F I S C A L   I M P A C T   R E P O R T

ORIGINAL DATE 2/16/19
SPONSOR Martinez, J. **LAST UPDATED** 2/21/19 **HB** 489/aHCEDC

SHORT TITLE Liquor Permit, Tax & Definition Changes **SB**

ANALYST Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY19	FY20	FY21	FY22	FY23		
	($80)	($90)	($100)	($120)	Recurring	Drug Court Fund
	($690)	($790)	($910)	($1,040)	Recurring	Local DWI Grant Fund
	($770)	($880)	($1,010)	($1,150)	Recurring	General Fund

Parenthesis ( ) indicate revenue decreases

SOURCES OF INFORMATION

LFC Files

Responses Received From
Regulation and Licensing Department (RLD)
Taxation and Revenue Department (TRD)
Department of Finance and Administration, DWI grant program (DFA/DWI)
Economic Development Department (EDD)
New Mexico Tourism Department (NMTD)

SUMMARY

Synopsis of House Commerce and Economic Development Committee Amendment

HCEDC amendment to House Bill 489 revises the excise tax rates for microbrewed beer, cider and craft distillers. The new rates are progressive.

	Current Law	HB-489	HB-489/aHCEDC
Standard beer excise tax rate	on beer, $.41 per gallon; 1 barrel = 31 gallons		
Microbrewer tax rates	$.08 per gallon on the first 10,000 barrels and $.28 per gallon for	$.08 per gallon on the first 60,000 barrels and $.28 per gallon for volumes from 60,000 to 200,000 barrels.	$.08 per gallon on the first 30,000 barrels, $.28 per gallon for volumes from 30,000 to 60,000 barrels and

	volumes from 10,000 to 15,000 barrels.		$.41 for volumes from 60,000 barrels to 200,000.
Cider	$.41 per gallon	$.08 per gallon on the first 60,000 barrels and $.28 per gallon for volumes from 60,000 to 200,000 barrels.	$.08 per gallon on the first 30,000 barrels, $.28 per gallon for volumes from 30,000 to 60,000 barrels and $.41 for volumes from 60,000 barrels to 200,000.
Standard Tax Rate on spirituous liquors,	$1.60 per liter		
Craft distiller spirits	$1.60 per liter	$.08 per liter up to 10% alcohol by volume; $.32 per liter for spirits over 10% by volume: limit 375,000 liters sold	For spirits up to 10% alcohol by volume, $.08 per liter for the first 250,000 liters, $.28 per liter for next 250,000 liters; for spirits over 10% by volume, $.32 per liter on first 175,000 liters and $.65 per liter for next 175,000 liters sold.

Synopsis of Original Bill

House Bill 489 amends sections of the Liquor Excise Tax Act and the Liquor Control Act.

In the Liquor Excise Tax Act, the bill changes the definition of “cider” to include cider made from pears, not just apples, and to increase the maximum percent of alcohol by volume allowed to eight and one-half percent from seven percent. It also changes the definition of “microbrewer” to a person who produces less than two hundred thousand barrels of beer per year. Currently, the maximum production amount varies between five thousand and fifteen thousand barrels of beer during specific years in order to qualify for the special microbrewer excise tax rates. The bill also establishes new tax rates for cider and spirituous liquors manufactured by a craft distiller. These rates per liter are comparable to the microbrewer rate on beer per gallon.

The bill creates a preferential tax rate for craft distillers of spirituous liquor in much the same way existing statute provides a preferential rate for craft beer (microbrewers.) Instead of the current rate of $1.60 per liter for spirituous liquor~~, a craft distiller would pay a rate of $.32 per liter on the first 375,000 liters sold~~. Per HCEDC amendment, the following rates apply: for spirits up to 10% alcohol by volume, $.08 per liter for the first 250,000 liters, $.28 per liter for next 250,000 liters; for spirits over 10% by volume, $.32 per liter on first 175,000 liters and $.65 per liter for next 175,000 liters sold.

In the Liquor Control Act, the bill also amends the definition of “cider” to include cider made from pears, not just apples, and to increase the maximum percent of alcohol by volume allowed to eight and one-half percent from seven percent; adds “cider” to the fermented beverages that are not considered spirituous liquors; adds “cider” to the definitions of “winegrower” and “winery”; and adds “cider” throughout Section 60-6A-11 Winegrower’s License.

HB 489 creates private celebration permits for craft distiller's, winegrower's and small brewers and changes their hours of operation on Sundays. The bill would allow sale and service by the drink for all small manufacturer's and by the bottle for winegrower's to begin at 11:00 am in any local option district, instead of at 12:00 p.m.

The bill adds language that conditions annual renewal of a small brewer license upon submission of proof that the small brewer either: had at least fifty percent of his gross receipts from the sale of beer derived from beer produced by the licensee or produced no less than fifty barrels of beer at the licensee's premises.

The effective date of this bill is July 1, 2019. The delayed restoration of previous provisions slated for 2024 has been deleted in this bill. In general, LFC recommends adding a certain date for repeal of any tax expenditure.

FISCAL IMPLICATIONS

TRD has provided a fiscal estimate, which discusses the methodology applied as follows:

> For the effects on cider revenue, the Taxation and Revenue Department (TRD) began with data on cider sales from current liquor excise tax returns, then estimated how much would qualify for the new small winegrower rate as specified in the bill. Cider is already a growing industry in the state, and future monthly taxable gallons were estimated from the 50 months of filings on record. The loss of $0.33 per taxable gallon or $.13 per taxable gallon for higher volumes was then applied.
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> For the increased limits on microbrewer sales, TRD looked at the two New Mexico breweries that appear to currently exceed the 15,000 barrel limit. Both of these brewers would not currently qualify as microbrewers and therefore should be paying the full 0.41/gallon rate for beer. Only one of these two would be affected by the amendment. Based on a rough estimate of growth from published reports the new progressive tax rates were applied.
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> For the reduced tax rates for spirituous liquors, TRD looked through current liquor tax returns and at the distilling trade reports to determine a population of approximately 10 distilleries in the state currently. Based on nationwide reported numbers of average craft distillery production, and the loss of revenue of $1.42 per liter, an estimate of lost revenue was reached. It was assumed no current brewers would qualify for the $.08, although this is a market niche that could be filled.
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> The cumulative effect of this lost revenue was then allocated to the three funds currently having distribution, as given in current statute.

RLD notes that the bill includes a fee of $10 for each private celebration permit issued to a winegrower or small brewer. It is unknown how many private celebration permits would be issued, however, as the Special Dispenser Permits currently issued to dispenser type license holders carry a fee of $25, there may be a reduction in revenue generated.

RLD notes that the monetary value of a dispenser license may decrease to the extent that such value reflects the exclusive ability to cater private events.

There are several notes applicable to the current state of the microbrewery industry and the underlying tax treatment of liquor sales:

- Sales of beer, wine, cider and spirts are all subject to the gross receipts tax at whatever rate is in effect in each local community where sales are made. The preferential liquor excise tax for microbrewers, small winers and craft distillers are imposed in addition to the gross receipts tax;
- The liquor excise tax is imposed on a wholesaler, not the manufacturer or the retailer;
- Sales by a manufacturer to a wholesaler in another state are not subject to the liquor excise tax in New Mexico, but may be imposed on the wholesaler in that other state;
- Similarly, sales of any goods to an out-of-state buyer may be deducted from gross receipts tax;
- LFC staff estimates that 16 percent of production by the four microbreweries that would benefit from the provisions of this bill is exported.
- In 2018, the four larger microbreweries hired an additional 67 workers. Taken against the current preferential tax rates, this is about $6,900 per permanent job created.

DFA/DWI is somewhat concerned with a reduction in funding of this critical program: "This will reduce the amount transferred to the Local DWI Fund … as this fund currently receives 45 percent of the Liquor Excise Tax collected. The reduction in funding available to the Local DWI fund means a reduction of services that each county DWI Program may be able to provide. Each county DWI Program provides Prevention, Enforcement, Treatment and DWI Compliance Monitoring services through this funding source."

The provisions of this bill expand a tax preference. Other provisions apparently provide similar and equitable tax and regulatory treatment for various craft distillers, microbrewers and small wineries.

SIGNIFICANT ISSUES

The microbrewer excise tax rates are comparable with regular rates in Texas, Colorado, Arizona and Texas, which do not have special rates for microbreweries.

TRD notes that by matching the federal Alcohol and Tobacco Tax and Trade Bureau (ATTTB)'s definitions of cider (absent a Technical Issue noted below), the bill adheres to the policy issue of simplicity. Also, by matching the rate to that of microbrewers, the bill adheres to a policy of equity.

TRD also notes the following:

> The lower tax rates for microbrewers that currently exists appears to have been quite successful for the industry in New

New Mexico -- If manufacturer is licensed as a microbrewer, then the first 10,000 barrels are taxed at a rate of $2.48 per barrel - $0.08 per gallon. A microbrewer whose sales exceed 10,000 bbls - 15,000 bbls is taxed at a rate of $8.68 per barrel - $0.28 per gallon. For a brewer not licensed as a microbrewer is taxed at $12.71 per barrel - $0.41 per gallon.
Texas -- Beer (less than 4% ABW): $6.00 per barrel - $0.19 per gallon; Ale and Malt Liquor (more than 4% ABW): $6.138 per barrel - $0.198 per gallon
Colorado -- $0.08 per gallon
Arizona -- $4.96 per barrel - $0.16 per gallon
California -- $6.20 per barrel - $0.20 per gallon
https://www.brewersassociation.org/government-affairs/laws/state-excise-tax-rates

Mexico, as the Brewers Association now lists New Mexico as 12th among states in craft breweries per capita. Increasing the cap at which the lower tax rate applies will further encourage growth among the medium and larger brewers in the state.

The large reduction in tax rates (95 percent) for craft distillers, although not necessarily equitable with the 80% reduction in microbrewers rates, will probably not have much effect as the craft distilling industry is currently quite small in the state, and there is still room for growth in both industries.

Overall with this expenditure, as with all expenditures designed to help a young local industry, a phase-out should be considered. As the organizations involved mature, they should be able to contribute similarly to others paying full tax in the industry. This is borne out by the two former microbreweries that have exceeded the size at which they qualify for the lowered rate, but still continue to grow.

Industry sources have provided the following explanations of each of the features of the bill:

- Private Celebrations: Currently, craft beverage manufacturers can serve and sell at Public Celebrations (festivals, art openings) but not at Private Celebrations (weddings, graduations). This bill adds Private Celebrations as an allowable use with no package sales.
- Sunday Opening Time: Other types of license holders are permitted to open at 11:00am on Sundays for brunch and telecast sporting events. This is not allowed for craft beverage manufactures. This bill brings parity.
- Explicit Allowance for Cider Manufacture: The current statutes create confusion and question regarding whether those classified as “winegrowers” can manufacture cider. This bill explicitly includes the manufacture of cider under the definition of a winegrower to match federal licensing requirements.
- Definition of Cider: The federal definition of cider includes pears (not just apples) and has a maximum alcohol content of 8.5 percent (over this number is considered fruit wine). This bill seeks to match that definition.
- Production Requirements for Small Brewers: This bill sets a requirement of production in order to renew the license (similar to the qualifications for craft distilleries
- Excise Tax Stratification for Small Producers:
  - Cider: This bill enacts a tiered tax structure for cider to match the structure already in place for grape wine. Compared to last year’s SB32, this bill proposes higher production tiers. However no cider manufacturer in the state in close to the second tier in either version of the bill.
  - Distilled Spirits: This bill enacts a tiered tax structure and distinguishes between lower-alcohol content spirits and traditional spirits. SB413 creates a lower alcohol category, which is not currently manufactured by any NM producers.
  - Beer: the tiered tax structure in place for microbreweries breweries appears to have coincided with significant expansion and growth. Unfortunately, the best performers are being penalized for their contribution and reinvestment. The two largest microbrewers apparently no longer qualify for preferential tax rates, because their production has exceeded 15,000 barrels for the previous three fiscal years. This bill adjusts the tiered tax structure so that the most successful microbrewers do not have to pay the same tax rates as the multi-national macro breweries. SB413 removes the sunset of the current excise tax structure and changes the tiers.

Last year's HB285 FIR discussed some of these issues: The following is copied directly from that analysis.

> Local craft distiller products are sometimes sold and consumed in similar venues and similar fashions as craft beer, so this might satisfy the LFC tax policy principle of equity, by treating similar taxpayers fairly. As this bill provides a tax advantage for small distillers (similar to the advantage currently enjoyed by microbrewers), and there is a good chance most or all of New Mexico's distillers would qualify for this tax rate, this also provides the state's distillers with an advantage when competing with products from large national or multinational distillers. More than 13 million liters of spirituous liquor are sold in New Mexico each year, and the Regulation and Licensing Department reports the state is home to 12 licensed craft distillers.
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> Natalie Bovis wrote an article in August 2015 in the award-winning *New Mexico Magazine* about the state's growing distillery scene, and an excerpt is provided below. The entire article can be found at:
> https://www.newmexico.org/nmmagazine/articles/post/tasting-nm-strong-stuff-92082/
>
> Local New Mexico cocktail culture is experiencing a boomlet, thanks in part to the 2011 Craft Distillers bill, which allows distillers to also serve as distributors and retailers. This opened the door for distilleries to become venues, like wine-tasting rooms and microbreweries.
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> Although most distilleries use local ingredients, even spirits companies that rely on key ingredients and processing from neighboring Mexico (Silver Coin Tequila, Del Maguey Mezcal) have given New Mexico's mixology scene a boost by basing their operations here.
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> And it's only getting easier for entrepreneurial purveyors of liquid mirth. It took two and a half years for White Rock–based Don Quixote Distillery to become the first licensed distillery in New Mexico history, back in 2004. "Laws were out of date, and there was confusion between federal, state, and county licenses," says Don Quixote cofounder Olha Dolin, who surmises that she and her husband, Ron, were the first because other would be distillers threw in the towel after being defeated by red tape.
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> Several new distilleries have made the scene since the Dolins staked their claim, and it's likely that more will soon join them. Last month, another piece of legislation was passed that allows folks who are exploring the idea to rent excess working space from one of New Mexico's licensed craft distillers without having to commit to the equipment and paperwork.

EDD notes the following significant issue:

> The changes to the brewer's renewal are significant in that it makes the brewer prove two key components. First, that they have produced a minimum of 50 barrels and, second, that a minimum of 50% of their sales have come from their product. This insures that a brewer is truly a brewer and not just a reseller. The rules and process for proving these numbers will be critical to the success and ease of monitoring these items.

NMTD notes"

> Tourism is a significant economic driver throughout New Mexico, and "liquid tourism" (tourism based around the enjoyment of breweries, distilleries and wineries—whether touring, consuming or hands-on experiences) is an increasingly important part of the tourism economy.
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> In 2017, 8.2% of New Mexico's 15.7 million overnight trips and 5.9% of New Mexico's 19.7 million day trips included beer tastings or brewery tours as a special activity of interest. This compares to just 5.6% of US overnights and 3.7% of US day trips, respectively, indicating that brewery tours and beer tasting act as a draw for New Mexico at more than the national rate.
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> For wine tastings and winery tours, 6.9% of overnight visitors and 4.1% of day trip visitors cited these as activities of special interest. This compares to 4.7% of national overnights and 3.5% of national day trips. Once again, wine tasting and tours act as a significant tourism draw for New Mexico.
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> In particular, craft distilleries and microbreweries are becoming motivators for travel nationwide, compared to large-scale producers. A 2017 report from the American Craft Spirits Association indicated that tourism to craft distilleries is up 26% from 2016 to 2017, with the Western United States leading the way in growth. Likewise, microbreweries have seen so much growth that Travelocity released a beer travel index in 2016 to measure and rank beer tourism destinations across the United States.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is <u>not</u> met since TRD is <u>not</u> required in the bill to report annually to an interim legislative committee regarding the data compiled from the reports from taxpayers taking advantage of this tax preference and other information to determine whether the deduction is meeting its purpose.

ADMINISTRATIVE IMPLICATIONS

TRD reports implementing the changes proposed would have a moderate impact on the Information Technology Division, with soft costs of approximately $35 thousand.

RLD indicates similarly indicates minimal administrative impact: "The review and issuance of the new private celebration permits could likely be absorbed by current Alcohol and Gaming staff."

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

HB 489 duplicates SB 413, and contains similarities to SB 306 (2019) and to SB 32, SB-204 and HB-285 from the 2018 legislative session.

TECHNICAL ISSUES

TRD notes a small technical issues: there is a slight difference in wording for the rate of alcohol in cider. The bill allows for "not more than eighth and one-half percent" while the ATTTB allows for less than 8.5 percent. This means a cider which had exactly 8.5% alcohol would qualify as cider in New Mexico, but not nationally. TRD recommends the bill be amended to match the ATTTB verbiage.

RLD notes that this bill proposes a definition of “private celebration” that differs from the otherwise equivalent administrative definition of a “private party” at NMAC 15.10.2.7.AA, which excludes parties with a promotional or other commercial purpose.

OTHER SUBSTANTIVE ISSUES

According to the Beer Institute, all U.S. brewers and beer importers received some excise tax relief under the federal Tax Cuts and Jobs Act, which specifically:

- Reduced the federal excise tax to $3.50 per barrel on the first 60,000 barrels for domestic brewers producing fewer than 2 million barrels annually;
- Reduced the federal excise tax to $16 per barrel on the first 6 million barrels for all other brewers and all beer importers; and
- Kept the excise tax at the current $18 per barrel rate for barrelage over 6 million.

Note that the qualification for the lowest rate is set at 60,000 barrels annually, but the TCJA allows a progressive rate structure for microbrewers, defined as those that produce fewer than 2 million barrels annually. This bill is roughly based on this progressive rate structure of the federal law.

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