

A Report to the 2003 Minnesota Legislature

# **Taxation of Beverage Alcohol in Minnesota**

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Replacing Current Alcohol Excise Taxes and  
the Additional 2.5 Percent Sales Tax on Alcoholic Beverages

MINNESOTA • REVENUE

This report was prepared by the Minnesota Department of Revenue in consultation with the alcoholic beverage industry in Minnesota.

Correspondence from industry representatives (with the permission of the author) will be available upon request.

If you have questions about this report, call the Minnesota Department of Revenue's Special Taxes Division at 651-297-1882.

This report is available on our website at [www.taxes.state.mn.us](http://www.taxes.state.mn.us).

# MINNESOTA • REVENUE

January 2, 2003

The Honorable Lawrence J. Pogemiller  
Chair, Senate Committee on Taxes  
Room 235, State Capitol  
75 Constitution Avenue  
St. Paul, Minnesota 55155

The Honorable Ron Abrams  
Chair, House Committee on Taxes  
Room 585, State Office Building  
100 Constitution Avenue  
St. Paul, Minnesota 55155

Dear Senator Pogemiller and Representative Abrams:

This report examines options for replacing the current excise taxes on alcoholic beverages and the additional 2.5 percent sales tax imposed at retail. In addition, it recommends one option for replacing the taxes.

This report was mandated under Laws 2002, First Special Session, Chapter 5, Article 12, Section 90. Minnesota Statutes, Section 3.197, specifies that a report to the legislature must include the cost of its preparation. The approximate cost of preparing this report is \$7,000.

Sincerely,

Dennis J. Erno  
Acting commissioner

cc: Secretary of the Senate  
Chief Clerk of the House  
Legislative Reference Library – 6 copies

# Introduction

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Minnesota's participation in the Streamlined Sales Tax Project (SSTP) occasioned this study. The SSTP is an effort among the states and business interests to simplify and modernize sales and use tax administration and compliance for all types of commerce, including increased uniformity among the states. One project goal is the development of a system by which vendors located in one state can collect and remit sales and use taxes on sales made to purchasers in another state.

Many states have unique features in their sales and use tax laws that complicate compliance for out-of-state vendors. Tax rates unique to particular products and services are examples of such complications. Accordingly, one provision in the agreement approved by the implementing states requires each participating state to have only one sales tax rate.

Minnesota now taxes beverage alcohol at 9 percent. The general sales tax rate is 6.5 percent. Beer containing not more than 3.2 percent alcohol by weight is taxed at 6.5 percent if sold by a vendor licensed to sell 3.2 beer only.

A 2001 session law (see below) instructed the Commissioner of Revenue to study a tax to replace the current excise taxes on alcoholic beverages and the additional 2.5 percent sales tax imposed at retail.

This report examines possible replacements for the existing excise taxes and the additional 2.5 percent sales tax to which alcoholic beverages are subject.

In conducting this study, the department looked to the characteristics of a good revenue system. The 2.5 percent sales tax and the excise taxes on alcohol comprise a small percentage of general revenues. Accordingly, any amendments to them will have negligible influence on the tax system overall.

The department's primary guiding principles were easing taxpayer compliance and containing the costs of administration and enforcement.

The department met three times with all industry sectors, and separately with individuals and smaller groups within the industry, to discuss issues and concerns.

This report includes a description of Minnesota's current taxation of alcoholic beverages, a discussion of replacement options and other issues to consider. No single tax will achieve revenue neutrality among beverage types and sales locations. The options imposing a tax at retail would complicate retailer tax compliance and not comply with the SSTP as of the date of this report. An adjustment to the existing excise taxes would impose the fewest compliance difficulties for the industry and the lowest administrative costs for the department.

The Department of Revenue conducted this study using internal resources only.

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## **Laws of Minnesota 2001 First Special Session, Chapter 5, Article 12**

*Sec. 90. [PLAN FOR REPLACEMENT OF REVENUES RAISED BY CURRENT TAXES ON ALCOHOL.] The commissioner of revenue, in consultation with interested parties from the alcohol beverage industry, shall prepare a plan to replace the current higher sales tax on liquor and beer under Minnesota Statutes, section 297A.62, subdivision 2, and the liquor tax under Minnesota Statutes, chapter 297G, with a single tax on liquor. The commissioner shall report the plan to the legislature by January 1, 2003. The plan should include recommendations for tax rates, tax base, and tax administration, and should be structured so that the revenue raised is equivalent to the revenue lost from the repeal of the current taxes. The plan should also, to the extent practical, mirror the current incidence of the tax as it relates to different types of liquor, and whether the liquor is consumed on-site or off-site. [EFFECTIVE DATE.] This section is effective the day after final enactment.*

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# Current alcohol excise taxes

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Minnesota imposes an excise tax on beverage alcohol containing more than one-half percent alcohol by volume. The broad categories are fermented malt beverages (beer, malt liquor, ale, malt-based coolers and other malt beverages) hereinafter “**beer**,” **wine** and **distilled spirits**.

Beer tax is payable by the brewer, importer or other person making the first sale in Minnesota. Taxes on wine and distilled spirits are payable by the wholesaler on delivery to a retailer in Minnesota.

According to the industry, the person paying the tax adds the tax to its product cost and marks it up to the purchaser. Thus, the tax on beer is marked up three times to the consumer. Taxes on wine and distilled spirits are marked up twice. Additionally, the excise tax becomes embedded in the product’s retail price, which then is subject to the retail sales tax. In meetings with industry representatives, participants indicated that they would not be willing to reduce markup percentages to avoid compounding any excise tax increases.

## Beer

Minnesota has two excise tax rates for beer. Beverages containing not more than 3.2 percent alcohol by weight are taxed at \$2.40 per barrel (31 U.S. gallons). That is equivalent to \$0.0774 per gallon or \$0.0073 per 12-ounce serving.

Beverages containing more than 3.2 percent alcohol by weight (strong beer, ale, malt liquor, malt-based coolers, etc.) are taxed at \$4.60 per barrel, approximately \$0.15 per gallon or \$0.014 per 12-ounce serving. That tax is tied for 33<sup>rd</sup> highest among the 50 states and the District of Columbia. The national median, expressed in cents per gallon, is \$0.185 with rates ranging from \$0.02 per gallon in Wyoming to \$0.92 per gallon in Hawaii.

Special provisions in other states, including local taxes, bulk beer rates, keg fees and others, complicate direct state-to-state comparisons. (See page 3 for comparisons with adjoining states; see pages 13, 14 and 15 for rates by state.)

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## Number of Minnesota excise tax payers and other filers

Distilled spirits	6
Wine	47
Beer	132
Common carriers	14
<b>Total</b>	<b>199</b>

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## Wine

There are six tax categories of wine. It has been more than 20 years, however, since we have seen any product in categories 4 and 5 below. The categories are:

1. Cider
2. Still wine containing not more than 14 percent alcohol by volume;
3. Still wine containing more than 14 percent alcohol by volume but not more than 21 percent;
4. Still wine containing more than 21 percent alcohol by volume but not more than 24 percent;
5. Still wine containing more than 24 percent alcohol by volume.
6. Sparkling wine.

Still wine containing not more than 14 percent alcohol constituted 89.4 percent of wine sales in liters and 69.4 percent of the wine excise tax collected in calendar 2001. Minnesota’s tax rate is tied for 40<sup>th</sup> highest among the District of Columbia and the 46 states that impose an excise tax on wine. Four states control some or all product distribution. State rates for low alcohol still wine range from \$0.11 per gallon in Louisiana to \$2.25 per gallon in Florida. Minnesota’s rate, \$0.08 per liter or \$0.30 per gallon, is half the national median.

# Current alcohol excise taxes *(continued)*

With certain exceptions, Minnesota imposes a \$0.01 tax per container of spirits or wine containing 200 milliliters or more.

## Distilled spirits

The most recent data available indicates that 32 states and the District of Columbia levy an excise tax on distilled spirits. The remaining 18 states control the product's wholesale and/or retail distribution and gain revenue from product markups, fees and other types of taxes.

Among the 33 jurisdictions imposing excise taxes, Minnesota's tax (\$5.03 per gallon or \$1.33 per liter) is seventh highest. The national median is

\$3.30 per gallon, and rates range from \$1.50 per gallon in Maryland and the District of Columbia to \$6.50 per gallon in Florida. If the control states' markups, fees and other revenues were equated to a volume-based excise tax, Minnesota's ranking would be lower. Iowa, for example, studied abandoning its exclusive distribution of distilled spirits in favor of a controlled private market. It found that a revenue neutral tax, if placed on raw gallons, would be \$13.31 per gallon or \$3.52 per liter.

Minnesota taxes miniatures of distilled spirits, bottles containing 50 milliliters or less, at \$0.14 per bottle.

**TABLE A. Minnesota's excise tax rates compared to adjoining states**

Rates expressed in dollars per gallon

	<b>Beer</b>	<b>Wine</b> (not over 14% alcohol)	<b>Wine</b> (over 14% alcohol)	<b>Sparkling wine</b>	<b>Distilled spirits</b>
Minnesota	\$0.15	\$0.30	\$0.95	\$1.82	\$5.03
Wisconsin	0.06	0.25	0.45		3.25
Iowa	0.19	1.75			Control
South Dakota	0.27	0.93	1.45	2.07	3.93
North Dakota	0.16	0.50	0.60	1.00	2.50

Minnesota's beer tax, as expressed in the statute, is \$4.60/barrel. One barrel equals 31 U.S. gallons. Wine and spirits taxes are expressed both in amounts per gallon and per liter. The Department of Revenue works with the metric rates because the standards of fill for distilled spirits and wine are metric. Cider and 3.2 beer do not appear above because few states have comparable categories. Blank spaces indicate that the category does not exist in that state's tax scheme, or the data was not reported.

**Iowa**—Wine containing less than 5 percent alcohol is taxed at \$0.19 per gallon.

**South Dakota**—Wine containing more than 21 percent alcohol is taxed at \$2.07 per gallon. Spirituous alcohol containing less than 14 percent alcohol is taxed at \$0.93 per gallon. Also, South Dakota imposes a 2 percent wholesale tax on wine and distilled spirits.

**North Dakota**—Bulk (keg) beer is taxed at \$0.08 per gallon. The higher beer tax applies to beer in bottles and cans only. The high alcohol wine rate applies to wine containing more than 17 percent alcohol. The sales tax rate on all alcohol currently is 7 percent.

*Source of data: Federation of Tax Administrators; rates as of Jan. 1, 2002*

# Replacing current taxes

## Excise tax vs. sales tax

**For beer, cider and low-alcohol wine,** the 2.5 percent sales tax raises more revenue than does the excise tax.

### Example 1

Price of six-pack of beer = \$5.00  
Sales tax at 2.5 percent = \$0.125  
Excise tax = \$0.084 (approx)

### Example 2

Price of bottle of low-alcohol wine = \$20.00  
Sales tax at 2.5 percent = \$0.50  
Excise tax (\$0.06 excise + \$0.01 bottle tax) = \$0.07

At on-sale, where prices are higher than at off-sale, the difference in favor of the sales tax increases markedly.

**For distilled spirits,** the excise tax produces more revenue than the 2.5 percent sales tax, at least at off-sale.

### Example 3

Excise tax on one-liter bottle of spirits (\$1.33 excise + \$0.01 bottle tax) = \$1.34

The liter price would need to exceed \$53.60 for the 2.5 percent sales tax to exceed the excise tax.

## Implications of a replacement tax

Any volume-based replacement tax that redistributes the existing 2.5 percent sales tax to the wholesale or brewer/importer level will have three consequences:

1. It will shift the burden somewhat from on-sale to off-sale. That is because wholesale prices for a particular product vary less than retail prices, which are higher at on-sale than at off-sale.
2. It will increase the incidence to the consumer if percentage markups remain at current levels. The tax will become part of the product price subject to markup through the chain of distribution.
3. It will shift the burden somewhat from higher priced products to lower priced products. The tax will be uniform for each beverage category regardless of product price.

A price-based tax at wholesale would yield the first two results above. It is uncertain if or to what extent any of the above will lower demand.

## Replacement options

The following options conform to the legislative directive:

1. Increase current volume-based excise taxes at wholesale. Repeal 2.5 percent sales tax.
2. Impose price-based tax at wholesale. Repeal 2.5 percent sales tax and current excise taxes.
3. Increase current excise tax on distilled spirits, and impose price-based tax at wholesale for beer and wine. Repeal 2.5 percent sales tax.
4. Impose price-based tax at retail. Repeal 2.5 percent sales tax and current excise taxes.
5. Impose volume-based tax at retail. Repeal 2.5 percent sales tax and current excise taxes.

## Option 1—

### Increase current volume-based excise taxes at wholesale

	CURRENT TAX	PROPOSED TAX
<b>3.2 Beer</b>	\$2.40/barrel	\$2.40/barrel
<b>Beer</b>	\$4.60/barrel	\$11.46/barrel
<b>Cider</b>	\$0.04/liter	\$0.24/liter
<b>Wine</b>	\$0.08/liter	\$0.28/liter
<b>Strong wine</b>	\$0.25/liter	\$0.45/liter
<b>Sparkling wine</b>	\$0.48/liter	\$0.68/liter
<b>Spirits</b>	\$1.33/liter	\$1.75/liter

### Advantages

- All remitters are in the department's excise tax administration system.
- Requires only a rate change to existing taxes thereby imposing little administrative burden on the department or burden on taxpayers to learn a new law, reprogram computers, etc.
- Relatively easy and inexpensive to administer because there would be fewer taxpayers and information reporters than if the tax were imposed at retail.

# Replacing current taxes *(continued)*

- Tax would be uniform for each type of product across all segments of the industry.
- Estimated fewer delinquencies than for a tax at retail. The department rarely has to pursue delinquent excise tax payments. In comparison, the department sent delinquency notices to approximately 12 percent of retail licensees in fiscal years 2001 and 2002.

## Disadvantages

- Would increase inventory costs for beer wholesalers and retailers of all products.
- Tax would not grow with the economy unless it were indexed or the legislature were to adjust the rate periodically. Currently, the excise tax is not indexed. The sales tax varies with retail price, which over time, and on average, increases.

## Other considerations

- Increasing excise taxes may result in product prices being marked up at retail at or beyond the amount of increase. If the higher prices did not reduce demand significantly and consumers did not substitute lower-priced products for that which they normally consume, sales tax collections would rise slightly since the 6.5 sales tax would be imposed on a higher price.
- Excise tax is invisible to the consumer.

## Concerns raised by alcohol beverage industry

- Increasing excise taxes may ultimately result in a decline in sales. The tax would be added to the product cost and marked up at each level of distribution. If markup percentages remained at current levels, the product cost to the consumer would increase and could result in decreased sales.
- Regional specialty brewers may be more affected by an excise tax increase than large national brewers. Regional brewers are less able to absorb a tax increase for the short term or spread its effect over a larger market. If excise taxes increase, industry representatives suggest expanding the small brewer credit to apply to a greater volume of a qualifying brewer's production.

## Option 2—

### Impose price-based tax at wholesale

See Table B on page 13 for wholesale rate analysis.

	CURRENT TAXES		REPLACE WITH
	EXCISE TAX	SALES TAX	TAX AT WHOLESALE
<b>3.2 Beer<sup>1</sup></b>	\$2.40/barrel	6.5%	1.1%
<b>Beer</b>	\$4.60/barrel	9.0%	5.8%
<b>Cider</b>	\$0.04/liter	9.0%	4.1%
<b>Wine</b>	\$0.08/liter	9.0%	4.8%
<b>Strong wine</b>	\$0.25/liter	9.0%	7.7%
<b>Sparkling wine</b>	\$0.48/liter	9.0%	11.5%
<b>Spirits</b>	\$1.33/liter	9.0%	17.2%

<sup>1</sup> Amount of 3.2 beer sold at 9% rate is not significant

## Advantages

- All remitters are in the department's excise tax administration system.
- Tax would be relatively easy and inexpensive to administer because there would be fewer taxpayers and information reporters than if the tax were imposed at retail.
- Collections would grow with the economy for the product.
- For beer and wine, the incidence of the tax would shift less within a product category than under a volume-based tax.
- Estimated fewer delinquencies than for a tax at retail.

## Disadvantages

- Would require brewers, and wine and distilled spirits wholesalers to revise their tax calculations and systems.
- Would require the department to revise forms and its record-keeping systems. However, those should be one-time costs and rather small.
- Tax would increase inventory costs for beer wholesalers and retailers of all products subject to tax.

*Continued next page*

# Replacing current taxes *(continued)*

- Inventory no longer would serve as an audit crosscheck.

## Other considerations

Same as under Option 1.

## Option 3—

### Impose combination of volume-based and price-based taxes at wholesale

#### Advantages

- By taxing beer and wine by price and distilled spirits by volume, the replacement tax would more closely approximate the taxes it would replace.
- Would be easy to administer.

#### Disadvantages

- Adds complexity for wholesalers selling both spirits and wine.
- Would require the department to revise forms and its record-keeping systems. However, those should be one-time costs and rather small.

## Option 4—

### Impose price-based tax at retail

See Table C on page 14 for retail rate analysis.

	CURRENT TAXES		REPLACE WITH
	EXCISE TAX	SALES TAX	TAX AT RETAIL
<b>3.2 Beer<sup>1</sup></b>	\$2.40/barrel	6.5%	0.8%
<b>Beer</b>	\$4.60/barrel	9.0%	4.0%
<b>Cider</b>	\$0.04/liter	9.0%	2.9%
<b>Wine</b>	\$0.08/liter	9.0%	3.4%
<b>Strong wine</b>	\$0.25/liter	9.0%	5.3%
<b>Sparkling wine</b>	\$0.48/liter	9.0%	7.9%
<b>Spirits</b>	\$1.33/liter	9.0%	9.6%

<sup>1</sup> Amount of 3.2 beer sold at 9% rate is not significant

#### Advantages

- For beer, cider and table wine, the tax would most closely approximate the taxes it would replace.

- Would have the lowest incidence for the consumer assuming the markup effect of a tax imposed at wholesale.
- Retailer base is identified.
- Would reduce inventory costs for retailers and beer wholesalers.
- Tax would grow with the retail economy for the product.

#### Disadvantages

- Under the SSTP, a new priced-based tax at retail could not be a sales tax. The Department of Revenue would need to create a new mechanism to receive, process and account for the new alcoholic beverage tax payments.
- Retailers would be required to file two monthly returns: one for sales tax and one for the alcoholic beverage tax.
- Cash registers would need to add a rate for each classification of beverage to maintain some revenue neutrality across beverage types. At stores without computerized cash registers, the process would be manual, both a nuisance and a process highly prone to error.
- Estimated increased number of delinquencies than for a tax at the wholesale or manufacturer level. While the department eventually collects most of that delinquency, pursuing it is costly, and receipt of the funds is delayed.
- Minnesota would not be in compliance with the SSTP. (SSTP strongly suggests states avoid creating new taxes outside of the SSTP Act or Agreement in order to continue the tax treatment of a particular category of property or service. Enacting such a tax places an additional burden on sellers.)

#### Concerns raised by alcohol beverage industry

A new tax with a unique rate for each classification of beverage would be cumbersome and highly prone to error.

# Replacing current taxes *(continued)*

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## **Option 5—**

### **Impose volume-based tax at retail**

Retail representatives, legislative staff and Department of Revenue personnel considered this option too impractical to explore seriously, even though it is technically within the legislative mandate.

## **Additional options**

Industry representatives and others suggested that the legislative goals might be reached by the following means, even though they are outside the legislative directive.

## **Option 6—**

### **Impose gross receipts tax. Repeal 2.5 percent sales tax. Keep current excise taxes.**

#### **Advantages**

- Would duplicate the existing system. Wholesalers and brewers would see no change, and retailers would pay tax on alcohol at a rate slightly lower than 9 percent but under a different tax law.
- Only method that would achieve revenue neutrality across beverage types and between on-sale and off-sale.
- Taxpayer population is known.
- Gross receipts tax would grow with the industry economy.

#### **Disadvantages**

- Minnesota would not be in compliance with the SSTP.
- Retailers would be required to file two returns: one to remit sales tax and one to remit the gross-receipts tax.

## **Option 7—**

### **Wait to see if the SSTP grants an exception for alcohol**

#### **Advantages**

- Taxpayers and the department would not need to make adjustments.
- Taxpayer costs would not increase.
- The incidence to the consumer would not change.
- Outcome most favored by industry.

#### **Disadvantages**

- There may never be an exception for alcohol. Some states have requested an exception, but so far, the SSTP has rejected those requests. Doing nothing risks noncompliance with the SSTP.

# Other issues to consider

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## Small brewer credit

Brewers whose production does not exceed 100,000 barrels in a fiscal year receive a credit on their first 25,000 barrels of production in the following fiscal year.

If current excise taxes are increased (Option 1), the credit, if unamended, also will include a partial exemption for what is now sales tax remitted by the consumer.

## Bottle tax

Minnesota once had certification stamps for wine and distilled spirits. That provision was repealed in 1959. However, the charge, now called the bottle tax, endures. Wholesalers consider it an inconvenience, and it complicates audits for the department. In calendar 2001, the tax raised approximately \$506,000. A one-cent per liter increase in the volume rates would offset repeal of the bottle tax and raise a small amount of additional revenue. In past years, several distributors have said that they would accept an increase in the volume rate in exchange for bottle tax repeal. During our meetings in 2002, wholesaler representatives were unsure how their clients would react to such a change.

## Sparkling wines

Minnesota subjects sparkling wines, for example, champagne, to a tax higher than that for still wines of the same alcohol content. Some have questioned whether that is still good policy. If Minnesota were to tax still and sparkling wines based on their alcohol content, a revenue neutral rate would be \$0.10 per liter. Many states do so. Others tax sparkling wines at the same rate as higher alcohol wine. How such a change might affect the consumption of product in either category is uncertain.

## Estimated rates

The projected rates in this report are based on the best data available to the department and industry in late 2002. In addition to its own statistics, the department relied on *Adams Liquor Handbook*, which is widely cited in liquor studies and analyses. The department assumes that if this tax change goes forward in 2006, the legislature will select a new tax and determine rates in 2005 and base its decision on what then will be more current data.

The department acknowledges that shifting some of the sales tax to the level of the current excise taxes could increase retail prices by something more than the amount of the rate increase and that a price elasticity of demand should apply. The extent to which that would influence retail prices and consumer demand is uncertain. If the legislature amends the existing excise taxes, the department will explore the price elasticities further in its revenue analysis.

## Indexing

The legislature directed that the replacement tax be revenue neutral as closely as possible. Excise taxes are set at a fixed amount per unit of volume. The sales tax varies with the product's retail price. Unless the legislature indexes an excise tax or periodically adjusts its rate, over time it will yield a declining percentage of general revenues. Sales taxes, on the other hand, vary with product prices, which over time have increased. If the legislature increases the existing excise taxes as the replacement tax, it may wish to consider indexing the tax to achieve revenue neutrality beyond the date of enactment.

# Conclusion

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For many years, the Department of Revenue has attempted to define and promote the general attributes of a good tax system. Two such attributes are minimizing compliance difficulties for taxpayers, and containing administrative costs and burdens for government.

## Imposing a tax at retail

The only replacement tax option that would approach absolute revenue neutrality requires imposing a tax at retail (Option 4). Yet, such a tax would not comply with the SSTP or, at the least, would run contrary to its policies and purpose. In addition, a tax at retail falls short of meeting the attributes of a good tax system.

### Expensive to administer

- Over 5,700 establishments hold retail liquor licenses. Approximately 5,000 other retailers are licensed to sell 3.2 beer. Thus, the total number of filers for a replacement tax at retail would be about 10,700. In comparison, there are currently 199 businesses that file excise tax returns.
- The department would need to create a mechanism to administer the tax. Start-up costs, including computer system design and delivery, might approach \$250,000. Ongoing administrative costs, depending on the number of staff devoted to the new tax, could exceed \$1,000,000 annually.

### Complicates compliance for taxpayers

- A retail tax, if it were to achieve revenue neutrality among beverage types, would require multiple tax rates: one, or possibly two, for beer; four for wine; and one for distilled spirits. That would complicate compliance for all retailers.

In establishments that lack computerized cash registers, compliance could become especially complex and error prone, particularly when trying to classify sales by beverage type during busy times.

Taking a retail tax one step further and implementing separate tax rates for on-sale and off-sale would further complicate administration

and compliance. Consider, for example, an on-sale, off-sale municipal retailer that might not be computerized and would have to report sales in each of 12 or 14 tax rates on an alcohol tax return in addition to having to file a sales tax return. For that reason the department did not calculate separate rates for on-sale and off-sale establishments even though it would more closely approximate the legislative directive.

### Cost of collection is high

- In fiscal years 2001 and 2002, approximately 12 percent of licensed retailers received at least one delinquency notice from the Department of Revenue. Eventually, the department collects most of that revenue but beyond its due date and at a cost. The growth in tax and non-tax debt argues against enacting a tax scheme that places an additional tax obligation on a population with a fairly high rate of late payment. Rarely has the department had to pursue an excise tax filer for a past-due return or payment.

### Other issues

- Moving the excise taxes to retail would defer collection of that revenue until the month following the consumer's purchase. Conversely, converting the 2.5 percent sales tax to an excise tax at the current point of imposition would accelerate the collection of some revenue.

## Imposing taxes at wholesale

A price-based excise tax on beer and wine and a volume-based tax on distilled spirits (Option 3) would most closely approximate revenue neutrality among beverage types.

### Complicates compliance for taxpayers

- This options would add complexity for wholesalers distributing both spirits and wine.

It also would require forms redesign and some one-time changes to department systems.

*Continued next page*

# Conclusion *(continued)*

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## **Increasing current excise taxes**

Increasing current excise taxes (Option 1) seems to be the most workable solution. It reduces the sales tax rate on alcohol without affecting general revenues. Although it would fall short of some revenue neutrality goals, it would best meet the attributes of a good tax system.

## **Inexpensive and easy to administer**

It would require only a tax rate change in the current excise tax system and a sales tax rate reduction at retail.

## **Minimizes compliance difficulties**

Not only would retailers' compliance burden not increase, an excise tax adjustment would be less likely to increase tax delinquencies than would a tax at retail.

## **Complies with SSTP**

It would comply with the SSTP in that it would create no additional filing requirements for retailers.

## **Other issues**

- The department assumes neither a legislative appropriation nor a new dedicated administrative fee imposed on the industry. Rate changes to existing taxes would spare the department from having to divert declining real and nominal resources to implementing and administering a new tax.
- It would raise industry objections to its markup effect on the consumer and burden shifting among products and sales locations.

Ultimately, choosing a replacement tax will require weighing competing interests and policies, such as the state's revenue needs versus potential tax-driven market changes; minimizing costs for state government, retailers and wholesalers versus business changes that might result; and balancing interests among various segments of the alcohol beverage industry.

The taxation of alcohol influences consumer prices, which in turn may affect consumption. That is central to much discussion unrelated to tax policy per se. We have ignored those considerations in preparing this report.

**TABLE B. Wholesale Rate Analysis**

Tax imposed on sales price by wholesaler/Multiple rates

	3.2 Beer	Beer	Cider	Wine	Strong wine	Sparkling wine	Spirits	Total
U.S. wholesale (000's)	\$2,416,668	\$37,861,135	\$259,239	\$9,920,725	\$367,909	\$504,828	\$18,731,001	\$70,061,505
Estimated MN wholesale	\$42,775,024	\$670,142,090	\$4,588,530	\$175,596,833	\$6,511,989	\$8,935,456	\$331,538,718	\$1,240,088,639
Estimated current								
2.5% sales tax	\$0	\$25,200,795	\$169,877	\$6,500,976	\$244,303	\$334,485	\$15,112,157	\$46,055,950
Current excise tax	\$484,620	\$15,241,592	\$30,372	\$2,324,593	\$272,990	\$717,624	\$42,914,233	\$61,986,024
2.5% sales + excise	\$484,620	\$40,442,387	\$200,249	\$8,825,569	\$517,293	\$1,052,109	\$58,026,390	\$108,041,974
6.5% sales tax on embedded 2.5%	\$0	\$1,638,052	\$11,042	\$422,563	\$15,880	\$21,742	\$982,290	\$2,993,637
Net new tax	\$484,620	\$38,804,335	\$189,207	\$8,403,006	\$501,413	\$1,030,367	\$57,044,100	\$105,048,337
Current tax as percent of wholesale price	1.1%	5.8%	4.1%	4.8%	7.7%	11.5%	17.2%	8.5%
Current excise tax rate	\$2.40/barrel	\$4.60/barrel	\$0.04 /liter	\$0.08 /liter	\$0.25/liter	\$0.48/liter	\$1.33/liter	
Volume sold	201,925	3,313,390	759,300	29,057,413	1,091,960	1,495,050	32,266,341	
Additional tax rate needed	\$0.00	\$7.11	\$0.21	\$0.21	\$0.21	\$0.21	\$0.44	
Proposed excise tax	\$2.40	\$11.71	\$0.25	\$0.29	\$0.46	\$0.69	\$1.77	

**Note:**

- All estimates for fiscal year 2002.
- Estimated total wholesale estimates based on information from *Adams Liquor Handbook 2002*.
- National estimates apportioned to Minnesota (.0177 expected apportionment factor).
- Retail distribution from *Adams Liquor Handbook 2002* used to estimate 2.5% sales tax distribution.
- 3.2 beer is taxed at 9% only at establishments holding an intoxicating liquor license and it is assumed that this is not a significant factor.
- FY 2002 collection information from Minnesota Department of Revenue (used to breakout current excise tax).

Source: *Minnesota Department of Revenue (Jan. 3, 2003)*

**TABLE C. Retail Rate Analysis**

Tax imposed on retail price/Remitted by retailer/Multiple rates

	3.2 Beer	Beer	Cider	Wine	Strong wine	Sparkling wine	Spirits	Total
U.S. retail sales (000s)	\$4,067,084	\$65,872,916	\$444,046	\$16,993,045	\$638,590	\$874,319	\$39,502,000	\$128,392,000
Estimated distribution of Minnesota retail sales	\$62,237,264	\$1,008,031,812	\$6,795,092	\$260,039,042	\$9,772,135	\$13,379,419	\$604,486,260	\$1,902,503,760
Estimated 2.5% sales tax	\$0	\$25,200,795	\$169,877	\$6,500,976	\$244,303	\$334,485	\$15,112,157	\$46,055,950
Current excise tax	\$484,620	\$15,241,592	\$30,372	\$2,324,593	\$272,990	\$717,624	\$42,914,233	\$61,986,024
2.5% sales + excise tax	\$484,620	\$40,442,387	\$200,249	\$8,825,569	\$517,293	\$1,052,109	\$58,026,390	\$108,041,974
Current tax as percent of retail price	0.8%	4.0%	2.9%	3.4%	5.3%	7.9%	9.6%	5.7%
Current excise tax rate	\$2.40/barrel	\$4.60/barrel	\$0.04/liter	\$0.08/liter	\$0.25/liter	\$0.48/liter	\$1.33/liter	
Volume sold	201,925	3,313,390	759,300	29,057,413	1,091,960	1,495,050	32,266,341	
Additional tax rate needed	\$0.00	\$7.61/barrel	\$0.22/liter	\$0.22/liter	\$0.22/liter	\$0.22/liter	\$0.47/liter	
Proposed excise tax	\$2.40	\$12.21/barrel	\$0.26/liter	\$0.30/liter	\$0.47/liter	\$0.70/liter	\$1.80/liter	

Note:

- All estimates for fiscal year 2002.
- Minnesota total retail sales are set at \$1,902,503,760 (which represents Minnesota sales tax collections divided by the 9% tax rate). It is assumed that little, if any, 3.2 beer is included because 3.2 beer is taxed at 9 percent only at establishments holding an intoxicating liquor license.
- Percentage distributions at retail by beverage type based on information from *Adams Liquor Handbook 2002*.
- Adjustments for on-sale/off-sale consumption shifts not included.
- FY 2002 collection information from Minnesota Department of Revenue (used to breakout current excise tax).

Source: Minnesota Department of Revenue (Jan. 3, 2003)

**TABLE D. State Beer Excise Tax Rates** (Jan. 1, 2002)

	<b>Excise tax rate</b> (\$ per gallon)	<b>Sales tax applied</b>	<b>Other taxes</b>
Alabama	\$0.53	Yes	\$0.52/gallon local tax.
Alaska	0.35	n/a	
Arizona	0.16	Yes	
Arkansas	0.23	Yes	Under 3.2% alcohol = \$0.16/gallon; \$0.008/gallon. 3% tax off-premises. 10% tax on-premises.
California	0.20	Yes	
Colorado	0.08	Yes	
Connecticut	0.19	Yes	
Delaware	0.16	n/a	
Florida	0.48	Yes	2.67¢/12 ounces on-premises retail tax.
Georgia	0.48	Yes	\$0.53/gallon local tax.
Hawaii	0.92	Yes	\$0.53/gallon draft beer.
Idaho	0.15	Yes	Over 4% alcohol = \$0.45/gallon.
Illinois	0.185	Yes	\$0.16/gallon in Chicago. \$0.06/gallon in Cook County.
Indiana	0.12	Yes	
Iowa	0.19	Yes	
Kansas	0.18	—	Over 3.2% alcohol = 8% sales tax off-premises and 10% sales tax on-premises. Under 3.2% alcohol = 4.25% sales tax.
Kentucky	0.08	Yes*	9% wholesale tax.
Louisiana	0.32	Yes	\$0.048/gallon local tax.
Maine	0.35	Yes	Additional 5% tax on-premises.
Maryland	0.09	Yes	\$0.2333/gallon in Garrett County.
Massachusetts	0.11	Yes*	0.57% on private club sales.
Michigan	0.20	Yes	
Minnesota	0.15	—	Under 3.2% alcohol = \$0.077/gallon. 9.0% sales tax.
Mississippi	0.43	Yes	
Missouri	0.06	Yes	
Montana	0.14	n/a	
Nebraska	0.23	Yes	
Nevada	0.09	Yes	
New Hampshire	0.30	n/a	
New Jersey	0.12	Yes	
New Mexico	0.41	Yes	
New York**	0.135	Yes	\$0.12/gallon in New York City.
North Carolina	0.53	Yes	\$0.48/gallon bulk beer.
North Dakota	0.16	—	7% state sales tax. Bulk beer = \$0.08/gallon.
Ohio	0.18	Yes	
Oklahoma	0.40	Yes	Under 3.2% alcohol = \$0.36/gallon. \$1.00/case on-premises. 12% tax on-premises.
Oregon	0.08	n/a	
Pennsylvania	0.08	Yes	
Rhode Island	0.10	Yes	\$0.04/case wholesale tax.
South Carolina	0.77	Yes	
South Dakota	0.27	Yes	
Tennessee	0.13	Yes	17% wholesale tax.
Texas	0.19	Yes	Over 4% alcohol = \$0.198/gallon. 14% tax on-premises. \$0.05/drink on airline sales.
Utah	0.35	Yes	Over 3.2% alcohol sold through state store.
Vermont	0.265	No	6% to 8% alcohol = \$0.55. 10% sales tax on-premises.
Virginia	0.26	Yes	
Washington	0.261	Yes	
West Virginia	0.18	Yes	
Wisconsin	0.06	Yes	
Wyoming	0.02	Yes	
Dist. of Columbia	0.09	Yes	8% sales tax off-premises. 10% sales tax on-premises.
U.S. median	\$0.185		

\* Sales tax is applied to on-premises sales only.

\*\* Tax rate scheduled to decrease to 12.5 cents per gallon 9/1/03.

SOURCE: FTA website [www.taxadmin.org/fta/rate/beer.html](http://www.taxadmin.org/fta/rate/beer.html)

**TABLE E. State Wine Excise Tax Rates** (Jan. 1, 2002)

	<b>Excise tax rate</b> (\$ per gallon)	<b>Sales tax applied</b>	<b>Other taxes</b>
Alabama	\$1.70	Yes	Over 14% alcohol sold through state store.
Alaska	0.85	n/a	
Arizona	0.84	Yes	
Arkansas	0.75	Yes	Under 5% alcohol = \$0.25/gallon. \$0.05/case. 3% tax off-premises. 10% tax on-premises. Sparkling wine = \$0.30/gallon.
California	0.20	Yes	
Colorado	0.32	Yes	
Connecticut	0.60	Yes	Over 21% alcohol and sparkling wine = \$1.50/gallon.
Delaware	0.97	n/a	
Florida	2.25	Yes	Over 17.259% alcohol = \$3.00/gallon. Sparkling wine = \$3.50/gallon. 6.67¢/4 oz. retail tax on-premises.
Georgia	1.51	Yes	Over 14% alcohol = \$2.54/gallon. \$0.83/gallon local tax.
Hawaii	1.36	Yes	Sparkling wine = \$2.09/gallon. Wine coolers = \$0.84/gallon.
Idaho	0.45	Yes	
Illinois	0.73	Yes	Over 20% alcohol = \$4.50/gallon. \$0.30/gallon in Chicago. \$0.16 to \$0.30/gallon in Cook County.
Indiana	0.47	Yes	Over 21% alcohol = \$2.68/gallon.
Iowa	1.75	Yes	Under 5% alcohol = \$0.19/gallon.
Kansas	0.30	No	Over 14% alcohol = \$0.75/gallon; 8% tax off-premises. 10% tax on-premises.
Kentucky	0.50	Yes*	9% wholesale tax.
Louisiana	0.11	Yes	14% to 24% alcohol = \$0.23/gallon. Over 24% alcohol and sparkling wine = \$1.59/gallon.
Maine	0.60	Yes	Over 15.5% alcohol sold through state stores. Sparkling wine = \$1.25/gallon. Additional 5% sales tax on-premises.
Maryland	0.40	Yes	
Massachusetts	0.55	Yes*	Sparkling wine = \$0.70/gallon.
Michigan	0.51	Yes	Over 16% alcohol = \$0.76/gallon.
Minnesota	0.30	—	14% to 21% alcohol = \$0.95/gallon. Under 24% alcohol and sparkling wine = \$1.82/gallon. \$0.01/bottle tax (except miniatures). 9.0% sales tax.
Mississippi	0.35	Yes	Over 14% alcohol and sparkling wine sold through the state.
Missouri	0.36	Yes	
Montana	1.06	n/a	Over 16% alcohol sold through state stores.
Nebraska	0.75	Yes	Over 14% alcohol = \$1.35/gallon.
Nevada	0.40	Yes	14% to 22% alcohol = \$0.75/gallon. Over 22% alcohol = \$2.05/gallon.
New Hampshire	**	n/a	
New Jersey	0.70	Yes	
New Mexico	1.70	Yes	Over 14% alcohol = \$6.06/gallon.
New York	0.19	Yes	
North Carolina	0.79	Yes	Over 17% alcohol = \$0.91/gallon.
North Dakota	0.50	—	Over 17% alcohol = \$0.60/gallon. Sparkling wine = \$1.00/gallon. 7% state sales tax.
Ohio	0.32	Yes	Over 14% alcohol = \$1.00/gallon. Vermouth = \$1.10/gallon. Sparkling wine = \$1.50/gallon.
Oklahoma	0.72	Yes	Over 14% alcohol = \$1.44/gallon. Sparkling wine = \$2.08/gallon. \$1.00/bottle on-premises. 12% tax on-premises.
Oregon	0.67	n/a	Over 14% alcohol = \$0.77/gallon.
Pennsylvania	**	Yes	
Rhode Island	0.60	Yes	Sparkling wine = \$0.75/gallon.
South Carolina	0.90	Yes	\$0.18/gallon additional tax.
South Dakota	0.93	Yes	14% to 20% alcohol = \$1.45/gallon. Over 21% alcohol and sparkling wine = \$2.07/gallon. 2% wholesale tax.
Tennessee	1.10	Yes	\$0.15/case and 15% tax on-premises. Under 7% alcohol = \$1.10/gallon.
Texas	0.20	Yes	Over 14% alcohol = \$0.408/gallon. Sparkling wine = \$0.516/gallon. 14% tax on-premises. \$0.05/drink on airline sales.
Utah	**	Yes	
Vermont	0.55	Yes	Over 16% alcohol sold through state store. 10% sales tax on-premises.
Virginia	1.51	Yes	Under 4% alcohol = \$0.2565/gallon. Over 14% alcohol sold through state store.
Washington	0.87	Yes	Over 14% alcohol = \$1.72/gallon.
West Virginia	1.00	Yes	5% local tax.
Wisconsin	0.25	Yes	Over 14% alcohol = \$0.45/gallon.
Wyoming	**	Yes	
Dist. of Columbia	0.30	Yes	8% sales tax off-premises. 10% sales tax on-premises. Over 14% alcohol = \$0.40/gallon. Sparkling wine = \$0.45/gallon.
U.S. median	0.60		

\* Sales tax is applied to on-premises sales only.

\*\* All wine sales are through state stores. Revenue in these states is generated from various taxes, fees and net profits.

Source: FTA website [www.taxadmin.org/fta/rate/wine.html](http://www.taxadmin.org/fta/rate/wine.html)

**TABLE F. State Liquor Excise Tax Rates** (Jan. 1, 2002)

	<b>Excise tax rate</b> (\$ per gallon)	<b>Sales tax applied</b>	<b>Other taxes</b>
Alabama	**	Yes	
Alaska	\$5.60	n/a	Under 21% alcohol = \$0.85/gallon.
Arizona	3.00	Yes	
Arkansas	2.50	Yes	Under 5% alcohol = \$0.50/gallon. Under 21% alcohol = \$1.00/gallon. \$0.20/case. 3% retail tax off-premises. 14% retail tax on-premises.
California	3.30	Yes	Over 50% alcohol = \$6.60/gallon.
Colorado	2.28	Yes	
Connecticut	4.50	Yes	Under 7% alcohol = \$2.05/gallon.
Delaware	3.75	n/a	Under 25% alcohol = \$2.50/gallon.
Florida	6.50	Yes	Under 17.259% alcohol = \$2.25/gallon. Over 55.780% alcohol = \$9.53/gallon. 6.67¢/ounce retail tax on-premises. \$0.83/gallon local tax.
Georgia	3.79	Yes	
Hawaii	5.92	Yes	
Idaho	**	Yes	
Illinois	4.50	Yes	Under 20% alcohol = \$0.73/gallon. \$0.50/gallon in Chicago. \$1.00/gallon in Cook County.
Indiana	2.68	Yes	Under 15% alcohol = \$0.47/gallon.
Iowa	**	Yes	
Kansas	2.50	No	8% retail tax off-premises. 10% retail tax on-premises.
Kentucky	1.92	Yes*	Under 6% alcohol = \$0.25/gallon. \$0.05/case. 9% wholesale tax.
Louisiana	2.50	Yes	Under 6% alcohol = \$0.32/gallon.
Maine	**	Yes	
Maryland	1.50	Yes	
Massachusetts	4.05	Yes*	Under 15% alcohol = \$1.10/gallon. Over 50% alcohol = \$4.05/proof gallon. 0.57% tax on private club sales.
Michigan	**	Yes	
Minnesota	5.03	—	\$0.01/bottle tax (except miniatures). 9.0% sales tax.
Mississippi	**	Yes	
Missouri	2.00	Yes	
Montana	**	n/a	
Nebraska	3.00	Yes	
Nevada	2.05	Yes	Under 14% alcohol = \$0.40/gallon. Under 21% alcohol = \$0.75/gallon.
New Hampshire	**	n/a	
New Jersey	4.40	Yes	
New Mexico	6.06	Yes	
New York	6.44	Yes	Under 24% alcohol = \$2.54/gallon. \$1.00/gallon New York City.
North Carolina	**	Yes*	
North Dakota	2.50	—	7% state sales tax.
Ohio	**	Yes	
Oklahoma	5.56	Yes	\$1.00/bottle on-premises. 12% tax on-premises.
Oregon	**	n/a	
Pennsylvania	**	Yes	
Rhode Island	3.75	Yes	
South Carolina	2.72	Yes	\$5.36/case. 9% surtax.
South Dakota	3.93	Yes	Under 14% alcohol = \$0.93/gallon. 2% wholesale tax.
Tennessee	4.00	Yes	\$0.15/case and 15% tax on-premises. Under 7% alcohol = \$1.10/gallon.
Texas	2.40	Yes	14% tax on-premises. \$0.05/drink on airline sales.
Utah	**	Yes	
Vermont	**	No	10% sales tax on-premises.
Virginia	**	Yes	
Washington	**	Yes*	
West Virginia	**	Yes	
Wisconsin	3.25	Yes	
Wyoming	**	Yes	
Dist. of Columbia	1.50	Yes	8% sales tax off-premises. 10% sales tax on-premises.
U.S. median	\$3.30		

\* Sales tax is applied to on-premises sales only.

\*\* In 18 states, the government directly controls the sales of distilled spirits. Revenue in these states is generated from various taxes, fees and net liquor profits.

Source: FTA website [www.taxadmin.org/fta/rate/liquor.html](http://www.taxadmin.org/fta/rate/liquor.html)