for Alcoholic Beverages (Form DR 0449) by adding a line on which taxpayers could report this information. The Department of Revenue would also have to capture and house the additional data collected in GenTax, the Department of Revenue's tax processing system, which would require additional resources and may not be practical given the small size of the exemption for each taxpayer (see the Tax Expenditures Overview Section of the Office of the State Auditor's *Tax Expenditures Compilation Report* for additional details of Department of Revenue data and the potential costs of addressing the limitations).

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

THE GENERAL ASSEMBLY MAY WANT TO CONSIDER CLARIFYING STATUTE TO SPECIFY WHETHER THE FOREIGN ALCOHOL EXEMPTION SHOULD APPLY TO ALCOHOLIC BEVERAGES THAT ENTER COLORADO THROUGH MEANS OTHER THAN AIR TRAVEL FROM A FOREIGN COUNTRY. Although statute [Section 44-3-106(4), C.R.S.] limits the exemption to alcoholic beverages that individuals bring into the state by passenger flights originating in another country, Department of Revenue taxpayer guidance indicates that it currently allows an exemption for up to 1 gallon (4 liters) of alcoholic beverages regardless of where the alcoholic beverages were obtained or how individuals brought them into Colorado (e.g., driven in, brought in on domestic flights, mailed). This practice likely aligns with our inferred purpose of the Foreign Alcohol Exemption since it would also be difficult to enforce the state excise tax on small amounts of alcoholic beverages brought in for personal use through other means of transport. However, clarifying statute to indicate the General Assembly's intent would assist taxpayers in determining when they are required to pay the excise tax. If the General Assembly expanded the Foreign Alcohol Exemption to include alcohol brought into the state through all forms of travel, it would likely have little additional revenue impact to the State since this is already the Department of Revenue's practice. If the General Assembly instead directed the Department of Revenue to enforce the excise tax on instances that fall outside of current statute, it could increase state revenue; however, we lacked data to quantify this impact and the increased revenue would likely be offset by increased administrative and enforcement costs incurred by the Department of Revenue to enforce the excise tax.