19.1066.01000

FISCAL NOTE

Requested by Legislative Council
01/14/2019

Revised
Bill/Resolution No.: HB 1473

1 A. **State fiscal effect:** *Identify the state fiscal effect and the fiscal effect on agency appropriations compared to funding levels and appropriations anticipated under current law.*

	2017-2019 Biennium		2019-2021 Biennium		2021-2023 Biennium	
	General Fund	Other Funds	General Fund	Other Funds	General Fund	Other Funds
Revenues			$(1,557,000)	$1,557,000		
Expenditures						
Appropriations						

1 B. **County, city, school district and township fiscal effect:** *Identify the fiscal effect on the appropriate political subdivision.*

	2017-2019 Biennium	2019-2021 Biennium	2021-2023 Biennium
Counties			
Cities			
School Districts			
Townships			

2 A. **Bill and fiscal impact summary:** *Provide a brief summary of the measure, including description of the provisions having fiscal impact (limited to 300 characters).*

HB 1473 repeals the wholesale liquor tax and imposes a higher gross receipts (sales) tax rate on liquor.

B. **Fiscal impact sections:** *Identify and provide a brief description of the sections of the measure which have fiscal impact. Include any assumptions and comments relevant to the analysis.*

Section 10 of HB 1473 increases the gross receipts tax rate on alcoholic beverages from 7% to 8.5%. Section 11 repeals the wholesale liquor taxes.

3. **State fiscal effect detail:** *For information shown under state fiscal effect in 1A, please:*

A. **Revenues:** *Explain the revenue amounts. Provide detail, when appropriate, for each revenue type and fund affected and any amounts included in the executive budget.*

If enacted, HB 1473 is expected to be approximately revenue-neutral overall. There would be a reduction in state general fund revenues of an estimated $17.9 million in the 2019-21 biennium due to the repeal of the wholesale liquor tax. There would be an increase in revenues of the same amount from the proposed increase in the gross receipts tax from 7% to 8.5%. Revenue from the gross receipts tax goes primarily to the state general fund, but it also goes to the state aid distribution fund (SADF). This would result in an expected reduction in state general fund revenues of $1.557 million and an increase in expected SADF of the same amount.

B. **Expenditures:** *Explain the expenditure amounts. Provide detail, when appropriate, for each agency, line item, and fund affected and the number of FTE positions affected.*

C. **Appropriations:** *Explain the appropriation amounts. Provide detail, when appropriate, for each agency and fund affected. Explain the relationship between the amounts shown for expenditures and appropriations. Indicate whether the appropriation or a part of the appropriation is included in the executive budget or relates to a continuing appropriation.*

Name: Kathryn Strombeck

Agency: Office of Tax Commissioner

Telephone: 701.328.3402

Date Prepared: 01/20/2019

19.1066.01000

FISCAL NOTE
Requested by Legislative Council
01/14/2019

Bill/Resolution No.: HB 1473

1 A. **State fiscal effect:** *Identify the state fiscal effect and the fiscal effect on agency appropriations compared to funding levels and appropriations anticipated under current law.*

	2017-2019 Biennium		2019-2021 Biennium		2021-2023 Biennium	
	General Fund	Other Funds	General Fund	Other Funds	General Fund	Other Funds
Revenues			$(1,557,000)	$1,557,000		
Expenditures						
Appropriations						

1 B. **County, city, school district and township fiscal effect:** *Identify the fiscal effect on the appropriate political subdivision.*

	2017-2019 Biennium	2019-2021 Biennium	2021-2023 Biennium
Counties			
Cities			
School Districts			
Townships			

2 A. **Bill and fiscal impact summary:** *Provide a brief summary of the measure, including description of the provisions having fiscal impact (limited to 300 characters).*

HB 1473 repeals the wholesale liquor tax and imposes a higher gross receipts (sales) tax rate on liquor.

B. **Fiscal impact sections:** *Identify and provide a brief description of the sections of the measure which have fiscal impact. Include any assumptions and comments relevant to the analysis.*

Section 10 of HB 1474 increases the gross receipts tax rate on alcoholic beverages from 7% to 8.5%. section 11 repeals the wholesale liquor taxes.

3. **State fiscal effect detail:** *For information shown under state fiscal effect in 1A, please:*

A. **Revenues:** *Explain the revenue amounts. Provide detail, when appropriate, for each revenue type and fund affected and any amounts included in the executive budget.*

If enacted, HB 1474 is expected to be approximately revenue-neutral overall. There would be a reduction in state general fund revenues of an estimated $17.9 million in the 2019-21 biennium due to the repeal of the wholesale liquor tax. There would be an increase in revenues of the same amount from the proposed increase in the gross receipts tax from 7% to 8.5%. Revenue from the gross receipts tax goes primarily to the state general fund, but it also goes to the state aid distribution fund (SADF). This would result in an expected reduction in state general fund revenues of $1.557 million and an increase in expected SADF of the same amount.

B. **Expenditures:** *Explain the expenditure amounts. Provide detail, when appropriate, for each agency, line item, and fund affected and the number of FTE positions affected.*

C. **Appropriations:** *Explain the appropriation amounts. Provide detail, when appropriate, for each agency and fund affected. Explain the relationship between the amounts shown for expenditures and appropriations. Indicate whether the appropriation or a part of the appropriation is included in the executive budget or relates to a continuing appropriation.*

Name: Kathryn Strombeck

Agency: Office of Tax Commissioner

Telephone: 701.328.3402

Date Prepared: 01/20/2019

2019 HOUSE FINANCE AND TAXATION

HB 1473

2019 HOUSE STANDING COMMITTEE MINUTES

Finance and Taxation Committee
Fort Totten Room, State Capitol

HB 1473
1/22/2019
31195

☐ Subcommittee
☐ Conference Committee

Committee Clerk: Mary Brucker

Explanation or reason for introduction of bill/resolution:

A bill relating to removal of a requirement for persons engaged in wholesale sale and delivery of alcoholic beverages to collect alcoholic beverages wholesale taxes, and an increase in the alcoholic beverages gross receipts tax on all sales of alcoholic beverages; relating to elimination of alcoholic beverage wholesale taxes.

Minutes: Attachment 1

Chairman Headland: Opened hearing on HB 1473.

Representative Ruby: Introduced bill. This bill also affects the breweries, wineries, and distilleries that collect both the wholesale tax and the retail tax when they sell it to retail. I look at this as a streamlining of government. I discussed this with Commissioner Rauschenberger who helped me draft the bills but is not in support or opposition of the bill. The wholesalers have a wholesale tax so when they sell their product to the retailer they are paying the cost of the product plus that tax. When they add the 7% tax to the retail side they are getting that from the customer. My goal was to get rid of the middle transaction. It raises the gross production or sales tax to 8.5% which is revenue neutral and only one transaction takes place. When the wholesaler is able to sell the product they can sell it for their cost without adding the wholesale tax on it. When it goes to the end user the customer is still paying the same amount, 8.5% on a lower amount than they were at 7% when it was the product plus the wholesale tax. Initially I asked them to take out the reporting of it but there is some value to it. There are requirements of what they can and cannot make. It sounded like there was still a need to report the product or gallons of alcohol distributed and sold. The wholesalers who are part of the production and retail have requirements for reporting in addition to reporting to the federal government. If there are any ways to streamline that I wouldn't mind seeing an amendment if you chose to do that. I think this will help find efficiency within our agencies. The fiscal note shows a reduction in general funds and in other funds it's an increase. All the excise tax went to the general fund but the gross production tax is divided by percentage to the political subdivisions. This isn't really taking away that amount, it's just affecting the $1.5 million but then that's going to the political subdivisions.

Chairman Headland: Who brought this bill to you?

Representative Ruby: I had discussions with wineries. I don't know if the wholesalers are for it or against it because it is revenue neutral. The general public is going to pay the same for the alcohol if we keep this in place.

Chairman Headland: That would be under the assumption the wholesaler industry is going to reduce their product to the amount of tax they're paying which I don't think they have to.

Representative Ruby: There isn't. I feel the people that would be most concerned with that are the people that don't believe in the free market system as well. I don't feel concerned with that because I trust that the free market works.

Chairman Headland: This bill would shift that burden to the retail industry who would then have to remit gross receipts. I think some business people would maybe object to that.

Representative Ruby: They are already at 7% so this would add another 1.5% so it's the same transactions and collections they would have. They would just have to change the tax level in their systems. It's not putting anymore burden on them than it was before.

Vice Chairman Grueneich: The 1.5% tax by wholesalers would now be picked up by the retailers?

Representative Ruby: It's not a 1.5% tax on wholesale. For beer we're at .16 and a 7% tax on that. For wine we're at .50 and for spirits we're at 2.5. It's a different tax on the wholesale side. The 7% is added to all the different types. I asked them to make sure this was revenue neutral on that side. If the wholesalers didn't drop the price, there would probably be some sort of an increase but I don't foresee that being an issue.

Chairman Headland: Do you think this bill will allow for contraband alcohol to be sold across the state when it's taxes at the wholesale level regulators know where the alcohol is coming from and if we take that step away I don't know how they're going to know.

Representative Ruby: Since there are still reporting requirements and when the sales tax comes in the retailer would do it now if they're going to do it. I think tax audits would take care of that.

Chairman Headland: Information received indicates that today there are 56 entities paying the alcohol tax on beer and 57 on hard liquor. If we change it this way there will be over 1,600 retail places that would have to be looked at by the regulators to make sure that all the alcohol is being taxed.

Representative Ruby: I didn't get that information. It saves the wholesaler time from having to collect and submitting the tax. The reports would be ongoing. All the retailers are subject to the rules of sales tax and reporting requirements so that hasn't changed. I don't see how there would be any problems.

Chairman Headland: Is there support? Is there opposition?

Janet Seaworth, Executive Secretary and legal counsel for North Dakota Beer Distributors Association: Distributed written testimony, see attachment #1. Ended testimony at 22:29.

Representative Ertelt: On your first bullet point you state it would minimize the ability to monitor because I don't see it tied to the tax itself. You state the manufacturer reports shipments into the state and the wholesaler reports shipments received and pays the tax. Aren't those separate activities so the reporting isn't tied to the tax or is it?

Janet Seaworth: The tax is tied to gallon age so the wholesaler reports the gallon age to the state that they receive from the brewer and they pay the tax based on that. All states have this system where the manufacturer reports shipments into the state and the wholesaler reports shipments they get. It's easy for the state to make sure there is no leakage and everything that come in is taxed. The problem is that there is no mechanism for wholesalers to report their sales to retailers and retailers to report what they've received from wholesalers so there would be no way for the state to regulate that unless you're going to do field audits.

Representative Ertelt: Is there that requirement today about the sale from the wholesaler to the retailer and how much is sold?

Janet Seaworth: No there is not. In order to affect adequate regulation of this if this bill would pass you would have to have some sort of mechanism like that which would be incredibly burdensome.

Representative B. Koppelman: Does this affect the beer industry more negatively than the spirits industry?

Janet Seaworth: It's possible. It's my understanding that the laid in costs for beer on the Minnesota side are already lower. The laid in costs for beer in North Dakota is already higher so our taxes are already higher on beer. If you add an additional sales tax, we will no longer be competitive with our neighboring states. I can't speak specifically to distilled spirits but the assumption is that this will be revenue neutral. I think if you talk to anybody in the industry they will tell you that it's probably not going to happen.

Chairman Headland: What is occurring today that this bill is trying to fix?

Janet Seaworth: I'm not hearing any problems. I have represented the beer industry for over 25 years and have never had any problems reported. It's very straight forward and isn't burdensome. We have just over 50 taxpayers and they do it electronically. It's clean, there's no leakage because everybody knows everybody. It's easy to make certain that 56 licensees are paying their taxes. I don't understand the issue that is to be addressed here.

Chairman Headland: Further opposition?

Rudy Martinson, North Dakota Hospitality Association: I'm not sure either what problems this bill is intended to solve. We feel the division of labor in terms of taxation reporting and tracking of alcohol as it moves throughout the state is working and going well

under the current system. Moving all of that burden and the tax collection responsibility over to the retail side of the industry doesn't make a lot of sense to me.

Chairman Headland: Are there any questions? Is there further opposition? Seeing none we will close the hearing on HB 1473.

2019 HOUSE STANDING COMMITTEE MINUTES

Finance and Taxation Committee
Fort Totten Room, State Capitol

HB 1473
2/4/2019
32129

☐ Subcommittee
☐ Conference Committee

Committee Clerk: Mary Brucker

Explanation or reason for introduction of bill/resolution:

A bill relating to removal of a requirement for persons engaged in wholesale sale and delivery of alcoholic beverages to collect alcoholic beverages wholesale taxes, and an increase in the alcoholic beverages gross receipts tax on all sales of alcoholic beverages; relating to elimination of alcoholic beverage wholesale taxes.

Minutes: No attachments

Chairman Headland: This is Representative Ruby's bill on changing the alcohol three tier system.

Representative Dockter: I think every session they bring this bill and try a different angle. Now we're in microbrews. **MADE A MOTION FOR A DO NOT PASS**

Representative Blum: SECONDED

Chairman Headland: I think this bill is attempting to fix something that I don't see as a problem. This could hurt the regulatory abilities of the state to have an exact accounting of what's coming into the state as far as gallonage of alcohol. I think the current system is fine. I don't think there's a problem having a wholesale tax and an additional sales tax. I'm supporting the do not pass.

Representative Fisher: What does this do for small wineries?

Chairman Headland: I don't know that we had testimony that specifically addressed the small wineries. When I read some of the testimony it would certainly increase the number of points that we tack on the 1,600 wholesale licensees for having to look at compliance with the tax code. According to the testimony compliance would be difficult.

Representative B. Koppelman: I think the concept was we don't need to count gallons between the manufacturer and the wholesaler. We should eliminate that tax at the middle person then increase sales tax at the end. The people who are already collecting sales tax now as a retailer would just collect the higher rate of sales tax but then they wouldn't pay any tax to the wholesaler which was the whole idea. The hope was that the wholesaler wouldn't

back fill that tax and increase their price but it would lessen the price to the retailer and be equal or less tax to the consumer. It may create some hardship with the feds as they set up this three tier system.

Chairman Headland: In Janet Seaworth's testimony she thinks there are certainly some economic consequences that could occur specific to border activity. I don't know that it's a real burden to anybody the way we're doing it right now. If there is a question of regulatory of what is being brought into the state and what is sold that would present some concerns.

Representative Steiner: I had a note from a wholesaler in Fargo that said that would be him at a disadvantage with Minnesota by less than two percent. I think it's a pretty big change for very little benefit.

Chairman Headland: Agree. Any other discussion?

ROLL CALL VOTE: 13 YES 1 NO 0 ABSENT

MOTION CARRIED

Vice Chairman Grueneich will carry this bill.

Date: 2-4-19
Roll Call Vote #: 1

2019 HOUSE STANDING COMMITTEE
ROLL CALL VOTES
BILL/RESOLUTION NO. HB 1473

House Finance and Taxation Committee

☐ Subcommittee

Amendment LC# or Description:

Recommendation:
☐ Adopt Amendment
☐ Do Pass ☑ Do Not Pass ☐ Without Committee Recommendation
☐ As Amended ☐ Rerefer to Appropriations
☐ Place on Consent Calendar

Other Actions: ☐ Reconsider ☐

Motion Made By Rep. Dockter Seconded By Rep. Blum

Representatives	Yes	No	Representatives	Yes	No
Chairman Headland	✓		Representative Eidson	✓	
Vice Chairman Grueneich	✓		Representative Mitskog	✓	
Representative Blum	✓				
Representative Dockter	✓				
Representative Ertelt	✓				
Representative Fisher	✓				
Representative Hatlestad	✓				
Representative Kading	✓				
Representative Koppelman	✓				
Representative Steiner	✓				
Representative Toman		✓			
Representative Trottier	✓				

Total (Yes) 13 No 1

Absent 0

Floor Assignment Rep. Grueneich

If the vote is on an amendment, briefly indicate intent:

REPORT OF STANDING COMMITTEE

HB 1473: Finance and Taxation Committee (Rep. Headland, Chairman) recommends **DO NOT PASS** (13 YEAS, 1 NAYS, 0 ABSENT AND NOT VOTING). HB 1473 was placed on the Eleventh order on the calendar.

2019 TESTIMONY

HB 1473

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HB 1473
Testimony before the House Finance and Taxation Committee
January 22, 2019

Mr. Chairman, members of the House Finance and Taxation Committee, my name is Janet Seaworth, I am the Executive Secretary and legal counsel for the North Dakota Beer Distributors Association. We have eighteen family owned and operated beer distributorships in our association. We serve every retailer in the state. We have concerns about HB 1473.

1. **Every state, the District of Columbia, and the federal government, impose wholesale taxes on beer.** In addition to providing revenue, the wholesale tax allows the state to monitor and regulate the flow of alcohol into the state from the manufacturer to the wholesaler. The manufacturer reports shipments into the state and the wholesaler reports shipments received and pays the tax. This provides the state with a limited number of points to tax, which ensures substantial compliance and limits opportunities for untaxed alcohol to enter the distribution chain. According to the tax department, the state currently collects beer excise taxes from 56 in-state licensees. If the bill passes, the state will increase the number of points to tax and control from 56 wholesale licensees to over 1,600 retail licensees. That is not efficient and increases opportunities for noncompliance. Because we now collect taxes from a limited number of wholesale taxpayers, we have good compliance without expending a lot of state resources. Distributors view compliance as pretty straightforward and not overly burdensome. We see no need to shift this tax burden to retailers.

2. **Increased sales taxes on alcohol could result in economic consequences related to cross border activity.** Retailers are concerned about the higher alcohol sales tax proposed by HB 1473 and how that will compare to neighboring states. Higher costs to North Dakota consumers can lead to cross-border activity and loss of tax revenue when North Dakota residents decide to drive to East Grand Forks, Moorhead, and Breckenridge to buy less expensive beer. This "cross-border" activity was the focus of a report by Price Waterhouse entitled *An Examination of the Tax Incentives and Economic Consequences of Cross-Border Activity* (July, 1990) commissioned by the American Legislative Exchange Council. The study encourages legislators to consider cross-border effects when formulating tax policy.

Thank you. We are concerned about the effects of this bill on retailers and we urge you to give the bill a do not pass recommendation.

Thank you.

Janet Demarais Seaworth
North Dakota Beer Distributors Association
PO Box 7401
Bismarck, ND 58507-7401
(701) 258-8098

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STATE TAX RATES ON BEER

(January 1, 2018)

	EXCISE TAX RATES ($ per gallon)	GENERAL SALES TAX APPLIES	OTHER TAXES
Alabama	$0.53	Yes	$0.52/gallon local tax statewide
Alaska	1.07	n.a.	
Arizona	0.16	Yes	
Arkansas	0.23	Yes	3% off- 10% on-premise tax
California	0.20	Yes	
Colorado	0.08	Yes	
Connecticut	0.24	Yes	
Delaware	0.26	n.a.	
Florida	0.48	Yes	
Georgia	0.32	Yes	$0.53/gallon local tax
Hawaii	0.93	Yes	$0.54/gallon draft beer
Idaho	0.15	Yes	over 4% - $0.45/gallon
Illinois	0.231	Yes	$0.29/gallon in Chicago and $0.09/gallon in Cook County
Indiana	0.115	Yes	
Iowa	0.19	Yes	
Kansas	0.18	--	8% off- and 10% on-premise
Kentucky	0.08	Yes	10.5% wholesale tax
Louisiana	0.40	Yes	$0.048/gallon local tax
Maine	0.35	Yes	7% on-premise saales tax
Maryland	0.09	--	9% sales tax
Massachusetts	0.11		0.57% on private club sales
Michigan	0.20	Yes	
Minnesota	0.15	--	under 3.2% - $0.077/gallon, 9% sales tax
Mississippi	0.4268	Yes	
Missouri	0.06	Yes	
Montana	0.14	n.a.	
Nebraska	0.31	Yes	
Nevada	0.16	Yes	
New Hampshire	0.30	n.a.	
New Jersey	0.12	Yes	
New Mexico	0.41	Yes	
New York	0.14	Yes	additional $0.12/gallon in New York City
North Carolina	0.6171	Yes	
North Dakota	0.16	--	7% state sales tax, bulk beer $0.08/gal.
Ohio	0.18	Yes	
Oklahoma	0.40	Yes	under 3.2% - $0.36/gallon; 13.5% on-premise
Oregon	0.08	n.a.	
Pennsylvania	0.08	Yes	
Rhode Island	0.11	Yes	$0.04/case wholesale tax
South Carolina	0.77	Yes	
South Dakota	0.27	Yes	
Tennessee	1.29	Yes	Excise Barrelage Tax and Wholesale Tax
Texas	0.194	Yes	14.95% on-premise and $0.05/drink on airline sales
Utah	0.4129	Yes	over 3.2% - sold through state store
Vermont	0.265	Yes	more than 6% alcohol - $0.55; 10% on-premise sales tax
Virginia	0.2565	Yes	
Washington	0.26	Yes	
West Virginia	0.18	Yes	
Wisconsin	0.06	Yes	
Wyoming	0.02	Yes	
Dist. of Columbia	0.09	Yes	9% off- and on-premise sales tax
U.S. Median	$0.20		

Source: Compiled by FTA from state sources.

Note: n.a. = not applicable. These 5 states do not have a general sales tax.

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STATE TAX RATES ON DISTILLED SPIRITS
(January 1, 2018)

STATE	EXCISE TAX RATES ($ per gallon)	GENERAL SALES TAX APPLIES	OTHER TAXES
Alabama	see footnote (1)	Yes	
Alaska	$12.80	n.a.	under 21% - $2.50/gallon
Arizona	3.00	Yes	
Arkansas	2.50	Yes	under 5% - $0.50/gallon, under 21% -$1.00/gallon; $0.20/case; 3% off- 14% on-premise retail taxes
California	3.30	Yes	over 50% - $6.60/gallon
Colorado	2.28	Yes	
Connecticut	5.40	Yes	under 7% - $2.46/gallon
Delaware	4.50	n.a.	25% or less - $3.00/gallon
Florida	6.50	Yes	under 17.259% - $2.25/gallon, over 55.780% - $9.53/gallon
Georgia	3.79	Yes	$0.83/gallon local tax
Hawaii	5.98	Yes	
Idaho	see footnote (1)	Yes	
Illinois	8.55	Yes	under 20% - $1.39/gallon; $2.68/gallon in Chicago and $2.50/gallon in Cook County
Indiana	2.68	Yes	under 15% - $0.47/gallon
Iowa	see footnote (1)	Yes	
Kansas	2.50	--	8% off- and 10% on-premise retail tax
Kentucky	1.92	Yes	under 6% - $0.25/gallon; $0.05/case and 11% wholesale tax
Louisiana	3.03	Yes	
Maine	see footnote (1)	Yes	
Maryland	1.50	Yes	9% sales tax
Massachusetts	4.05		under 15% - $1.10/gallon, over 50% alcohol - $4.05/proof gallon; 0.57% on private club sales
Michigan	see footnote (1)	Yes	
Minnesota	5.03	--	$0.01/bottle (except miniatures) and 9% sales tax
Mississippi	see footnote (1)	Yes	
Missouri	2.00	Yes	
Montana	see footnote (1)	n.a.	
Nebraska	3.75	Yes	
Nevada	3.60	Yes	5% to 14% - $0.70/gallon, 15% to 22% - $1.30/gallon
New Hampshire	see footnote (1)	n.a.	
New Jersey	5.50	Yes	
New Mexico	6.06	Yes	
New York	6.44	Yes	under 24% - $2.54/gal.; additional $1.00/gal. in New York City
North Carolina	see footnote (1)	Yes (2)	
North Dakota	2.50	--	7% state sales tax
Ohio	see footnote (1)	Yes	
Oklahoma	5.56	Yes	13.5% on-premise
Oregon	see footnote (1)	n.a.	
Pennsylvania	see footnote (1)	Yes	
Rhode Island	5.40	Yes	
South Carolina	2.72	Yes	$5.36/case and 9% surtax; additional 5% on-premise tax
South Dakota	3.93	Yes	under 14% - $0.93/gallon; 2% wholesale tax
Tennessee	4.40	Yes	15% on-premise; under 7% - $1.10/gallon.
Texas	2.40	Yes	14.95% on-premise and $0.05/drink on airline sales
Utah	see footnote (1)	Yes	
Vermont	see footnote (1)	no	10% on-premise sales tax
Virginia	see footnote (1)	Yes	
Washington (3)	14.27	--	$9.24/gal. on-premise; 20.5% retail sales tax, 13.7% sales tax to on-premise
West Virginia	see footnote (1)	Yes	
Wisconsin	3.25	Yes	$0.03/gallon administrative fee
Wyoming	see footnote (1)	Yes	
Dist. of Columbia	1.50	--	9% off- and on-premise sales tax
U.S. Median	$3.77		

Source: Compiled by FTA from state sources.
Notes:
n.a. = not applicable. These 5 states do not have a general sales tax.
(1) In 17 states, the government directly controls the sales of distilled spirits. Revenue in these states is generated from various taxes, fees, price mark-ups, and net liquor profits.
(2) General sales tax applies to on-premise sales only.
(3) Washington privatized liquor sales effective June 1, 2012.

JAN 14 '91 17:31 ALEC

AMERICAN LEGISLATIVE EXCHANGE COUNCIL

The State Factor

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July, 1990

THE TAX INCENTIVES AND ECONOMIC CONSEQUENCES OF CROSS-BORDER ACTIVITY

Executive Summary

State legislators are under increasing pressure to raise taxes in order to balance their budgets. Although raising taxes is an obvious tactic to combat revenue shortfalls, state governments need to be aware that higher taxes may bring about undesirable and unintended consequences. For example, high taxes may deter businesses from moving to a state, and thus hinder economic growth. Similarly, relatively high sales and excise taxes may cause the price of goods in a particular state to rise above levels existing in neighboring states. If the price differentials are significant, residents may travel out-of-state to purchase certain consumer items. This phenomenon, known as "cross-border activity," is the focus of this report.

Cross-border activity is often motivated by tax differentials on alcoholic beverages, tobacco products, and gasoline -- three goods commonly subject to state excise taxes. When a state's residents travel across-the-border to purchase goods, the state loses retail sales, retail employment, and tax revenue to neighboring states. At the same time, a state that maintains competitive or low excise and sales taxes can increase its tax revenue base by attracting consumers from bordering states. The revenue gains achieved by a state with low taxes necessarily come at the expense of states with higher taxes.

To determine the effects of state sales and excise tax rates on cross-border activity, ALEC commissioned the independent accounting and consulting firm of Price Waterhouse to examine tax differentials on motor fuels, tobacco products, and alcoholic beverages in order to:

1) Examine the conditions and incentives necessary for cross-border activity to occur between neighboring states.

2) Estimate the economic gains due to cross-border activity that accrue to states with low consumer excise tax structures, and the economic losses experienced by neighboring, higher tax states.

3) Consider the implications of cross-border activity on states' tax policies.

ALEC * 214 Massachusetts Ave., NE * Washington, DC 20002 * (202) 547-4646
Executive Director Samuel A. Brunelli
Publications Director Michael Tanner

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This edition of *The State Factor* is a summary version of the Price Waterhouse study: *An Examination of the Tax Incentives and Economic Consequences of Cross-Border Activity* (July, 1990). This edition includes the analyses for the states of New Hampshire - Massachusetts and Indiana - Illinois.

Summary of State Benefits and Losses

New Hampshire and Massachusetts

New Hampshire

The results of our analysis suggest that New Hampshire benefits significantly at the expense of Massachusetts from cross-border sales of cigarettes, wine, and distilled spirits. On average, during the period 1975-88, it is estimated that 41.7 percent of New Hampshire cigarette sales and 29.3 percent of wine and distilled spirits sales were to Massachusetts residents. The average annual economic benefits of this cross-border activity were:

* $22.6 million in additional excise tax revenue
* $104.2 million in additional retail sales revenue
* 796 additional jobs with $8.6 million in compensation

Massachusetts

While New Hampshire gained from cross-border sales, Massachusetts lost. This analysis estimates that the state lost 13.0 percent of annual cigarette sales and 7.2 percent of annual wine and distilled spirit sales due to residents purchasing these goods in New Hampshire. The average annual economic losses of this cross-border activity were:

* $27.4 million in lost excise tax revenue
* $132.6 million in foregone retail sales revenue
* 1,546 lost jobs totaling $14.7 million in compensation

Indiana and Illinois

Indiana

Overall, it is estimated that Indiana realized a net economic benefit from cross-border activity with Illinois during 1975-1988. The state received favorable cross-border trade in tobacco products and motor fuels, yet lost sales in wine and distilled spirits. On average, an estimated 14.8 percent of Indiana motor fuel sales and 9.4 percent of Indiana tobacco sales were to Illinois residents. However, the state lost an estimated 44.9 percent of wine and distilled spirits sales to Illinois. The net average annual economic benefits of this cross-border activity were:

* $58.8 million in additional sales and excise tax revenue
* $311.6 million in additional retail sales
* 1,996 additional jobs with $22.5 million in compensation

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Illinois

It is estimated that Illinois was a net loser to Indiana in terms of cross-border activity in motor fuels, tobacco products, and wine and distilled spirits sales. The state gained in wine and distilled spirit sales, yet lost on tobacco products and motor fuels sales. Our analysis estimates that Illinois lost 9.1 percent of annual motor fuels sales and 5.2 percent of annual tobacco sales due to residents purchasing these goods in Indiana. At the same time, Illinois gained 12.9 percent in wine and distilled spirits sales from favorable cross-border trade. The net average annual economic losses of the cross-border activity were:

* $69.7 million in lost sales and excise tax revenue
* $376.8 million in foregone retail sales
* 2,949 in lost jobs totaling $31.0 million in compensation

Main Implication: State Legislators Should Not Ignore Cross-Border Issue

The main conclusion of this study is that state legislators need to take cross-border effects seriously when formulating tax policy. The following points summarize the link between tax policy and cross-border sales:

1) A state with high sales and excise taxes relative to surrounding states can lose significant amounts of tax revenue and retail activity when residents purchase goods out-of-state.

2) A small state can dramatically increase its effective tax base by having competitive sales and excise taxes. In fact, any state where a relatively large number of another state's residents live close-by has the potential to gain substantially from cross-border sales.

3) Competition for cross-border sales exists on a commodity by commodity bases. A state which enjoys favorable cross-border trade in one commodity should realize that it may be losing sales in other commodities due to unfavorable price and tax differentials.

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KPMG Tax Study: "An Analysis of the Structure and Administration of State and Local Taxes Imposed on the Distribution and Sale of Beer."

Findings:

Our review of the various taxes imposed on the distribution and sale of beer and the legal structure surrounding alcoholic beverages along with the interviews we conducted yields a number of findings regarding the administration of various types of taxes on beer.

- Of the three types of taxes on the distribution and sale of beer, gallonage taxes are most closely aligned with the characteristics used here to evaluate the administration of taxes on beer. Several features, including the number of taxpayers, simplicity of the tax and the availability of third party reports to verify compliance, contribute significantly to the ability to ensure compliance with gallonage taxes without an excessive burden being imposed on taxpayers. Of these, the most important are the limited number of taxpayers and the use of third party reports in ensuring compliance.
- The persons interviewed for this report do not consider complying with gallonage taxes to be a significant burden. Similarly, no one interviewed for the report considered noncompliance with the gallonage tax to be a significant issue. They find compliance to be straightforward and relatively simple. Retail and special sales taxes, on the other hand, necessarily involve more compliance and administrative issues because of the large number of sellers, many of whom are smaller, involved.
- Other features of the regulatory system governing the sale of alcoholic beverages, including the three-tier system of distribution, exclusive territories for beer wholesaling and various controls on the retailing of beer, significantly contribute to the administration of all types of taxes on beer. These regulations, taken together, create the opportunity to monitor the flow of alcoholic beverages in the state, provide state regulators and tax administrators with a limited number of points to tax and/or exercise control over the flow of alcoholic beverages, limit opportunities for contraband (i.e., untaxed) alcoholic beverages to enter the distribution chain, and ensure compliance with the various tax systems. In particular, requirements that suppliers must sell only to licensed wholesalers and that retailers may purchase product only from certain licensed wholesalers is fundamental to ensuring compliance with beer taxes in an

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efficient manner. Without these controls, the level of resources necessary to achieve any given level of compliance would be substantially greater than at present.

- Taxes imposed on the distribution and sale of beer are not subject to the level of noncompliance and evasion that exists with respect to cigarette taxes at either the wholesale or the retail level. The principle reasons for this are: (a) The three-tier system effectively limits the sources from which beer may enter the retail market to that provided by licensed wholesalers where tax compliance can be effectively controlled; (b) Federal law provides that the sale of beer and other alcoholic beverages on lands under the jurisdiction of Indian tribal governments (when authorized by the tribal government) is subject to state taxation and regulation as well as tribal regulation and taxation; and (c) The volume and bulk associated with large quantities of beer make it a less likely product for contraband sales.

- Information available from beer wholesalers as part of the gallonage tax administration process has proved helpful in promoting compliance with other beer-related taxes. The most visible of these examples is the program for reporting sales to off-premise retailers in Texas that has allowed the tax administration agency to model off-premise retailer sales and improve compliance significantly among such entities.

- The Kentucky and Tennessee wholesale gross receipts taxes were born from unique circumstances in each state, and they tend to be artifacts of those particular environments. A gallonage tax can achieve a similar incidence as the gross receipts tax albeit the price-based feature of the gross receipts tax means that revenues will increase as prices increase which is not the case with a gallonage tax. To the extent that beer can be distributed without going through licensed wholesalers because of direct sales to consumers or retailers from suppliers, receipts from the wholesale tax would be diminished or compliance (particularly for the Tennessee local tax) would be complicated. The price posting law in Tennessee is important to maintaining local revenue in that state.

- While some states have made efforts to automate the gallonage tax process, such efforts are quite limited compared to some other taxes. In our estimation, most wholesalers have in place various automated systems that would interface well with electronic filing requirements. Electronic filing would, in our estimation, enable states to more effectively use both gallonage tax returns and supplier reports. The current paper-based system requires wholesalers to devote resources to manually transcribing otherwise electronic records.