



Testimony on SB 1564
Senate Business & Transportation Committee
Submitted by Cannon Beach Distillery
February 12, 2018

Chair Beyer and members of the Committee, thank you for sponsoring and hearing this legislation. SB 1564 has the potential to benefit the craft distilling industry as well as the State of Oregon. Thank you for your time in reading this testimony.

Cannon Beach Distillery was established in November of 2011, and opened its doors to the public on July 1st 2012. Since its establishment, every drop of spirit has been fermented from raw ingredients, distilled, matured, processed, and labeled by C.B.D. in its production facility in Cannon Beach.

The Distillery is a sole proprietorship owned by Michael Selberg who conducted every aspect of the business, from fermentation to bottling, planning to accounting, by himself for the first two years. He built the business one batch of spirits at a time with minimal startup funds. The success of the business plan was entirely dependent on tasting room sales. Initial batch sizes were so small that they would often sell out before the next batch was ready. Revenue from one batch went towards increasing the size of the next. In this way, Cannon Beach Distillery grew at an incremental pace until it reached a point where it could utilize the OLCC distribution system by having a reliable inventory.

Six years later, 85% of C.B.D. spirits sold by the bottle are still sold directly out of its tasting rooms in Cannon Beach. In 2017 C.B.D. received payment for 673 cases of spirit. 102 cases were sold through OLCC distribution and 571 cases were sold out of the distillery.

Those 571 cases produced \$105,523.46 in revenue for the state of Oregon, which amounts to 33.7% of the total cost of the bottles sold.

Since 2012, The State of Oregon has received over \$400,000.00 of revenue resulting from bottles sold out of C.B.D. tasting rooms in Cannon Beach. State employees never handled those bottles. They were manufactured, stored, promoted, and sold by C.B.D. employees in C.B.D. tasting rooms.

C.B.D. employs four people, which includes the owner. Two people do all of the production and split time with the other two conducting all the sales. Annual payroll typically equals half of the revenue produced for the State of Oregon. With Operating and Production costs, the business is barely able to break even, and often takes a loss.

These struggles have nothing to do with the quality and demand for the product. C.B.D. has been awarded over 20 national and international awards for its spirits. In 2014, the American Distilling Institute awarded C.B.D. with the Best Rum in the largest competition of craft spirits in the country. Single release Whiskey batches regularly sell out within hours of release. The tasting room is one of the most successful in all of Oregon.

SB 1564 would stimulate the craft distilling industry in ways that would guarantee the future success of distilleries like C.B.D., as well as increase revenue for the State of Oregon over time. The most significant hurdle to the success of C.B.D. is the revenue taken by the State of Oregon. These payments severely limit usable cash flow that is desperately needed to pay employees, purchase ingredients, and update production equipment. Distillery tasting rooms can only be successful up to a point based on the fact that spirits must be purchased in person, and cannot be sold directly to bars and restaurants. An influx of cash would allow Distilleries to increase overall production. Distilleries like C.B.D. would be capable and eager to supply a much higher percentage of their product to OLCC distribution, where the State of Oregon makes closer to 48% of the total cost of that bottle rather than 37%. It is undeniable that bars and restaurants purchase more bottles annually than distillery tasting room customers. SB 1564 would open up the market for these distilleries to make their way into OLCC liquor stores, increasing revenue for the distillery and the State of Oregon.

SB 1564 has the potential to be as successful as the small winery tax exemption that created massive growth for the Oregon wine industry. Wineries that produce less than 100,000 gallons of wine are exempt from paying the 'privilege tax' in Oregon. SB 1564 functions on the same fundamental principles that have already been proven to succeed.

However, it should be noted that SB 1564 should not be seen as a tax cut. Every distillery owner signs a 'Distillery Retail Outlet Agent Agreement' with the OLCC. In this contract, item 19 regarding the 'Sale of Distilled Liquor Manufactured by the Distillery' reads:

"At the time of transaction, the distilled spirits product becomes the property of the commission, and, therefore, the proceeds from the sale belongs to the commission."

The bottle being sold and money being received is property of the State of Oregon and the distillery is reimbursed by the OLCC for its portion from the money received. How can a distillery be taxed on bottles it doesn't own? Also, there is no reference to a "distilled spirits tax" in any of the Oregon revised statutes or tax codes. In this way SB 1564 serves another important function, it gives ownership of those spirits back to the distillery that manufactured them. Crafting a spirit from scratch is hard work, and often takes years. Oregon distilleries deserve to own the products they sell. It might seem like a small detail, but it means a tremendous amount to people who take great pride in their work.

The disparity in revenue produced by the State of Oregon between distillery tasting rooms and other beverage alcohols also needs to be discussed. C.B.D. produced

\$105,523.46 in revenue for the State from the sale of 571 cases of spirit through its tasting room. The current Beer privilege tax is \$2.60 per barrel (31 gallons). The current Wine privilege tax is \$0.67 per gallon for wine under 14% ABV and \$0.77 a gallon for wine over 14% ABV.

To produce \$105,523.46 in privilege tax from the sale of beer, a brewery would need to sell 40,585.95 barrels of beer. That is over 1.25 million gallons of beer to produce the equivalent revenue as C.B.D.'s 571 cases of spirits. Assuming the beer is 5% ABV, that is over 13.4 million standard drinks of beer to the 120,000 standard drinks of spirit we sold by the bottle.

Only three breweries in Oregon during all of 2016 sold and paid tax on more than 40,000 barrels of beer. They are all national brands with dozens of employees. Again, C.B.D. has four employees that produce this revenue strictly from bottle sales out of its tasting room.

The same system could be applied to wine. A winery would have to pay tax on 157,497.7 gallons of wine, or 66,287 cases. That would make C.B.D. the 6th largest winery in the state based on privilege taxes paid in 2016. However, the 571 cases of spirit has the equivalent amount of alcohol as 4,700 gallons of wine at 12% ABV. By that metric, if C.B.D. were a winery it would not have to pay any tax under the small winery exemption.

Finally, much has been said about the changes in the federal excise tax on distilled spirits. Opponents to SB 1564 have accused distilleries of being greedy by wanting more relief after already receiving a tax break. The federal excise tax is determined based on the quantity of alcohol being removed from a bonded premise at a rate of \$2.70 per proof gallon (down from \$13.50) for the first 100,000 gallons. A proof gallon is equivalent to 1 gallon of 100 proof alcohol (50% ABV). To put this in perspective, a 750mL bottle of 40% alcohol contains 0.158 proof gallons. The federal tax on that bottle has been reduced from \$2.14 to \$0.43, for a savings of \$1.71 per bottle. This is a great deal for all distilleries, but particularly benefits manufacturers that produce higher quantities and are capable of producing liquor at far lower costs per bottle.

The \$105,523.46 of Oregon revenue produced from the sale 571 cases comes from 1,128.08 proof gallons of C.B.D. spirit. An excise tax rate of \$93.54 per proof gallon would be needed to produce the same revenue off of 1,128.08 proof gallons. Most other states use an excise tax to produce revenue off of liquor, but only 10 have an excise tax rate above \$10.00. So while it is nice that the federal government dropped it's excise tax rate, a savings of \$1.71 per bottle pales in comparison to the \$14.82 average that C.B.D. pays per bottle to the State of Oregon.

The only issue with SB 1564 is that it makes the same mistake as current Oregon policy by creating caps and determining revenue based on the cost of the bottle at sale rather than the quantity of alcohol in that bottle. Taxes and fees determined on the cost of bottle are detrimental to smaller producers who can only produce small batches far higher production costs. Think about an \$8 bottle of vodka versus a \$50 bottle of Whiskey, both bottled at 80 proof. Both could be sold out of a distillery

tasting room similar to that at C.B.D. The Vodka was sourced from an out of state wholesale distillery, filtered and bottled in a cheap plastic bottle, while the Whiskey was made from local grains that needed processing, distillation, and years of maturation. At the average C.B.D. rate from 2017, the State of Oregon would receive \$2.67 for sale of the Vodka and \$16.85 for the sale of the Whiskey even though they have the same alcohol content. The current system rewards lower production costs, which discourages distillers from buying higher price point local ingredients. Most Oregon distillers are pushed into a lower price point, and higher volume system that does not reward more technical, craft spirits.

Rather than having a cap on the amount of money a distillery can sell out of its tasting room, it seems to make more sense to control the amount of alcohol it can sell tax free. If any tax is going to be collected from tasting rooms, it should be an excise tax based on the quantity of alcohol rather than the price at which it is sold. The original concept of the OLCC was to determine the price of a bottle based on a wholesale to retail markup. That model makes sense for distributed products, but fails small, craft distillers when applied to tasting rooms.

In conclusion, it is clear that the current model of collecting Oregon revenue from distillery tasting rooms disproportionately hurts smaller, craft distilleries. C.B.D. is a unique model in this state, but the revenue produced off of its limited sales is equal to some of the largest breweries and wineries in Oregon. This disparity is unreasonable and unethical. SB 1564 corrects these issues, but could be better. The bill could be greatly improved by substituting a proof gallon limit on tasting room sales, and/or creating excise tax rates for tasting room bottle sales rather than percentage rates based on bottle costs. Minor reductions on Oregon revenue from these changes would be short lived and lead to increases in revenue just as they did when similar changes were made in the Oregon Wine industry.

Line 2 of Title 37, Chapter 471.030 defining the purpose of the Liquor Control Act in Oregon says, "**It is the policy of the State to encourage the development of all Oregon industry**".

In the six years Cannon Beach Distillery has been operating, it is not reasonable to conclude that the State of Oregon has followed through with this promise. Please help encourage the development of our industry now.

Account of taxable beer and wine sales from 2016 can be found on the OLCC website at:

http://www.olcc.state.or.us/pdfs/wine/wine_2016_12_ytd.pdf

http://www.olcc.state.or.us/pdfs/beer/beer_2016_12.pdf