State of California

Board of Equalization
Legal Department-MIC: 82

Memorandum

To : Dennis Maciel, Chief
Excise Taxes Division (MIC:56)

Date: April 2, 2003

From : Monica Gonzalez Brisbane
Senior Tax Counsel (MIC:82)

Subject: **Request for Legal Opinion –**
Alcoholic Beverage Tax Regulation 2550

This is in response to your January 15, 2003, memorandum addressed to Assistant Chief Counsel Janice Thurston concerning the application of Alcoholic Beverage Tax Regulation 2550 dealing with unaccounted for losses of distilled spirits. Specifically, you ask, "[S]hould a specific deduction be allowed for the exact quantity of product lost due to breakage caused by warehouse handling of distilled spirits within the category of unintentional destruction (accounted for loss) under Regulation 2550?"

CONCLUSION

As discussed below, the plain language of the regulation dictates that no deduction for loss of distilled spirits should be allowed for "unintentional destruction" unless all requirements of Regulation 2550(a) are met. Regulation 2550(a) requires a statement under oath and proof of loss in the form of paid insurance or carrier claims retained on the taxpayer's premises for verification. If these requirements are not met, no deduction should be allowed.

DISCUSSION

Regulation 2550, *Destruction and Unaccounted For Losses of Distilled Spirits*, provides:

> **(a) Unintentional Destruction.** The term "unintentional destruction" shall mean destruction of distilled spirits by fire, earthquake, floods, breakage in transit, accident, or by any other cause, when the exact quantity destroyed is known. Claims for loss by unintentional destruction must be filed with the Board in Sacramento immediately following the close of business on the last day of the month in which the loss is discovered. The claim must state under oath of the licensee that the distilled spirits were so damaged that they could not be used for any purpose. Proof of loss satisfactory to the Board in the form of paid insurance or carrier claims must be retained on the taxpayer's premises for verification.

> (b) **Unaccounted For Losses.** Unaccounted for losses shall include all other losses disclosed by physical inventory due to pilferage, handling, etc. The allowable tolerance for unaccounted for losses of distilled spirits acquired by any distilled spirits taxpayer shall not exceed one-tenth of one percent of the total sales of the distilled spirits. In the case of distilled spirits taxpayer who holds licenses for two or more premises, the tolerance allowed by this rule shall be computed and applied separately to the transactions for each premises, unless the Board has granted the taxpayer permission to file a consolidated tax return.
>
> (Emphasis added)

As you have stated, the Regulation provides two separate calculations for losses. One for "Unintentional Destruction" and one for "Unaccounted For Losses." The key distinction between the two calculations is whether or not the exact quantity is known.

Your memorandum provides that "we have recently observed that more than one taxpayer has interpreted Regulation 2550(a), 'unintentional destruction' to include breakage caused by warehouse handling when the exact quantity is known and have taken deductions for these quantities. They have submitted statements under penalty of perjury and declared the losses as 'accounted for losses.'" Specifically, your memorandum provides that "In the case we are currently examining, the taxpayer maintains detailed daily records of their losses and files a statement under penalty of perjury that the subject losses were so destroyed or damaged that they could not be used for any purpose. This statement is filed along with their tax return, which includes a deduction for the specific amount of lost product." However, you state that because the taxpayer does not carry any insurance policy for such losses, no insurance claims were available upon your examination of records and no outside carriers were involved in the loss to warrant carrier claims.

In our opinion, the plain language of the regulation prevails. No loss can be taken under subsection (a) unless a claim is made under oath and proof of loss in the form of paid insurance or carrier claims are retained on the taxpayer's premises for verification. The Board does not consider a loss an "unintentional destruction" unless the requirements of the subsection are met. It is not relevant that the taxpayer may have an "exact quantity destroyed" or made a statement under oath. A taxpayer that is claiming a loss as unintentional destruction, without the final criteria under subsection (a) that there be paid insurance or carrier claims retained on the taxpayer's premises, is claiming a loss in error.

You state that your confusion starts from the definition of "unintentional destruction" which includes "loss due to, accident, or by any other cause." You believe that the language "or by any other cause" opens the door for losses due to warehouse breakage. Warehouse breakage could fit under subsection (a), but only if all the

requirements of the subsection are met, namely statement under oath and proof of loss in the form of paid insurance or carrier claims retained by the taxpayer. If there is no proof of loss, as required, the taxpayer is taking the loss in error and it should be disallowed. If the taxpayer cannot meet the requirements of subsection (a), then the taxpayer is only allowed what you refer to as the "tolerance allowance" provided for in subsection (b).

Please let me know if you have any further question concerning this matter.

MGB/ef

cc: Ms. Judy Nelson (MIC:82)
Mr. Bill Kimsey (MIC:56)
Mr. Vic Day (MIC:56)
Mr. Brian Ishimuru (MIC:56)

State of California

Board of Equalization
Excise Taxes Division

Memorandum

Date: January 15, 2003

To: Ms. Janice Thurston
Assistant Chief Counsel, MIC: 82

FROM: Dennis Maciel, Chief
Excise Taxes Division, MIC: 56

Subject: Request for Legal Opinion - Alcoholic Beverage Tax Regulations

We are requesting a legal opinion with respect to the application of the Alcoholic Beverage Tax Law to product lost due to "breakage" pursuant to Alcoholic Beverage Tax Regulation 2550. Specifically, should a specific deduction be allowed for the exact quantity of product lost due to breakage caused by warehouse handling of distilled spirits within the category of unintentional destruction (accounted for loss) under Regulation 2550?

Regulation 2550, *Destruction and Unaccounted For Losses of Distilled Spirits*, provides two separate calculations for losses. Part (a) Unintentional Destruction, provides that "The term 'unintentional destruction' shall mean destruction of distilled spirits by fire, earthquake, floods, breakage in transit, accident, or by any other cause, when the exact quantity destroyed is known. Claims for loss by unintentional destruction must be filed with the Board in Sacramento immediately following the close of business on the last day of the month in which the loss is discovered. The claim must state under oath of the licensee that the distilled spirits were so damaged that they could not be used for any purpose. Proof of loss satisfactory to the Board in the form of paid insurance or carrier claims must be retained on the taxpayer's premises for verification."

Regulation 2550 (b), provides that " Unaccounted for losses shall include all other losses disclosed by physical inventory due to pilferage, handling, etc. . . . losses of distilled spirits acquired by any distilled spirits taxpayer shall not exceed one-tenth of one percent of the total sales of the distilled spirits."

It is not common to observe that detailed records of such losses are maintained and any losses due to mishandling by the taxpayer would fall within the 1/10th of one percent tolerance allowed for "unaccounted for losses" provided under Regulation 2550 (b). However, we have recently observed that more than one taxpayer has interpreted Regulation 2550 (a), "unintentional destruction" to include breakage caused by warehouse handling when the exact quantity is known and have taken deductions for these quantities. They have submitted statements under penalty of perjury and declared the losses as "accounted for losses". Accounted for losses are not subject to the allowable tolerance of 1/10th of one percent of total sales as are the unaccounted for losses.

In the case we are currently examining, the taxpayer maintains detailed daily records of their losses and files a statement under penalty of perjury that the subject losses were so destroyed or damaged that they could not be used for any purpose. This statement is filed along with their tax return, which includes a deduction for the specific amount of lost product. Because the taxpayer does not carry any insurance policy for such losses, no insurance claims were available upon our examination of records and no outside carriers were involved in the loss to warrant carrier claims. Therefore, the taxpayer is unable to and has not met the final criterion under Regulation 2550 (a).

In a memorandum from Bob Frank to Pete Lee, cc: E. V. Anderson, John Murray, Legal, and several auditors, dated January 30, 1985, copy attached, the above subject was addressed and the following guidance was provided: ...

> "(2) Bottles broken in the warehouse due to careless handling or accident will be considered unaccounted for losses. Although the exact quantity lost be known, these are handling losses and should be subject to the allowable tolerance of 1/10 of 1% of total sales."

We are not absolutely convinced this interpretation applies to our situation. There is no mention that amounts were claimed with the Board, such as on a tax return, nor is there any indication that a statement under oath was filed to validate the losses.

Our confusion in this area starts from the definition of "unintentional destruction" which includes loss due to, accident, or by any other cause. This appears to open the door for losses due to warehouse breakage. Additionally, the matter is further complicated by the fact that these losses are unintentional, are recorded, and claimed on tax returns along with a statement under penalty of perjury attesting to the loss. However, independent documentation, such as insurance claims, are not available to validate the loss through a third party. Accordingly, such statements filed by taxpayers could be viewed as self-serving with no avenue for Board staff to verify the losses through and independent party.

In the cases at hand, the losses exceed the tolerance level for unaccounted for losses. As such, we request your guidance regarding the interpretation of Regulation 2550 and whether or not these losses should be allowed on an actual basis independent of the tolerance limitation for unaccounted for losses.

Attachment

Cc: Mr. Bill Kimsey
Mr. Victor Day
Mr. Brian Ishimaru

Memorandum

To : Bob Frank

Date January 30, 1985

From Pete Lee

Subject: Alcoholic Beverage Tax Regulation 2550 regarding losses and allowances

In my January 9, 1985 memo to you I described several situations in which distilled spirits taxpayers experience losses of inventory. After discussing the matter with both you and Ed King my instructions are to handle the situations as follows:

(1) When a taxpayer receives a shipment of distilled spirits and some of the goods are damaged or missing, the taxpayer shall be allowed to claim an accounted for loss as long as he makes a claim against the carrier or insurance company. This allowance would not be conditioned upon payment of the claim, since payment of the claim has no bearing as to how the loss occurred.

(2) Bottles broken in the warehouse due to careless handling or accident will be considered unaccounted for losses. Although the exact quantity lost may be known, these are handling losses and should be subject to the allowable tolerance of 1/10 of 1% of total sales.

PL:kw

cc: E. V. Anderson
John Murray
Ed King
Alan Malbouvier
Lorene Fravel
Marcine Crane, Jr.