

MAKING CERTAIN ALLOWANCES FOR LOSSES BY LEAKAGE AND EVAPORATION OF BRANDY AND FRUIT SPIRITS UNDER CERTAIN CONDITIONS

JULY 25, 1939.—Ordered to be printed

Mr. JOHNSON of Colorado, from the Committee on Finance, submitted the following

REPORT

[To accompany H. R. 6268]

The Committee on Finance, to whom was referred the bill (H. R. 6268) to authorize the Commissioner of Internal Revenue to make certain allowances for losses by leakage and evaporation upon withdrawal of packages of brandy or fruit spirits under certain conditions, having had the same under consideration, report it to the Senate without amendment and recommend that the bill do pass.

The purpose of the proposed legislation is fully explained in the report of the Committee on Ways and Means, House of Representatives, which accompanied the bill, and which is attached hereto and made a part of this report.

[H. Rept. No. 1119, 76th Cong., 1st sess.]

The Committee on Ways and Means, to whom was referred the bill (H. R. 6268) to authorize the Commissioner of Internal Revenue to make certain allowances for losses by leakage and evaporation upon withdrawal of packages of brandy and fruit spirits under certain conditions, report it back to the House without amendment and recommend that the bill do pass.

GENERAL STATEMENT

The purpose of H. R. 6268 is to remedy a patent inequity in the law, created entirely by inadvertence, which compels fruit distillers to pay the Federal tax of \$2 per proof gallon on brandy and fruit spirits, lost through normal leakage and evaporation, where the brandy or fruit spirits has been stored at any time in a storage tank. It is the purpose of H. R. 6268 to extend to such brandy or fruit spirits the same loss allowances which apply to brandy or fruit spirits not stored at any time in a storage tank. The failure of the present law to provide loss allowances on brandy or fruit spirits stored at one time in storage tanks is simply the result of an omission in the language of the law.

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When normal fruit distillery operations were resumed following repeal, an acute shortage developed in Government-bonded-warehouse facilities in California. This shortage necessitated the erection of a number of storage tanks, for temporary deposit of the brandy or fruit spirits until small cooperage (casks and barrels) became available, and warehouse facilities were enlarged. In no known instance was the brandy or fruit spirits stored in such tanks longer than a few months. As quickly as small cooperage and warehouse storage space permitted, the brandy or fruit spirits was packed for further storage and ageing.

Federal law (Internal Revenue Code, sec. 2901 (a)) then and now provides for loss allowances, resulting from normal shrinkage (leakage and evaporation), where the brandy or fruit spirits is in "casks or packages of a capacity of 40 or more wine-gallons" or in "casks or packages" of not less than 20 gallons. No specific provision was made for loss allowances in the case of containers other than "casks or packages." It is obvious, however, that this omission was due to the fact that the storage of brandy or fruit spirits (as well as other distilled spirits) in tanks simply was not given consideration, rather than any deliberate intention to exclude from the loss-allowance provision brandy or fruit spirits deposited for temporary storage in tanks.

As a result of this legislative oversight, fruit distillers have been called upon to pay the Federal tax of \$2 per proof gallon on brandy or fruit spirits lost through normal leakage and evaporation, simply because, for a brief period of time, the brandy or fruit spirits was stored in a Government-bonded warehouse storage tank. The injustice of this situation becomes increasingly apparent when it is realized that the fruit distiller first suffers the loss of the brandy or fruit spirits itself (and the financial investment which such loss represents) and then is compelled to pay the Federal tax on such nonexistent brandy or fruit spirits.

All of the brandy or fruit spirits for which loss allowances are provided in H. R. 6268 is, and has been, continuously under Government lock and key. No question of fault or negligence is involved. Full protection of the revenue is afforded in the language of the proposed amendment, in that allowance for losses will be granted only where the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, finds that the loss is a proper one under the law.

The Treasury Department has no objection to the enactment of this bill, as indicated by the following letter from that Department.

TREASURY DEPARTMENT,
Washington, June 28, 1939.

Hon. ROBERT L. DOUGHTON,
Chairman, Committee on Ways and Means,
House of Representatives, Washington, D. C.

MY DEAR MR. CHAIRMAN: Further reference is made to your letter of May 11, 1939, enclosing a copy of a bill (H. R. 6268, 76th Cong., 1st sess.) and requesting my recommendations or comments in respect of the proposed legislation. The bill would authorize the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, to make allowances for losses by leakage and evaporation in accordance with section 2901, Internal Revenue Code, upon withdrawal of packages of brandy or fruit spirits now deposited in internal-revenue bonded warehouses, which were filled from storage tanks in bonded warehouses prior to June 26, 1936.

Section 2901 (a), Internal Revenue Code, provides for the allowance of losses of distilled spirits from packages by leakage or evaporation in accordance with the graduated scale of such losses, based on length of storage, contained in the section. It is provided that the time of storage shall run from the date of original gage as to fruit brandy, or original entry as to all other spirits. This allowance of losses was first authorized by section 50 of the act of August 27, 1894 (28 Stat. 564). During all that time the administrative practice of the Treasury Department has been to allow the losses only as to such packages as were filled prior to entry into the warehouse.

By Treasury Decision No. 25 of the Bureau of Industrial Alcohol, signed by the Commissioners of Industrial Alcohol and Internal Revenue, and approved by the Secretary of the Treasury on January 19, 1934, part three of Regulations 7, Treasury Department, May 1930, relative to the production, fortification, tax payment, etc., of wine and the production of grape brandy for fortification was made applicable to brandy plants and the warehousing, etc., of brandy produced for any lawful purpose. Part three was, therefore, in effect as to brandy during the period beginning on January 19, 1934, and ending on June 26, 1936. The relation of this period to the bill and this report will clearly appear from this report.

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Paragraph 431 of Regulations 7 provided during the period just mentioned that after being run into locked receiving tanks at the brandy distillery the brandy would be:

"(a) Transferred to weighing tank, gauged, and conveyed by pipe line to the winery; or

"(b) Transferred to weighing tank, gauged, and conveyed to tank cars for shipment to a winery; or

"(c) Transferred to weighing tank, gauged, and conveyed to storage tanks in the brandy deposit room, pending removal to the winery by pipe line; or

"(d) Transferred to weighing tank, gauged, and conveyed to storage tanks in the distillery bonded warehouse, where such warehouse is provided; or

"(e) Drawn into casks, gauged, and removed to a winery or to a bonded warehouse, or placed in the brandy deposit room, pending removal to a winery or bonded warehouse."

It is apparent from this paragraph that the Treasury Department authorized (1) the conveyance of brandy by pipe line to bonded warehouses for storage in warehouse storage tanks, or (2) the deposit of brandy in warehouse in casks.

Regulations 7 provided further:

"PAR. 433. When brandy is transferred to storage tanks in the brandy deposit room or warehouse, after gauging, as above provided, it will be regauged by weighing tank before removal unless it is drawn into packages and then gauged."

"PAR. 456. The allowances provided in section 50 of the act of August 27, 1894, as amended, for losses of spirits in warehouse by leakage, evaporation, and soaking, will be made on packages of brandy deposited in bonded warehouses, under the conditions set forth in such law.

"PAR. 457. No allowance can be made for losses under section 50 of the act of August 27, 1894, as amended, from receiving tanks in the distillery or from storage tanks in the brandy deposit room or in the warehouse, and the tax must be paid on all such losses: *Provided, however*, That where there is a deficiency of not over one-half of 1 percent on such tanks, the same will be ascribed to variation in gauge, there being no evidence to the contrary, and no tax will be exacted thereon."

Since paragraph 456 provided that the allowances under section 50 of the act of August 27, 1894, would be made on packages (casks, par. 431) of brandy deposited in the bonded warehouse, and since paragraph 457 provided that no allowances would be made for losses from storage tanks in the warehouse, it follows that no losses were authorized to be allowed from packages (casks) filled from storage tanks. It is obvious that packages filled from storage tanks in the warehouse are not "deposited" therein, because the spirits were deposited (prior to the date of filling the casks) when they were conveyed to the warehouse storage tanks.

I have given this brief outline of the loss allowance and the application of the law: (1) In order that it may clearly appear that at no time heretofore has it been the practice, or permissible under the law and regulations, to grant the allowances as to packages filled from storage tanks in warehouse; and (2) because it has been brought to my attention by the officials of the Bureau of Internal Revenue that inquiry has been made of them heretofore concerning allowances of losses from wooden packages filled from warehouse storage tanks during the period commencing on or shortly after December 5, 1933, and ending on or before June 26, 1936, by persons who believed that after adoption of the repeal amendment the rule as to loss allowances had been changed. There is, of course, nothing in the regulations to indicate to anyone that the adoption of the twenty-first amendment in any way affected the internal-revenue laws relating to the allowance of losses from distilled-spirits packages. Only the prohibitory laws which depend for their validity on the eighteenth amendment were affected by the twenty-first amendment.

A check of the warehouse records covering fruit spirits and brandy in the State of California indicates that only two concerns filled packages with brandy or fruit spirits drawn from warehouse storage tanks. One of these concerns so filled 1,557 such packages. The other concern so filled, so far as is definitely ascertainable, 1,327 such packages. Of the packages so filled by the first-mentioned concern, there are only 2 left in warehouse. The packages withdrawn did not receive the allowances for loss accorded packages filled at cisterns in distilleries and deposited in warehouses. Of the packages filled by the second concern there remains in storage 1,214. It appears, therefore, that the first concern has withdrawn 1,555 of the packages, paying full tax thereon without benefit of any allowance for loss by leakage or evaporation, and the second concern has withdrawn 113 of its packages, leaving on deposit 1,214 packages as to which, if the proposed legislation is enacted, they will receive the benefit of the loss allowance established by law on packages filled from cisterns and deposited in warehouses. In addition to the foregoing packages, Bureau records for the second concern show 703 barrels filled,

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with 184 remaining, which apparently were filled from tanks. Should it be established that these packages were all filled from tanks, the figures given above for the second concern would be increased accordingly.

In view of the above, it is clear that all brandy manufacturers should have been aware of the fact that under the law and regulations they would not be entitled to allowances of loss by leakage and evaporation from packages filled from warehouse storage tanks and that the manufacturers who so filled packages did so in disregard of the laws and regulations. Nevertheless, since only a few taxpayers, and a relatively small amount of revenue, are involved, the Treasury Department will interpose no objection to the passage of the bill.

The Department has been advised by the Bureau of the Budget that there is no objection to the submission of this report to your committee.

Very truly yours,

JOHN W. HANES,
Acting Secretary of the Treasury.

Therefore, it is the unanimous recommendation of your committee that the bill do pass.

