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The Three-Tier System: Primer on Kansas' Beverage Alcohol System

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The Three-Tier System: Overview

Since passage of the 21st Amendment to the United States Constitution repealed Prohibition and granted each state the right to control the importation, distribution, and use of alcoholic beverages within its borders, Kansas has relied upon the three-tier alcohol distribution system to ensure alcohol is distributed and consumed safely. Our alcohol distribution system has evolved over time, and here is a historic overview:

Tied Houses: Before 1919

From the colonial times until 1919, when the 18th Amendment ushered in Prohibition, alcoholic beverages were sold in a free-wheeling system. The system had only two tiers: suppliers distributed alcoholic beverages directly to retailers. Suppliers of spirits and beer (wine was a minor market) frequently owned or controlled retailers by threatening to cut off supply. This "tied" the retailers to the manufacturers so that they typically were forced to sell only one manufacturer's brands or maximize sales without regard to the consumer's wellbeing. .

Prohibition: 1919-1933



In 1919, the American Temperance Union and Anti-Saloon League urged lawmakers to outlaw the sale and possession of alcohol. The advent of Prohibition by adoption of the 18th Amendment, however, didn't mean the end of

alcohol consumption. Production and distribution went underground through the "bootlegging system". It became clear that Prohibition was not a workable solution.

Repeal of Prohibition: 1933

In 1933, the 21st Amendment repealed Prohibition and granted states the authority to control the importation, distribution and use of alcoholic beverages within its boundaries. Kansas initially enacted a law providing for cereal malt beverages sales in 1936. Not until 1949 did Kansas repeal its



constitution's prohibition amendment, and like many other states, decided to create a regulated three-tier system to distribute alcohol to prevent the abuses

seen prior to Prohibition—and to respect those local communities that decided to remain "dry." The pre-1919 phenomenon of the tied-house, a regime under which a brewer, vintner or distiller, typically owned one or more retail establishments, (e.g. vertical integration) was prohibited. Enshrined in the Federal Alcohol Act passed in 1933, these "tied-house," anti-competitive arrangements are explicitly forbidden within the nation's three-tier distribution system.

At the state level, two legal approaches emerged in the wake of the 21st Amendment's passage: a competitive model and a so-called control model. Today a majority of states permit the private sector to distribute and sell alcoholic beverages including Kansas. A minority of states decided to adopt a so-called control model, under which the state is involved in one or more tiers of the traditional three-tier distribution system. Control state markets like Pennsylvania not only manage the distribution tier (and related tax revenue collections) but also the retail tier, while other control states like Michigan and Vermont take different approaches.

New Independent, Kansas-based Tier

Between the supplier and retailer state legislators, in licensing states, consistent with federal law, required a new state-based "tier" to be created: **the independent licensed distributor**. The independent in-state distributor was created to serve as a "buffer" between the other two tiers. In addition this created a new entity to put a local "face" on the alcoholic beverage industry. Furthermore, legislators could ensure safeguards were followed.

Distributors are required to follow strict guidelines and procedures for distribution of alcoholic beverages, and provide valuable services to businesses and consumers. The role of the distributor is to:

- Consolidate orders for both manufactures and retailers;
- Promote and market alcoholic beverages to properly licensed retailers in the state;
- Warehouse tens of thousands of distinct alcoholic beverage products from around the world for easy and timely delivery to Kansas-based retailers;
- Provide retailers with products—both in-stock and special-order—to meet the demands of customers;
- Pay gallonage taxes to the state; and,
- Ensure alcohol is sold only in "wet" areas of the state by limiting the channel of alcohol.

The responsibilities and legal requirements of each tier are laid out clearly in state statutes, which are regulated by the director of alcoholic beverage control. The three-tier system enables states to track the actual movement of beverage alcohol from the producers and importers to

consumers which also ensures the integrity of the product. This system of checks and balances eliminates the economic incentive for illegal manufacturing, diversion and distribution of alcohol. Consumers benefit from the healthy competition and facilitation of a wide selection of brands in the marketplace - from big-name distillers, vintners and breweries to specialized, small-batch operations. These checks and balances work to ensure that:

- Minors do not have access to alcohol;
- Alcohol is not sold or distributed in "dry" communities in which alcohol sales are banned or restricted; and,
- Proper taxes are collected and remitted back to state and local governments.



The Importance of State Regulation

The 18th & 21st Amendments to the U.S. Constitution reflect a heated debate which resulted in a compromise that has worked well for over 72 years in Kansas. Providing transportation, logistics, storage, sales, marketing, delivery and constant maintenance of beverage alcohol is costly. The strength of state alcohol regulation is key to a safe and viable system of alcohol control and distribution. Serving in numerous roles and performing an array of tasks, distributors serve as a critical link in an efficient system that allows smaller, more unique products access to market, provides consumers with the choice they desire at a great value and ensures a safe and orderly marketplace. The independence of tiers prevents the formation of vertical monopolies and corrupt sales practices in the industry. **It is the greatest antitrust law ever written.**

The Three-Tier System Provides Jobs To Thousands of Kansans

Alcoholic beverage sales are a key component to Kansas' growing service sector, including entertainment, food services and tourism industries. The three-tier system provides over 14,000 jobs throughout the state at wholesalers, retailers, in restaurants and clubs, at farm wineries, in micro-breweries, micro-distilleries and in support businesses.

To preserve jobs during the COVID-19 pandemic the Legislature authorized curbside service and "cocktails-to-go."

SEE ECONOMIC IMPACT TABLE ON REVERSE



WINE & SPIRITS
WHOLESALEERS
OF AMERICA

Economic Impact of Kansas' Wine & Spirits Distributors

American, family-owned wine and spirits distributors are the local marketing and logistics experts in every state and every district.

	Jobs	Wages	Economic Impact
Direct Impacts			
Wineries	127	\$2,866,600	\$36,460,200
Distilleries	43	\$1,424,100	\$43,674,900
Distributors	353	\$27,115,000	\$82,497,700
Retailers	7,726	\$183,450,000	\$408,229,300
Total Direct Impacts	8,249	\$214,855,700	\$570,862,100

Supplier Impacts			
Agriculture	361	\$14,589,200	\$79,940,600
Business & Personal Services	683	\$39,846,400	\$83,905,900
Mining	120	\$6,691,500	\$15,804,300
Construction	43	\$2,280,000	\$6,311,100
FIRE	364	\$18,315,600	\$81,276,800
Manufacturing General	201	\$12,298,300	\$85,312,500
Retail	45	\$1,371,700	\$3,641,500
Transportation & Communications	260	\$17,345,400	\$69,320,500
Travel and Entertainment	118	\$2,120,600	\$6,404,400
Wholesaler	101	\$7,843,600	\$23,651,200
Government	47	\$3,599,000	\$8,287,900
Other	0	\$0	\$0
Total Supplier Impacts	2,343	\$126,301,300	\$463,856,700

Induced Impacts			
Agriculture	283	\$9,927,000	\$57,366,600
Business & Personal Services	1,175	\$56,043,000	\$109,519,000
Mining	92	\$4,966,100	\$11,725,500
Construction	34	\$1,770,500	\$5,056,200
FIRE	341	\$16,982,100	\$119,376,300
Manufacturing General	341	\$25,082,100	\$211,392,700
Retail	430	\$11,997,100	\$35,011,500
Transportation & Communications	156	\$11,090,200	\$51,802,700
Travel and Entertainment	446	\$9,217,700	\$28,420,600
Wholesaler	82	\$6,329,600	\$19,225,400
Government	33	\$2,345,900	\$7,946,700
Other	77	\$2,311,100	\$2,041,000
Total Induced Impacts	3,490	\$158,062,400	\$658,884,200

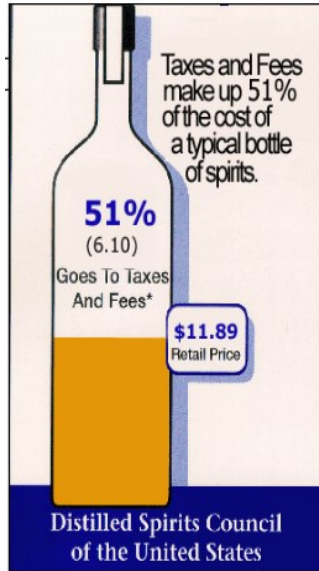
	Jobs	Wages	Economic Impact
Total Economic Impacts	14,082	\$499,219,400	\$1,693,603,000

Fiscal Impacts	Business Taxes	Consumer Taxes
Federal Taxes	\$102,790,300	\$44,507,200
State Taxes	\$89,140,100	\$110,626,900
Total Taxes	\$191,930,400	\$155,134,100

**Total Tax Burden
on
Alcoholic Beverages
in Kansas**

In FY2020, Kansans contributed \$144,703,848 in taxes and fees on purchases of alcohol through excise, gallonage and enforcement taxes. These collections do not include the millions paid by the three tiers for: food permits, local licenses and standard business taxes paid by Kansas-based wholesalers and retailers, including: Kansas franchise taxes, motor fuels taxes, sales and use taxes, unemployment compensation taxes and local property taxes. Also not included here are the sales taxes paid by consumers on beer not exceeding 6% by volume at grocers and convenience stores. Collections for recent years are set out below:

Source: Kansas Dept. of Revenue



**The Individual Roles
of Tiers in Tax Collection**

Specific alcohol-related federal, state and local taxes are applied to alcoholic liquors Kansans consume at each level of the three-tier system, as follows:

Tier 1 Tax Collection

The federal excise tax is applied at the manufacturer level (tier 1). For spirits this is \$13.50 per proof gallon.

Tier 2 Tax Collection

Kansas-based distributors (tier 2) pay the state a gallonage tax which varies depending on the product and its alcohol content. The Kansas Alcoholic Beverage Control reports that wholesalers paid \$23,146,036 in state gallonage taxes for FY2020.

Tier 3 Tax Collection

Kansas based retailers (tier 3) collect an enforcement tax of 8% and drinking establishments collect an excise tax of 10% on the drink price. Drink tax collections in FY2020 were \$41,399,255 and package retail taxes were \$74,666,698.

Revenue Collected by the ABC

Revenue Source	FY 2017	FY 2018	FY 2019	FY 2020
Liquor License, Registration & Permit fees	\$2,590,848	\$3,562,016	\$2,678,691	\$3,835,764
Label fees	\$1,234,770	\$1,242,960	\$2,097,955	\$1,313,020
CMB Retail Stamps	\$76,375	\$84,925	\$80,250	\$78,300
ABC Liquor Fines	\$359,625	\$317,791	\$461,880	\$268,775
Gallonage – Alcohol & Spirits*	\$10,925,959	\$11,304,926	\$12,145,178	\$11,645,348
Gallonage – Beer	\$7,951,621	\$8,033,170	\$8,341,132	\$9,349,792
Gallonage – CMB	\$1,543,341	\$1,478,506	\$1,256,708	\$599,353
Gallonage – Wine	\$1,652,696	\$1,643,063	\$1,551,001	\$1,547,543
Total	\$26,335,235	\$27,667,357	\$28,612,795	\$28,637,895

* 10% of gallonage tax on alcohol and spirits goes to Kansas Department of Aging and Disability Services (KDADS) community alcoholism and intoxication program and 90% to the state general fund.

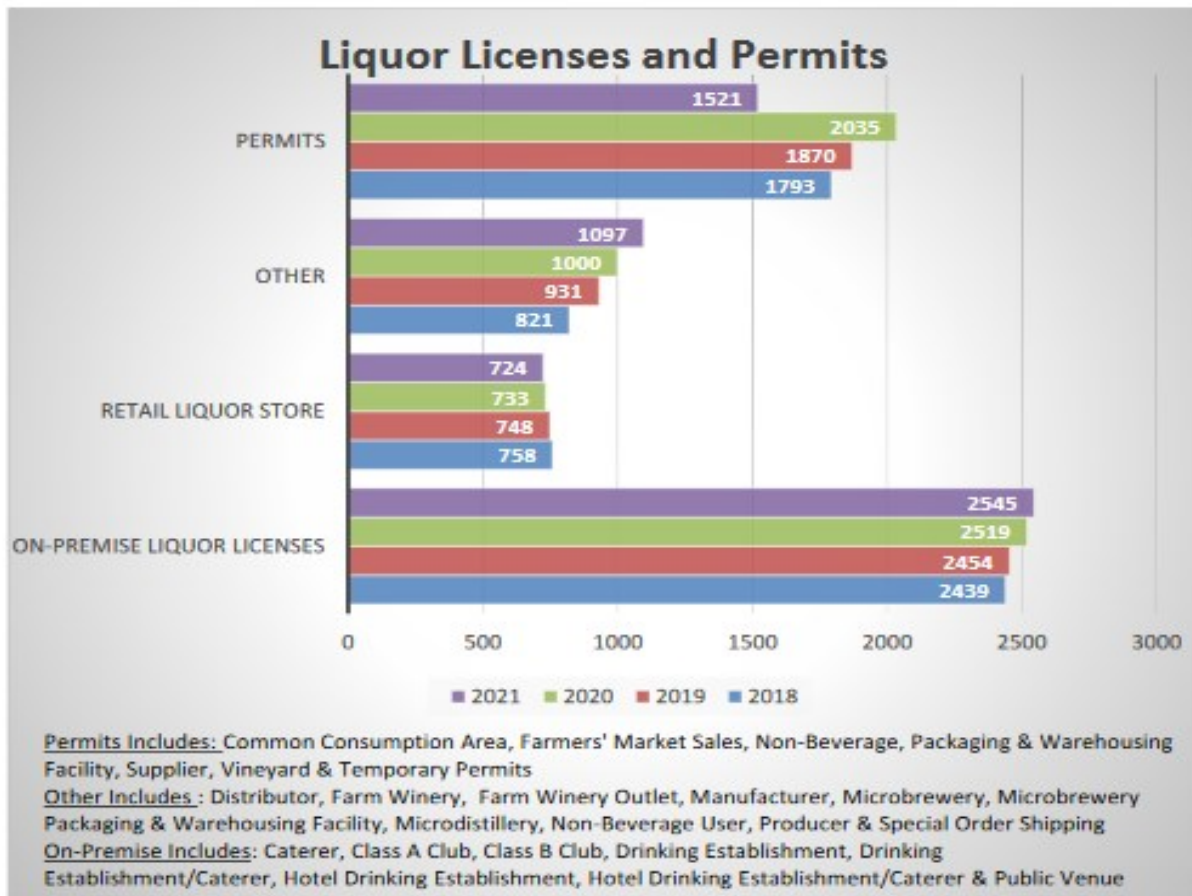
Tax Revenue Collected by the Division of Taxation

Tax Type	FY 2017	FY 2018	FY 2019	FY 2020
Liquor Enforcement (8% tax)	\$71,527,599	\$73,474,859	\$74,264,394	\$74,666,698
Liquor Drink (10% tax)*	\$44,164,016	\$46,190,396	\$48,831,089	\$41,399,255
Total	\$115,691,615	\$119,665,255	\$123,095,483	\$116,065,953

* 70% of liquor drink tax goes to local alcoholic liquor fund; 5% goes to the KDADS community alcoholism and intoxication program and 25% to the state general fund.

The Role of Retailers

Kansas' locally owned retailers represent the third tier. As businesses that have direct interaction with customers retailers play a significant role in ensuring safeguards are followed and enforced. Today tens of thousands of different beverage alcohol products from around the world are available for sale at retail to customers over the age of 21 by persons 21 years of age or older. Locally owned retailers provide accountability and responsibility for the safe sale of alcohol, thereby supporting efforts to stop under-age drinking and impaired driving. Retailers provide thousands of quality local jobs that are not transferable out of the community. They are responsible, philanthropic members of their communities accounting for millions of dollars in charitable donations, and thousands of hours of community service. Because face-to-face transactions with the customer occurs at the third tier, retailers must follow strict requirements to avert the sale of alcohol to minors.



The Three-Tier Alcohol Distribution System Why It Works

Designed to prevent the abuses that led to Prohibition, the three-tier system has created the most innovative, competitive and consumer-friendly system in the world. The system creates a framework of regulations, which mandate responsibility and accountability in beverage alcohol distribution. Disrupting this regulated chain would have adverse ramifications on public safety and marketplace stability. Vertical integration would benefit only large-chain businesses. Benefits of Three-Tier Regulations:

- Efficiency in collecting taxes,
- Preventing the sale of alcohol to minors,
- Fostering and overseeing responsible competition,
- Creating balance between and within the tiers,
- Ensuring public safety,
- Preventing the sale of counterfeit and dangerous or deadly products.

Requirements of the Third Tier

Clear responsibilities and legal requirements for Kansas retailers are laid out in the Liquor Control Act, which is regulated by the Kansas Alcoholic Beverage Control and enforced by Kansas law officers. What types of alcohol, beer, wine, or spirits, are sold by retailers and how it is consumed, on-premise or off-premise, depends on a number of factors. The Liquor Control Act and the Club and Drinking Establishment Act allow only authorized retailers to sell specific alcoholic beverages during specified business hours. County and city ordinances may limit alcohol sales in certain zoned areas. State law restricts sales near schools or churches.

Microbreweries and farm winery outlets operate as part of the third tier selling directly to consumers. Wineries may also ship out-of-state in conformity with other states' laws.



Clear Safeguards

Many on-premise and off-premise retailers participate in industry sponsored efforts to deter underage drinking and participate in server training programs.



The Kansas Wine & Spirits Wholesalers Association (KWSWA) is dedicated to promoting responsible beverage alcohol practices in the state of Kansas. KWSWA is the Kansas trade organization representing the wholesale branch of the wine and spirits industry. KWSWA provides its members with advocacy before the Legislature, state agencies, regulatory bodies, courts, and other alcohol beverage industry organizations. In addition, KWSWA offers a wide range of services in the areas of public affairs, education and social responsibility issues. This Primer on Kansas' beverage alcohol laws has been prepared to assist you in understanding the intricate workings of our present system.

In adopting a face-to-face wine shipping law in recent years the Legislature permitted consumers to purchase and ship to their homes wine while at any winery in the USA so as to assure that IDs are checked. Wine shippers are registered with the state to certify that state taxes are collected and paid and that internet purchases are delivered only to 21 year olds by shippers.

CONCLUSION

Since the repeal of prohibition the three-tier system of distribution has served Kansas well. Preserving this system will ensure the market place remains orderly, that only unadulterated product is available to consumers and that the state collects the taxes it has imposed on beverage alcohol.

