Legislative Analysis

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REPEAL OF OFF-PREMISES LIQUOR TAX

Senate Bill 331 without House amendment
Sponsor: Sen. Joe Hune
House Committee: Regulatory Reform
Senate Committee: Regulatory Reform

First Analysis: 6-28-11

BRIEF SUMMARY:

Senate Bill 331 would repeal Section 1205 of the Liquor Control Code, which imposes a 1.85% tax on the retail sale price of spirits for off-premises consumption.

FISCAL IMPACT:

The 1.85% specific tax generates approximately $14.0 million annually and is credited to the Liquor Purchase Revolving Fund (LPRF), which the Liquor Control Commission uses to replenish, maintain, warehouse, and distribute liquor stock throughout the state and for operations to administer the Liquor Control Code. Under Section 221 of the Liquor Control Code (MCL 436.1221) and Section 435 of the Management and Budget Act (MCL 18.1435), the "net income" from the LPRF at the end of a fiscal year is transferred to the General Fund. Given this flow of funds, by eliminating the 1.85% specific tax, Senate Bill 331 would effectively reduce the General Fund/General Purpose Revenue by approximately $14.0 million annually.

THE APPARENT PROBLEM:

Generally speaking, the Michigan Liquor Control Code separates establishments that sell alcohol into two distinct categories: off-premises licensees that are licensed to sell alcohol to consumers for consumption off the licenses premises (such as supermarkets and package stores), and on-premises licensees that are licensed to sell alcohol to consumers for consumption on the licensed premises (such as restaurants and bars).

For example, a Specially Designated Distributor license (SDD) is needed to sell spirits to a consumer for off-premises consumption and Specially Designated Merchant (SDM) licensees can sell only beer and wine for off-premises consumption. A different license is needed to sell alcohol for on-premises consumption. Holders of a Class C or Class B hotel license, such as restaurants and large hotels, can sell beer, wine, and spirits for consumption only on the licensed premises, and holders of a tavern license or Class A hotel license can sell beer and wine for on-premises consumption. In some cases, a restaurant may be eligible for an SDM license to sell beer and wine to a customer for off-premises use.

Off-premise retailers currently pay a 1.85% tax per bottle for liquor they purchase from the Liquor Control Commission that is not paid by on-premises retailers. This levy was initially established to fund alcohol treatment programs administered by the state. The problem this bill seeks to address is said to stem from the passage of the "catering bills" earlier this session (see <u>Background: Passing of Catering Bills</u>). Now, on-premise licensees that are also licensed caterers can use their own liquor when catering events and no longer have to purchase the liquor from off-premise retailers. Off-premise retailers believe they could stand to lose a substantial percentage of their business to on-premise licensees when it comes to catering events. As a way for the retailers to offset that potential loss, they are seeking to eliminate the 1.85% tax that is exclusive to them.

THE CONTENT OF THE BILL:

Senate Bill 331 would repeal Section 1205 of the Liquor Control Code, which imposes a 1.85% tax on the retail selling price of spirits for off-premises consumption, in addition to any other taxes imposed by law

Section 1205 requires the Liquor Control Commission to collect the specific tax at the time it sells the spirits. The commission is required to deposit the entire proceeds in the State Treasury, which is credited to the Liquor Purchase Revolving Fund.

Additionally, under the Code, if a specially designated distributor (SDD) sells alcoholic liquor to a hotel or merchant licensed to sell spirits for off-premises consumption, the alcohol may not be sold at less than the minimum retail selling price fixed by the Commission. "Minimum retail selling price" means the retail selling price plus certain specific taxes, including the 1.85% specific tax imposed under Section 1205. Senate Bill 331 would delete reference to that tax from the definition of minimum selling price.

MCL 436.1229 and 2205

HOUSE COMMITTEE ACTION:

The committee reported the Senate-passed version without amendment.

BACKGROUND INFORMATION:

<u>History of the Specific Tax.</u> The specific tax on the retail selling price of spirits for off-premises consumption was initially set at 1% but was increased to 1.85% in 1978. The initial tax of 1% was created mainly to fund grants that are provided to local centers for the treatment of people addicted to alcohol and other drugs. It was increased to 1.85% to pay for a new treatment referral program for people identified as intoxicated in public.

It appears the argument for taxing only off-premises retailers was because off-premises licensees purchased liquor from the state at a price fixed by the Commission and then sold it at a price fixed by the Commission. In theory, then, this tax would not negatively impact their gross profits as the tax would be reflected in the retail sales price of each bottle of spirits, and every off-premises retailer bought and sold spirits at the same price. On the other hand, on-premises licensees have no fixed price at which they sell spirits (drink prices by the glass generally vary from establishment to establishment) and subjecting them to the 1.85% specific tax could have led to a negative impact on sales and profits.

(While there is still a fixed minimum price at which bottles of spirits must be sold, retailers have been allowed to charge more than that minimum since the passage of Public Act 407 of 2004. In other words, package stores cannot sell spirits below a price determined by the LCC but can sell spirits at a higher price.)

Taxes Imposed on Spirits. Currently Michigan imposes specific taxes on spirits purchased by on-premises retailers equaling 12%, and imposes taxes totaling 13.85% on spirits purchased for off-premises consumption. These taxes are distributed as follows: 4% credited to the General Fund, 4% credited to the School Aid Fund, 4% credited to the State Convention Facility Development Fund, and the additional 1.85% to the Liquor Purchase Revolving Fund.

According to the Tax Foundation, from 2000-2010, Michigan's specific taxes on spirits were equal to $10.91 per gallon. Other regional states include: Illinois at $8.55 per gallon, Indiana at $2.68 per gallon, Minnesota at $5.03, New York at $6.44 per gallon, Ohio at $9.04 per gallon, and Wisconsin at $3.25 per gallon. During that time period, Michigan ranked 10th nationally in terms of the taxes per gallon of spirits.[1] According to the Federation of Tax Administrators, the U.S. median for tax per gallon on spirits is $3.75.[2] It is important to note that in Michigan and Ohio, the government directly controls the sales of spirits.

Pricing of Spirits in Michigan. Section 233 of the Liquor Control Code provides for a retail selling price and a minimum retail selling price. As defined in MCL 436.1229, the "retail selling price" means the price the Commission pays for spirits plus the gross profit established in Section 233." Additionally, "minimum retail selling price" is defined as the retail selling price plus the specific taxes imposed under the Code.

The Liquor Control Commission arrives at a retail selling price by adding a 65% "markup" (established by statute) to the base price it pays for the product. The LCC sells the product to retailers at a "discount" of 17% from that price (which represents the gross profit to retailers.) The minimum price to off-premises consumers is the retail selling price plus taxes. Sales tax is added after the other taxes.

The following is an example of how the minimum retail selling price (shelf price) is calculated using a bottle of spirits that, after the LCC markup, has a price of $10.

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[1] http://www.taxfoundation.org/taxdata/show/245.html
[2] Federation of Tax Administrators, February 2010.
http://www.taxadmin.org/fta/rate/liquor.pdf

<u>Off-premise Liquor Licensee Price Calculator</u>

Example Base Price (Retail Selling Price)	$10.00
(Less) Discount - 17%	$1.70
(Add) Specific Taxes 12% (calculated on base price)	$1.20
(Add) Off-premise tax - 1.85% (calculated on base price)	$0.19
Off-premise purchase price (cost to licensee) Plus Taxes (passed on to the consumer)	$9.69
(Add) Licensee Profit from MLCC	$1.70
Minimum Selling (Shelf) Price	$11.39

***The 6% state sales tax is applied at the point of sale to the customer and cannot be reflected in the shelf price.*
***The base price includes a 65% markup on the original purchase price paid by LCC at the time of purchase from the supplier.*
***Off-premise licensees are prohibited from selling liquor at less than the minimum retail selling price. (MCL 436.1229 & 1233 and Rule 436.1529)*

<u>Passage of the Catering Bill.</u> Public Act 20 of 2011 amended the Liquor Control Code to create a new liquor permit that would allow the sale and delivery of beer, wine, and spirits for off-premise consumption at private events. The situation being addressed concerned establishments licensed to sell alcohol on and/or off the licensed premises that also provide catering services. Previously, if a host hired an establishment to cater an event that was held at a location other than at the licensed premises, the establishment could supply the food and wait staff, but could not sell and deliver the alcohol. Rather, the host had to purchase the alcohol from a retailer with a specially designated distributor (SDD) or specially designated merchant (SDM) license and transport the alcohol to the event's location. PA 20 of 2011 now allows the establishments licensed to serve food and liquor and licensed to sell alcohol to provide both at catered events. For a detailed analysis of Public Act 20 0f 2011 please visit:
http://www.legislature.mi.gov/documents/2011-2012/billanalysis/House/pdf/2011-HLA-0005-3.pdf

<u>Estimated Price Reduction.</u> According to the Liquor Control Price List, the following are the estimated price reductions from eliminating the 1.85% tax for a 750 mL bottle of some popular spirits[3]:

- Captain Morgan Spiced Rum, $0.24 (Current minimum shelf price of $14.98)
- Jim Beam - $0.28 (Current minimum shelf price of $16.98)
- Dewar's White Label - $0.37 (Current minimum shelf price of $22.95)
- Crown Royal - $0.41 (Current minimum shelf price of $24.95)
- Absolut - $0.44 (Current minimum shelf price of $26.99)

[3] The estimated price reduction is equivalent to the 1.85% specific tax currently built into the minimum shelf price for off-premise retailers.

ARGUMENTS:

For:

Supporters of Senate Bill 331 feel the 1.85% specific tax on the retail price of liquor sold to off-premises retailers is unfair because it singles out one particular class of retail licensee over others. Committee testimony revealed supporters feel this legislation is a follow-up bill to the catering bill that was passed earlier this session (see <u>Background: Passing of the Catering Bill</u>); that bill, in theory, could cause off-premise licensees, such as package stores and supermarkets, to lose a percentage of their business to on-premise licensees because caterers would no longer have to purchase spirits from off-premise licensees. As a way for the retailers to offset that potential loss, they are seeking to eliminate a tax that is exclusive to them.

Supporters also feel eliminating the 1.85% off-premise tax will lead to increased liquor sales and conversely more revenue for the state. It is thought that individuals living on or near the border would be more likely to buy liquor in Michigan if the shelf price were to be lowered.

Against:

Opponents of this legislation point to the $14 million in revenue that the 1.85% specific tax on off-premise retailers generates for the General Fund. At a time when many budget areas are seeing dramatic reductions, eliminating this specific tax would be irresponsible. This is revenue that could be going to schools, public safety, and social safety net programs. A reduction in the General Fund could also be detrimental to alcohol rehabilitation programs offered by the state. Alcohol and drug courts have proven to be effective in helping repeat offenders but require a significant investment from government. Some have even contended that instead of eliminating a tax for off-premise retailers, the Legislature should consider expanding the 1.85% specific to include on-premise licensees.

Response:

Supporters have contended that any revenue reductions to the General Fund will be offset by an increase in over-the-counter sales, especially in border areas, because the retailers will pass the 1.85% tax reduction on to its customers.

Rebuttal:

The 1.85% specific tax is calculated on the base price of the liquor and reflected in the purchase price paid by the retailer. Elimination of the tax would lower the retail selling price and the minimum retail price (shelf price) by 1.85%. It would only result in consumer savings **if** retailers reflected their reduced purchase price in the shelf price. For retailers that currently sell at the minimum retail price, perhaps it is reasonable to assume they would continue that practice and pass the 1.85% savings on to the consumer. However, for businesses selling above the minimum retail price, it cannot be determined if they would reduce the shelf price to reflect the reduction in taxes. (It likely would depend on competitive factors.) If the shelf price were not lowered, retailers would simply realize an additional 1.85% in revenue. Additionally, it is difficult to predict if sales would rise in border areas. While consumers may see shelf prices decrease by 1.85%, Michigan's liquor taxes would still be higher than neighboring states. When compared to bordering states Michigan's total spirits tax per gallon would still be higher. Critics do not believe the shelf price will drop significantly enough to change where individuals purchase alcohol (See <u>Background: Estimated Price Reduction</u>).

Against:

Some people believe that increasing the availability or consumption of alcohol leads to an increase in alcohol-related problems for individuals and for society at large. To the extent reducing alcohol prices leads to increased consumption, lower prices and taxes should be avoided.

POSITIONS:

Associated Food and Petroleum Dealers, Inc. supports the bill. (6-15-11)

Michigan Grocers Association supports the bill. (6-15-11)

Michigan Liquor Control Commission is neutral on the bill. (6-15-11)

Michigan Licensed Beverage Association is neutral on the bill. (6-15-11)

Michigan Alcohol Policy opposes the bill. (6-15-11)

Montcalm Coalition to Prevent Underage Drinking opposes the bill. (6-22-11)

Michigan Council on Alcohol Problems opposes the bill. (6-22-11)

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