

EXEMPTION FOR ALCOHOL PRODUCED BY INDIVIDUALS FOR PERSONAL USE



APRIL 2020
2020-TE11

EVALUATION SUMMARY

THIS EVALUATION WILL BE INCLUDED IN COMPILATION REPORT SEPTEMBER 2020

YEAR ENACTED	1971
REPEAL/EXPIRATION DATE	None
REVENUE IMPACT	Less than \$500,000 (CALENDAR YEAR 2017)
NUMBER OF TAXPAYERS	Could not determine
AVERAGE TAXPAYER BENEFIT	Could not determine
IS IT MEETING ITS PURPOSE?	Yes

WHAT DOES THIS TAX EXPENDITURE DO?

Under Section 44-3-106(2)(c), C.R.S., individuals are exempt from paying alcohol excise tax on limited quantities of beer, wine, and cider produced at home for personal use and not for sale.

WHAT IS THE PURPOSE OF THIS TAX EXPENDITURE?

Statute does not explicitly state a purpose for this tax expenditure. We inferred that this is a structural expenditure meant to reduce administrative costs to the State and individuals who produce alcoholic beverages at home and define the tax base for the state alcohol excise tax.

WHAT DID THE EVALUATION FIND?

We determined that the Homemade Alcohol Exemption is meeting its purpose because eligible individuals are using it to avoid paying tax on the alcoholic beverages they produce at home.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

We did not identify any policy considerations related to this expenditure.

EXEMPTION FOR ALCOHOL PRODUCED BY INDIVIDUALS FOR PERSONAL USE

EVALUATION RESULTS

WHAT IS THE TAX EXPENDITURE?

The Exemption for Alcohol Produced by Individuals for Personal Use (Homemade Alcohol Exemption) [Section 44-3-106(2)(c), C.R.S.] exempts Colorado adult residents from paying state excise tax on beer, wine, or cider they produce at home for personal use and not for sale. Both state and federal law [Section 44-3-901(1)(h), C.R.S., and 26 USC 5601] prohibit individuals from producing spirits privately and therefore, spirits are not included in the exemption. Statute limits the amount of alcohol that individuals can produce annually under the Homemade Alcohol Exemption to the amount that is exempt from the federal alcohol excise tax, which is up to 100 gallons of beer, wine, or cider if there is one adult in the household and up to 200 gallons if there are at least two adults in the household. This expenditure was created in 1971 by House Bill 71-1049, the same bill that first legalized home production of alcohol in Colorado. At that time, only home production of wine was legal and included in the exemption. Homemade beer and cider were added to the provision in 1986 by House Bill 86-1070, after home beer production became legal at the federal level. Since then, the provision has remained functionally unchanged.

According to Section 44-3-503(1)(a), C.R.S., all alcohol “sold, offered for sale, or used” in the State of Colorado is subject to an excise tax, unless specifically exempt. Therefore, without the Homemade Alcohol Exemption, alcohol produced for personal use would be subject to the tax because it is “used” in Colorado. EXHIBIT 1.1 provides the state excise tax rates for beer, wine, and cider, which are the types of beverages that can qualify for the exemption.

EXHIBIT 1.1. EXCISE TAX RATES BY ALCOHOLIC BEVERAGE TYPE	
BEVERAGE TYPE	TAX RATE
Beer, malt liquors, fermented malt beverages, & hard cider	\$0.08 per gallon
Wine	\$0.0733 per liter
SOURCE: Office of the State Auditor review of Colorado Revised Statutes.	

Individuals are not required to take any action to claim the Homemade Alcohol Exemption. There is no reporting or other administrative process required to claim this exemption.

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURE?

Statute does not identify the intended beneficiaries of the Homemade Alcohol Exemption. Based on the operation of the provision, we inferred that the intended beneficiaries are individuals who make beer or wine at home for personal use who directly benefit from reduced taxes and compliance costs.

In addition, the State may also be an intended beneficiary of this expenditure. Specifically, the amount of excise tax the State would otherwise collect from residents who produce alcohol for personal use would be small, and the exemption may benefit the State by avoiding the cost of administering and enforcing the tax.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute does not explicitly state a purpose for the Homemade Alcohol Exemption. Based on its operation and legislative history, we inferred that the purpose of this expenditure is to avoid the cost of administering the excise tax for alcoholic beverages produced at home for personal use. Specifically, because the amount of tax that could be collected from each individual who produces homemade alcohol is small, it appears that the General Assembly may not have considered it to be cost-effective to require individuals to file and for the State to enforce the excise tax for limited quantities of alcoholic beverages made at home for personal use. Furthermore, the Homemade Alcohol Exemption was implemented by the

same legislation that legalized home alcohol production for personal use. This suggests that the General Assembly never intended to tax this type of activity and that the exemption is a structural provision intended to define the tax base for the state excise tax on alcohol.

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

We determined that the Homemade Alcohol Exemption is meeting its purpose because it prevents taxation of alcohol produced by individuals for personal use and is being used by eligible individuals.

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

PERFORMANCE MEASURE: *To what extent do eligible individuals use the Homemade Alcohol Exemption?*

RESULTS: The exemption appears to be widely used by eligible individuals who produce homemade alcohol in the state. Because individuals who qualify for the exemption are not required to take any administrative action to claim it, such as reporting the amount and type of alcoholic beverages produced under the exemption, the Department of Revenue has no data on the extent to which the exemption is used. However, there is no process available for individuals who produce alcohol at home for personal use to pay an excise tax, which makes it unlikely for individuals who qualify for the exemption to pay the tax. Further, according to stakeholders we contacted, there is no confusion in the home brewing community about homemade alcohol's tax-exempt status, and stakeholders have no knowledge of any home alcohol producers attempting to pay excise tax.

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

Based on stakeholder estimates of the amount of alcoholic beverages produced at home in Colorado, we estimate that the Homemade Alcohol Exemption reduced state revenue by less than \$500,000 in Calendar Year 2017. Specifically, the American Homebrewers Association (Association), a national organization that promotes home beer production, estimates that there are between 50,000 and 100,000 home producers of beer in Colorado. According to an Association survey conducted in 2017, the average home brewer produces 52 gallons of beer per year. Based on these estimates, the revenue foregone by the State from alcohol excise tax not collected on home production of beer was between \$208,000 and \$416,000 in Calendar Year 2017.

While we did gather data from stakeholders on the average volumes of wine and cider produced by individuals in 2017, we were unable to similarly estimate the total revenue impact of tax-exempt homemade wine and cider because we lacked data on the number of home producers of wine and cider in Colorado. However, according to the information provided by stakeholders, individuals generally produce significantly lower volumes of wine and cider per year than they do beer. Therefore, in preparing our estimate we assumed that the home production of these beverages increased the revenue impact of the exemption by no more than 20 percent, or about \$83,000 in Calendar Year 2017, which we included in our estimate above.

In addition to reducing homemade alcohol producers' taxes, the exemption has also likely saved the State administrative and compliance costs. Although the Department of Revenue was unable to estimate the potential cost of enforcing an excise tax on homemade alcoholic beverages, Department staff indicated that enforcing full compliance would increase its costs and require additional resources.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURE HAVE ON BENEFICIARIES?

If the Homemade Alcohol Exemption were eliminated, individuals who produce alcoholic beverages at home would be subject to excise tax. According to the Association's 2017 survey conducted through home alcohol production supply stores nationwide, the average home brewer produces 52 gallons of beer per year; the average home producer of wine makes 23 gallons of wine per year; and the average home producer of cider makes 12.5 gallons of cider per year. Applying relevant excise tax rates to these quantities would result in average annual excise taxes per producer of: \$4.16 for home beer brewers; \$3.47 for home winemakers; and \$1.84 for home cider makers. Although this would be a small additional tax, according to the Association, the elimination of this expenditure would have a substantial impact on the home brewing community because the additional burden of filing the tax may discourage potential home brewers from participating. In addition, if home alcohol production were to diminish, home alcohol production supply stores would suffer from reduced business. However, liquor stores and other alcoholic beverage retailers could see an increase in sales to the extent individuals purchase alcoholic beverages that they otherwise would have made at home.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

Overall, we identified similar exemptions in 35 other states and the District of Columbia. In 24 of these other states and the District of Columbia, we found statutes that explicitly exempt beer and wine produced by individuals for personal use from state tax. The 11 additional states do not explicitly exempt private production of beer and wine, but generally have liquor and/or tax codes written to only tax alcoholic beverages sold or offered for sale, not "used." Since alcohol produced by individuals for personal use is not sold or offered for sale, it appears that such beverages are implicitly tax-exempt in these states as well.

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

According to federal law [26 USC 5042 and 5053], home production of beer and wine for personal use is legal and exempt from federal excise tax—up to 100 gallons for households with one adult and up to 200 gallons for households with at least two adults. Because the quantity eligible for the exemption under the State’s Homemade Alcohol Exemption is tied to the federal exemption, if the federal exemption were eliminated, the state exemption would be nullified.

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

The Department of Revenue was unable to provide us with data on the amount of alcoholic beverages produced in Colorado that was exempt because it does not collect any data from individuals who use the exemption. To collect this information, the Department would have to require and enforce reporting of exempt home alcohol production by individuals. This would require the Department to create at least one new reporting form, and then capture and house the data collected on that form in GenTax, the Department’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?

We did not identify any policy considerations related to the Homemade Alcohol Exemption.