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

BILL ANALYSIS

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

Senate Bill 579 (Substitute S-2)
Sponsor: Senator John Proos
Committee: Regulatory Reform

Date Completed: 4-25-18

CONTENT

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

- **Revise the percentage of gross profit returned to the Michigan Liquor Control Commission (MLCC) from the sale of alcoholic liquor by specially designated distributors.**
- **Allow 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 in Michigan.**
- **Require MDARD to submit to the MLCC an annual report that included the name of each qualified distiller that was certified.**
- **Prescribe penalties, including a misdemeanor penalty, for a small distiller that provided false information to the MLCC**
- **Require a qualified small distiller to keep certain records and accounts of all transactions pertaining to the operation of its distillery, and give MDARD access to the records and accounts pertaining to the small distiller's small grain handling.**
- **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, 2020.**

Gross Profits From Spirits

The Code requires the Michigan Liquor Control Commission to establish uniform prices for the sale of alcoholic liquor by specially designated distributors (businesses licensed to sell packaged liquor for off-premises consumption). The prices must return a gross profit to the MLCC of at least 51%, but not more than 65%.

The bill would require the MLCC, except as otherwise provided and subject to prices approved by the State Administrative Board, to establish uniform prices that would return a gross profit to the Commission as follows:

- For 2018, not greater than 65%.
- For 2019, not greater than 64.5%.
- For 2020, not greater than 64.5%; or 64%, beginning with the second quarterly price for 2020, if the 2019 total sales of spirits in Michigan increased by at least 2%.

-- For 2021, not greater than the percentage established for 2020; or a 0.5% reduction from the previous year, beginning with the second quarterly price for 2022, if the 2021 sales of spirits in Michigan increased by at least 2%.
-- For 2022, not greater than the percentage established for 2021; or a 0.5% reduction from the previous year, beginning with the second quarterly price for 2022, if the 2021 sales of spirits in Michigan increased by at least 2%.
-- For 2023 and each year after that, the percentage established in 2022.

Qualified Small Distillers

The Code defines "small distiller" as a manufacturer of spirits annually manufacturing in Michigan not more than 60,000 gallons of spirits, of all brands combined. The bill would define "qualified small distiller" as a small distiller certified by the Department of Agriculture and Rural Development as having at least 40% of the small distiller's base distillate distilled from distilled grain grown and harvested in Michigan.

By February 1, 2019, and each February 1 after that, a small distiller could file an application with MDARD to be certified as a qualified distiller. An application would have to be on a form prescribed and furnished by MDARD. The Department could charge a reasonable certification fee.

The Department would have to certify than an applicant for certification was a qualified small distiller if MDARD determined that it met the requirements for a qualified small distiller.

By October 1, 2019, and each October 1 after that, MDARD would have to submit a report to the MLCC that included the name of each qualified distiller that was certified.

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

A small distiller that supplied false information to MDARD would be guilty of a misdemeanor punishable by imprisonment for up to one year or a fine of up to $3,000, or both. A small distiller that supplied false information would have to pay the MLCC the difference between the gross profit the MLCC would have received if the small distiller were not a qualified small distiller, as determined by the Commission.

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 qualified small distiller's possession, copies of all contracts, and acknowledgement forms returned to and settled by the small distiller. The Department could examine the records and accounts pertaining to the qualified small distiller's distilled grain handling business at any time during normal business hours.

The bill would define "distilled grain" as any of the following: dry barley, malted barley, oats, a small grain, a cereal grain, potato, corn, or fruit.

"Acknowledgment form" would mean a scale weight ticket, a load slip, or any other evidence of deposit issued by a small distiller or the small distiller's authorized representative to a depositor that identifies the distilled grain being transferred from possession of the depositor to the possession of the small distiller.

"Depositor" would mean either of the following:

-- A person that delivers distilled grain to 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 acknowledgment form issued by a depositor for distilled grain.

"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.

MCL 436.1233 Legislative Analyst: Stephen Jackson

FISCAL IMPACT

The bill would have an overall negative fiscal impact on the Michigan Liquor Control Commission within the Department of Licensing and Regulatory Affairs (LARA) and on several State funds, including the School Aid Fund and the State 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 would change the required gross profit returned to the MLCC from the sale of alcoholic liquor beginning in the calendar year 2019. The current gross retail mark-up is 65%. The bill would reduce this required return to 64.5% in 2019. It further would reduce the gross profit percentage by 0.5 percentage point for each subsequent year, provided that the previous year's total sales of spirits had increased 2% or more from the previous year. The reduction would begin in the year's second quarter.

As a result, if sales were increased by at least 2% in both 2019 and 2020, the gross profit percentage in 2021 would be set at not more than 63.5%. If reduced to 63.5%, the State would experience annual revenue losses estimated as follows: $10.9 million in General Fund/General Purpose revenue, $474,300 to the School Aid Fund, $474,300 to the Convention Facility Development Fund, and $711,500 in lost sales tax revenue. These costs are estimated using full-year revenue, as a by-quarter breakdown is unavailable.

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 State's General Fund. In FY 2016-17, the total amount lapsed was approximately $209.7 million. The bill would result in a reduction in future lapse amounts due to the losses noted above, dependent on the Fund's fiscal year revenue and expenses.

The bill also would establish an application process for the certification of small distillers within the Department of Agriculture and Rural Development, which would affect LARA and specifically the MLCC. The gross return on each bottle of spirits from a qualified small distiller would be set at 32.5% rather than the current 65% (or the percentage proposed by the bill). The number of small distillers that would be affected by this change is unknown. An estimate using FY 2016 data on brands producing less than 60,000 gallons annually suggests a loss of approximately $7.3 million in revenue, but the actual loss would likely be less due to the limited number of distillers that would receive certification.

The bill proposes a punishment for supplying false information to MDARD of up to one year in prison and/or a fine of $3,000. Increased misdemeanor arrests and convictions could increase resource demands on law enforcement, court systems, community supervision, and jails. Any associated increase in fine revenue would increase funding to public libraries.

The bill's provisions would result in Department of Agriculture and Rural Development assuming costs, 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. The Department also would be required to submit an annual report to the commission, beginning October 1, 2019, 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 actual cost of administering the bill's provisions would have to be supported with General Fund revenue.

Fiscal Analyst: Bruce Baker
Elizabeth Raczkowski

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