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State and Local Advisory Council Food Definitions Workgroup – Definition of Candy

Introduction:

In March 2010, the State and Local Advisory Council (SLAC) formed a workgroup that was assigned the task of drafting rules related to the various food-related definitions contained in the Streamlined Sales and Use Tax Agreement (SSUTA). The rules are to specifically address the definitions of “candy,” “soft drink,” “dietary supplement,” and “prepared food.” “Bottled water” was also added to this rulemaking list after the Streamlined Sales Tax Governing Board (SSTGB) adopted that definition. The goal of the rules is to help retailers and the states consistently apply these definitions and provide specific examples of various foods and food ingredients that do and do not fall within a particular definition along with the rationale that led to the decision.

The workgroup is co-chaired by Judy Niccum (Minnesota) and Craig Johnson (Wisconsin). Members of the workgroup included both state and business representatives.

“Candy” is the first food-related definition addressed in these rules. The purpose of this paper is to provide the background on how the workgroup reached the conclusions it did in areas where differences of opinion existed and explain what other interpretations or language was also considered in developing the workgroup’s draft rule on candy. Please be aware this paper does not address every element of the workgroup’s draft rule on candy.

Background

The Streamlined Sales and Use Tax Agreement, Appendix C, Part II, defines “candy” as follows:

“Candy” means a preparation of sugar, honey, or other natural or artificial sweeteners in combination with chocolate, fruits, nuts or other ingredients or flavorings in the form of bars, drops, or pieces. “Candy” shall not include any preparation containing flour and shall require no refrigeration.

Three Interpretative Opinions 2007-3, 2009-4, and 2009-5 of the definition of candy have been previously approved by the SSTGB.

- Interpretation 2007-3 adopted September 20, 2007 provides, “A product does not contain flour unless the product label specifically lists “flour” as an ingredient.”
- Interpretation 2009-4 adopted September 29, 2009 provides, “The definitions in the Agreement are meant to be objective tests to determine the classification of an item and

the intent of the user is not relevant. Baking ingredients such as M&M's Baking Bits meet the definition of candy and should be classified as such."

- Interpretation 2009-5 adopted December 17, 2009 provides, "(1) Breakfast cereals are not candy because they are not sold in the form of bars, drops, or pieces. (2) Naturally or artificially sweetened breakfast bars, Caramel Corn Rice Cakes, and Rice Krispie Treats that do not have ingredient labeling specifying flour and do not require refrigeration are candy. These products are sold in the form of bars and meet the objective test in the definition of candy. (3) Lightly Salted Rice Cakes that do not contain natural or artificial sweeteners according to the ingredient labeling are food and food ingredients and are not classified as candy."

One of the more significant problems in adopting a candy definition was distinguishing between a cookie, which states wanted to continue to treat as food, and candy. In adopting this definition in 2002, states realized that certain products such as Kit Kat®, Twix®, Reese Sticks®, and some licorice would no longer be candy under the SSUTA definition because these products ingredient labels contained a specific listing for flour. In addition, states were aware that granola bars, Slim-Fast® Bars and similar breakfast bars and nutrition bars would be considered candy when the product ingredient labeling did **not** contain a specific listing for flour because they are sold in the form of bars and do not require refrigeration.

Overall Intent of the Definition of "Candy"

During the rule drafting process, questions were raised as to whether the definition of candy was intended to be applied to every type of food and food ingredient sold or if it was intended to only be applied to types of products that are commonly thought of as candy.

Note: The workgroup also considered the language "commonly and traditionally sold as candy." However the workgroup opted not to use this language since it would raise the question about new products and whether they would be thought of as "traditionally" being sold as candy. If they are new products, at what point would they be thought of as "traditionally being sold as candy?"

Based on discussions in the workgroup meetings and input from several of the people that were involved with the drafting of the candy definition contained in the SSUTA, the workgroup concluded that the definition of candy was intended to provide an objective or bright-line test for determining whether food products commonly thought of as candy, such as cookies, are candy. There was never any intent to apply the definition of candy to food products that are not commonly thought of as candy, such as breakfast cereal, meats, and canned fruits and vegetables. The workgroup is not aware of any member state that currently considers these items to be candy. In this regard one prominent tax expert has noted, "Developing these definitions was challenging because existing state definitions are far from uniform, and political sensitivities to taxes on food required a set of definitions that would allow states to re-create their existing food tax bases as faithfully as possible. As with other SSUTA definitions, the Agreement's drafters sought to achieve this objective by adopting broad food definitions coupled with various "carve-out" definitions for common subclassifications." *Hellerstein, State Taxation, Chapter 19A.04 (WG&L 2010)*. To further promote simplification consistent with this approach, the workgroup has created a draft Appendix to include along with the rule, which is designed to help member states and retailers differentiate between items commonly thought of as candy from those not commonly thought of as candy.

Note: The workgroup did consider including the following language in the rule: “This definition applies to all types of food and food ingredients and any food or food ingredient that meets all of the requirements of the definition of ‘candy’ will be considered ‘candy’ under this definition, regardless of whether or not the item may commonly be thought of as ‘candy’.” If this interpretation would have been adopted, products such as potato chips, beef jerky, and certain canned fruits and vegetables would have been treated as “candy.” The workgroup did not believe this was the intent of the definition. Moreover, concern was expressed that requiring retailers to look at every food product sold, in order to determine if the candy definition applied, would not simplify tax administration and instead might impose a substantial burden on retailers by requiring them to devote significant resources towards identifying a range of products not contemplated as candy when the candy definition was adopted by the SSTGB.

Bars, Drops, or Pieces

One of the requirements a food product must meet before it is considered candy is that it must be sold in the form of “bars, drops, or pieces.” However, the definition of candy does not further define these terms. Specific definitions for each of these terms are included in the rule on candy.

The term “pieces” generated a great deal of discussion among the workgroup members. With regard to the term “pieces,” the workgroup took into account Interpretation 2009-5 relating to breakfast cereals and the determination that breakfast cereals were not sold in the form of pieces, but instead consisted of a loose mixture of the ingredients to form a single product.

Based on the rationale of this Interpretation, the workgroup concluded that items such as trail mix, while they may contain one or more ingredients that are candy, such as chocolate chips, the product as a whole is not “candy,” but instead is a loose mixture of the ingredients of a single product, similar to cereal. However, the workgroup also discussed those products that are made up exclusively of a loose mixture of all different types of “candy” and concluded that those types of products are “candy” since its only “ingredients” are products that when looked at individually, are candy. An example is included in the rule on candy to illustrate this concept.

The workgroup also discussed items such as spray candy and cotton candy and concluded that since those items are not sold in the form of bars, drops, or pieces, they are not candy. Note: Cotton candy will many times, however, be sold as “prepared food.”

Flour

The definition of candy specifically excludes any product that contains “flour.”

One suggestion discussed was to consider “whole grain,” when listed on a product label, to be considered “flour.” That suggestion was rejected by the workgroup since that would have required an amendment to the existing definition of candy and would not provide the bright-line test inherent in the current definition. The workgroup also took into account Interpretation 2007-3 which determined that “flour substitutes” are not “flour” and that a product does not contain flour unless the product label specifically lists “flour” as an ingredient.

Thereafter, two different options were considered in this area. The options were:

1. A product is considered to contain “flour” if, according to the Food and Drug Administration’s food labeling standards, the product contains a “grain-based” flour, or
2. A product is considered to contain “flour” if the word “flour” appears anywhere on the ingredients label, in accordance with the Food and Drug Administration’s food labeling standards.

Based on the history of the definition of candy that was provided by several workgroup members who were involved with the drafting of the definition of “candy,” the definition was drafted to try to distinguish between what was a cookie and what was candy. In addition, various dictionary definitions of “flour” were discussed and several of them referred to flour as products consisting of milled wheat or similar products made from another grain.

The workgroup concluded the term “flour” is intended only to include “grain-based” flours and does not include flour made from other food products such as peanuts and cocoa. Therefore, language consistent with Option 1 was included in the workgroup’s draft rule on candy.

Note: Under Option 2, the workgroup considered including language in the rule which would have provided the following: “In order for a product to be treated as containing flour, the product label must specifically list the word “flour” as one of the ingredients. There is no requirement that the “flour” be grain-based.” If this language had been selected any product whose ingredient label contained the word “flour” would not have been considered “candy,” even if it was peanut flour, cocoa flour, or any other finely ground ingredient labeled as “flour.”

Refrigeration

The definition of candy excludes products that require refrigeration. Various discussions were held relating to the requirement that in order for a product to be considered “candy” it cannot require refrigeration. Questions were raised whether this requirement meant that the product always needed refrigeration only prior to purchase, such as ice cream bars, or whether this requirement was meant also to contemplate products that required refrigeration at some future point in time, such as after the product was opened. The workgroup concluded that regardless of whether the product required refrigeration at all times prior to purchase or only after it was opened, the product is considered to require refrigeration and is not candy.

Questions were also raised and discussed relating to whether or not the product label must indicate that refrigeration is required to exclude a product from the candy definition. The workgroup concluded that the product label must indicate that refrigeration is required, except in the case of individually packaged items where it would be anticipated that the entire product would be consumed as soon as it was opened, such as an individual serving of sweetened fruit snacks, would be considered to require refrigeration as long as the label on the multiple serving size of the same product indicated that refrigeration was required.

Bundled Transactions

It is common for packages to be sold that will contain a mixture of food items that meet the definition of candy and food items that do not meet the definition of candy. For example, a retailer may sell a box of chocolate bars where some of the bars contain flour (and are not

candy) and other bars do not contain flour (and are candy). Retailers need clarity in how these types of transactions should be treated.

After discussion, the workgroup concluded the following:

- For packages containing a separate ingredient list for each product contained in the package:
 - A retailer will consider the package to be a bundled transaction containing primarily “candy” products, if more than 50% of the products included in the package meet the definition of candy. A member state must apply their state’s laws, rules, and policies on bundled transactions to determine the proper sales and use tax treatment of the bundled transaction.
 - A retailer will consider the package to be a bundled transaction containing primarily non-candy products, if the individual ingredient list for 50% or more of the products included in the package do not meet the definition of candy. Each member state must apply their state’s laws or rules on bundled transactions and exclusions related thereto to determine the proper sales and use tax treatment.
- If the label on the package does not contain a separate ingredient list for each product contained in the package and the package contains items that meet the definition of candy, a retailer will consider the package to be a bundled transaction containing primarily “candy” unless the retailer is able to ascertain that 50% or less of the products are “candy.”

Note: The workgroup also considered an alternative to the above positions which would have provided that if any of the products included in the package were not candy based on the fact that “flour” was identified in the ingredient list on the packaging for all products, then the entire product would be considered a “food and food ingredient” and would not be considered “candy.” Although it was agreed that there were pros and cons of both approaches, the alternate position considered was not adopted. At least three concerns were raised with the alternative approach. First, there is risk that many of the packages under discussion may consist primarily of candy items. Second, the approach may not be fully consistent with the bundled transaction definition contained in SSUTA 330. Third, this approach could result in different tax treatment for two similar products based simply upon a manufacturer’s decision to include a separate ingredient label for each product in a package and another manufacturer’s decision not to do so, which could result in complexity and confusion for retailers.