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No on 2H
Via e-mail

Re: Legal Analysis of Ordinance 8130

To Whom It May Concern:

You have requested legal analysis of the proposed City of Boulder Ordinance No. 8130, "Sugar Sweetened Beverage Product Distribution Tax," (hereinafter, "the Ordinance"). As the co-author of Colorado Sales & Use Taxation and a lecturer on state and local taxes, I provide you with the following interpretation of the proposed law. The Ordinance is nine pages long and I'll be as concise as possible in explaining how the Sugar Sweetened Beverage Product Distribution Tax ("Sweetened Beverage Tax") would be implemented and in unpacking its many nuances.

Using a simple hypothetical, two Boulder County grade school students have lemonade stands; one just within the City and one just outside the city limits. Jane runs the stand in Boulder and sells Skratch Labs "lemons and limes exercise hydration mix," that she purchases from a local company through a specialty sports store in Boulder. Jack's stand, just down the road, sells Kool-Aid that he buys online and gets shipped to him via common carrier.

The Ordinance levies the excise tax on each "distributor of sugar-sweetened beverage products" under Section 3-16-3. Relevant to the lemonade stands, Section 3-16-4 defines "powder" to mean any solid mixture, containing one or more caloric sweetener as an ingredient, intended to be used in making, mixing, or compounding a sugar-sweetened beverage by combining the powder with one or more ingredients." The tax of two cents per fluid ounces is twice that of the current or proposed sweetened beverage taxes in northern California.

Section 3-16-4 broadly defines "sugar-sweetened beverage" to include any non-alcoholic beverage with at least 5 grams of caloric sweetener per 12 fluid ounces. That definition encompasses soda, sports drinks, energy drinks, sweetened ice teas, sweetened coffees, chai, kombucha, sweetened coconut waters, and many other beverages. It excludes, among others, beverages in which milk is the primary ingredient, including flavored milks, like chocolate milk, alcohol, 100% natural fruit or vegetable juices with no added caloric sweetener but only if the juice is the original liquid resulting in the pressing of such fruits and vegetables. The term also

includes products made from dilution or syrup or powder and, according to Section 3-16-2(b)(2), the tax is calculated on the "largest volume of fluid ounces of sugar-sweetened beverages that could be produced from syrup or powder upon the initial distribution of syrup or powder."

Section 3-16-4 oddly defines "distributor" or "distribute" to exclude "retail sale to a consumer." That exclusion means that neither Jane nor Jack qualify as distributors and so the tax must be levied upstream in the flow of commerce. Section 3-16-6 empowers the Boulder City Manager to develop a registration system whereby distributors of sugar-sweetened beverages must register with Boulder prior to distributing any sugar-sweetened beverages. The sports shop selling Skratch Labs to Jane would have to register but Jack's Kool-Aid vendor would not.

The City Manager is authorized to enforce the tax, including "provisions for the reexamination and correction of returns and payments, and for reporting" and the "determination of whether and how a distributor who receives, in the city, sugar-sweetened beverage products from another distributor must report to the city the volume of sugar-sweetened beverage products received from that distributor." Section 3-16-6(d).

To aid in the collection of Sweetened Beverage Tax, retailers that receive sweetened beverage products from distributors "shall provide to the city evidence that the distributor from whom the sugar-sweetened beverage products were received has registered as a distributor with the city and that registration is current." Section 3-16-7(b). In other words, Boulder requires purchasers to report their supply to the City and the Manager has audit and enforcement authority, including penalties and penalty interest of up to 1% per month. Section 3-16-9 and B.R.C. Section 3-2-22(j). The revenues from this excise tax "shall be designated for the administrative cost of the tax" as the first allocation of the collections, pursuant to Section 3-16-11.

Thus, applying the Ordinance, because Jane buys locally, the tax would be levied on her "distributor," defined under Section 3-16-4 as "any person who distributes sugar-sweetened beverage products in the city." Since Jane buys the Skratch Labs powder, which sells for approximately $20 for a bag that makes 38 8-ounce servings, from the Boulder sports specialty retailer, the shop would have to charge her $6.08 in Sweetened Beverage Tax, in addition to state, county, district, and city sales tax. Ordinance Section 3-16-10 specifically states that the Sugar-Sweetened Beverage Tax is "a tax upon the privilege of conducting business, specifically, distributing sugar-sweetened beverage products within the City of Boulder." And, further, that it is "not a sales, use, or other excise tax on the sale, consumption or use of sugar-sweetened beverage products." There is no small business exception in the Ordinance to shield lemonade stands.

Jack's lemonade stand is outside of the City so he does not have to pay the tax. Accordingly, Jack saves what would have been $21.76 in Sweetened Beverage Tax on a container of Kool-Aid that makes 136 8-ounce servings and sells for $6.98 from an out-of-state vendor with a shipping cost of $3.85. Had the Sweetened Beverage Tax been a sales and use tax and had Jack's lemonade stand been in the City of Boulder, he would have had to accrue the tax as a complementary use tax. However, since the Ordinance specifically states that it is not that type of excise tax, he does not fall under its purview because he purchases from a vendor outside

Colorado and so, even if Jack's stand were within the city limits, in contrast to Jane, who will see her Skratch powder cost increased dramatically, Jack would have no tax.

While the specialty sports retailer selling to Jane, as the distributor under the Ordinance, would have to pay the Sweetened Beverage Tax, that business would have to either pass the tax on to Jane or otherwise transfer the cost to its other products. That is because of the difference between the "imposition of a tax," and the "incidence of a tax." While the tax is imposed at the level of the distributor, the economic reality of such an excise tax is that it is passed through to the end purchaser such that the incidence, the ultimate bearer of the tax burden. So if Jack charges 25 cents for a 12-ounce cup of Kool-Aid, Jane would only be able to compete with him by clearing one cent after she incurred the 24 cents of Sweetened Beverage Tax on the 12 ounces of Skratch Labs.

This would also be the case for contracts that are in place when the Ordinance takes effect on July 1, 2017, if approved in next week's election. The Ordinance makes no exception for pre-existing contracts and so the distributor would bear the initial onus of the tax. However, as discussed above, that tax imposition does not necessarily prescribe the tax incidence and it is an economic reality that the burden would be passed downstream to the retailers and restaurants and, ultimately, to the customers and patrons unless competition from outside of Boulder precluded price increases. In that case, it would be hard to determine where retailers and restaurants could absorb such substantial cost increases.

No Tax on Remote Distributors

The Ordinance was not drafted by Boulder's City Attorney and appears to be language borrowed from similar sweetened beverage tax proposals in Northern California, where local taxes on the sale of specific products are preempted by state law. Cal. Rev. & Tax. Code Sections 30111, 30462(b). As such, the tax is imposed on each "distributor" under Section 3-16-3. Section 3-16-4 defines "distributor" or "distribute" to exclude "retail sale to a consumer." Notably absent from the proposed language in the Ordinance is a small business exception in the California taxes, where the tax does not apply to business entities that sell or serve sugar-sweetened beverage products to final consumers and have less than $100,000 in annual gross receipts. E.g. Oakland Municipal Code, Chapter 4.52.020.P. and 4.52.030.C.2.

The exclusion for retail sales means that Boulder businesses would be able to avoid the Sweetened Beverage Tax simply by purchasing from sources that are outside the City of Boulder or, to be well beyond the City's reach, Colorado. Such purchases would need to be from vendors that have no nexus, i.e., no substantial physical presence, in the State. Out-of-state vendors that lack nexus do not have to collect excise taxes in remote jurisdictions through the protection of the Commerce Clause of the U.S. Constitution, as interpreted by the U.S. Supreme Court. Quill Corp. v. North Dakota, 504 U.S. 298 (1992).

The effect of Ordinance No. 8130 will be to push Boulder businesses to purchase beverages, syrups and powders that come within the scope of the Sweetened Beverage Tax from vendors outside Colorado in order to save what is a substantial tax – more than $60 on a $75 purchase of "bag-a-box" sweetened tea syrup.

This is rational and prudent business sense, given the definitional exclusion written into the Ordinance that cuts out retail sales to consumers. It is perfectly legal and a sound business practice for a Boulder restaurant to opt for such a tax-free strategy and purchase from remote vendors to save what would be more than a 75% price increase. While it will likely cause an increase in common carrier sweetened beverage deliveries into Boulder, the proposed ordinance will have a corresponding drop-off in business from Colorado distributors. The unintended impact of the tax will be to discourage Boulder businesses from buying locally, not to mention environmental consequences.

The foregoing legal analysis is not intended to be political in nature and my law firm, Hutchinson, Black and Cook, LLC, does not take a position with respect to the ballot measure regarding the Ordinance.

By: _____

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