Liquor and Spirits Taxation: RTDs/Fortified Wine

House Ways and Means Committee

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How does the State get money liquor?

- Under current law, the State receives money from the sale of these products in three ways:
  - 5% tax on the gross sales of liquor (Liquor Tax)
    - Spirit is defined in statute based upon ABV, but the tax is applied to the entire sale price
    - All tax revenue goes to the General Fund
  - "Profit" from the Department of Liquor and Lottery
    - Every year there is a direct app from DLL Enterprise Fund to the General Fund
    - This profit is included in that direct app.
      - Sometimes the direct app exceeds DLL's profits for a year. In other years it does not, so there are some retained earnings
      - The size of the direct app is a function of profits, but also DLL needs in a given year
  - Sales Tax, which goes to the Education Fund

How much do we receive from Liquor?

State Tax Revenues from Liquor					
	FY2018	FY2019	FY2020	FY2021	FY2022
Liquor Tax	$19.8	$21.4	$3.6	$4.8	$5.0
Direct App	$1.0	$1.8	$23.0	$22.7	$22.7
Sales Tax (estimated)	$5.9	$6.4	$4.3	$5.8	$6.0
Total	**$26.7**	**$29.6**	**$30.9**	**$33.3**	**$33.7**
Grey indicates Act 73 of 2019 changes					

- Note: Act 73 of 2019:
  - Liquor tax used to be 25% (for DLL) and direct app was much smaller
  - Act 73 of 2019 changed the tax to a flat 5%, and DLL was required to send a certain amount to the General Fund as a direct app based upon the forecast:
    - $18.37 million in FY20
    - $18.74 million in FY21

Revenue/Tax Consequences H.730

- Proposal in this committee is the following:
  - Ready-to-Drink (RTD) beverages with less than 12% and less than 24 fl oz packaging would be eligible for distribution/retail model.
  - Fortified wines would be eligible for retail distribution model.
- Tax consequences:
  - Both would change from the 5% liquor tax to the vinous beverage tax
    - The vinous beverage tax is a 55 cent per gallon tax paid at the wholesale level.
  - The profit on these categories would go to retailers, not DLL.
  - Sales tax stays the same

Liquor Tax vs Gallonage Tax

- In general, the liquor tax is a higher tax rate than the gallonage tax.
- Example:
  - RTD cocktail with 4 cans, 335ml each. Retails for $11.99.
  - 4/355ml is 0.375 gallons of beverage.
  - We would collect approximately $0.57 on this sale for the liquor tax.
  - We would collect $0.21 for the liquor tax.
- Takeaway: Decrease in revenues from these categories by switching taxes.
- How much from these categories? **JFO estimates:**
  - -$77,000 in FY2023
  - -$96,000 in FY2024
- Subject to some uncertainty
  - Moving to retail model is likely to boost overall sales relative to the control model.
    - JFO's model assumes this growth, but if that is underestimated, the revenue loss would to be less.
    - JFO believes it would still be a revenue loss because of the difference in taxes

The Loss in DLL Profit

- By moving to retail model, DLL no longer earns the 45-50% profits on these categories.
- On these categories of beverage, JFO estimates combined losses of:
  - -$1.1 million in FY2023
  - -$1.7 million in FY2024
- This estimate is subject to some uncertainty.
  - The growth of the two categories, especially RTD, is unpredictable.
    - JFO's model assumes rapid growth in RTD market, even without changing to a retail model.
  - If moving to retail model boosts FF wine sales growth significantly, the revenue loss could be less.

Where will the revenue loss be felt?

- The FY2023 Governor's recommended direct app is $19.431 million
  - DLL's direct app and budget does not assume this revenue loss.
  - For FY23, the Enterprise Fund is expected to have some retained earnings/profit.
- Revenue Impact in FY2023:
  - If the direct app stays the same as the Governor's recommendation, the Enterprise Fund will have reduced retained earnings.
  - If the Legislature wants to keep the Enterprise Fund whole, then the direct app will need to go up, and the General Fund will lose money.
- In future fiscal years, fiscal loss is the potential for a higher direct app from the Enterprise Fund.
  - In this way, JFO is considering a General Fund revenue loss in the future.

Other Considerations

- DLL has the option to mitigate the loss through its business operations:
  - It could raise prices modestly
  - Rather than stock RTD and FF wines, it could stock higher margin spirits like tequila, mezcal, and whisky.
  - JFO has not "booked" this potential offset.
- One option to offset DLL profit: mandate a certain direct app like Act 73 of 2019.
  - In the bill, state that the direct app must be a certain level, based upon the Consensus Forecast for liquor revenues:
    - Use growth in Consensus Forecast to grow either the FY2023 or FY2022 direct app.

Hypothetical Direct App Projections						
	FY2021	FY2022	FY2023	FY2024	FY2025	FY2026
Direct App Based upon forecast growth on FY23 Level	$22.70	$23.00	$19.43	$20.18	$20.93	$21.67
Direct App Based upon forecast growth on FY22 Level			$23.92	$24.84	$25.76	$26.68

Sales and Use Tax

- JFO estimates that this bill will boost sales tax revenue, benefitting the Education Fund.
- The move to the retail model is expected to boost sales.
- JFO preliminary estimates:
  - +$40,000 in FY2023
  - +$136,000 in FY2024