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Subjecting Craft Breweries to the QALICB Test

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Question: Would a craft brewery, the principal business of which is the production and wholesale of beer to retailers, be considered a qualified business for purposes of the New Markets Tax Credit (NMTC) program?

Answer: Treasury regulations generally define a qualified business as any trade or business subject to some exclusions. These exclusions include the following:

1. Residential rental property;
2. Business who predominantly develops or holds intangibles for sale or license;
3. Business whose principal activity is farming;
4. Operation of any private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling, or any store the principal business of which is the sale of alcoholic beverages for consumption off premises.

Based upon this rule, the question of whether a craft brewery business qualifies depends on whether it is a store whose principal business is the sale of alcoholic beverages for consumption off premises. The determination rests on three central questions:

1. whether or not a craft brewery is considered a store for purposes of the Internal Revenue Code (IRC),
2. whether or not the craft brewer has to look to the ultimate consumer, and
3. whether the term premises refers to the wholesale brewery's premises or the retailer's premises.

Although the term "store" is not defined in the IRC, a store is commonly thought to constitute a retail establishment that sells items to the end user–not for resale. While most craft brewers sell some beer to end users, their principal business frequently consists of the production and wholesale of beer to retailers–not end-use consumers. Accordingly, it is plausible that a craft brewery may not even meet the definition of a "store" for purposes of the rule.

Another difficult question–and one that is also not answered in the regulations–is whether the phrase "sale of alcoholic beverages for consumption" applies to the initial brewer sale to a retailer who is expected to resell and therefore not consume the alcohol or whether the brewer has to look through to the ultimate consumer sale. Looking through to the ultimate consumer adds undue complexity and while

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it's not uncommon for tax compliance to be complex, it is common for Treasury to address any required look-through rules. Therefore, it is plausible that wholesalers of alcohol could qualify as their sales are not initially for consumption.

Similar to the consumption question, it is unclear to whose premises for consumption that the rule is referring? If the rule is referring to the brewery's premises, then a wholesale brewer would certainly not qualify regardless of where the alcohol was ultimately consumed–regardless of whether the retail customer were a bar or a retail grocery store, the beer would ultimately be consumed off-premises. If the rule is referring to the premises where the ultimate consumer purchased the alcohol, then we go back to a required look-through analysis discussed above. It is conceivable that the reference to "store" limits the application of this rule to retailers. If this is the case, a craft brewery whose principal business is the wholesale of beer would not need to be concerned with the ultimate customer consuming on premises or off. Unfortunately however, without specific guidance it is not possible to be certain.

In conclusion, the application of the qualified business rules to craft breweries is a complicated task. In particular, in order to determine with confidence whether a craft brewery is a store the principal business of which is the sale of alcoholic beverages for consumption off premises, we need additional guidance on what is meant by store, what is meant by premises and whether any look-through rules are applicable to the test. ❖

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