



Senate Fiscal Agency
P.O. Box 30036
Lansing, Michigan 48909-7536



Telephone: (517) 373-5383
Fax: (517) 373-1986

Senate Bill 349 (as passed by the Senate)
Sponsor: Senator Curtis S. VanderWall
Committee: Regulatory Reform

Date Completed: 4-9-20

RATIONALE

The Michigan Liquor Control Code requires the Michigan Liquor Control Commission (MLCC) to establish uniform prices for the sale of alcoholic liquor in State liquor stores and by specially designated distributors. The prices must return a gross profit to the Commission of between 51% and 65%. Apparently, this "markup" on liquor products is higher compared with other states; most other states charge a flat excise tax based on the volume of liquor produced (see **BACKGROUND**). In Michigan, beer and wine have a flat rate based on volume, instead of a percentage markup like liquor. Some believe that this is unfair, and that small-market distillers in Michigan are at a disadvantage because of the current pricing method. In an effort to make the spirits market more competitive and fair, and to assist Michigan distilleries and farmers, it has been suggested that the State decrease the markup on spirits produced by distillers that use a specified amount of Michigan-grown distilled grain in their products.

CONTENT

The bill would amend the Michigan Liquor Control Code to do the following:

- **Beginning February 1, 2020, allow a small distiller or an out-of-State entity that was the substantial equivalent of a small distiller to file an application with the Department of Agriculture and Rural Development (MDARD) to be certified as a qualified small distiller, i.e., a distiller that produced at least 40% of its distilled base distillate from distilled grain grown and harvested in Michigan.**
- **Specify that for each bottle of spirits produced by a qualified small distiller, the price for each bottle would have to return a profit to the MLCC of 32.5%, beginning January 1, 2021.**
- **Require MDARD to submit to the Commission an annual report that included the name of each qualified distiller.**
- **Prescribe penalties, including a misdemeanor penalty, for a small distiller or an out-of-State entity that was the substantial equivalent of a small distiller that provided false information to the Commission.**
- **Require a qualified small distiller to keep certain records and accounts of all transactions pertaining to the operation of its distillery.**

Qualified Small Distiller; Certification

Specifically, no later than February 1, 2020, and each February 1 thereafter, a small distiller or an out-of-State entity that was the substantial equivalent of a small distiller could file an application with MDARD to be certified as a qualified small distiller. The application would have to be on a form prescribed and furnished by MDARD. The Department also could charge a reasonable certification fee.

"Qualified small distiller" would mean a small distiller or an out-of-State entity that is the substantial equivalent of a small distiller certified by MDARD as having at least 40% of the base distillate of the small distiller or the out-of-State entity that is the substantial equivalent of a small distiller distilled from distilled grain grown and harvested in the State. "Distilled grain" would mean any of the following: dry barley, malted barley, oats, a small grain, a cereal grain, potato, corn, fruit, sugar beets, or honey.

Beginning January 1, 2021, for each bottle of spirits produced by a qualified small distiller of which at least 40% of the base distillate was distilled from grain grown and harvested in Michigan as determined by MDARD, the price for each bottle would have to return a gross profit to the Michigan Liquor Control Commission of 32.5%.

The Department would have to certify that an applicant was a qualified small distiller if it determined that the base distillate of the small distiller or the out-of-State entity that was the substantial equivalent of a small distiller was at least 40% distilled from distilled grain grown and harvested in Michigan.

No later than October 1, 2020, and each October 1 thereafter, MDARD would have to submit a report to the Commission. The report would have to include the name of each qualified small distiller certified under the bill.

A qualified small distiller certificate would expire on February 1 following the date of issuance.

Penalties

A small distiller or an out-of-State entity that was the substantial equivalent of a small distiller that supplied false information to MDARD or the Commission would be guilty of a misdemeanor punishable by imprisonment for up to one year or a fine of not more than \$3,000, or both. The offending entity also would have to pay the Commission the difference between the gross profit the Commission would have received if it were not a qualified small distiller, as determined by the Commission.

Records & Accounts

A qualified small distiller would have to keep a complete and accurate set of records and accounts of all transactions pertaining to the operation of its distillery, including records and accounts of all distilled grain received in or withdrawn from the distillery, all acknowledgment forms and Michigan certification of origination statements in the distiller's possession, copies of all contracts, and acknowledgement forms returned to and settled by the qualified small distiller. The Department and the Commission could examine the records and accounts pertaining to the qualified small distiller's distilled grain handling business at any time during normal business hours.

"Acknowledgment form" would mean a scale weight ticket, a load slip, or any other evidence of deposit issued by a small distiller, an out-of-State entity that is the substantial equivalent of a small distiller, or the authorized representative of a small distiller or out-of-State entity that is the substantial equivalent of a small distiller to a depositor that identifies the distilled grain being transferred from possession of the depositor to the possession of the small distiller or the out-of-State entity that is the substantial equivalent of a small distiller. "Michigan certification of origination statement" would mean a signed statement from a depositor or producer on an acknowledgement form that deposited distilled grain was grown and harvested in Michigan. "Depositor" would mean either of the following:

- A person that delivers distilled grain to a small distiller or an out-of-State entity that is the substantial equivalent of a small distiller for storage, processing, shipment, or sale and that has title to distilled grain at the time of delivery.
- A person that owns or that is the legal holder of an acknowledgement form issued by a depositor for distilled grain.

BACKGROUND

According to the Federation of Tax Administrators, 17 states (including Michigan) directly control the sales of distilled spirits, and generate revenue using various taxes, fees, price markups, and net liquor profit requirements.¹ The remaining states use an excise tax rate that applies a flat tax on each gallon of spirits produced. The median tax rate for those states is \$3.77. Most states also include state sales tax on the purchase of spirits.

According to the Michigan Department of Licensing and Regulatory Affairs (LARA), spirits sold by all license types totaled approximately \$1.52 billion between the months of January and December in 2019. Between the months of January and December in 2016, spirits sold by all license types totaled approximately \$1.30 billion. The Wine and Spirits Wholesalers of America reports that, in 2018, distilleries accounted for 551 jobs in Michigan, paid \$45.0 million in wages, and contributed \$531.0 million to Michigan's economy.²

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

The current pricing system for spirits in Michigan is unfair for small and craft distillers. Generally, the costs associated with starting a distilling business and producing spirits are high, especially if the product is of high quality and uses premium ingredients. This means that the wholesale price of the finished product usually is higher to cover these costs, particularly for a small distributor that may not have the equipment or purchasing power to minimize production expenses. Because the State applies a markup on the price of the finished spirit product instead of a flat volume-based tax (as with beer and wine), small distillers are punished for creating a high-quality product or for having higher production costs associated with creating the product, as their products are more expensive for consumers compared with those of larger competitors that can buy cheaper ingredients in bulk. By reducing the markup costs for certain distillers that use Michigan ingredients, the bill would encourage continued growth of small distillers and incentivize the use of Michigan-made products in spirits.

Legislative Analyst: Drew Krogulecki

FISCAL IMPACT

The bill would have an overall negative fiscal impact on the MLCC within LARA and on several State funds, including the School Aid Fund and the General Fund. The bill also contains provisions that could generate fee revenue for the State. The proposed misdemeanor would have an indeterminate fiscal impact on local units of government.

The bill also would establish an application process for the certification of small distillers within MDARD, which would affect LARA and specifically the MLCC. The Liquor Purchase Revolving Fund is the enterprise fund used by the MLCC to conduct the State's business as the sole wholesaler of distilled spirits. Each year, the profit generated through this activity lapses to the General Fund. The bill would result in an unknown reduction in revenues to the Liquor Purchase Revolving Fund and consequently would result in a decrease in funds lapsing to the General Fund.

¹ "State Tax Rates on Distilled Spirits - January 1, 2020", Federation of Tax Administrators, taxadmin.org. Retrieved on 4-6-20.

² "Economic Impact of Michigan's Wine & Spirits Distributors", Wine & Spirits Wholesalers of America, wswa.org. Retrieved on 4-8-20.

Under the bill, the gross return on each bottle of spirits from a qualified small distiller would be set at 32.5% rather than the current 65.0%. The number of small distillers that would be certified by MDARD and consequently affected by this change is unknown. Recent data on the number of bottles sold by qualified small distillers are unavailable. Analysis using data from fiscal year (FY) 2011-12 suggests a maximum potential revenue loss of \$9.4 million across all funds, including a reduction in General Fund revenue (\$8.5 million), School Aid Fund revenue (\$600,000), Convention Facility Fund revenue (\$300,000), and a loss of less than \$50,000 in local revenue due to reductions in sales tax revenue to constitutional revenue sharing. However, the actual loss of revenue to the Liquor Purchase Revolving Fund likely would be less due to the limited number of distillers that would receive certification. In addition, any effect the proposed lower markup would have on distiller behavior likely would take place over several years. As a result, the long-term effect of the reduced profit percentage on State revenues is unknown.

The bill also would result in costs to MDARD, including the hiring of 1.0 FTE auditor position at an estimated cost of \$150,000 for salary and other expenses. The Department could receive applications from small distillers to qualify as a "qualified small distiller", and would be allowed to charge a reasonable certification fee (in an unspecified amount). The Department then would be required to certify an applicant as a qualified small distiller if it determined that at least 40% of the small distiller's base distillate was distilled from distilled grain grown and harvested in Michigan. The Department, along with the Commission, could examine the records and accounts pertaining to the qualified small distiller's distilled grain handling business. Beginning October 1, 2020, the Department would have to submit an annual report to the Commission, which would include the name of each qualified small distiller certified. The actual amount of revenue provided from application fees to MDARD to support certification activities would depend upon the amount of the fee and the number of distillers applying for certification. Any restricted funding amounts that fell short of the actual cost of administering the bill's provisions would have to be supported with General Fund revenue.

Fiscal Analyst: Bruce Baker
Elizabeth Raczkowski

SAS\A1920\s349a

This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.