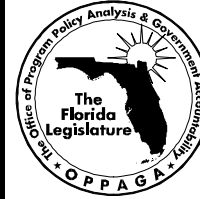




## Office of Program Policy Analysis And Government Accountability



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### Review of the Surcharge on Alcoholic Beverages for On-Premises Consumption

#### Report Abstract

- **Mispayment of the surcharge is a widespread problem. The Department of Business and Professional Regulation could more effectively administer the surcharge program by increasing taxpayer education, implementing audit policies and procedures more consistently, and increasing automation of the audit selection process.**
- **Florida's surcharge places a burden on state administering agencies and Florida businesses. To reduce administrative costs and ease the burden on Florida businesses, the Legislature could impose the surcharge at the wholesale level or repeal it and increase excise taxes. Either option would save approximately \$2.3 million annually and reduce record-keeping requirements for Florida businesses.**

#### Purpose of Review

The Joint Legislative Auditing Committee, at the request of the Senate Ways and Means Committee, directed OPPAGA to address specific questions regarding the administration of the On-Premises Consumption Alcoholic Beverage Surcharge Program by the Department of Business and Professional Regulation (Department). We grouped these questions into the following overall issue areas:

1. Is the Department administering the surcharge effectively?
2. What policy options to the current surcharge program exist?

#### Background

Chapters 561 through 565, 567, and 568, F.S., are commonly referred to as Florida's "Beverage Law," and provide for the regulation of the state's alcoholic beverage industry. Section 561.501, F.S., establishes a surcharge on beer, liquor, and wine sold by licensed alcoholic beverage retailers for on-premises consumption.

The surcharge is based on the type of alcoholic beverage and volume sold for on-premises consumption. A fee of \$.04 is imposed on each 12 ounces of beer and \$.10 is imposed on each ounce of liquor and each 4 ounces of wine. Retailers have the option of calculating the surcharge based on actual drinks sold or volume of alcohol purchased from wholesale distributors. For keeping prescribed records, proper accounting, and remitting the surcharge in a timely manner, Florida law authorizes retailers to deduct a collection allowance of 1% of the monthly surcharge owed.

As of June 1996, there were 19,060 licensed retail establishments subject to the surcharge. They range in size from small, locally owned establishments to large national chains and include bars, restaurants, hotels, and package liquor stores that sell alcoholic beverages both for on- and off-premises consumption.

In fiscal year 1995-96, the surcharge generated \$100 million in state revenue. Pursuant to s. 561.121, F.S., surcharge revenue is primarily credited to the General Revenue Fund, with 9.8% transferred to the Children and Adolescents Substance Abuse Trust Fund for substance abuse programs.

The Department's Division of Alcoholic Beverages and Tobacco enforces the Beverage Law and applicable

rules and regulations, including those pertaining to the surcharge program. To encourage compliance with the Beverage Law, the Department has the power to revoke licenses and make arrests.

The Department of Revenue (DOR) assists the Division in collecting the surcharge. Retailers are required to remit the surcharge to DOR by the 15<sup>th</sup> of the month after the surcharge is imposed. The Division also audits retailers required to pay the surcharge via eight district offices located throughout the state.

The Department of Business and Professional Regulation may assess penalties against a retailer for late payment, underpayment, or non-payment of the surcharge. However, it may settle or reduce penalties if it finds that noncompliance is due to reasonable cause. It may also reduce a retailer's surcharge liability based on doubt of liability or collectability of the surcharge. If retailers fail to pay assessed penalties, interest, and/or the surcharge due, district offices may refer cases to one of the Department's 20 enforcement offices for collection.

## Findings

**Mispayment of the surcharge is a widespread problem. The Department of Business and Professional Regulation could more effectively administer the surcharge program by increasing taxpayer education, implementing audit policies and procedures more consistently, and increasing automation of the audit selection process.**

### Mispayment of the Surcharge Is Widespread

Approximately 97% of audited retailers included in our sample either underpaid or overpaid the surcharge. We reviewed a random sample of 300 Department audits completed between July 1, 1995, and June 30, 1996. Sample results show 211 retailers (70%) underpaid the surcharge and 80 (27%) overpaid the surcharge (see Exhibit 1). While the extent to which these sample results can be generalized is unclear, Department management and audit staff indicate surcharge mispayment is a widespread problem.

### Exhibit 1 Approximately 97% of Retailers in Our Sample Either Underpaid or Overpaid the Surcharge

Audit Findings	Retailers in Sample (n=300)	Percent Under/Overpayment
Underpaid	211	70%
Overpaid	80	27%
Correctly paid	9	3%

Source: Office of Program Policy Analysis and Government Accountability.

The Department could likely reduce surcharge mispayment by improving taxpayer education, further increasing the consistency of its implementation of auditing policies and procedures, and expanding the use of automation for audit selection.

### More Taxpayer Education Is Needed

Retailer confusion over how to calculate the surcharge significantly contributes to both underpayment and overpayment. According to Department management and audit staff, calculation errors are a primary reason retailers mispay the surcharge. For example, retailers may misread wholesaler invoices when determining the volume of alcohol subject to the surcharge or fail to keep adequate records. According to audit supervisors, some retailers who are unsure about the amount of surcharge they owe may intentionally overpay to avoid possible sanctions for underpayment.

The Department has no formal taxpayer education programs in place statewide. When the surcharge was first implemented, the Department held several seminars across the state to provide retailers with information on calculating and remitting the tax. According to Department officials, these seminars were largely unattended and were discontinued. To provide basic information on calculating the surcharge, the Department provides new licensees with an information packet.

The Department could likely reduce retailer calculation errors by providing taxpayer education on maintaining records, reporting requirements, reading wholesaler invoices, and converting differing volume measures to ounces.

### **Inconsistent Implementation of Auditing Policies and Procedures Contributes to Retailer Confusion**

The Department could help improve its effectiveness by implementing its auditing policies and procedures more consistently. An August 1996 Department study showed differences in the auditing policies and procedures used in its five largest district audit offices. Differences include the alcoholic drinks exempted from the surcharge, records required to substantiate the surcharge owed, audit periods and criteria used to expand audits, and the audit verification process.

Taken together these differences could unfairly tax retailers and contribute to retailer confusion regarding surcharge calculation and the records required to substantiate exemptions. This is especially the case for retail establishments with multiple locations throughout the state. For example, a retailer with establishments in two districts may be required to keep different documentation by each district to substantiate surcharge deductions.

### **Increased Automation in Audit Selection Would Improve Effectiveness**

The Department could further help reduce surcharge underpayment by improving its audit selection process. According to Department management, their audit strategy is to audit all retailers subject to the surcharge every three years. Thus, audit staff consider whether a retailer has been previously audited as a primary factor during audit selection. Other factors they consider include referrals or complaints, proximity to other retailers audited, auditor judgment, and payment or license history.

To more effectively use its resources, the Department could select for audit retailers with the largest potential underpayments. Doing so would help ensure the Department increases the revenue it collects per audit conducted.

To improve the audit selection process, the Department is expanding its use of automation. This process, piloted in the Pensacola district, compares wholesaler sales invoice data to retailer information maintained in the Department's computer system. The Department selects retailers based on discrepancies between wholesaler and retailer information. According to

Department management, audit selection should be automated in all district offices by late 1997. Increased automation should improve the Department's ability to identify and select retailers who have the largest potential underpayments. In addition, automation may help the Department identify those retailers who need assistance calculating the surcharge owed.

**Florida's surcharge places a burden on state administering agencies and Florida businesses. Ensuring proper surcharge payment is labor intensive and costly for state agencies and increases record-keeping and reporting requirements for retailers.**

Most states impose taxes on the sale of alcoholic beverages. Typically this is in the form of a sales tax, excise tax, and/or surcharge. Florida's alcoholic beverage tax collections per capita are among the highest in the country.<sup>1</sup>

The surcharge is the most complicated alcoholic beverage tax to administer, audit, and enforce. Compared to the excise tax imposed on 232 wholesalers, the surcharge involves a much larger number of businesses and requires more resources to ensure that businesses remit the surcharge owed. The Department requires 58 positions at a cost of \$2.3 million annually to collect approximately \$100 million in surcharge revenue. In contrast, the Department requires 39 positions at a cost of \$1.6 million to collect approximately \$442 million in alcoholic beverage excise taxes annually.

Surcharge collection places a high workload on the state. Each month DOR receives and processes surcharge payments for approximately 20,000 retailers. This process requires substantial coordination between DOR and the Department. The Department sends letters to approximately 2,000 retailers each month who fail to remit the surcharge owed. In comparison, Department management indicates that voluntary payment of the excise tax is virtually 100%.

Ensuring accurate surcharge payment is labor intensive and costly. Due to the high rate of surcharge underpayment, the Department must audit a large percentage of retailers to make sure retailers accurately

<sup>1</sup> Sales taxes are based on retail purchase prices while excise taxes and the surcharge are based on the volume of spirits, wine, and beer sold. Tax collections per capita are based on the most current data available (1993).

remit the surcharge. Auditing is further complicated by the two methods used to calculate the surcharge. In fiscal year 1995-96, the Department's auditors conducted approximately 4,000 audits. The Department was authorized 39 auditor positions and \$1.4 million for salaries and benefits in fiscal year 1996.

The surcharge also places a burden on the approximately 20,000 retailers who must keep precise records and file detailed monthly reports. Retailers are required to document the type and volume of alcohol consumed on their premises and subject to the surcharge. Retailers must also account for the volume of alcohol used in cooking, spilled, or given away during promotions and not subject to the surcharge. Many of these establishments are small, locally owned bars or restaurants whose owners may be unaware of requirements and/or have limited resources for keeping records. Without accurate records, retailers often miscalculate the surcharge they owe. When retailers do not maintain adequate records, Department auditors have difficulty determining the surcharge owed and whether any additional tax is due.

Keeping precise records is more difficult for retail package stores that also sell alcoholic beverages for on-site consumption. These establishments must maintain separate sales records for package sales and sales subject to the surcharge and must keep track of liquor transferred from package operations for consumption on-premises. According to Department audit staff, these establishments frequently commingle sales due to their inexperience in keeping records.

**Based on the problems identified, two policy options appear to be most beneficial: (1) impose the surcharge at the wholesale level and (2) repeal the surcharge and increase excise taxes. Implementing either of these options would save state funds and lessen burdens on Florida businesses .**

Based on interviews with stakeholders including Department administrators, legislative staff, and industry representatives, we identified two policy options for the surcharge program. The Legislature could impose the surcharge at the wholesale level or repeal the surcharge and increase excise taxes. We used four criteria to evaluate these options:

1. **Ease of Administration:** The extent to which the option will decrease state workload in administering the surcharge.
2. **Effectiveness:** The option's potential to increase surcharge collections while minimizing the burden on private enterprise.
3. **Cost Savings:** The option's potential to save state revenue.
4. **Feasibility:** Whether the option could be implemented in a reasonable fashion.

We evaluated imposing the surcharge at the wholesale level, eliminating the sales method of calculating the surcharge, and transferring surcharge administration to DOR. We also evaluated the option of repealing the surcharge and increasing either excise or sales taxes, and the benefits and drawbacks of maintaining the current system. Exhibit 2 shows our assessment of these options using the four criteria and Exhibit 3 describes the options' advantages and disadvantages.

**Impose the Surcharge at the Wholesale Level.** This option's main advantage is it reduces state agencies' administrative workload and saves approximately \$2.3 million annually. The number of remittances received and processed each month would decrease substantially because there are fewer wholesalers than retailers (232 wholesalers compared to almost 20,000 retailers). This option also would reduce state resources needed for taxpayer education programs. Since the Department currently audits all wholesalers for excise taxes annually, it could eliminate or reassign 58 positions at an annual savings of \$2.3 million. Imposing the surcharge at the wholesale level would also reduce record-keeping requirements on the retailers.

Furthermore, the option would ensure the collection of surcharge revenues from alcoholic drinks sold at all retail establishments. Audit staff indicated that before some retailers are audited they file for bankruptcy. Thus, these surcharge fees go uncollected.

However, some disadvantages to this option also exist. Representatives of wholesale associations oppose this option because it shifts record-keeping and remittance responsibilities to the wholesalers. The option may increase the occurrence of licensees purchasing from

retail package stores rather than wholesalers, in an attempt to avoid the surcharge. Another disadvantage is that wholesalers would need to determine sales subject to the surcharge for retail establishments that sell alcoholic drinks for consumption on-premises and off-premises (e.g., package liquor stores with lounges). The Department may need to provide wholesalers with additional assistance. This option may place a financial burden on retailers with large inventories, such as restaurants with large wine cellars, who would have to pay the surcharge when they purchase the alcohol.

**Repeal the Surcharge and Increase Excise Taxes.** This option is viable for two reasons. First, since the Department already collects excise taxes, repealing the surcharge would reduce state agency workload and eliminate surcharge administration. As with the previous option, the state could save a minimum of \$2.3 million annually by eliminating 58 surcharge auditor and staff positions. Second, repealing the surcharge would reduce record-keeping requirements for retailers.

However, increasing the excise tax has drawbacks. Florida’s excise taxes are already among the highest in the country. The Legislature would need to raise the excise tax by approximately 25% to replace the surcharge revenue. An increase in excise taxes would likely affect the prices of alcoholic beverages currently not subject to the surcharge, such as those purchased at package liquor stores and neighborhood supermarkets for consumption at home.

Information on the economic impact of increasing excise taxes is inconclusive. In 1993, alcoholic beverage manufacturers and distributors testified that increasing the excise tax by 25% would reduce alcoholic beverage consumption and eliminate approximately 5,000 jobs and \$88 million in wages. The overall decrease in the state’s economic activity could reduce revenue generated from other Florida taxes. However, the Florida Restaurant Association, speaking on behalf of Florida alcoholic beverage retailers, testified that decreased off-premises alcohol consumption would result in only small declines in employment and wages. These declines would be more than offset by increased sales in restaurants, lounges, and other consumption on-premises establishments.

**Exhibit 2  
Two Options Appear Most Beneficial**

Policy Option	Criteria			
	Ease of Administration	Effectiveness	Cost Savings	Feasibility
Maintain the current system				✓
Eliminate the sales method of calculating the surcharge	✓			
Impose the surcharge on wholesalers	✓	✓	✓	✓
Transfer the administration of the surcharge to the Department of Revenue		✓	✓	
Repeal the surcharge	✓			
Repeal the surcharge and increase excise taxes	✓	✓	✓	✓
Repeal the surcharge and increase sales taxes evenly on beverages currently subject to the surcharge	✓		✓	✓

Source: Office of Program Policy Analysis and Government Accountability.

**Exhibit 3**  
**Advantages and Disadvantages Exist for Each Policy Option**

Policy Option	Advantages	Disadvantages
<b>Maintain the current system</b>	<ul style="list-style-type: none"> <li>✦ DBPR familiarity with system.</li> <li>✦ Raises approximately \$100 million in state revenue annually.</li> </ul>	<ul style="list-style-type: none"> <li>■ Most complicated alcoholic beverage tax to administer, audit, and enforce.</li> <li>■ Ensuring accurate payment is labor intensive and costly.</li> <li>■ Entails burdensome record keeping for Florida businesses.</li> <li>■ Requires additional education to reduce taxpayer confusion.</li> </ul>
<b>Eliminate the sales method of calculating the surcharge</b>	<ul style="list-style-type: none"> <li>✦ Easier bookkeeping requirements.</li> <li>✦ Simplifies the audit process by reducing the number of calculation methods retailers could use.</li> </ul>	<ul style="list-style-type: none"> <li>■ Places financial burden on retailers with large inventories who would be required to remit surcharge prior to actual retail sale of alcoholic beverages.</li> </ul>
<b>Impose the surcharge at the wholesale level instead of the retail level</b>	<ul style="list-style-type: none"> <li>✦ Reduces overall state agency administrative workload and saves a minimum of \$2.3 million currently used to collect the surcharge.</li> <li>✦ Reduces record-keeping requirements on retailers.</li> <li>✦ Ensures that all retailers pay the surcharge.</li> </ul>	<ul style="list-style-type: none"> <li>■ Increases record-keeping and reporting requirements on wholesalers.</li> <li>■ May increase the problem of licensees buying from retail package stores.</li> <li>■ Requires retailers to pay the surcharge prior to the actual sale of alcoholic beverages.</li> <li>■ Requires wholesalers to develop a method of estimating sales subject to the surcharge for retailers that sell for both on-premises and off-premises consumption.</li> </ul>
<b>Transfer the administration of the surcharge to the Department of Revenue</b>	<ul style="list-style-type: none"> <li>✦ Places the surcharge with other similar revenue generating programs.</li> <li>✦ Already utilizing DOR resources to collect remittances.</li> </ul>	<ul style="list-style-type: none"> <li>■ Surcharge administration would no longer be in the same agency as other alcoholic beverage licensing and enforcement functions.</li> <li>■ Administrative workload and taxpayer education problems would follow surcharge to DOR.</li> </ul>
<b>Repeal the surcharge</b>	<ul style="list-style-type: none"> <li>✦ Reduces overall state agency administrative workload and save minimum of \$2.3 million currently used to collect the surcharge.</li> <li>✦ Reduces record-keeping requirements on retailers.</li> </ul>	<ul style="list-style-type: none"> <li>■ Results in the loss of approximately \$100 million in state revenue annually.</li> </ul>
<b>Repeal the surcharge and increase excise taxes</b>	<ul style="list-style-type: none"> <li>✦ Simpler revenue collection process.</li> <li>✦ Saves minimum of \$2.3 million currently used to collect the surcharge.</li> <li>✦ Entire population audited each year.</li> </ul>	<ul style="list-style-type: none"> <li>■ Florida already has comparatively high state excise taxes.</li> <li>■ Results in a tax increase on alcoholic beverages not currently subject to the surcharge (data on the economic impact is inconclusive).</li> </ul>
<b>Repeal the surcharge and increase sales taxes evenly on beverages currently subject to the surcharge</b>	<ul style="list-style-type: none"> <li>✦ Reduces overall state agency administrative workload by consolidating two taxes (thus eliminating processing of remittances and conducting of audits for both surcharge and sales tax).</li> <li>✦ Consolidates the number of forms retailers are required to complete when remitting taxes.</li> </ul>	<ul style="list-style-type: none"> <li>■ Requires changes in current sales tax forms.</li> <li>■ Redistributes the tax across alcoholic beverages, thus, alcoholic beverages such as beer would be taxed more heavily (unclear economic impact).</li> <li>■ Requires retailers that sell for consumption both on-premises and off-premises to maintain separate records for sales subject to the surcharge.</li> <li>■ Since a smaller portion of retailers are audited for the sales tax compared to the surcharge, underpayments would less likely be detected.</li> </ul>

Source: Office of Program Policy Analysis and Government Accountability.

## Conclusions and Recommendations

Approximately 97% of audited retailers included in our sample either underpaid or overpaid the surcharge. Retailer confusion over how to calculate the surcharge significantly contributes to mispayment and points to the need for additional taxpayer education programs. We identified several options for increasing taxpayer education:

- The Department could require each retailer to attend an individualized orientation session prior to license issuance. Retailers would be required to attend as a condition of obtaining a license. However, it would require additional staff resources or staff reassignment and would not involve educating the approximately 20,000 existing licensees.
- Alternatively, the Department could provide an “open” orientation every few months. This would involve district auditors providing regular orientation sessions to larger audiences. Providing orientation sessions at several different times would increase convenience to the retailers and may increase attendance. Again, it would be effective to tie the orientations to license issuance. Programs such as these have been attempted in a few districts with good results and could be expanded statewide.

We also found that inconsistent implementation of policies and procedures contributes to retailer confusion regarding the calculation of the surcharge and the record-keeping requirements. To further reduce retailer confusion, we recommend the Department increase the consistency of staff implementation of policies and procedures. In August 1996, the Department provided audit staff additional guidelines through a written summary of agreements reached to address the implementation of its audit policies and procedures. We recommend that the Department monitor the implementation of these agreements to minimize differences that could unfairly tax retailers or result in retailer confusion over how much tax is owed.

Furthermore, we found that surcharge underpayment could be reduced by improving the Department’s audit selection process. We recommend that the Department expand its use of automation for audit selection. According to Department management, the audit selection process should be fully automated by late 1997. Once fully automated, Department management believes staff will be able to complete 5,000 to 6,000 surcharge audits annually. Increased automation should improve the Department’s ability to identify and select retailers who have the largest potential underpayments. In addition, automation may help the Department identify retailers who need assistance calculating the surcharge owed.

Currently, Florida’s surcharge places a burden both on state administering agencies and Florida businesses. Collecting the surcharge places a high workload on state administering agencies. Compared to other tax programs, such as the excise tax, the surcharge involves a much larger number of businesses remitting the tax and requires more resources to ensure that businesses remit surcharge payments. Ensuring accurate payment of the surcharge also is labor intensive and costly. Furthermore, the surcharge places a burden on retailers by requiring them to keep precise records and file detailed monthly reports.

To address the problems identified, we recommend that the Legislature consider the following options:

1. Impose the surcharge at the wholesale level; or
2. Repeal the surcharge and increase excise taxes.

Implementing either of these options would greatly reduce the workload of state agencies administering the program, save state resources, and lessen the burden placed on Florida businesses currently subject to the surcharge.

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## Agency Response

The Secretary of the Department of Business and Professional Regulation provided the following written response to our review.

### **More Taxpayer Education is Needed**

The Department agrees that retailer confusion over how to calculate the surcharge has contributed to both overpayment and underpayment, and that additional education is needed. In addition to the steps that the Department is currently undertaking to educate both new and existing licensees, we will review the options you have identified for increasing taxpayer education. As you pointed out in your review, "open" orientation programs have been attempted in a few District offices with good results. However, an expansion of this or most any other education program will likely require additional resources.

### **Inconsistent Implementation of Auditing Policies and Procedures Contribute to Retailer Confusion**

The Department will monitor the implementation of the additional guidelines that were provided to the audit staff through a written summary of agreements in August 1996. Additionally, we will continue to review audit policies and procedures statewide to ensure that licensees are treated fairly and consistently concerning the surcharge program.

### **Increased Automation in Audit Selection Would Improve Effectiveness**

The Department will continue to expand its use of automation in order to improve the audit selection process. The process that was piloted in the

Pensacola District office is currently being expanded to the Tampa and Miami District offices. This audit process compares wholesaler sales data to vendor purchase information, and selects vendors for audits based on discrepancies. This process should be automated in all District offices by late 1997. Based on the support and completion of this project, the Department will be able to audit every licensee in the program. Continuing the automation program will require additional technical resources to maintain the quality of this collection system.

This project was conducted in accordance with applicable evaluation standards. Copies of this report may be obtained by telephone (904/488-1023 or 800/531-2477), by FAX (904/487-3804), in person (Claude Pepper Building, Room 312, 111 W. Madison St.), or by mail (OPPAGA Report Production, P.O. Box 1735, Tallahassee, FL 32302). Web site: <http://www.state.fl.us/oppaga/>

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