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ARIZONA LUXURY TAX RULING LTR 20-3

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ISSUE:

This ruling addresses the taxation of ready-to-drink (RTD) beverages for luxury tax purposes.

APPLICABLE LAW:

Arizona Revised Statutes (A.R.S.) §§ 42-3002 and 42-3051 establish the state's exclusive authority to levy luxury taxes on tobacco products and alcoholic beverages, thereby preempting any of the state's political subdivisions from imposing such tax.

A.R.S. § 42-3003(B)(2) establishes the department's powers and authority over the administration of Arizona luxury taxes, including valuation, computation, estimation, supervision, and direction relating to public revenue and taxation.

A.R.S. § 42-3052 establishes the particular categories of tobacco products and liquor upon which luxury tax is applied and their corresponding rates. For liquor, the categories and luxury tax rates are as follows:

- \$3.00 per gallon for each sealed container of spirituous liquor, with a proportionate rate applying for quantities less than or more than one gallon.¹ "Spirituous liquor" is defined as "any liquid that contains more than [0.5% alcohol by volume (ABV)], that is produced by distillation of any fermented substance and that is used or prepared for use as a beverage," excluding "medicines that are unsuitable for beverage purposes."²
- \$0.84 per gallon for each container of non-cider vinous liquor with a 24% or lower ABV, with a proportionate rate applying for quantities less than or more than one gallon.³
 - Vinous liquor is defined as "any liquid that contains more than [0.5% ABV] and that is made by the process of fermentation of grapes, berries, fruits, vegetables or other substances but" excludes both liquids made by fermenting or distilling hops or grains and "[m]edicines that are unsuitable for beverage purposes."
 - Cider is defined as "vinous liquor that is made from the normal alcoholic fermentation of the juice of sound, ripe apples, pears or other pome fruit" with greater than 0.5% ABV but no more than 7.0% ABV.⁴

¹ A.R.S. § 42-3052(1).

² A.R.S. § 42-3001(24).

³ A.R.S. § 42-3052(2).

⁴ A.R.S. § 42-3001(4).

- \$0.25 per 8-ounce or smaller container of non-cider vinous liquor with an ABV of greater than 24%, with the tax applying for a container containing more than 8 ounces at a rate of \$0.25 for each 8 ounces.⁵
- \$0.16 per gallon of malt liquor or cider, with a proportionate rate applying for quantities less than or more than one gallon.⁶ “Malt liquor” is defined as “any liquid that contains more than [0.5% ABV] and that is made by the process of fermentation and not distillation of hops or grains,” excluding liquids made by distillation and “[m]edicines that are unsuitable for beverage purposes.”⁷

A.R.S. § 42-3352 through 42-3355 provides the reporting and payment requirements for liquor wholesalers, craft distilleries, farm wineries, and microbreweries required to be licensed by the Arizona Department of Liquor Licenses and Control.

DISCUSSION:

In this ruling, the term “RTD” refers to any drink sold at retail in a can, bottle, or other container that consists of a combination of non-alcoholic ingredients (*e.g.*, carbonated or still water, juice, sweeteners, flavoring agents) and one or more of the four categories of liquor defined in the Arizona luxury tax statutes: spirituous liquor, vinous liquor, malt liquor, and cider. These drinks, which are otherwise made to order in a bar or lounge setting by a bartender or mixologist, are prepared and bottled by beverage producers to allow for immediate consumption by consumers.⁸

For luxury tax purposes, if non-alcoholic ingredients are combined with a liquor from one of the four categories found in Arizona luxury tax statutes to produce an RTD, it is only the ABV and not the liquor category of the product that changes. The only change recognized for tax purposes is if the RTD’s total ABV falls below 0.5%, such that it no longer constituted a liquor subject to Arizona luxury tax.

⁵ A.R.S. § 42-3052(3).

⁶ A.R.S. § 42-3052(4).

⁷ A.R.S. § 42-3001(13).

⁸ See, *e.g.*, Heather Burrell, *Ready-to-drink beverages: a convenient answer to consumer demand for functionality?*, FOODBEV MEDIA (Sept. 3, 2019), <https://www.foodbev.com/news/ready-to-drink-beverage-trends>.

Example 1: Assume that a gin and tonic consists of a base liquor of 46% ABV gin combined with tonic water and a twist of lime. When sold as three separate ingredients, gin—the sole liquor that the drink contains—is the only item subject to Arizona luxury tax. Gin is produced by distilling grain mash with juniper berries and other botanical flavoring agents. As such, it would be taxed as a spirituous liquor, by virtue of the distillation process used to produce its alcoholic content, its preparation for beverage purposes, and ABV of greater than 0.5%.

If a gin and tonic is sold in a 12-ounce canned RTD format, the drink would remain subject to luxury tax as a spirituous liquor by virtue of these same three characteristics, assuming the ABV of the beverage remains higher than 0.5%. The addition of the tonic water and lime juice would not change the tax treatment of the RTD as a spirituous liquor, just as the addition of water by a distillery would not change the tax treatment of its gin as a spirituous liquor unless the ABV fell below 0.5%.

Because the \$3.00-per-gallon luxury tax rate on spirituous liquor is prorated based on the volume in which it is sold, the luxury tax on a 12-ounce canned gin and tonic is equal to

$$\frac{\$3.00}{gal} \times \frac{1 gal}{128 oz} \times 12 oz \approx \$0.281$$

For an RTD that contains more than one category of alcoholic beverage, however, the department will apply luxury tax to the product at the tax rate equal to the highest rate of liquor incorporated into the RTD.

Example 2: Assume that sangria consists of 1 part 40% ABV brandy to 9 parts 14.5% ABV red wine, combined with other non-alcoholic ingredients (juice and sweetener). When sold as separate ingredients, both the brandy and wine would be subject to Arizona luxury tax. Brandy is a spirit distilled from a fermented fruit juice such as grapes or apples. Red wine is produced through the fermentation of grapes. As such, brandy would be taxed as a spirituous liquor, by virtue of the distillation process used to produce its alcoholic content, its preparation for beverage purposes, and ABV of greater than 0.5%. The wine is taxed as a vinous liquor, by virtue of its production from the fermentation from grapes, preparation, and ABV of greater than 0.5%.

If the sangria is sold in a 12-ounce canned RTD format, the drink would remain subject to Arizona luxury tax. While the non-alcoholic ingredients would not change the taxability of the beverage, assuming the ABV remains greater than 0.5%, the RTD would be taxed as a spirituous liquor.

Because \$3.00-per-gallon luxury tax rate on spirituous liquor with a 24% or lower ABV is prorated based on the volume in which it is sold, the luxury tax due on a 12-ounce can of sangria is equal to

$$\frac{\$3.00}{gal} \times \frac{1 gal}{128 oz} \times 12 oz \approx \$0.281$$

RULING:

Arizona taxes RTD beverages pursuant to Arizona law requiring that the state luxury tax be applied to all enumerated liquors.⁹ Under the express duties and powers conferred to it in the area of luxury taxation by the Arizona Legislature pursuant to A.R.S. § 42-3002, but mindful that ambiguities in taxation statutes are to be resolved in favor of the taxpayer,¹⁰ the department rules that luxury tax shall be levied as follows:

- For an RTD beverage containing one of the four categories of alcoholic beverages enumerated in Arizona luxury tax statutes (*i.e.*, malt liquor, vinous liquor, spirituous liquor, and cider), the entire beverage is subject to luxury tax at the rate that applies to the base liquor of the RTD.
- For an RTD beverage containing more than one of the four enumerated categories, the entire beverage is subject to luxury tax at the rate that applies to the highest rate of liquor incorporated into the RTD.

This ruling applies only to the RTD beverages of a manufacturer or producer who either sells at wholesale or is required to be licensed as a craft distillery, farm winery, or microbrewery by the Arizona Department of Liquor Licenses and Control.

Grant Nulle

[Grant Nulle \(Oct 27, 2020 09:42 PDT\)](#)

Signed: Grant Nulle, Deputy Director

Date: Oct 27, 2020

Explanatory Notice

The purpose of a tax ruling is to provide interpretive guidance to the general public and to department personnel. A tax ruling is intended to encompass issues of law not adequately covered in statute, case law or administrative rules. A tax ruling is a position statement that provides interpretation, details or supplementary information concerning the application of the law. Relevant statute, case law or administrative rules, as well as a subsequent ruling, may modify or negate any or all of the provisions of any tax ruling. See GTP 96-1 for more detailed information regarding documents issued by the Department of Revenue.

⁹ A.R.S. § 42-3051.

¹⁰ *Ebasco Servs. Inc. v. Ariz. St. Tax Comm'n*, 105 Ariz. 94, 97 (1969) (en banc).