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SENATE

} REPORT
} No. 1668.

THE MEDICINAL SPIRITS ACT OF 1927

FEBRUARY 28, 1927.—Ordered to be printed

Mr. SHORTRIDGE, from the Committee on Finance, submitted the following

REPORT

[To accompany S. 5801]

The Committee on Finance, to which was referred the bill (S. 5801) to conserve the revenues from medicinal spirits and provide for the effective Government control of such spirits, to prevent the evasion of taxes, and for other purposes, having had the same under consideration, report it back to the Senate without amendment and recommend that the bill do pass.

Following is the House report from the Committee on Ways and Means on the identical bill (H. R. 17130):

[House Report No. 2127, Sixty-ninth Congress, second session]

The Committee on Ways and Means, to which were referred various bills providing for the better control and disposition of existing stocks of medicinal spirits, and for the manufacture of future supplies of such spirits, having held extended hearings and having carefully and diligently considered the subject matter included in the several bills so referred, respectfully reports back to the House, by unanimous vote, H. R. 17130, a bill entitled "A bill to conserve the revenues from medicinal spirits and provide for the effective Government control of such spirits, to prevent the evasion of taxes, and for other purposes," with the recommendation that the bill do pass.

INTRODUCTION

The eighteenth amendment, the legislative enactments for the enforcement thereof, and the court decisions, recognize that it remains the duty of the United States—

1. To assure to its citizens a necessary supply of pure medicinal spirits for medicinal purposes.
2. To prevent the diversion of medicinal spirits to beverage purposes.

I. THE PRESENT EMERGENCY

Under existing law and present conditions, an adequate supply of medicinal spirits of the purity and soundness essential to their use as medicine, can not be insured now or in the future, the program of law enforcement can not be adequately effectuated, and the revenues from medicinal spirits can not be safeguarded, unless legislation is

now enacted to meet the present emergency. This emergency is attributable to—

A. Exhaustion of the present supply of medicinal spirits by consumption and evaporation.

B. Loss of taxes through failure to conserve the present supply.

C. Impurity of present supply.

D. Diversions of medicinal spirits for beverage purposes contrary to law.

It is impossible to determine the exact amount of medicinal spirits in the United States to-day without gauging, testing, and bottling. As nearly as can be estimated, the existing supply will be exhausted in about four and one-half years unless immediately bottled. If bottled, enough will be saved to last one year longer.

Under existing law, and based upon medical experience, most medicinal spirits are unfit for medicinal use until they have been stored in oak charred barrels for at least four years. If permits were issued for the immediate manufacture of new medicinal spirits, such manufacture could not be started before the fall of 1927, due to the fact that there are no distilleries in condition to-day to permit of immediate operation, and to the fact that medicinal spirits are not made except in the spring and fall; and spirits so manufactured would not be fit for use for medicinal purposes until four years after their manufacture. It is, therefore, evident that unless (1) the existing supply is immediately bottled, and (2) permits immediately issued for the manufacture of a new supply—the country will be without medicinal spirits at the end of about four and one-half years. The bottling can not be accomplished under existing law. The manufacture can not satisfactorily be accomplished under existing law.

Medicinal spirits must be pure. To-day it is highly improbable that pure medicinal spirits are in any great number of cases reaching the public. Under the present law the distribution is uncontrollable to such an extent that a pure supply can not be assured.

Further, the present supply is rapidly evaporating. The Government loses tax on the evaporated spirits. These taxes will be conserved if the spirits are placed in glass.

Proper provisions of law to prohibit diversion are also necessary to meet the emergency.

II. PROPOSED METHODS OF MEETING EMERGENCY

A. *Permits for new manufacture*

The Willis-Campbell Act provides:

* * * nor shall any permit be granted authorizing the manufacture of any spirituous liquor save alcohol until the amount of such liquor now in distilleries or other bonded warehouses shall have been reduced to a quantity that in the opinion of the commissioner will, with liquor that may thereafter be manufactured and imported, be sufficient to supply the current need thereafter for all non-beverage uses. * * *

Under the provisions of that act permits may be issued for the manufacture of a new supply of medicinal spirits, but there is no discretion to grant permits to a limited number of distillers to the exclusion of other distillers equally responsible and equally qualified.

All doubt as to this phase of the matter has been set at rest by an opinion of the Attorney General of the United States and decisions of the Federal courts.

As there would be no limit upon the number of distilleries, and as a large number of applications for permits have already been filed, a chaotic condition would result under the present law with an indefinite number of distilleries in operation, attendant increase of expense of appropriations, the increased difficulty of enforcement, and the loss of the good results heretofore obtained through concentration. Under the proposed bill the distilleries are limited to not less than two nor more than six. All other things being equal, the fewer permits to be issued (a) the less expense to Government for guarding and superintending, (b) the less the cost to manufacture pure spirits, and (c) the greater control over distribution. There should be at least two distilleries so that competition may be insured.

To issue more than six permits would be to cut down the volume of each distillery to an amount too small to allow of economical distillation and would serve to increase the expense of guarding and superintendence. The number of permits should be determined solely from the viewpoint of best serving the interests of the Government and of the ultimate consumer, and the determination of the number is therefore best left to the sound discretion of the Secretary of the Treasury.

The 10-year period for distillation permits has been adopted, since the spirits must remain in wood for at least four years; therefore, the distiller will have manufactured five successive yearly crops before he will be able to sell his first year's crop and commence to realize on his first year's investment. The bill also provides for a renewal of the permits in the event that the Secretary of the Treasury desires so to do, and the permittee has complied with the law and the provisions of the permit. This renewal secures the benefits flowing from a continuous production by the same distillers if experience proves it advantageous so to do.

B. Conservation of taxes through bottling

Under existing law bottling can not be compelled. Under the proposed bill bottling can be compelled through the provisions of the permit issued to the concentration warehouseman. The Secretary of the Treasury is authorized to cause the bottling of all existing spirits with all the advantages of savings flowing therefrom.

Medicinal spirits stored in barrels evaporate at the rate of 1 gallon for each six months, or 2 gallons a year. This loss is at the rate allowed by the Government based on experience tables. In addition there is considerable loss through leakage, and there is presented greater opportunity for tampering with spirits in bulk through dilution and other illegal acts, rendering such spirits unfit for medicinal use.

The present supply of medicinal spirits is contained in about 450,000 barrels, originally containing from 48 to 50 gallons each—now containing about 27 gallons each. It is apparent that if these medicinal spirits are bottled evaporation will cease. The additional taxes which will be collected by the Government on the existing supply by reason of the saving in gallonage will amount to about \$4,000,000.

Bottling would also prevent diversion of medicinal spirits, which now takes place to some extent in warehouses, and will prevent the substitution therefor of water, alcohol, and coloring matter.

C. Concentration

Under the present law, concentration was made by the Secretary of the Treasury of stocks from about 300 warehouses into 37—now 31—warehouses. The ownership of the spirits in these 300 warehouses was scattered and difficult of ascertainment. In part, they were owned by the corporations owning such warehouses, but as to a large proportion such ownership was evidenced by negotiable warehouse receipts which passed from hand to hand, and there were no complete records available to show the then ownership.

The expense of concentration would naturally fall upon the owners of the spirits. Since such ownership could not be definitely ascertained, and since there was no legal way to compel the warehousemen to bear the expense of removal of the spirits which were not owned by them and no appropriation therefor was made by Congress, the assistance of the owners of the various warehouses was requested in order to carry into effect the concentration. In pursuance of such request, arrangements were satisfactorily concluded with the owners of the warehouses whereby they undertook to advance to the unknown owners the funds necessary to concentrate their spirits.

The Commissioner of Internal Revenue personally inspected and selected some 51 warehouses, and under his direction all spirits within the United States were concentrated therein; such warehouses being formally designated as concentration warehouses. At that time, after investigation, each concentration warehouseman was permitted, with the sanction of the Government, to charge for storage, bottling, and other incidental services to be rendered to the owners, at rates not in excess of those stated by such warehouseman in his application for designation as a concentration warehouseman. It appears that the result of this concentration was to reduce effectively the diversion and loss in the concentration warehouses of the spirits so concentrated, to effect a substantial reduction in the evasion of taxes, and to effect a considerable saving of governmental expense in guarding the spirits and supervising shipments thereof from the warehouses.

By limiting the warehouses as provided in the bill to the proposed number of six, further substantial savings will be effected in Government expenses, tax evasion will be further decreased, and other economies and more effective supervision of distribution will be brought about through elimination of the various intermediate movements. It is asserted by the Treasury Department that economies in administrative costs can be effected to the extent of at least \$1,000,000 a year.

The bill compels concentration by providing that all stocks shall be concentrated within six warehouses within a limited time, and restricting the issuance of permits for purchase to permits for purchase only from such warehouses after such time as 5,000,000 gallons of medicinal spirits have been concentrated therein. Teeth are therefore put in the proposed law which will accomplish the result

intended, a result that can not be accomplished under the present law. Concentration is spread over a two-year period for the reasons that it involves a very considerable operation. The necessary concentration warehouses must be acquired and conditioned, and considerable financing is necessary to cover the cost of such concentration. The bottling of the spirits should be effected before concentration, so that advantage may be taken of bottling facilities in the 31 present concentration warehouses, each of which has its own bottling plant, and so that the bottling may be the more quickly consummated with a greater conservation of the spirits through prevention of evaporation. These operations, it is calculated, will take a period of time which can not safely be fixed at less than two years, although it may well be that they will sooner be consummated.

D. Restrictive distribution and purity of medicinal spirits

Under the present system of distribution, a serious situation has been created through diversion and dilution of spirits after leaving the concentration warehouse and prior to reaching the retail druggist, which results to a large extent in impure and sometimes poisonous medicinal spirits being sold on prescription by retail druggists. It is imperative that medicinal spirits be pure. This can not be accomplished under the present system. To-day medicinal spirits in large part are sold to wholesale druggists or middlemen and delivery made through various forms of transportation to such wholesale druggists or middlemen who in turn make a like delivery to the retail druggist. These many movements have made possible a very considerable diversion through cutting of the spirits.

A basic difficulty exists in fixing the responsibility for diversion, as it may have occurred while the spirits are in the course of transit or in the hands of the middleman, the wholesale druggist, or the retail druggist. It has proven most difficult, almost impossible, to ascertain the point at which the diversion has occurred, so as to fix the responsibility therefor, for the discovery of the impure article is usually made while it is in the hands of the ultimate consumer. Each of the intermediate permittees and carriers responsible for the transportation can insist that the diversion must have occurred before or after, as the case might be, the period when the goods were under his control.

Under the proposed bill the Secretary of the Treasury is authorized to compel the direct shipment in whole or in part by railway express from the authorized concentration warehouses, where such spirits are under the strictest governmental control, direct to the retail druggist. By this method the purity of the spirits when delivered to the retail druggist is assured. The responsibility for delivery of pure spirits against physicians' prescriptions will be placed thereby squarely on such retail druggist. It is believed that there will be little diversion after reaching the retail druggist's hands, but certain it is that diversion, dilution, or tampering under this plan would be too certain of detection and the loss of permit and the severe penalties incurred under the proposed act will necessarily deter even a dishonest druggist from violation of law. This insures in the only practical way the purity and soundness of medicinal spirits to the legitimate consumer.

Moreover, provision is made for distinctive labeling and distinctive containers, with severe penalties for imitation, for refilling of bottles, mutilation of labels. These restrictions will prevent so-called splitting of spirits and other evils and will go far in supplementing and aiding the provision for direct shipment in preserving purity and soundness of spirits in their final distribution.

III. REVENUES DERIVED FROM NEW MANUFACTURE

In addition to the conservation of taxes by bottling, as heretofore discussed in the report, additional revenue will be provided through the tax on the new supply manufactured and sold which, based upon the present withdrawals of medicinal spirits of 2,000,000 gallons a year at tax rate of \$1.10 per gallon, will produce \$2,200,000 a year.

IV. PROTECTION OF CONSUMERS' PURCHASE PRICE

Distribution to the public at a fair and reasonable price is assured by provisions that (1) the manufacturer of new medicinal spirits is required as a condition of his permit to sell spirits manufactured by him at a price not in excess of a fair and reasonable price, (2) persons holding permits to manufacture may acquire existing spirits only at the fair market value specified in the bill, (3) each bottle of medicinal spirits withdrawn from a concentration warehouse must bear upon its label a statement of the price at which it is sold, and (4) if any retail druggist sells medicinal spirits for more than their fair market value, the Secretary of the Treasury is authorized to revoke his permit.

V. CONCLUSION

Medicinal spirits are recognized by law and the medical fraternity as an important pharmaceutical product. That being true, it follows that it is and must be a matter of concern to all citizens of the United States and to their Representatives in Congress that such product be pure and of standard quality. By existing law, there is recognized the obligation to provide a reasonably adequate supply of medicinal spirits. It can not be doubted that the duty to supply assumes purity of the supply.

An emergency exists not only as to the exhaustion of present supply of spirits but in an urgent need for a greater measure of control in the distribution of medicinal spirits. It is believed that the bill furnishes the only satisfactory solution of this situation. At the same time it will—

1. Conserve about \$4,000,000 of revenue.
2. Prevent the evasion of taxes.
3. Insure purity of medicinal spirits.
4. Require no appropriations or Government financing.
5. Effect economies in administration to an amount of at least \$1,000,000 a year.
6. Insure increased control through further concentration.
7. Provide for replenishment on a basis which will secure lowest possible purchase price to the consumer.
8. Effectively and for all time prevent deception of the people of the United States by the organized bootlegging industry through

the use of counterfeited labels and trade-marks and the diversion of sound spirits for use in flavoring and coloring of injurious and poisonous products.

9. Furnish assurance that spirits in concentration warehouses will, when shipped therefrom, be medicinally sound, remain so through shipment by railway express direct to the retail druggist, thereby placing upon the latter the full responsibility for the purity of the product which such retail druggist sells on prescription to the ultimate legitimate consumer.

The enactment of legislation at this session to accomplish the above enumerated purposes has been recommended by the Treasury Department, medical associations, and the organizations which have made a study of the question, irrespective of whether such organizations favor or oppose the prohibition laws as such.

VI. DIGEST OF THE BILL BY SECTIONS

SECTION 1. DEFINITIONS

Section 1 merely defines terms of frequent recurrence in the act. "Distilled spirits" is defined as meaning whisky, brandy, rum, gin, and other distilled spirits, except alcohol.

SECTION 2. MANUFACTURE

Section 2 provides for the replenishment of the existing supply of medicinal spirits. Only spirits sufficient to maintain a stock sufficient in each year to supply the requirements for medicinal and nonbeverage purposes may be manufactured—thus making permanent the general policy of limitation contained in the Willis-Campbell Act, section 2 (52 Stat. 222). Within this limitation, the Secretary of the Treasury is authorized to issue permits for the manufacture of spirits. The requirement of existing law that all permits must be issued without discrimination to applicants of like responsibility and of like qualifications is abrogated by the provision giving the Secretary of the Treasury authority to select from applicants for permits to manufacture, two or more, but not more than six, persons, and issue permits to manufacture to them alone. Further authority is given the Secretary of the Treasury to prescribe in each permit the kind and quantity of spirits to be manufactured, the periods in which such manufacture shall take place, and such other requirements as he may deem necessary. The requirement of existing law (sec. 6, Title II of the national prohibition act) that permits may be issued for one year only, is changed by the provision that the Secretary may in his discretion issue permits to manufacture for a period not in excess of 10 years. Each permittee is required to manufacture according to a formula prescribed by the Secretary of the Treasury, to sell all spirits manufactured at a fair and reasonable price, and to comply with the provisions of section 5, relating to the acquisition of existing stocks. If the permittee has in good faith complied with all provisions of the law, the regulations, and his permit, the Secretary is authorized to renew the permit. If the permittee has violated any provision of the law, the regulations, or his permit, the Secretary

may revoke the permit. The provisions of existing law prescribe the procedure for such revocations. (See national prohibition act, Title 2, sec. 9, 41 Stat. 305, 311-312). The Secretary is forbidden to issue any permits for manufacture in any State which prohibits the manufacture and sale, for use, of distilled spirits for medicinal purposes.

Under existing law, powers and duties in respect of the manufacture, taxation, and traffic in intoxicating liquors, are conferred or imposed upon the Commissioner of Internal Revenue. Under this section, as throughout the act, powers and duties in respect of such matters are conferred or imposed upon the Secretary of the Treasury. This is done in order that the act may conform to the provisions of section 4 (a) of H. R. 10729 (now pending before the Congress), which transfers to the Secretary of the Treasury the rights, privileges, powers, and duties in respect of such matters, conferred or imposed upon the Commissioner of Internal Revenue.

SECTION 3. CONCENTRATION

This section supplements, but does not repeal, the provisions of the act making appropriations for the Treasury Department for the fiscal year ending June 30, 1923, approved February 17, 1922 (42 Stat. 366, 375). Under that act, for the purpose of concentration, the removal of spirits from one warehouse to another was permitted. The present bill requires the concentration in not more than six concentration warehouses (herein called authorized concentration warehouses) within two years of all existing stocks of distilled spirits. These warehouses are required to be owned or leased by permittees authorized to manufacture under section 2, and the selection of the warehouse is committed to the Secretary of the Treasury. As a condition to the issuance of a permit to maintain one of these authorized concentration warehouses, the permittee is required to comply with all regulations made by the Secretary of the Treasury as to the management of the warehouse, the bottling, storing, and handling of distilled spirits within the warehouse, and the schedule of maximum rates prescribed by the Secretary for bottling, storage, and other warehouse services. After the expiration of two years, all warehouses, other than these authorized concentration warehouses, may no longer be used for the storage of distilled spirits.

SECTION 4. BOTTLING OF EXISTING STOCK

This section authorizes the Secretary of the Treasury to require such distilled spirits as are suitable for medicinal use, and as he shall prescribe, to be bottled. Such bottling is required to be in accordance with existing law, except that, where the spirits are deficient as to proof, the Secretary of the Treasury may by regulation permit the addition of spirits of the same kind (whether or not such spirits are of the same season's production and produced by the same producer) to other spirits, in order to raise the proof to standard. This exception is necessitated by the impossibility in many instances, under present conditions, of making the necessary increase in proof.

SECTION 5. ACQUISITION OF EXISTING STOCKS

It is contemplated that persons holding permits to manufacture under section 2, who alone may maintain and operate the authorized concentration warehouses under section 3, will purchase a considerable part of the present stock of distilled spirits. Section 5 provides that such persons in acquiring such spirits are required to purchase without discrimination between the owners of existing stocks, and to purchase only at a fair and reasonable price, subject to the limitation that that price shall not exceed the fair market value of such spirits at warehouses on December 1, 1926, plus necessary carrying charges from that date to the date of purchase. All contracts for the acquisition of such spirits must be submitted to the Secretary of the Treasury for his approval or disapproval of the terms thereof, and no permit to purchase may be issued until the contract has been so submitted and approved.

Where the Secretary of the Treasury disapproves any contract for the acquisition of spirits, a board of arbitration is provided to which the parties may submit their contract, and in accordance with the decision of which the Secretary of the Treasury is required to approve or again disapprove the contract.

SECTION 6. DISTRIBUTION

When the concentration of the existing stock of distilled spirits into the authorized concentration warehouses (as required by sec. 3) has resulted in a stock of 5,000,000 gallons being stored in such authorized warehouses, the fact is promulgated by the Secretary of the Treasury. Commencing 30 days thereafter, all retail druggists, hospitals, physicians, and other persons authorized to use distilled spirits, must obtain their supplies from the stock in an authorized concentration warehouse.

The Secretary of the Treasury is given authority to require shipment of distilled spirits from an authorized concentration warehouse to retail druggists and physicians only by railway express, and to revoke the permit of any druggist, or other person authorized to sell at retail, who sells at more than a fair and reasonable price.

This section does not prohibit wholesale druggists, or other persons authorized under existing law to deal at wholesale, from contracting with respect to, or arranging for the purchase of, spirits stored in authorized concentration warehouses, but it does prohibit the acquisition of any spirits once withdrawn from an authorized concentration warehouse from any one other than a retail druggist (and from him only in retail quantities). The handling of, but not the dealing in, distilled spirits by wholesalers and middlemen is thus eliminated.

SECTION 7. DISTINCTIVE BOTTLES AND LABELS

This section requires all distilled spirits hereafter bottled—

- (1) To be placed only in official distinctive bottles.
- (2) To be tested before bottling.
- (3) To bear an official distinctive label certifying that the spirits are "Medicinal spirits bottled under the medicinal spirits act of 1927," and such further facts as the Secretary shall prescribe.

(4) To bear before withdrawal from an authorized concentration warehouse, a statement upon the label as to the price at which the retail druggist or other purchaser has bought the spirits.

If the spirits are hereafter manufactured and bottled, no print, label, mark, or trade-mark may appear upon the bottle, except such as are required by law or may be prescribed by the Secretary of the Treasury.

Spirits not bottled under the foregoing requirements may not, commencing six months after the approval of the act, be purchased by any retail druggist or physician.

Subdivisions (c), (d), and (e) make criminal any counterfeiting of bottles or labels, any tampering with labels, any sale of bottled spirits in other than the original unopened bottle (with authority to the Secretary to make exceptions for emergencies), and any palming off of refilled official bottles as medicinal spirits lawfully bottled.

SECTION 8. IMPORTATION

Only when the Secretary of the Treasury finds that the available stock of spirits suitable for medicinal use of a particular class or kind is insufficient to meet the demand for distilled spirits of that class or kind, may distilled spirits be imported; and then only of the class and kind, in the quantity, by such persons, and subject to such other requirements, as the Secretary of the Treasury may prescribe.

SECTION 9. SEPARABILITY OF PROVISIONS

This section provides for the separability of provisions in the event any particular provision of the act is declared unconstitutional.

SECTION 10. EXISTING LAW

The provisions of the act making appropriations for the Treasury Department for the fiscal year ending June 30, 1923 (42 Stat. 375), with respect to concentration, and all provisions of existing law with respect to the taxation of distilled spirits remain in full force and effect under the act. All provisions of the national prohibition act, and acts supplementary thereto, including their provisions as to applications for permits, the issuance and revocation of permits and bonds, are in all respects continued in effect, except only to the extent that special provisions are made in this act for such matters.

Subdivision (b) excepts from the provisions of the act certain brandy and rum manufactured for nonbeverage purposes in very limited quantities.

SECTION 11. SHORT TITLE

This section provides that the act may be cited as "The medicinal spirits act of 1927."

Following is a letter dated February 25, 1927, signed by the Secretary of the Treasury, in relation to the bill (S. 5801):

FEBRUARY 25, 1927.

MY DEAR MR. CHAIRMAN: I have the request of the Committee on Finance, dated February 24, 1927, for a report on S. 5801, a bill to conserve the revenues from medicinal spirits and provide for the effective Government control of such spirits, to prevent the evasion of taxes, and for other purposes.

S. 5801 is identical with H. R. 17130 which was drafted by a Subcommittee of the Committee on Ways and Means of the House, reported out by unanimous report of the Committee on Ways and Means, and is now under consideration by the House of Representatives. The Treasury believes that the present emergency and the problems in connection therewith were met more effectively under the proposed Treasury bill H. R. 17040, which was not voted out of committee; and while S. 5801 and its corresponding bill in the House, H. R. 17130, have administrative features in connection with price fixing, which the Treasury is not anxious to assume, the bill will meet the administrative requirements in the medicinal spirits emergency situation.

S. 5801 limits permits for manufacture of new spirits for replenishment to not less than two and not more than six distilleries, thus avoiding the serious alternative, under existing law, of having to grant an indefinite number; it provides for concentration in glass of all existing stocks into not more than six concentration warehouses, and thus accomplishes most desirable conditions for law enforcement and economy, as well as conservation of existing stocks and tax revenue thereon; it provides for placing all existing spirits into distinctive bottles under distinctive labels, with severe penalties for imitation, adulteration, etc., and, most desirable for law enforcement and to insure pure medicinal spirits, it provides for direct shipment from concentration warehouse to retail druggist.

To sum up, I believe the bill will accomplish the two main administrative purposes that I had in mind in recommending legislation at this time. It makes provision for the future supply of medicinal spirits under proper control and, in the second place, it corrects those existing conditions which make it difficult to prevent the diversion of medicinal spirits to beverage purposes and the adulteration of the supply actually sold in the retail trade for legitimate medicinal use.

Very truly yours,

A. W. MELLON,
Secretary of the Treasury.

HON. REED SMOOT,
Chairman Committee on Finance, United States Senate.

