

Legislative Analysis



BUDGET AGREEMENT: LIQUOR CONTROL AMENDMENTS

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**House Bill 6426 as enacted
Public Act 175 of 2010**

**House Bill 6427 as enacted
Public Act 176 of 2010**

**Sponsor: Rep. Bert Johnson
House Committee: Regulatory Reform
Senate Committee: None (Referred directly to the Floor)**

Complete to 10-6-10

A SUMMARY OF HOUSE BILLS 6426 & 6427 AS ENACTED 9-30-10

House Bills 6426 and 6427 would implement several changes to the state's liquor laws included as part of the Fiscal Year 2010–2011 budget agreement. The changes address bootlegging, value-added packaging, sampling, instant rebates, and wine auctions.

House Bill 6426

The bill would amend the Liquor Control Code to increase penalties for bootlegging spirits, and to allow sampling, instant rebates, and value-added packaging.

Bootlegging: The bill would prohibit a person, even if not licensed by the LCC, from selling, delivering, or importing spirits unless that sale, delivery, or importation is made by the commission, the commission's authorized agent or distributor, an authorized distribution agent, a person licensed by the commission, or by prior written order of the LCC.¹ The penalty for violating this provision would depend on the volume of spirits illegally sold, delivered, or imported, as follows:

- At least 80,000 ml: A felony, punishable by up to four years' imprisonment and/or a fine of up to \$5,000.
- 8,000 - 79,999 ml: A misdemeanor, punishable by 93 days' imprisonment and/or a fine of up to \$2,500.
- Less than 8,000 ml: A state civil infraction, punishable by a civil fine of up to \$1,000.

¹ For background information on bootlegging in the state, see, *Illegal Importation of Alcohol into Michigan: An assessment of the issue and recommendations*, Michigan Liquor Control Commission, January 15, 2008, [http://www.michigan.gov/documents/dleg/Illegal_Importation_of_Alcohol_1_14_08_221682_7.pdf].

Additionally, a retail licensee who sells, offers to sell, accepts, furnishes, possesses, or allows the consumption of bootlegged spirits would be subject to an administrative fine of not more than \$2,500 per occurrence, as well as additional license sanctions, as follows:

- 1st violation: License suspension of 1-30 days, or revocation.
- 2nd violation: License suspension of 31-90 days, or revocation.
- 3rd+ violation: License revocation

Sampling: The bill would allow consumer sampling of spirits, beer, and wine to occur on the premise of specially designated distributors (SDD),² conducted by vendors of spirits³ and manufacturers⁴ under a new consumer sampling event license and subject to the following requirements.

- The LCC would have to be notified in writing at least 10 days before the event.
- Each vendor or manufacturer would be limited to three sampling events per SDD per calendar month.
- The vendor or manufacturer must have a licensed representative present at the SDD establishment during the sampling event.
- The value of the product sampled does not exceed \$100.
- Sampled products are only provided to consumers at least 21 years of age.
- The SDD does not receive any fee or other consideration of value in return for hosting the sampling event.
- Each consumer is limited to three samples of no more than 1/3 oz. per sample.
- Samples are free.
- The product used to provide samples must be purchased from the SDD hosting the event at the LCC-determined minimum retail price.⁵
- The sampling event occurs during times when not otherwise prohibited.
- Sampling events may be advertised.
- Servers must demonstrate sufficient training.
- The vendor or manufacturer and SDD must comply with the LCC code and other applicable administrative rules.

The bill also allows the LCC to issue an order or administrative rules further defining licensing standards and other requirements on the conduct of a consumer sampling event. Violations of the sampling event provision would be subject to applicable penalties as prescribed in the Liquor Control Code.

Value-Added Packaging: The bill would also require the LCC to allow manufacturers or out-state sellers of spirits⁶ to package nonalcoholic carbonated beverages with spirits, as

² A specially designated distributor (SDD) is an entity licensed to sell spirits for off-premise consumption.

³ A vendor of spirits is a person that sells spirits to the LCC. (The LCC is the state's wholesaler of spirits.)

⁴ A manufacturer is a person engaged in the manufacture of alcoholic liquor, including, but not limited to, a distiller, a rectifier, a wine maker, and a brewer.

⁵ The minimum retail price is the sum of the LCC's purchase price, the LCC mark-up, and specific taxes.

⁶ An "out-state seller of spirits" is not a phrase used in the Liquor Control Code. The code does refer to "outstate sellers of mixed spirit drinks" and "suppliers of spirits," but it is unclear what "out-state seller of spirits" means.

part of a marketing and sales promotion program. Generally, as the wholesaler of spirits in the state, the Liquor Control Commission would be required to receive returnable containers under the state's Deposit Law. The bill would require the LCC to work with the Department of Treasury to avoid that situation, but still allow returnable containers to be redeemed elsewhere. The LCC could implement this provision through issuance of an order, promulgation of administrative rules, or executing a memorandum of understanding with the Department of Treasury.

Instant Rebates: The bill would require the LCC to allow non-mail-in rebates or instant coupons for spirits, provided the discounts do not impact the profit margins achieved by the LCC under the Code.⁷ The LCC would implement this provision through the issuance of an order or promulgation of administrative rules. The LCC currently allows the use of mail-in coupons and rebates, subject to certain restrictions, including prior approval by the LCC.⁸

Wine Auctions: The bill would create a new category of liquor license allowing sales of wine via an auction (e.g. a private wine collection sold as part of consignment or estate sales). Under a wine auction license, an owner (not otherwise licensed under the act) could sell a private wine collection through an auction, by a specially designated merchant (SDM)⁹ or other seller partnering with an SDM. The wine auction license would be issued to the SDM or their partner once the application is approved by the LCC. The annual wine auction license fee would be \$50,000. The license would be valid for one year, and would allow licensees to hold up to 12 auctions per "license year."¹⁰ Wine sold through an auction would need a tag affixed to it indicating that it was purchased from a private collection. Wine sold through an auction to entities licensed to sell wine at wholesale or retail could be resold in a manner consistent with their license, provided the tag remains affixed to the bottle. The wine auction licensee would be responsible for the delivery, storage, and warehousing of wine sold through the auction, and would also be responsible for paying any applicable sales or excise taxes.¹¹ Wine auction licensees

⁷ A manufacturer's coupon does not have the effect of reducing sales tax revenue generated from a sale at which a manufacturer's coupon is used. See, the Department of Treasury's *Revenue Administrative Bulletin 1995-6* (June 27, 1995), which notes that "[w]hen a purchaser redeems a manufacturer's coupon, the manufacturer will reimburse the retail seller for the coupon amount. This is, in effect, a sharing of the purchase price with the purchaser. Therefore, the coupon amount does not reduce the seller's gross proceeds from the sale, because the seller receives the item's full purchase price." The bulletin is available at, [http://www.michigan.gov/documents/95-6_114846_7.pdf].

⁸ http://www.michigan.gov/documents/cis_lcc_couponrules_147813_7.pdf

⁹ A specially designated merchant (SDM) is an entity licensed to sell beer and wine for off-premise consumption.

¹⁰ Under Section 501 of the Liquor Control Code (MCL 436.1501), the license year runs from May 1st – April 30th.

¹¹ The General Sales Tax Act exempts from taxation sales made via an "isolated transaction" by unlicensed persons. On this point, Rule 13 of the Department of Treasury's Sale and Use Tax Rules (R 205.13) notes that such sales are made other than in the ordinary course of repeated and successive transactions of a like character" and, by way of example, include "[a] person sell[ing] his household furniture, a farmer sell[ing] his farm machinery or other farm equipment, a merchant sell[ing] his cash register, counters or other store fixtures at auction or otherwise." The rules further note that, "any person who in any manner or at any time advertises, solicits or offers tangible personal property for sale for the purpose of repeated sales is deemed to be regularly engaged in business and his sales are not considered casual or isolated, even though they may be few or infrequent. Rule 3 of the Department of Treasury's Specific Sales and Use Tax Rules (R 205.53) notes, "(1) Auctioneers, agents, factors, brokers, etc., selling tangible personal property on a repeated basis from a fixed location, are retailers [subject to taxation] regardless of whether the sales are on their own behalf or for a principal. (2) Where an auctioneer is engaged by a manufacturer, farmer,

would be exempt from the registration requirements of Article 29 (Auctioneers) of the Occupational Code.¹²

House Bill 6427

The bill would amend Chapter XXVA (Criminal Enterprises) of the Michigan Penal Code to add the following to the definition of the term *racketeering*: committing, attempting to commit, conspiring to commit, or aiding or abetting, soliciting, coercing, or intimidating a person to commit an offense for financial gain involving a felony violation (at least 80,000 ml) related to the illegal sale, delivery, importation of spirits.

FISCAL IMPACT:

The bills are part of the FY 2011 budget target agreement, which relies on \$9.1 million in additional revenue to the General Fund, as follows:

- Bootlegging Enforcement: \$4.0 million
- Value-Added Packaging: \$2.1 million
- Instant Rebates: \$1.7 million
- Sampling: \$0.8 million
- Wine Auctions: \$0.5 million

Industry experts suggest that these changes are expected to result in an increase in spirits sales occurring in the state. The state, through its imposition of various taxes on the sales of spirits, would then see an increase in tax revenue. Under the Liquor Control Code, the state imposes a series of specific taxes, totaling 13.85%, on spirits sold in the state, as follows:

- 1.85% specific tax credited to the Liquor Purchase Revolving Fund, only imposed on sales to off-premise licensees.
- 4.0% specific tax credited to the Convention Facilities Development Fund.
- 4.0% specific tax credited to the School Aid Fund.
- 4.0% specific tax credited to the General Fund.

The budget target agreement figures above only reflect the GF/GP revenues that are expected to increase through the enactment of HB 6426. This GF/GP revenue figure not only includes revenue directly credited to the General Fund (i.e., the 4% specific tax), but additional revenue credited to the Liquor Purchase Revolving Fund. The LPRF is used by the LCC to support its liquor merchandising operations, as well as administrative expenses of the Department of Energy, Labor, and Economic Growth and the Liquor

or householder to act as his agent in selling tangible property at the premises of the manufacturer, farmer, or householder, the auctioneer will not be liable for sales tax on such sales unless the auctioneer actually purchases the merchandise and then sells the property acquired on his own behalf."

¹² Under the Occupational Code, auctioneers are registered by the DELEG Bureau of Commercial Services. Registration with the bureau allows for the use of the title of "Registered Auctioneer." The article is not a licensure statute, which would restrict market entry to only those persons meeting certain qualifying criteria. In addition to the registration provisions, Article 29 also imposes certain other conditions on the business practices of "registered auctioneers" or registrants.

Control Commission.¹³ By statute, any excess revenue in the LPRF lapses to the General Fund.¹⁴ In addition to the increase in GF/GP revenue, it is anticipated that the changes would also result in an increase in School Aid Fund revenue of \$0.9 million and another increase of \$0.9 million credited to the Convention Facilities Development Fund.

Under the original target agreement, sampling was limited to spirits. Under HB 6426 as enacted, sampling now includes beer and wine as well. By making sampling available to beer and wine, the bill has the potential to result in increased sales of beer and wine, which, through the imposition of beer and wine excise taxes, has the effect of increasing revenue to the General Fund. Under the Liquor Control Code, the state imposes a beer tax of \$6.30/barrel and a wine tax of \$0.135/liter to \$0.20/liter. Based on the anticipated impact of sampling on spirits sales, sampling for beer and wine could result in an additional \$215,600 GF/GP revenue.

The increased revenue resulting from enhanced bootlegging penalties and enforcement are expected to stem from the imposition of additional administrative fines, which are credited to the General Fund, as well the realization of more sales occurring within the legal purchasing system rather than being made "off-the-books." Additionally, HB 6426 provides for the forfeiture of proceeds under the Criminal Enterprises Chapter of the Michigan Penal Code.

The FY 2011 DELEG Appropriations Act (2010 PA 186, HB 5884) provides the Liquor Control Commission with an additional 6.0 FTE positions, supported by \$0.5 million from the Liquor Purchase Revolving Fund. The act also included another \$0.5 million LPRF for necessary scanning equipment.

The Conference Committee also added boilerplate Section 371, which requires the LCC to coordinate its bootlegging investigation and enforcement activities with the activities of the Department of State Police concerning tobacco taxes (the MSP Tobacco Tax Team) and other illegal cash transactions. The boilerplate section also requires the LCC to submit an annual report summarizing its activities, including the value of the product seized, the number of arrests, the amount of penalties imposed, and the amount of additional taxes imposed and collected.

Additionally, the imposition of criminal penalties (fines and/or imprisonment) would also impact the corrections system. To the extent the bill resulted in an increase in the number of felony convictions, the State would incur additional costs for felony probation (annual average of \$2,000) and incarceration (annual average of \$34,000).

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■ 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.

¹³ In addition to administrative costs, \$2.5 million from the LPRF is also used within the DELEG budget to support the Fire Protection Grant program.

¹⁴ According to the LCC's 2009 financial statement, the General Fund transfer was \$161.0 million in FY 2009, up slightly from \$159.2 million in FY 2008.