

industry and others to whom TTB regulations apply.

I. Background Information

A. What Are Flavored Malt Beverages?

In recent years, flavored malt beverages have become increasingly popular and have gained greater market share. These products differ from traditional malt beverages and beer in several respects. Flavored malt beverages exhibit little or no traditional beer or malt beverage character. Their flavor is derived primarily from added flavors rather than from malt and other materials used in fermentation. Flavored malt beverages are marketed in traditional beer-type bottles and cans, and their alcohol content is similar to most traditional malt beverages—in the 4 to 6% alcohol by volume range.

Although flavored malt beverages are produced at breweries, their method of production differs significantly from the production of other malt beverages or beer. In producing flavored malt beverages, brewers brew a fermented base of beer from malt and other brewing material. Brewers then treat this base using a variety of processes in order to remove malt beverage character from the base; *i.e.*, they remove the color, bitterness, and taste that are generally associated with beer, ale, porter, stout, and other malt beverages. This leaves a base product to which brewers add various flavors, which typically contain distilled spirits, to achieve the desired taste profile and alcohol level.

Although the alcohol content of flavored malt beverages is similar to that of most traditional malt beverages, the alcohol in many of them is derived primarily from the distilled spirits component of the added flavors rather than from the fermentation of malt and other materials. In some cases, as much as 99% of the alcohol in the finished flavored malt beverage product comes from added flavorings containing distilled spirits and not from fermentation in the brewery. Because these alcohol beverages begin with a base of fermented beer, they are made at breweries, taxpaid at the rate applicable to beer, and distributed to the alcohol beverage market through beer and malt beverage wholesalers.

Flavored malt beverages are sold under many proprietary names and include alcohol beverages such as alcoholic lemonades, alcoholic colas, cooler-type products, and other flavored alcohol beverages. In the last two years, brewers have partnered with distilled spirits producers in order to label flavored malt beverages using

prominent distilled spirits brand names. Published statistics for calendar year 2001 indicate that flavored malt beverages constitute as much as 5% of the overall U.S. malt beverage market, or as much as 10 million barrels (of 31 gallons each) of the overall malt beverage market of approximately 200 million barrels.

B. What Is Our Authority To Regulate Beer and Breweries?

Beer is a taxed under the Internal Revenue Code of 1986 (IRC). The IRC both defines beer and imposes a Federal excise tax on beer removed from a brewery, or imported into the United States, for consumption or sale. Section 5052(a) IRC defines “beer” as:

* * * beer, ale, porter, stout, and other similar fermented beverages (including saké or similar products) of any name or description containing one-half of 1 percent or more of alcohol by volume, brewed or produced from malt, wholly or in part, or from any substitute therefor.

This statutory definition of beer is restated in our regulations in 27 CFR part 25, Beer.

This definition of beer originated in the internal revenue act passed by Congress in 1862 to help finance the Civil War and has remained essentially unchanged to the present day. (*See* § 50 of the Act of July 1, 1862, 12 Stat. 432, 450.) TTB and its predecessor agencies have long relied on this statutory definition in collecting the Federal excise tax on beer. Under IRC section 5051, the current excise tax on beer is \$18 per barrel of 31 gallons, with certain exceptions for qualified small domestic brewers.

The IRC also governs the establishment and bonding of breweries. IRC section 5401 requires a brewer to give notice to the Secretary of the Treasury and file a bond with the Secretary prior to commencing business at a brewery. TTB and its predecessor bureaus have long regulated the establishment and operation of breweries under these statutory provisions.

C. What Is Our Authority to Regulate Malt Beverages?

The Federal Alcohol Administration Act (FAA Act), 27 U.S.C. 211, defines a “malt beverage” as:

* * * a beverage made by the alcoholic fermentation of an infusion or decoction, or combination of both, in potable brewing water, of malted barley with hops, or their parts, or their products, and with or without other malted cereals, and with or without the addition of unmalted or prepared cereals, other carbohydrates or products prepared therefrom, and with or without the addition

of carbon dioxide, and with or without other wholesome products suitable for human food consumption.

This definition also appears in our regulations in 27 CFR part 7, Labeling and Advertising of Malt Beverages.

The FAA Act gives the Secretary of the Treasury or his designate authority to issue regulations providing the public with information about the identity and quality of malt beverages, and to prevent deception in the labeling and advertising of malt beverages. The FAA Act also requires that persons engaged in the business of wholesaling or importing malt beverages obtain permits. In addition, it requires bottlers or importers of malt beverages to obtain certificates of label approval prior to introducing malt beverages into interstate or foreign commerce. Regulations implementing these FAA Act provisions appear in 27 CFR part 7, Labeling and Advertising of Malt Beverages.

D. What Is Our Authority To Regulate Distilled Spirits?

Since the early days of the Republic, Congress has levied, and the Treasury Department has collected, taxes on distilled spirits. Today, under provisions of the IRC that define and tax distilled spirits, TTB regulates the production, labeling, and taxpayment of distilled spirits. Under other provisions of the IRC, we also oversee the qualification and operation of distilled spirits plants (DSPs).

IRC section 5002(a)(8) defines “distilled spirits” as:

* * * that substance known as ethyl alcohol, ethanol, or spirits of wine in any form (including all dilutions and mixtures thereof from whatever source or by whatever process produced).

IRC section 5001 imposes Federal excise tax on distilled spirits at the rate of \$13.50 per proof gallon. A proof gallon is one liquid gallon containing 50% alcohol by volume (100 proof) at 60° F.

The FAA Act, at 27 U.S.C. 211(a)(5), defines distilled spirits similarly as:

* * * ethyl alcohol, hydrated oxide of ethyl, spirits of wine, whiskey, rum, brandy, gin, and other distilled spirits, including all dilutions and mixtures thereof, for non-industrial use.

The FAA Act also gives us the authority to prescribe labeling and advertising regulations for distilled spirits.

The FAA Act requires distillers, blenders, bottlers, wholesalers, and importers of distilled spirits to obtain basic permits. It further requires these persons to obtain certificates of label approval for labels on bottles of distilled