



**House
Legislative
Analysis
Section**

House Office Building, 9 South
Lansing, Michigan 48909
Phone: 517/373-6466

**REGULATE INTERNET ALCOHOL
SALES**

**House Bill 4752 as enrolled
Public Act 289 of 2000
Second Analysis (7-10-00)**

**Sponsor: Rep. Nancy Cassis
House Committee: Regulatory Reform
Senate Committee: Economic Development,
International Trade and Regulatory
Affairs**

THE APPARENT PROBLEM:

Despite a statewide ban on selling alcohol to minors, some underage drinkers are finding that mail order and Internet companies are an easy way to circumvent the law. Sales via the Internet, or catalog sales such as beer- or wine-of-the-month clubs, do not involve face-to-face transactions with a picture identification; therefore, some underage persons have been able to purchase alcohol via the Internet or mail order by listing a false birth date and using a parent's credit card number. Since most deliveries are made during the day when parents typically are at work, minors can take possession of the alcohol, usually without a parent's knowledge.

Also at issue is that businesses selling alcohol directly to consumers, even to persons over 21, violate state laws that restrict the importation, transportation, sale, and delivery of alcohol to the state and its licensees. Michigan has a very strict regulatory framework for alcohol (see *Background Information*). Only licensed retailers may deliver alcohol directly to consumers, and retailers can only buy alcoholic products directly from licensed wholesalers, who buy from licensed suppliers. Internet and mail-order companies that ship alcohol directly to consumers are in direct violation of the Michigan Liquor Control Code. Besides being a code violation, direct shipment circumvents the tax structure in place on alcoholic beverages, thus reducing revenue to the general fund and School Aid Fund.

Laws vary widely from state to state regarding the direct shipment of alcohol to consumers. With regard to wine, at least twenty-three states, including Michigan, prohibit direct shipment of alcohol via common carrier, six allow limited direct shipping, and twelve states have a reciprocity agreement that allows small shipments for personal use only and delivery to persons over 21.

In light of the increase in buying wine, beer, and spirits over the Internet or through catalog sales, and the apparent ease for minors to access alcohol through these means, some feel that language should be added to the liquor code to specifically highlight that sales of alcohol via the Internet and mail order are prohibited unless a company is appropriately licensed by the Michigan Liquor Control Commission. Further, it is believed that requiring delivery to be made only to the person placing the order (or a designated recipient) upon proof that the person is 21 years of age or older should dissuade minors from attempting to illegally access alcohol through the anonymity of the Internet and mail order sales.

THE CONTENT OF THE BILL:

Under the Michigan Liquor Control Act, only the Liquor Control Commission and certain persons licensed or authorized by the commission are allowed to sell, deliver, or import alcoholic beverages into the state. House Bill 4752 would specify that the sale, delivery, or importation of alcoholic liquor would include, but not be limited to, "the sale, delivery, or importation of alcoholic liquor transacted or caused to be transacted by means of any mail order, Internet, telephone, computer, device, or other electronic means."

If a retail sale, delivery, or importation of alcohol occurred by any of these means, the retailer would have to comply with the following:

- Be licensed under the laws of the state.
- Pay any applicable taxes to the commission and comply with all prohibitions of state laws, which

include, but are not limited to, a prohibition on the sale of alcohol to minors.

Both a retailer and a person taking the order on behalf of a retailer would have to comply with the following:

- Verify the age of the individual ordering the alcohol by obtaining an affirmation that the person placing the order is of legal age to purchase alcohol. The person receiving and accepting the order would have to record the name, date of birth, telephone number, and address of the person placing the order on the order form or other verifiable record of a type and generated in a manner approved by the commission.
- Make available to the commission, upon request, any document that was used to verify the age of the individual ordering the alcohol.
- Stamp, print, or label on the outside of the shipping container, in a prominent fashion, that the package contains alcohol and that the recipient must provide identification verifying his or her age along with a signature.
- Place a label on the top panel of the shipping container that contains the name and address of the person who placed the order and the name of any designated recipient.

The bill would require the person who delivered the alcohol to verify that the person accepting delivery of the alcohol is of legal age and is either 1) the individual who placed the order; 2) the designated recipient who lives at the same address; or 3) is otherwise authorized through a commission rule to receive alcohol under this section of the liquor code. If a diligent inquiry revealed that the purchaser or designated recipient was underage, the delivery person would have to return the alcohol to the retailer. A delivery person would not be liable for damages suffered by the purchaser or retailer if the delivery person was unable to obtain the purchaser's legal age. "Diligent inquiry" is defined in the bill (and elsewhere in the code) as a good faith effort to determine the age of a person including an examination of an official Michigan driver's or chauffeur's license, an official state personal identification card, or any other bona fide picture ID that established the identity and age of the person.

In addition, the bill would make changes to a provision in the code pertaining to an individual importing alcohol from another state for personal use. Currently, a person 21 years or older may personally bring in alcohol from another state for personal use as long as

the amount is 312 ounces or less and contains less than 21 percent alcohol by volume. The bill would restrict this privilege to once in a 24-hour period. Further, shipping or importing alcoholic liquor of less than 21 percent alcohol from another state for personal use would have to be done in compliance with the regulatory framework established by the liquor code.

MCL 436.1203

BACKGROUND INFORMATION:

Michigan's Liquor Laws. Beer and wine is distributed in Michigan via a "three-tier system." A business may be licensed as either a supplier (brewers and vintners), wholesaler, or retailer (restaurants, package stores). Generally, a supplier contracts with a wholesaler to deliver a particular brand of product to licensed retailers in a designated geographic region. As part of the criteria for licensing, both wholesalers and retailers must have a building located within the state, but suppliers can be located either within or outside of the state. An "outstate" seller's license permits a supplier to handle products manufactured in other states and countries. Michigan wineries and microbreweries may sell their products directly to consumers on their own premises or directly to wholesalers, who then sell the product to retailers; an out-of-state winery or brewery is typically licensed as an outstate seller of beer or wine and sells its products to wholesalers. Very small breweries or wineries, who may not find it profitable to carry a license as an outstate seller, can sell to a licensed outstate seller of beer or wine, who then can market these products in the state.

Spirits are distributed in a similar manner, except that the state fills the role of the wholesaler. Under legislation that privatized the delivery system of spirits in the state, authorized distribution agents (ADAs) operate as agents of the state to receive shipments from suppliers, warehouse, and deliver spirits to retailers. Under the regulatory framework, manufacturers of spirits contract with an ADA to be the exclusive distributor of that product. A licensed retailer orders the desired product from whichever ADA represents that particular brand. The ADA forwards the order to the Michigan Liquor Control Commission (MLCC), which forwards the order to the supplier. The supplier ships to the ADA, who then delivers the product to the retailer for sale to the consumer.

Only a licensed retailer may sell directly to a consumer (except for wineries and microbreweries who may sell from their licensed premises only). Retailers are licensed for off-premise consumption (grocery stores,

package stores) or on-premise consumption (restaurants, bars). There are two classifications of off-premise license: a Specially Designated Merchant (SDM) may sell beer and wine and a Specially Designated Distributor (SDD) may sell spirits. An SDD licensee may also hold an SDM license. With a few exceptions, an SDD license is subject to a quota restriction based on population with one license per 3,000 population.

An unlicensed person who engages in any act that requires a license is guilty of a felony punishable by up to one year in jail and/or a \$1,000 fine. The law also allows the commission to levy a \$5,000 fine and to issue an assessment and demand for taxes owed. Michigan law does not prohibit a company from selling beer, wine, or spirits via the Internet or mail order, but requires that a business fit within the structure of the regulatory scheme in place. Basically, an in- or out-of-state business, in order to legally sell alcoholic products through these means, would first have to order from a licensed supplier (or, in the case of spirits, a licensed ADA), who would then sell the product to a licensed wholesaler, who would then deliver the product to a retailer, who then would repackage the product and deliver it to the person making the order. According to the MLCC, there are currently three out-of-state companies who are legally selling alcohol through sites on the Internet or through mail order.

Sales to Minors. The Liquor Control Code prohibits the sale or furnishing of alcohol to minors. Licensees guilty of a violation face both criminal and administrative sanctions, including license revocation. Also, a local government can, by resolution, request the MLCC to revoke a license for an off-premise licensee (SDD or SDM) who was found to have sold alcohol to minors three times in a calendar year [MCL 436.1501(3)] if the sales did not involve the use of a false ID.

Licensees are required to make a diligent inquiry to determine the age of a purchaser, which includes checking IDs. The Michigan Licensed Beverage Association sponsors an alcohol management training program that, among other things, trains employees of liquor licensees to do ID checks, as well as recognize when a customer is intoxicated.

Any person who sells or furnishes alcohol to a minor is guilty of a misdemeanor punishable by a fine of up to \$1,000 and imprisonment for up to 60 days for a first offense, and by a fine of up to \$2,000 and up to 90 days imprisonment for a second or subsequent offense. Delivery of alcohol to a minor by a nonlicensee that

leads to the death of the minor is a felony, punishable by up to 10 years in prison, a fine of up to \$5,000, or both.

Liquor Taxes. The MLCC levies a 51-65 percent markup on the cost of spirits from the supplier; the markup plus the supplier's cost becomes the base price. In addition, the commission then levies a four percent specific tax on the base price which is earmarked for the general fund, a four percent excise tax earmarked for the School Aid Fund, a four percent specific tax earmarked for the Convention Facility Development Fund, and a 1.85 percent specific tax on off-premise sales earmarked for the Liquor Purchase Revolving Fund. These taxes are collected and remitted to the commission by the licensed retailers.

Wine with 16 percent or less alcohol is taxed at 13.5 cents per liter, and wine with more than 16 percent alcohol is taxed at 20 cents per liter. Beer is taxed \$6.30 per barrel (smaller breweries and brewpubs are eligible for a \$2 per barrel credit). Mixed spirit drinks are taxed at 48 cents per liter. These taxes are collected and remitted to the commission by the licensed suppliers.

Sales and Use Tax. The issue of uniformity of sales and use tax laws is a hotly debated topic, as it is reported that over 7,500 state and local units of government currently levy sales taxes. Forty-five states have a sales and use tax in effect (Alaska does not have a state-imposed sales tax, but some local jurisdictions have a local sales tax.) A sales tax of six percent is collected on certain goods and services, including alcoholic liquor, purchased within the state of Michigan and a six percent use tax is levied on those same goods and services purchased outside of Michigan (remote sales), but consumed in the state, for which no sales tax (or a lower sales tax) was paid. About 73 percent of the sales tax and thirty-three percent of the use tax collected in Michigan goes to the School Aid Fund. The use tax in Michigan has been in effect since 1937, and is a complement to the sales tax. Businesses located outside of Michigan but having nexus within the state (a legal standard for determining whether physical presence exists) are required to collect and remit Michigan use tax, but the state cannot require a company that does not have nexus to collect the tax. It then becomes the consumer's responsibility to remit the appropriate use tax to the Michigan Department of Treasury on his or her state income tax form. Purchases made over the Internet or through catalog sales that do not charge Michigan sales tax are also subject to the use tax. In 1999, Michigan residents purchased about \$7.3 billion in mail order and Internet

goods. The Department of Treasury estimates that about \$173 million in use taxes from remote sales will be lost in fiscal year 1999-2000 alone. For more information on the use tax and how a consumer can remit tax owed to the state treasury, see the department's website at <http://www.treas.state.mi.us>.

Moratorium on Internet Taxes. According to the National Governor's Association, the federal Internet Freedom Act of 1998 does not ban the collection of sales and use taxes on goods sold over the Internet. The act does, however, impose a three-year moratorium on new taxes on Internet access, e.g., the monthly fees paid to companies like America Online to connect to the Internet.

The act also established the Advisory Commission on Electronic Commerce to study the issue of e-commerce and taxation. The commission report, released in April, 2000, contains several proposals regarding e-commerce and sales and use taxes. One of the proposals adopted by the commission calls for a clarification as to which factors, in and of themselves, would not constitute having physical presence in a state and so would not obligate a seller to collect and remit use taxes for that state. The commission also adopted a proposal to encourage both state and local governments to work with and through the National Conference of Commissioners on Uniform State Laws to draft uniform state and local sales and use tax policies that would create and maintain parity of collection costs between remote sellers and comparable brick and mortar sellers that do not offer remote sales. (Advisory Commission on Electronic Commerce Report to Congress, April 2000, Executive Summary, page 5.) Meanwhile, several other competing and conflicting proposals are circulating at the federal level, including proposals that would preempt state laws and ban all taxation on goods purchased over the Internet, and model legislation that calls for a streamlined approach to sales and use taxes, whereby a third party would be created to calculate, collect, and distribute the appropriate tax due to each state from Internet and mail order sales.

FISCAL IMPLICATIONS:

According to the House Fiscal Agency, the bill should have no effect on state costs as Internet, electronic, and mail order sales already fall under the act, and the commission already collects relevant fee revenue from several out-of-state sellers who conduct Internet, phone, and electronic sales. To the extent the bill clarifies current law, the agency reports that it could

increase state revenue derived from these types of sales. (6-16-00)

ARGUMENTS:

For:

Michigan has adopted a zero tolerance policy regarding underage drinking. In recent years, several laws have been adopted to amend various acts to toughen penalties and to reduce, if not eliminate, a minor's access to alcohol. However, as e-commerce expands and products are increasingly marketed via catalog sales, underage drinkers are finding new and easy sources from which to obtain beer, wine, and spirits. Though companies require a date-of-birth and a credit card number for purchase, underage drinkers report it is easy to record a false birth date and many have access to their parents' credit card account numbers. Added to that is the fact that most deliveries are made while parents are at work. Therefore, there is little disincentive for an underage person to attempt to buy liquor through the Internet or mail order sales.

The bill would strengthen current law in several ways. First, it would clearly specify that illegal sales to minors include Internet, mail order, and electronic transactions, such as fax orders. Secondly, it would require better record keeping and documentation of transactions. Most importantly, perhaps, is that the bill would require the package to be clearly marked as containing alcohol, and only the purchaser or a designated recipient could accept delivery. This should thwart those minors attempting to circumvent the law, as the delivery person would be prohibited from releasing the package unless the purchaser or designated recipient could prove that he or she is 21 or older.

For:

The bill requires that a licensed retailer legally engaging in Internet, electronic, and catalog sales of alcoholic beverages remit applicable taxes to the liquor commission. This provision will ensure the capture of excise taxes and sales and use taxes that are currently lost on such sales. As Internet and mail order sales of alcohol increase, as is expected, the loss in revenue to the School Aid Fund and general fund could be staggering.

Response:

The language in the bill pertaining to retailers paying applicable taxes to the commission may not have the intended effect. The only taxes that liquor licensees pay to the commission are those referenced in the liquor code. (See *Background Information.*) In the

case of beer and wine, specific taxes are collected by licensed suppliers, not by licensees at the retail level. Retailers do remit excise and specific taxes on spirits to the commission, but sales tax on all types of alcohol is paid to the state treasury under the General Sales Tax Act. To make changes in the way sales and use taxes are collected or enforced, it would be necessary to amend the General Sales Tax Act and the Use Tax Act.

For:

The bill would protect Michigan's three-tier system for beer and wine, along with protecting currently licensed businesses. To allow Internet and mail order companies to operate unchecked would create an unlevel playing field in favor of out-of-state businesses who could offer lower prices because they do not pay license fees or liquor taxes. The bill strengthens the liquor code by highlighting that for a company to legally sell alcohol in the state, it must fit within the established regulatory framework already in place. Enforcement of the bill would not hinder e-commerce or mail order sales, just regulate them as any business attempting to sell alcohol is regulated. It is important that only licensed retailers be allowed to deliver liquor to consumers; the liquor law contains many obscure provisions not quickly apparent to out-of-state businesses, such as the provision restricting deliveries of alcohol to 2- or 4-year colleges and universities (e.g., dormitories). Currently, there are three companies selling liquor on the Internet that operate legally within Michigan; therefore, it should not be difficult for other companies wishing to do business in Michigan to follow suit.

Response:

The bill is not needed. The Liquor Control Code prohibits the import, transport, delivery, and sale of alcohol by anyone other than licensees and grants the Liquor Control Commission authority to prosecute any person or business who attempts to circumvent the law. Earlier this year, the attorney general's office, in conjunction with the commission, successfully prosecuted an Illinois firm that was selling alcohol in Michigan in violation of current law. The bill would add nothing to the enforcement powers already enjoyed by the commission and law enforcement agencies.

Against:

The bill would put an unfair burden on delivery personnel who are not employees of liquor licensees to correctly determine if a purchaser is of legal age to accept delivery. Unlike the employees of package stores, checking IDs is not a principal part of the job for people who work for UPS, FedEx, or other delivery companies. Besides, since furnishing alcohol to minors

can result in criminal charges, especially if the alcohol led to the death of the minor, delivery people could be placed at greater risk of finding themselves in violation of the law simply by virtue of the fact that sales of liquor by Internet, phone, and mail are increasing. Also, unlike liquor license employees, delivery people typically do not have the same level of training in differentiating a fake ID from a valid one. Further, since even attempting to purchase alcohol if underaged is a violation of the law, would delivery personnel be obligated to report a minor who was listed on the package as the purchaser to local authorities? Would they then become embroiled in court cases as witnesses or defendants should a package fall into the hands of a minor? The burden for verifying a purchaser's age needs to rest with liquor licensees.

Response:

According to a representative from the Michigan Licensed Beverage Association, sponsors of the Techniques of Alcohol Management program, the program is open to members of the public, not just to association members. Therefore, delivery personnel could participate in the training. Secondly, the law states that licensees are responsible for the actions of their employees and agents. According to commission staff, if a retailer sent a package of alcohol via a delivery company, the delivery person would be considered to be an agent of the licensee. Therefore, the off-premise licensee would be subject to criminal fines and administrative sanctions for the actions of a delivery person. It would be logical to assume, then, as commerce using electronic means and mail expands, that retailers would find a way to increase the knowledge and ability of delivery personnel so that the law would be adhered to and that alcohol would not be delivered to underage persons.

Analyst: S. Stutzky

■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.