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Philadelphia Beverage Tax Scheduled to Take Effect January 1, 2017

On June 16, 2016, The Philadelphia City Council voted to approve a so-called "soda tax" making Philadelphia the first major city poised to implement such a tax.^[1] Despite the simple sounding nickname for the new tax, it now appears that the tax could, in practice, have a much broader impact in application than adding to the price of sodas.

Philadelphia will collect the "soda tax" starting January 1, 2017 (subject to the outcome of a lawsuit filed September 14, 2016, claiming the tax is unconstitutional and seeking to enjoin the City from collecting the tax). The official text of the ordinance establishing the tax can be found by [clicking here](#).

First, some background. The Philadelphia "soda tax" is the product of well-funded lobbying efforts. Proponents promoted the tax as a revenue bill to provide funding for schools and social programs rather than a public well-being measure meant to provide health benefits from reduced sugar consumption. Ultimately, the "soda tax" ordinance (as revised as discussed below) passed by a large margin. Municipalities, the beverage industry, health advocacy groups and others are now closely analyzing Philadelphia's strategy, implementation of its "soda tax," and pending legal challenge as they contemplate its actual application and legality, as well as future potential attempts to impose similar measures in other cities.

The ordinance's title, "Sugar-Sweetened Beverage Tax," reflects the tax's original target – sugar. The ordinance's initial draft imposed a 3 cent per ounce tax on sugar-sweetened beverages. At the last minute, however, the tax's scope was expanded to include all sweetened beverages, including no-calorie drinks containing artificial sweeteners, but those drinks were taxed at a reduced rate of 1.5 cents per ounce. As a result, the ordinance's final version expanded the definition of "sugar-sweetened beverage" to include any non-alcoholic beverage that contains any form of caloric sugar-based sweetener (such as sucrose or high fructose corn syrup) and/or any form of artificial sugar substitute (such as stevia or aspartame).

In addition to imposing a tax on "sweetened beverages," the "soda tax" ordinance will also require the creation of a distribution scheme for "sweetened beverages" that mirrors those required for the sale of alcohol and tobacco. The idea that "sweetened beverages" need to be regulated in a similar manner to age-restricted substances with proven public health risks is a novel one. Distributors of "sweetened beverages" will be required to register with the City of Philadelphia and will also be the parties responsible for collecting the new per ounce tax on sweetened beverages sold to "dealers." "Dealers" are defined as "any person engaged in the business of selling sugar-sweetened beverage for retail sale within the City." A "dealer" will be required

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to purchase its “sweetened beverages” strictly from registered distributors. A “dealer” must also identify itself as a “dealer” to distributors when purchasing sweetened beverages.

The new tax will apply to a wide variety of beverages beyond merely soda. In fact, the ordinance itself provides some examples of the other types of beverages that will be taxed including: “non-100%-fruit drinks; sports drinks; flavored water; energy drinks; pre-sweetened coffee or tea; and non-alcoholic beverages intended to be mixed into an alcoholic drink.”

There are also certain beverages that are specifically exempt such as: baby formula; medical food; products that are more than 50% milk by volume; products that are more than 50% fresh fruit and/or vegetables by volume (where the fruit or vegetable is added by someone other than the customer); unsweetened drinks to which the customer can add or request that the seller add, “sugar” (apparently an oversight by failing to mention artificial sweeteners); and any syrup or concentrate that a customer purchases to use as an ingredient in a beverage that they themselves mix. There is still some ambiguity regarding the scope of these exemptions. For example, it is not clear if a non-dairy alternative, like soy or almond milk, would qualify for an exemption if it were more than 50% by volume of the resulting beverage.

For non-alcoholic pre-mixed beverages sold in containers, determining whether the beverage is taxable or exempt should be relatively easy. The first inquiry is whether the beverage contains a sugar-based sweetener or artificial sweetener. If it does,

then the next step is to determine if there is a valid exemption for that type of beverage (e.g., whether the beverage is mostly milk or fruits and/or vegetables). A brief sampling of products that will and will not be subject to the beverage tax posted on the website philly.com^[2] illustrates some interesting applications of the tax. The taxable products listed include Coca-Cola Classic, Coca-Cola Zero, Gatorade G2 Grape, Snapple Iced Tea - Lemon and Monster Energy Drink while the list of tax exempt products includes Vita Coco Pure Coconut Water and Similac baby formula.

A distributor will be required to inspect the ingredients of every individual product to determine if that product qualifies for an exemption. A distributor might assume that the V8 line of products (whose marketing touts their fruit and vegetable content) should all be non-taxable because of the exemption for beverages that are more than 50% fruit and/or vegetables, but even within the same brand of products the tax can apply differently. According to the City of Philadelphia, a V8 Veggie Blends Carrot Mango drink qualifies for the exemption because it is 75% vegetable and fruit, but V8 Splash Carrot Orange Juice Drink is not tax exempt because it is sweetened and contains only 15% juice. A close inspection of the ingredients of each individual product will be required to ensure compliance with the new tax.

In some cases, even a close reading of a “beverage’s” ingredients will not be enough to determine if the tax should apply. “Beverages” that are mixed by “dealers” will require an even more careful and individual analysis. The tax will apply to any non-alcoholic syrup or other concentrate

intended to be used in the preparation of a beverage containing sugar-based or artificial sweeteners. Containers of syrups and concentrates are taxed by applying the 1.5 cents per ounce tax to the volume of beverage that will be produced from the container under the manufacturer’s specifications. While it may be simple to apply the “soda tax” to ingredients like soda-syrup when used to make fountain drinks, some types of “beverages” mixed by “dealers” will require more careful calculations. For example, certain drinks like smoothies, ice slushes, or root beer floats may still be completely exempt despite using ingredients that typically would be covered by the tax. If a made-to-order beverage contained more than 50% exempt ingredients (like milk, fruit or vegetables), it would qualify for an exemption despite the inclusion of sweetened syrups, concentrates, or even soda. Further, there may be both exempt and non-exempt uses for a particular sweetened beverage, syrup or concentrate. For example, a sweetened syrup or concentrate that would be taxed if used to make a beverage may be exempt if used as an ingredient in a baked good. In these cases, “dealers” and distributors would need a mechanism to claim a “partial exemption” for the portion of a “sweetened beverage” that was used for an exempt purpose.

The City of Philadelphia, distributors and “dealers” will have to work closely to develop procedures that ensure a smooth roll out of Philadelphia’s “soda tax.” “Dealers” who prepare “beverages” in their stores or restaurants would be wise to determine in advance how much of the “sugar-sweetened beverages” that they purchase will be used to produce

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tax exempt products. A dealer who has this information will be better able to avoid being overcharged by distributors for “beverages” used for exempt purposes. Similarly, distributors should consider developing procedures to account for “dealers” who may be claiming complete or partial exemptions when purchasing taxable beverages.

The Philadelphia “soda-tax” will certainly have significant practical ramifications for businesses that sell or distribute “sweetened beverages” in Philadelphia. Proper advance planning and analysis by distributors and “dealers” will help to minimize the risk of over-application and business disruption posed by the new tax and its seemingly byzantine requirements.

If you have any questions about the ordinance’s effect on your business, please contact Dean Fournaris, Robert Burstein or Jacob Sand.

[1] In 2012, the New York City Board of Health approved a New York City tax promoted by then Mayor Michael Bloomberg on large sugary fountain drinks, but it never went into effect after a successful legal challenge to the Board of Health’s authority to adopt the measure. The City of Berkeley, California adopted a 1 cent per ounce tax on sugar-sweetened beverages in November 2014.

[2] The Soda Tax: Will Your Favorite Beverage Cost More?, available at <http://www.philly.com/philly/infographics/383217911.html>

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