Congressional Research Service
Informing the legislative debate since 1914

Legal Sidebar

Hobby Distillers Association v. Alcohol and Tobacco Tax and Trade Bureau: The Limits on Taxing Schemes to Regulate Behavior

May 5, 2025

On July 10, 2024, in *Hobby Distillers Association v. Alcohol and Tobacco Tax and Trade Bureau*, the U.S. District Court for the Northern District of Texas granted the Hobby Distillers Association and one of its members, Scott McNutt, a permanent injunction preventing the federal government from enforcing federal statutes that prohibit at-home distilleries for beverage alcohol. For more than 150 years, Internal Revenue Code (IRC) Sections 5601(a)(6) and 5178(a)(1)(B) have restricted individuals from producing spirits at home for personal consumption by restricting the location of spirit distilleries and attaching criminal penalties to noncompliance. In *Hobby Distillers*, the district court held that IRC Sections 5601(a)(6) and 5178(a)(1)(B) were unconstitutional because Congress lacked authority to enact them under the Taxing, Necessary and Proper, and Commerce Clauses. According to the district court, the challenged provisions were not authorized under the Taxing Clause because they did not constitute a tax. The provisions did not fall within Congress's authority under the Necessary and Proper Clause either, in the court's view, because they were not "needful and 'plainly adapted'" to executing a tax on distilled spirits. Finally, the district court held that the provisions exceeded Congress's Commerce Clause authority to regulate local economic activity because (1) the Federal Alcohol Administration Act was not a comprehensive statutory scheme regulating the interstate spirits market, and (2) even if the Act was a comprehensive statutory scheme, the challenged provisions were not necessary to effectuate the Act.

The government filed an appeal on August 14, 2024. On appeal, the government contends, among other things, that IRC Sections 5601(a)(6) and 5178(a)(1)(B) are constitutional under the Necessary and Proper Clause as valid exercises of powers incidental to Congress's enumerated taxing power. The case is now before the U.S. Court of Appeals for the Fifth Circuit (the Fifth Circuit) under the name of *McNutt v. U.S. Department of Justice*, No. 24-10760. *Hobby Distillers* and the Fifth Circuit's forthcoming decision in *McNutt* could greatly influence the way courts analyze Congress's authority to use taxing schemes to regulate individual behavior.

This legal sidebar provides an overview of the statutory provisions at issue, summarizes the district court's Taxing and Necessary and Proper Clause rulings in *Hobby Distillers* that are on appeal in *McNutt*, and provides considerations for Congress.

Congressional Research Service
https://crsreports.congress.gov
LSB11305

Distilled Spirit Provisions

IRC Section 5001(a)(1) imposes a federal excise tax on "distilled spirits produced in . . . the United States . . . at a rate of $13.50 on each proof gallon . . . ." Under IRC Section 5001(b), the tax "attach[es] to distilled spirits as soon as [the distilled spirit] is in existence . . . ." IRC Section 5004(a)(1) stipulates, subject to certain exceptions, "[t]he tax imposed by section 5001(a)(1) shall be a first lien on the distilled spirits from the time the spirits are in existence as such until the tax is paid."

IRC Section 5178(a)(1)(B) restricts the location of distilled spirit production. It provides that "[n]o distilled spirits plant for the production of distilled spirits shall be located in any dwelling house, in any shed, yard, or inclosure [sic] connected with any dwelling house, or on board any vessel or boat, . . . or on premises where any other business is carried on (except when authorized under subsection (b))." IRC Section 5601(a)(6) "makes it a felony to violate IRC Section 5178(a)(1)(B)." IRC Section 5601(a) states:

> Any person who . . . uses, or possesses with intent to use, any still, boiler, or other utensil for the purpose of producing distilled spirits, or aids or assists therein, or causes or procures the same to be done, [at a location proscribed in IRC Section 5178(a)(1)(B)] (except as authorized by [IRC Section] 5178(a)(1)(C)), . . . shall be fined not more than $10,000 or imprisoned not more than 5 years, or both, for each such offense.

Taxing Clause

The district court in *Hobby Distillers* recognized Congress's "*broad* power to tax" under the Taxing Clause and Congress's ability to use taxes to "burden[] or influenc[e] behavior" but maintained that this "power [wa]s not limitless." Quoting the U.S. Supreme Court in *National Federation of Independent Business v. Sebelius* (*NFIB*), the district court reiterated, "'Congress's authority under the taxing power is limited to requiring an individual to pay money into the Federal Treasury, no more. If a tax is properly paid, the Government has no power to compel or punish individuals subject to it.'"

To decide whether the challenged provisions were an "appropriate use of the taxing power," the district court initially determined whether the provisions could be sustained as a tax. The court embraced the Supreme Court's functional approach in *NFIB* for determining whether an exaction was a tax. To establish "whether something Congress codifies as a tax is, really, a tax," the district court considered "how the exaction [wa]s assessed, by what mechanisms it [wa]s collected, . . . which agency [wa]s responsible for its enforcement," and if it "produce[d] *some* revenue for the government."

Examining IRC Sections 5601(a)(6) and 5178(a)(1)(B) in isolation, the district court concluded that the challenged provisions were "not within Congress's enumerated taxing power." The court reasoned IRC Section 5178(a)(1)(B) "simply prohibits the placement of a 'distilled spirit plant . . . in any dwelling house'" and IRC Section "5601(a)(6) merely makes it a felony to violate § 5178." The court described the challenged provisions' connection to the tax on distilled spirits as "facially tangential." The court observed that IRC Section 5178(a)(1)(B), unlike its neighbors in subparagraphs (A) and (C), "makes *no* mention of the secretary of the treasury, the commissioner of internal revenue, revenue generally, nor the protection of revenue." The court determined that no "'reasonable construction'" of IRC Section 5178(a)(1)(B) could "miraculously render §§ 5178(a)(1)(B) and 5601(a)(6) revenue-generating, as required by the constitution to sustain them as a tax."

Instead of simply disallowing at-home distilling, the court contemplated that IRC Section 5178(a)(1)(B) could have been written differently. Like subparagraphs (A) and (C) in IRC Section 5178(a)(1), Congress could have provided an "enforcement officer with discretion to judge" when "a 'residential' premises could nonetheless be adequately constructed to 'afford adequate security to the revenue' by preventing the disguise or withholding of non-tax paid product." Thus, the court concluded, "Congress did nothing more

than statutorily ferment a crime—without any reference to taxation, exaction, protection of revenue, or sums owed to the government." While the government argued that prohibiting distillery operations in certain locations where stills could be concealed was a proper use of the taxing power as it reduced "'frauds on the revenue,'" the district court stated that the government had conflated Congress's "enumerated taxing power with [Congress's] incidental powers contained in the necessary and proper clause—which is a distinct inquiry."

Necessary and Proper Clause

The district court conducted a separate inquiry to determine whether IRC Sections 5601(a)(6) and 5178(a)(1)(B) are "'necessary and proper' to execute taxes laid on distilled spirits." To convey the bounds of the Necessary and Proper Clause, the district court quoted the Supreme Court's conclusion in the 1819 case *McCulloch v. Maryland*: "Let the end be legitimate, let it be within the scope of the constitution, and all means which are appropriate, which are plainly adapted to that end, which are not prohibited, but consist with the letter and spirit of the constitution, are constitutional." Relying on *McCulloch*, the district court concluded that even though the Necessary and Proper Clause provides Congress with "broad power to enact statutes 'incidental'" to an enumerated power and "'conducive to its beneficial exercise,'" the "Clause does not confer any substantive, or independent power beyond those enumerated." In the district court's view, even when a law incidental to an enumerated power is "necessary—that is, appropriate, needful, or requisite," it "may still be *improper* when it violates the principles of a limited federal government." As support for its conclusion, the district court relied on Chief Justice Roberts's opinion in *NFIB*, Justice Alito's concurrence in *United States v. Comstock*, and the parties' reported arguments in *McCulloch* (which it appears the district court may have treated as portions of the decision). In *NFIB*, Chief Justice Roberts reflected on the Supreme Court's responsibility to set aside laws that were improper means for carrying Congress's enumerated powers into execution when they were, as stated in *McCulloch*, inconsistent "'with the letter and spirit of the Constitution.'" In *Comstock*, Justice Alito expressed that the Necessary and Proper Clause does "not give Congress *cart blanche*"—"the term [necessary] requires an 'appropriate' link between a power conferred by the Constitution and the law enacted by Congress." In *McCulloch*, the respondent contended that an incidental congressional act must be more than "'merely convenient'" to accomplish the execution of an enumerated power. The petitioner in *McCulloch* argued that powers incidental to Congress's enumerated powers must be "'suitable and fitted to the object; such as are best and most useful in relation to the end proposed.'"

The district court also determined that the government's reliance on another Supreme Court case, *Felsenheld v. United States*, for the applicable standard was "misplaced" because the "government [was] appl[ying] *Felsenheld* out of context." The district court observed that the *Felsenheld* Court considered whether Congress had the power to prohibit the placement of foreign articles in a package upon which a stamp was affixed to certify that the packaged contents had been taxed. The *Felsenheld* Court held "in the rules and regulations for the manufacture and handling of goods which are subjected to an internal revenue tax, Congress may prescribe any rule or regulation which is not in itself unreasonable." Applying this reasoning, the *Felsenheld* Court ruled Congress had the power to "prescribe that a package of any article which it subjects to a tax, and upon which it requires the affixing of a stamp, shall contain only the article which is subject to the tax." According to the district court in *Hobby Distillers*, *Felsenheld* and its progeny were not analogous to the case before it because *Felsenheld* and its progeny involved rules or regulations that were "integrally connected to the procedures for executing the tax at issue."

In reviewing Congress's powers incidental to the taxing power, the district court emphasized the taxing power's limited scope. Quoting *NFIB*, the court recognized that Congress cannot exercise the "'same degree of control over individual behavior'" under the taxing power as it does under the commerce power. Because the district court determined Congress's authority under the taxing power was limited to the span of time from when "a tax liability arises" to when it is paid, the applicable standard was not

whether IRC Sections 5178(a)(1)(B) and 5601(a)(6) had a "'reasonable connection' to revenue." The court remarked, "Congress cannot rely on a 'reasonable' or 'rational' connection to an existing tax to regulate *every* individual behavior occurring before that tax obligation becomes effective." Thus, the district court returned to the Supreme Court's conclusion in *McCulloch*, and then appeared to develop a new applicable standard that adopted a "needful" requirement and the "plainly adapted" requirement from *McCulloch*. The court proclaimed that the proper applicable standard was whether the provisions were "needful and 'plainly adapted' to executing Congress's taxes on spirits."

The district court determined that IRC Sections 5178(a)(1)(B) and 5601(a)(6) failed to meet its "needful and 'plainly adapted'" standard for two reasons. First, the provisions were not "needful" to carry out the execution of the taxing power because the provisions "criminalize[d] conduct of persons not subject to the tax." Referencing another distilled spirit provision, IRC Section 5004(a), the court stressed that the tax liability from the tax on distilled spirits does not arise until "'the spirits are in existence.'" Citing *NFIB*, the court reasoned, Congress cannot use powers incidental to the taxing power to "criminalize the conduct of a person to whom its enumerated taxing power does not yet apply." Second, the challenged provisions were not "'plainly adapted'" to executing Congress's power to lay and collect the tax on distilled spirits because "they [we]re not meaningfully connected to the modus operandi of spirits taxes." Unlike other distilled spirit provisions, the "plain text" of the challenged provisions "ma[de] no reference to any mechanism or process that operate[d] to protect revenue" and did not "touch the product to be taxed"— distilled spirts. The Court recognized that while the location prohibition "might be *convenient* to protect tax revenue on spirits, it [wa]s not a sufficiently clear corollary to the positive power of laying and collecting taxes."

The district court accordingly held that "neither Congress's enumerated taxing power nor its incidental powers sustain [IRC Sections 5178(a)(1)(B) and 5601(a)(6)] as enacted." Still, the district court acknowledged that the outcome might have been different if Congress had gone with another proposal discussed when IRC Sections 5178(a)(1)(B) and 5601(a)(6) were debated in 1867. As part of the debates to reform the taxation of spirits, there was a proposal to tax the capacity of distilleries. The district court proposed that if Congress had chosen to measure the tax by distillery capacity instead of the current measurement, by "each proof gallon" of distilled spirits, then "criminalizing the 'location of distilled spirits plants' would likely be fair game." The district court reasoned that there would be an "essential link" between the distillery location prohibition and a distillery capacity tax and its collection, because "the stills themselves—measured by capacity—would be subject to the tax." Consequently, the court suggested "Congress could prohibit stills in a myriad of places, like it can mandate the package size of other taxable commodities."

Considerations for Congress

If Congress sought to permit at-home spirit distilling and exempt certain amounts of distilled spirits produced for personal and family use from tax, Congress might consider changing distilled spirits laws to emulate the laws governing beer and wine. An adult can produce up to 100 gallons of beer and up to 100 gallons of wine per calendar year for personal or family use without being subject to alcohol excise taxes. In a household with two or more adults, the limit increases to 200 gallons of beer and 200 gallons of wine.

More generally, when developing taxing schemes with provisions that regulate individual behavior but do not raise revenue themselves, Congress might evaluate whether the provisions can be sustained under its enumerated powers other than the taxing power. For example, Congress may be able to sustain a provision that regulates local commercial activity under the Commerce Clause if the provision is part of a comprehensive statutory scheme. In a portion of the *Hobby Distillers* decision that has not been appealed, the district court ruled that the Federal Alcohol Administration Act was "not a 'comprehensive' scheme of

regulation because there are many aspects of the alcohol industry that Congress has left untouched." When a taxing scheme provision that regulates individual behavior cannot be sustained under another one of Congress's enumerated powers, Congress might consider drafting the provision in a way that touches the subject that is taxed.

Author Information

Milan N. Ball
Legislative Attorney

Disclaimer