EXCISE TAXES ON WINE AND SPIRITS IN PENNSYLVANIA

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Abstract

Pennsylvania's 18% "flood tax" levied on wine and spirits sales cannot easily be compared to the gallonage excise taxes levied by neighboring license states. This article presents comparisons of Pennsylvania's wine and spirits tax to its neighbors on both a market-wide and per-product basis, showing that the difference is great enough to represent a potential competitive disadvantage for private retailers selling to Pennsylvania customers in border markets, where cross-border shopping is likely to occur.

Background

The passage of the 21st Amendment in 1933 repealed national Prohibition, but permitted states to decide individually whether to re-legalize alcohol and to what extent. Each state that became "wet" enacted their own alcohol control laws with varying degrees of restrictiveness, dictated largely by the ideological make-up of the sitting legislature at the time Repeal flew through ratification.[1]

Some states, reluctantly conceding the failure of Prohibition to rid the nation of alcohol and its associated social ills, sought to re-legalize the liquor trade only so far as to eliminate bootlegging, thereby bringing the rule of law to what had been an out-of-control black market under Prohibition. In several of these states, including Pennsylvania, lawmakers determined that the harmful effects of alcohol consumption could be best contained if the government were the exclusive seller of liquor. Stores would be staffed by bureaucrats lacking any incentive to encourage sales, and profits from wine and spirits purchases would be put toward government programs for the good of society.[2]

In the same vein, those states that elected to license private-sector businesses to sell alcohol sought to impose "sin taxes" on the liquor trade, ostensibly to compensate society for the harm that re-legalization of alcohol was feared to bring. Private sellers were permitted to make their profit from alcohol sales, but part of their income would be paid to the state in the form of excise tax.

Since 1933, little improvement has been made in the uniformity of liquor control laws from state to state. Today, states can be divided broadly into two categories: "license" states, which allow beverage alcohol to be sold by the private sector and receive revenue through alcohol excise taxes; and "control" states, which retain a government monopoly on alcohol sales at either the wholesale or retail level, and receive revenue through mark-ups applied within the government alcohol sales system.

License states generally impose alcohol excise taxes based on liquid volume, in which a fixed tax amount is levied on each gallon of beer, wine or distilled spirits sold. As of January 1, 2010, the national median tax rates were $0.19 per gallon of beer, $0.67 per gallon of wine, and $3.75 per gallon of distilled spirits. This is equivalent to a tax of $0.17 per six-pack of beer, $0.13 per bottle of wine, and $0.74 per bottle of spirits.[3]

Pennsylvania, as a control state, receives an annual payment from the Pennsylvania Liquor Control Board (PLCB) which includes the year's profit from the government-owned wine and spirits stores. However, a much larger and more dependable stream of revenue is generated by an 18% sales tax levied on wine and spirits sold through the state stores.[4] Generally called the “Emergency Flood Tax” or “Johnstown Flood Tax” after its original purpose to help rebuild Johnstown following a 1936 flood, the revenue was long ago redirected into the General Fund. Government agencies now refer to this tax simply as the liquor tax. (It is important to note that state law levies the liquor tax only on sales made through the state stores. Where wine and spirits are permitted to be sold by private entities, such as limited wineries and distilleries of historical significance, the liquor tax is not charged.)

Although the liquor tax is nominally imposed as an additional sales tax, the PLCB takes advantage of a statutory option to fold the tax into shelf prices and instead remit 15.25% of gross revenue (net of the state's general sales tax) to the General Fund.

Historically, little thought has been given to the tax burden imposed by the liquor tax—producers and importers tend to regard it no differently than the other mark-ups that are applied by Pennsylvania's state stores in determining retail pricing. Now the liquor tax is a central factor in two separate policy initiatives, either of which could result in increased scrutiny of the tax and its associated market effects.

The first policy initiative is the proposed privatization of wine and spirits sales in Pennsylvania. The House Republican Caucus is expected to introduce legislation that would license private businesses to sell wine and spirits for off-premise consumption, as well as auction the assets of the existing state-owned retail system.[5] This legislation is expected to propose privatizing both the wholesale and retail levels of the wine and spirits trade in Pennsylvania. The impact of privatization on government revenue remains in question.

The second policy initiative is led by the PLCB, presumably in response to the privatization proposal. Currently, section 488 of the liquor code permits direct shipping of wine from out-of-state retailers to Pennsylvania consumers. The procedure is highly restrictive: the retailer must obtain a permit from the PLCB, wines sold must not be listed for sale by the PLCB itself, orders must be shipped to a state store for pick-up, and a number of surcharges must be paid by the customer, including the liquor tax (in its original form as an 18% additional sales tax) and a handling fee. Since the program was created in 2002, only a handful of out-of-state retailers have obtained direct-ship permits. The Board is considering whether to seek legislative measures which would loosen direct shipping restrictions, including lowering the tax charged and allowing direct shipping of spirits, to encourage greater participation.[6]

While seemingly in opposition, these proposals should be considered separately—the 21st Amendment authorizes each state to limit or prohibit importation of beverage alcohol across its borders, regardless of whether liquor is sold within the state by the government or private enterprise.

Both of these initiatives seek to extend Pennsylvania's wine and spirits excise tax base to include a significant volume of sales made by private businesses in a competitive market. This raises a number of interesting public policy questions about the market effects of the excise tax, and particularly on cross-border purchasing. (Although personal importation of beverage alcohol into Pennsylvania is illegal, widespread anecdotal evidence suggests that it is commonplace in areas near the state border, including Philadelphia.)

Any discussion of tax effects on local markets in border areas between two tax jurisdictions requires numerical comparison of the tax rates on each side of the border. Unfortunately, Pennsylvania's liquor tax calculated on sales price is not directly comparable to excise taxes in license states that are calculated on volume. In this article, I present two perspectives on Pennsylvania's liquor tax relative to the gallonage excise taxes assessed in our neighboring states.

Data Sources and Methodology

For this study, the PLCB provided sales records for all wine and spirits products sold through the state stores during the 12-month period from February 2010 to January 2011. This data set contained a list of all products with at least one sale occurring during that time period, and each product was listed by product code (SKU), description, package volume in fluid ounces, department (wine or spirits), and stock status (regular, limited-distribution or special-order). The

	Unique Product Codes	Total Units Sold	Total Gallons Sold
Wine	30,306	68,848,631	23,547,201
Spirits	3,482	65,322,691	16,422,462
Non-taxable mixers	39	490,031	151,285

Table 1: Summary of sales data

	Wine	Spirits	Total
Dollar sales in RY 2009-2010	772,081,909	1,017,090,306	1,789,172,215
Percentage of total sales in RY 2009-2010 (calculated)	43.15%	56.85%	100.00%
Tax revenue for 2/10 – 1/11 (estimated)	119,718,000	157,727,000	277,445,000

Table 2: Estimated breakdown of tax revenue

data is summarized in Table 1.

Alcohol content (ABV) of spirits products was determined by correlating the sales records with catalog listings downloaded from the PLCB website several times per week throughout the sales period under review. ABV data was crosschecked with catalog listings from the Virginia and North Carolina state stores, supplemented with product information published by manufacturers, importers and distributors as well as product label approvals retrieved from the Alcohol and Tobacco Tax and Trade Bureau of the US Department of the Treasury. Spirits products with no alcohol content data easily available, representing 1.7% of unit sales of spirits, were assumed to contain 20% alcohol as the vast majority of such products were ready-to-drink premixed cocktails.

Total liquor tax collected in Pennsylvania during the sales period under review was obtained from the Commonwealth of Pennsylvania Monthly Revenue Reports,[7] totaling $277,445,000. Wine and spirits are not reported separately, but because the liquor tax is assessed as a straight percentage of sales, wine versus spirits tax revenue can be split out based on the proportion of wine sales to spirits sales.

Dollar-denominated sales data was not provided by the PLCB for the sales period under review. However, an approximate breakdown can be obtained from the PLCB 2009-2010 Retail Year in Review.[8] This document lists total product sales by category, the proportions of which remain relatively consistent over time.

For the sake of simplicity, throughout this paper I assume that state-wide volume and product mix of wine and spirits sales would remain similar to the sales data set, regardless of whether consumers had the option to purchase from the state stores or private sellers.[9] Under this assumption, any increase in excise tax burden would be borne by the consumer in the form of higher prices, or producers and retailers in the form of lower margins.

Overall Excise Tax Revenue

Any proposed policy change which is expected to shift a nontrivial portion of wine and spirits sales from state stores to the private sector should include an examination of the effects on overall tax revenue. Complete privatization of wine and spirits sales certainly meets this criteria. Given Pennsylvania's ongoing budget crisis, I expect that any privatization proposal would need to maintain existing state revenue levels to be politically viable.

To avoid reinventing the wheel, policymakers drafting privatization legislation are likely to propose replacing the liquor tax with volume-based gallonage taxes assessed at the wholesale level, to match the taxation strategy followed by nearly all license states.[10] If the new tax rates were similar to those in neighboring states, Pennsylvania retailers would be on the same playing field as their cross-border competitors with respect to excise tax burden.

The tax revenue that would result from adopting the gallonage tax rates used by other states can be calculated by determining the total liquid volume of each product sold in Pennsylvania during the sales period under review and multiplying by the applicable gallonage rate. This also allows Pennsylvania's current tax burden on the wine and spirits market to be compared to the burden imposed by other states.

As Table 3 and Table 4 show, adopting the excise tax rates of a neighboring state would result in a drastic reduction of government revenue. Pennsylvania's liquor tax

	Wine		**Spirits**	
Using tax rates from...	Tax per gallon	Expected revenue	Tax per gallon	Expected revenue
Pennsylvania (existing tax)	$5.08*	119,718,000	$9.60*	157,727,000
New York	$0.30	7,064,160	under 24% - $2.54 24% and up - $6.44	98,062,249
New Jersey	$0.875	20,603,801	$5.50	90,365,116
Maryland	$0.40	9,418,881	$1.50	24,645,032
Delaware	$0.97	22,840,785	under 25% - $3.64 25% and up - $5.46	86,030,413
US median	$0.67	15,776,625	$3.75	61,612,579

* Calculated average for the sales period under review

Table 3: Hypothetical tax revenue generated by neighboring states' tax rates on actual PLCB sales during February 2010 – January 2011

imposes a far greater tax burden upon wine and spirits than the excise taxes of other states.

License states bordering Pennsylvania have substantially lower taxes on wine and spirits. Wine, especially, appears to be heavily overtaxed here. New York would have collected less than 6% of the tax revenue that Pennsylvania did—in other words, Pennsylvania taxes wine at an overall rate seventeen times higher than New York.

	Wine	Spirits
Pennsylvania	100.0%	100.0%
New York	5.9%	62.2%
New Jersey	17.2%	57.3%
Maryland	7.9%	15.6%
Delaware	19.1%	54.5%
US median	13.2%	39.1%

Table 4: Excise tax burden relative to Pennsylvania

Compared to the median tax rates of all license states, Pennsylvania taxes wine at an overall rate 7.5 times higher than average, and spirits at an overall rate 2.5 times higher than average.

The huge difference in excise tax revenues between Pennsylvania and license states presents a significant challenge to would-be entrants in a privatized wine and spirits market. Regardless of whether alcohol excise taxes are levied based on sales or volume, maintaining existing revenue levels would require an overall tax burden on wine and spirits well beyond that which private retailers in other states must absorb.

It would be reasonable to question whether operators in a free market could offer regionally competitive prices under such an oppressive tax regime without the benefit of a state-wide monopoly and the high-volume efficiencies that the government-owned retail system enjoys today. As a result, the private sector may exhibit greater interest in operating wine and spirits outlets near the center of the state rather than in border markets.

Per-product tax burden

More relevant to the direct-shipping initiative is the question of the tax burden imposed on individual products. Pennsylvania, like Ohio, New York, West Virginia and other states, levies the same alcohol excise taxes on direct shipments into the state as are levied on products sold through in-state retail outlets.

Because Pennsylvania's excise tax is calculated on sales price rather than volume, the tax distribution places a heavier burden on premium-priced items than under a gallonage tax. This difference can be seen in the range of popular products listed in Table 5.

Again, the tax levied on wine in Pennsylvania is far greater than in license states. Even on the least expensive wine, Pennsylvania's tax burden is six times the national average and more than twelve times the tax levied in New York. At the other end of the price spectrum, Pennsylvania levies $6.71 in excise tax on a $44 bottle of wine—fifty-one times the national average and a staggering one hundred twelve times greater than New York.

Excise taxes on value-priced spirits are similar between Pennsylvania and other states. In fact, 750 ML spirits products priced at $8.39 or less and 1.75 L spirits products priced at $19.54 or less enjoy a lower excise tax burden in Pennsylvania than in New York. Above this price point, the advantage disappears. Standard-sized 750 ML products priced at $17 have more than twice the tax burden in Pennsylvania as New York, and the difference increases to a factor of eight for super-premium spirits priced at $68.

In addition to the heavy burden of the liquor tax itself, the statutorily-prescribed method of tax collection for direct-shipped orders seems certain to illicit “sticker shock” from consumers. After the out-of-state retailer calculates the subtotal including shipping charges for an order, a $4.50 handling fee set by the Board must be applied. Then, the 18% liquor tax must be applied to the new subtotal, followed by the 6% state sales tax, which is calculated over all above charges including the 18% liquor tax.[11] Table 6 shows the state-imposed charges for a small range of example orders.

A modest order of six $10 bottles of wine (which includes any shipping charges applied by the retailer) would

Product	Retail price	PA tax	NY tax	NJ tax	US median tax
Arbor Mist Pinot Grigio (750 ML)	4.99	0.76	0.06	0.17	0.13
Franzia Sunset Blush (5 L)	12.49	1.91	0.40	1.16	0.88
Korbel Brut Champagne (1.5 L)	14.99	2.29	0.12	0.35	0.27
Martini & Rossi Asti Spumante (1.5 L)	24.99	3.81	0.12	0.35	0.27
Stag's Leap Merlot (750 ML)	43.99	6.71	0.06	0.17	0.13
Seagram's 7 Whiskey (750 ML)	10.99	1.68	1.28	1.09	0.74
Nikolai Vodka (1.75 L)	13.79	2.10	2.98	2.54	1.73
Jack Daniels Whiskey (750 ML)	21.99	3.35	1.28	1.09	0.74
Captain Morgan Spiced Rum (1.75 L)	29.99	4.57	2.98	2.54	1.73
Oban Scotch (750 ML)	69.99	10.68	1.28	1.09	0.74

Table 5: Per-product excise taxes

result in Pennsylvania taxes and surcharges of $20.68, adding a jaw-dropping 34% to the final cost of the wine. For larger orders, the impact of the fixed handling fee decreases, though this observation would likely be of little comfort to a customer paying $81 in state fees and taxes on a $300 case of wine.

For comparison, Table 7 lists the state taxes and fees that would be applied to the same example wine orders if they were direct-shipped to New York (assuming a typical combined state and county sales tax rate of 8%).

	Retailer total	Handling fee	Liquor tax (18%)	Sales tax (6%)	**Total PA surcharges**
Six bottles, $10 each	60.00	4.50	11.61	4.57	**20.68**
12 bottles, $10 each	120.00	4.50	22.41	8.81	**35.72**
Six bottles, $25 each	150.00	4.50	27.81	10.94	**43.25**
12 bottles, $25 each	300.00	4.50	54.81	21.56	**80.87**

Table 6: Pennsylvania taxes and fees for direct-ship wine orders

	Retailer total	State excise tax	Sales tax (8%)	**Total NY surcharges**
Six bottles, $10 each	60.00	0.36	4.83	**5.19**
12 bottles, $10 each	120.00	0.71	9.66	**10.37**
Six bottles, $25 each	150.00	0.36	12.03	**12.39**
12 bottles, $25 each	300.00	0.71	24.06	**24.77**

Table 7: New York taxes and fees for direct-ship wine orders

A customer in New York would owe only a quarter of the state-imposed taxes and fees on the modest six-bottle wine order as a customer in Pennsylvania, and would enjoy the additional convenience of having the products delivered to their residence rather than picking them up at a government facility.

Pennsylvania's absurdly high state taxes and fees on direct-shipped wine could explain, in large part, the limited interest from out-of-state retailers in participating in the existing direct-ship program. There may be little value in expanding or improving the program without a meaningful reduction in the taxes and fees imposed on direct-ship orders.

Conclusion

The 18% liquor tax levied on wine and spirits sales through the Pennsylvania state stores, as well as wine sold to Pennsylvanians by out-of-state retailers under section 488 of the liquor code, imposes a tax burden far beyond the alcohol excise taxes levied in neighboring license states. This tax burden represents a competitive disadvantage to private retailers legally selling wine and spirits to Pennsylvanians living near the state border, due to the widely-assumed high rates of cross-border shopping. Policymakers attempting to expand the roll of private enterprise in wine and spirits sales in the state should take into account the likely market effects of the liquor tax and consider taking steps to reduce the burden it would impose on a competitive wine and spirits market.

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Footnotes and References

1 Jurkiewicz, Carole L., and Murphy J. Painter. *Social and Economic Control of Alcohol: The 21st Amendment in the 21st Century* (2008), pp 97-100.

2 Pinchot, Gifford. “Liquor Control in the U.S.A.—State Store Plan.” *The Rotaria*n, January 1934.

3 State excise tax rates as of January 2010 provided by Federation of Tax Administrators, http://www.taxadmin.org/fta/rate/tax_stru.html.

4 Lutchansky, Nathan. “Maintaining State Revenue in a Privatized System,” *PLCB Users Group* (blog), March 17, 2011 (11:32 a.m.), http://plcbusersgroup.org/2011/03/maintaining-revenue.html.

5 Barnes, Tom. “Corbett seeking a price for state liquor stores,” *Pittsburgh Post-Gazette* (Pittsburgh, PA), March 30, 2011.

6 “Summary of Joe Conti’s Talk on Delivery Policy Changes,” memo to Wine & Spirits Advisory Council, March 2011.

7 PA Dept. of Revenue *Monthly Revenue Reports* available at http://www.portal.state.pa.us/portal/server.pt/community/monthly_revenue_reports/14801.

8 “2009-2010 Retail Year In Review” (Pennsylvania Liquor Control Board, 2010), http://www.portal.state.pa.us/portal/server.pt?open=18&objID=1020964&mode=2, pp 27, 32.

9 In actuality, moving from a value-based tax to a quantity tax would likely result in a shift in consumer behavior toward high-end products. There may also be a net expansion in sales due to the greater diversity of selection and pricing possible in a competitive marketplace. Modeling these effects is outside the scope of this study.

10 The upcoming privatization bill is expected to be based on House Bill 2350 from the 2009-2010 legislative session, which proposed replacing the existing liquor tax with a gallonage tax.

11 An example of how fees and taxes should be applied to direct-shipped orders may be found at http://www.portal.state.pa.us/portal/server.pt?open=514&objID=611784&mode=2.