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Liquor Taxes Could Go Up 400%, Thanks to Congressional Dysfunction

A temporary cut in federal taxes on alcohol fueled the growth of American distilleries, but its expiration threatens their demise.

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By Clay Risen

The last two years have been good ones for Lyon Distilling. At the small rum producer in St. Michaels, Md., a town on the Eastern Shore of Chesapeake Bay, production has jumped from 4,000 bottles a year to 40,000. Four employees have become 15.

Explosive consumer demand explains some of that growth, said Jaime Windon, the company's chief executive and co-founder. But she attributes most of it to a steep cut in federal excise taxes on alcoholic beverages, which Congress passed at the end of 2017 as part of the Tax Cuts and Jobs Act.

"We used to be tiny," she said. "Now we're running like a machine."

Thousands of small distilleries, breweries and wineries have similar stories. But their fortune may end soon, thanks to congressional paralysis: The tax cut, known as the Craft Beverage Modernization and Tax Reform Act, is set to expire on Dec. 31, and legislators have until Friday to extend it.

If they don't, distilleries like Lyon will face a 400-percent tax increase, with the first payment for many due on Jan. 15. That has craft-beverage producers scrambling.

"The anxiety level with these small distilleries is high," said Chris Swonger, the chief executive of the Distilled Spirits Council of the United States. Industry representatives expect that many small companies will have to lay off employees or close entirely, a turn that could undermine the country's boom in craft brewing and distilling.

Particularly frustrating for these companies is the fact that the tax cut enjoys overwhelming bipartisan support — a House bill to make it permanent, introduced earlier this year, has 324 co-sponsors, while an identical Senate version has 73.

Such legislation would normally sail through Congress, most likely as part of a so-called extender package of similar targeted cuts. Instead, observers say, it has become a casualty of congressional dysfunction and partisan fighting over taxes and spending.

The tax cut, originally introduced in 2015, was supposed to be permanent, but was trimmed to two years as a compromise to get it into the 2017 tax bill. Industry lobbyists assumed that making it permanent would not be a problem — this summer, the House Ways and Means Committee passed legislation to do so, and a Senate task force endorsed the idea.

But those proposals soon got caught up in larger debates about tax reform, and Congress let the issue sit idle. In recent days, Congressional offices have told lobbyists they are rushing to reach a deal on tax reform, which they hope to attach to the year-end spending bill. But they can't promise that an extension to the tax cut will be part of it.

"We're all a little dizzy," said Margie Lehrman, the chief executive of the American Craft Spirits Association, which lobbies on behalf of small distillers. "The congressional leadership seems stuck because of issues much larger than us."

Industry lobbyists and legislators who support the bill say that at this point the most they can realistically expect is a one-year extension. But such short-term relief would make it hard for distillers to make long-term investments, like hiring staff, increasing production or buying new equipment.

"The hard part for us is the lack of certainty," said Robert P. Koch, the president of the Wine Institute, which represents the wine industry in Washington. "To have it extended just one year makes it tough to plan."

The 2017 legislation cut the amount that all distilleries had to pay on the first 100,000 proof gallons from $13.50 to $2.70 (a proof gallon is a gallon of spirit at 50 percent alcohol). Breweries and wineries received similar reductions, though in their cases the cuts were largely reserved for small producers. Such excise taxes are paid on top of normal corporate taxes.

Trade associations representing all three industries said the vast majority of their members used the tax savings to invest in new equipment and jobs. Bob Pease, the president of the Brewers Association, which represents small breweries, said that craft breweries added 15,000 jobs in 2018, the latest year on record, after an average of just 5,000 for the previous three years.

“I’ve got 7,500 main-street members using that money to reinvest in their companies and their communities,” he said.

The sharp reduction in taxes also encouraged hundreds of new businesses to open, including about 2,000 breweries and 400 distilleries in the last two years. Those companies are especially unprepared for a sudden increase in their excise taxes, which, for most distillers, must be paid every other week.

“There are distillers now who do not know what it’s like not to pay more than $2.70,” said Ms. Windon. “I don’t know how their business plans will accommodate that.”

Extending popular, but temporary, tax cuts has long been an end-of-the-year ritual on Capitol Hill. But many of the temporary cuts have since been made permanent, leaving a dwindling number of affected groups to scramble for support every few years. A number of provisions being considered alongside the alcoholic beverage excise tax have already lapsed, including a biodiesel tax credit, despite strong support from Iowa Republican Charles E. Grassley, the head of the Senate Finance Committee.

Despite its strong bipartisan support, the Craft Act has its critics, many of whom say it gives away too much to big producers. All distillers, no matter the size, get a break on their first 100,000 proof gallons. While most craft distillers make only a small fraction of that — Lyon Distilling produces about 5,000 proof gallons a year — many large distillers make 100,000 gallons or more a week.

Large brewing companies also benefit. AB InBev, which owns Budweiser, Corona and many other brands, now receives about $12 million in tax savings. But bringing big producers on board was a political necessity, said Mr. Pease. “From our perspective, if that’s what it takes, we’re fine with that,” he said.

Still, even skeptics are shocked at how a bill with such broad support — and a track record of boosting investment and job growth — could be scuttled because of political logjams.

“Who doesn’t like the idea of a craft brewer getting a break?” said Adam Looney, a tax expert at the Brookings Institution who has criticized some elements of the tax cut. “It’s an indictment of Congress’s ability to do the basic elements of its job.”