

QUALIFIED SMALL DISTILLERS

Phone: (517) 373-8080
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House Bill 4842 as reported from committee
Sponsor: Rep. Pat Outman
Committee: Regulatory Reform
Complete to 6-29-21

Analysis available at
<http://www.legislature.mi.gov>

BRIEF SUMMARY: House Bill 4842 would amend the Michigan Liquor Control Code to decrease the markup on costs for qualified small distillers (as defined in the bill) who source a minimum of 40% of their distillate from Michigan-grown grain.

FISCAL IMPACT: The bill would reduce revenues to state government. (See **Fiscal Information**, below, for a more detailed discussion.)

THE APPARENT PROBLEM:

Spirits are typically distilled from grains (e.g., wheat, rye, barley, or corn) or produce (e.g., potatoes or fruits such as apples, pears, or plums). In recent years, Michigan has been home to a growing industry of small distillers. Unfortunately, the way in which spirits are taxed are reported to be disadvantageous to small distillers, and especially to those wishing to use Michigan-grown grains. Apparently, it is cheaper to buy grains that are grown in other states in bulk on the commodity market than to source the grains from local farmers. It has been suggested that changing the tax structure for small distillers who used a certain percentage of distillate from Michigan-grown grains would not only help grow the craft spirit industry but also create a market for products such as rye and other grains used in spirits.

THE CONTENT OF THE BILL:

House Bill 4842 would amend the Michigan Liquor Control Code to establish regulations for *qualified small distillers*.

Qualified small distiller would mean a *small distiller* or an out-of-state entity that is the substantial equivalent of a small distiller that is certified by the Michigan Department of Agriculture and Rural Development (MDARD) as having at least 40% of its base distillate distilled from distilled grain grown and harvested in Michigan.

A *small distiller* is defined in the code as a manufacturer of spirits that annually manufactures in Michigan not more than 60,000 gallons of spirits, of all brands combined.

Under the bill, no later than February 1, 2022, and each subsequent February 1, a small distiller or its out-of-state equivalent could file an application with MDARD to be certified as a qualified small distiller. MDARD would have to certify that an applicant is a qualified small distiller or out-of-state entity, which would mean, as determined by MDARD, that the base distillate of the small distiller or out-of-state entity is at least 40% distilled from the distilled grain grown and harvested in Michigan. The certificate would expire annually on February 1. MDARD could charge a reasonable certification fee.

No later than October 1, 2022, and each subsequent October 1, MDARD would have to submit a report to the Michigan Liquor Control Commission (MLCC) including the name of each qualified small distiller certified above.

Beginning January 1, 2023, for each bottle of spirits produced by a qualified small distiller of which at least 40% of the base distillate was distilled from grain grown and harvested in Michigan (as determined by MDARD), the price for each bottle would have to return a gross profit to the MLCC of 32.5%. (Under current law, the gross profit is 65%.)

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

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 at least the following:

- 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 distiller's possession. (Acknowledgment forms would include scale weight tickets, load slips, or other evidence identifying the distilled grain being transferred to possession of the small distiller. A Michigan certification of origination statement would be a signed statement by the deliver or producer of grain on an acknowledgment form that the grain was grown and harvested in Michigan.)
- Copies of all contracts.
- Acknowledgment forms returned to and settled by the qualified distiller.

MDARD and the MLCC would be able to examine the above records and accounts pertaining to the qualified distiller's distilled grain handling business at any time during normal business hours.

MCL 436.1233

BACKGROUND INFORMATION:

House Bill 4842 is a reintroduction of SB 349 of the 2019-20 legislative session as referred by the House Regulatory Reform committee to the House Ways and Means committee.

FISCAL INFORMATION:

House Bill 4842 would reduce revenues to the Liquor Purchase Revolving Fund (LPRF), which is the state's enterprise fund for the wholesaling of liquor. The net revenue of the LPRF lapses to the state's general fund (GF/GP), so the bill would potentially cause a reduction to GF/GP revenue. Under current law, spirits of which at least 40% of the base distillate is from Michigan grain and which is produced by entities labeled as "qualified small distillers" under the bill yield a 65% gross profit to the MLCC, which is deposited to the LPRF. The bill would stipulate that these spirits would instead return a gross profit of 32.5% to the MLCC. This lower gross

profit would result in reduced revenues to the LPRF. The amount of the reduction would depend on the volume of product that would meet the bill's parameters and is presently indeterminate. The bill also stipulates that small distillers and their out-of-state equivalents that supply false information to the MLCC would owe the MLCC the difference between the aforementioned gross profits, which would result in the current 65% gross profit being realized in these cases.

MDARD has estimated that the work necessary to certify applicants as qualified small distillers, including the examination of the records and accounts pertaining to the qualified small distiller's distilled grain handling business, would require MDARD to establish an auditor position at an estimated cost of \$150,000 for salary and other expenses.

The bill would authorize MDARD to charge a "reasonable certification fee." The bill does not specify the amount of the fee. The amount of annual fee revenue would depend on the number of applicants and the amount of the fee as established by the department. MDARD indicates that there are currently 136 small distillers as defined in section 111 of the Liquor Control Code. It is unknown how many of these current small distillers would apply to be certified as "qualified small distillers." As a result, annual fee revenue cannot be reasonably estimated at this time. [If all 136 small distillers applied for certification as qualified small distillers, the annual certification fee would have to be approximately \$1,100 in order to cover the estimated \$150,000 additional annual cost.]

The bill does not designate the distribution of fee revenue. If fee revenue is retained by MDARD, the funds could be used, subject to appropriation, to offset some of the additional costs associated with the new program activities as required by the bill. If restricted fee revenue did not cover all additional costs, those additional costs would have to be covered from some other restricted fund source within the MDARD budget, or with state General Fund revenue. The new program activities could be funded through an increase in state appropriations or through redirection of resources from other MDARD programs, which would reduce those affected programs accordingly.

Finally, House Bill 4842 creates a new misdemeanor offense for supplying false information to MDARD or the MLCC. The number of convictions that would result under provisions of the bill is not known. New misdemeanor convictions would increase costs related to county jails and/or local misdemeanor probation supervision. Costs of local incarceration in county jails and local misdemeanor probation supervision, and how those costs are financed, vary by jurisdiction. The fiscal impact on local court systems would depend on how provisions of the bill affected caseloads and related administrative costs. Any increase in penal fine revenue would increase funding for public and county law libraries, which are the constitutionally designated recipients of those revenues.

ARGUMENTS:

For:

Like craft beers and wines from small wineries, craft spirits have been growing in popularity in recent years. Michigan is now home to several craft distilleries, some of which grow some of their own grain or buy from local farmers. Reportedly, Michigan soil and weather are capable of producing high-quality grains. However, it is often more expensive for small distillers to buy locally, as opposed to buying on the commodities market, and under the current

tax structure for spirits, this results in a smaller profit margin for these craft distillers and a higher price per bottle for consumers over larger, national brands.

The bill would address the issue by reducing the markup on spirits by half for any small distiller that sources at least 40% of its distillate from Michigan-grown grains. Supporters believe that such a change could unleash the full potential of craft distillers in the state, increase tourism by creating destination venues for lovers of spirits, and be a boon to Michigan farmers by enlarging the market for a variety of grains.

Against:

According to the Michigan Spirits Association, House Bill 4842 would artificially create a huge price disparity between brands, with the bill benefitting only those distilleries that produced less than 60,000 gallons per year with at least 40% of the distillate produced from Michigan-grown grains. Applying the discount to all distillers who use Michigan grains could further grow the market for Michigan farm products and benefit consumers who have their favorite national brands.

Alternatively, industry members suggest reducing the state's markup over the next decade by one percent per year for all distillers—large and small—for any year in which the revenue to the state from spirits sales exceeded two percent. It is argued that this would benefit all spirit distillers, rather than a few small distillers, and would be unlikely to have a negative impact on the state's revenue. It is reported that annual revenue to the state from the markup on spirits has exceeded two percent of the state's revenue for the past five years.

POSITIONS:

A representative of the Michigan Craft Distillers Association testified in support of the bill. (6-15-21)

The following entities indicated support for the bill:

- Michigan Licensed Beverage Association (6-22-21)
- Potato Growers of Michigan (6-15-21)
- Michigan Farm Bureau (6-15-21)
- Emergent Malt (6-15-21)
- Heffron Farms (6-15-21)
- Paulen Farms (6-15-21)
- Lott Seed Farms (6-15-21)

The following entities indicated opposition to the bill:

- Michigan Liquor Control Commission (6-22-21)
- Michigan Spirits Association (6-15-21)

Legislative Analyst: Susan Stutzky
Fiscal Analysts: Marcus Coffin
William E. Hamilton
Robin Risko

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