

# Regulation of Beverage Alcohol in Illinois: Understanding the Three-Tier System



The Three-Tier System:

## At A Glance

### What is the Three-Tier System and when was it created?

The three-tier system provides for “checks and balances” in the way that alcohol is distributed and sold to retailers as well as to consumers. In this way, the three-tier system helps protect communities.

Under the current system, producers sell to licensed wholesalers (distributors), who sell to licensed retailers who, in turn, sell to the public.

Prohibition’s repeal by the 21<sup>st</sup> Amendment to the U.S. Constitution led to the addition of a middle (wholesaler/distributor) tier to separate and act as a buffer between retailers and manufacturers/suppliers. The wholesaler tier was tasked to ensure that the consumption and quality of alcoholic beverages were properly controlled and regulated and that taxes were collected to fund state and local governments.

Accompanying the repeal was a strong mandate that each state take steps to regulate their own industry. That state based regulatory system has allowed millions of Americans to enjoy a wide variety of choice in alcoholic beverages.

### Why was the Three-Tier System created?

The Three-Tier System was established by federal and state regulators after Prohibition to encourage moderation in consumption and protect excise tax revenue collection, while permitting states to establish their own sets of rules and regulations to reflect their local beliefs and practices.

The system seems to have been a success. As reported in the popular new Ken Burns documentary, *Prohibition*, Americans today drink **a third less** than their predecessors who by 1830 drank the equivalent of 88 bottles of whiskey every year.

### What benefits does the Three-Tier System provide?

The three-tier system mandates product integrity, and ensures that alcoholic beverages are not sold to minors or sold or delivered through other improper, unlawful channels.

The three-tier system protects the economy, too. Because

licensed beverage distributors act in cooperation with the state, they help ensure that alcohol beverage taxes are reliably and efficiently collected whenever alcohol is distributed properly. When alcohol is sold outside of these channels, states lose out on tax revenue.

Retailers also benefit from the three-tier system through greater access to products and brand selection than would otherwise be available. Under the three-tier system, big and small retailers alike can profit and thrive.

### Who are wine and spirits distributors and what role do they play in the three-tier system?

Wine and spirits distributors serve as the middle tier in the three-tier system, and are the key link between alcohol manufacturers and retailers. They purchase wine and spirits from suppliers and importers and, in turn, sell to retailers. Wine and spirits distributors ensure the safe, legal and responsible delivery of alcohol to licensed retailers, and prevent access to alcohol by minors.

Distributors’ sales and delivery personnel check licenses in each retail account to verify that the business is currently licensed to sell alcoholic beverages and that the license has not been suspended for any reason. They also verify that the account is not delinquent in accordance with the Illinois 30-day Credit Law. The licensed retailer then ensures that only those of legal drinking age are allowed to purchase or consume alcoholic beverages.

Wholesalers devote resources to fight against underage drinking, drunk driving and alcohol abuse and to support responsible consumption through numerous programs – from distributing pamphlets and videos to help parents talk to their children about underage drinking, to providing resources for law enforcement and retailers, and sponsoring free cab rides home for patrons without designated drivers. Wholesalers are family owned and operated businesses that give back to their communities through charitable donations to worthy organizations, schools and religious institutions.

The three-tier system of distribution ensures the efficient collection of federal, state and local taxes.

The Three-Tier System:

## ***Historical Perspective***

The production of an alcoholic beverage is a very simple process—fermentation, by which sugar is transformed to produce ethyl alcohol. The regulation of alcoholic beverages is more complex and has evolved from governmental controls, societal attitudes and experience.

### ***Colonists Brew Up Rebellion***

Beverage alcohol has played an important role throughout American history and culture. Alcoholic beverages are the only consumer product mentioned in the United States Constitution and are the subject of not one, but two, constitutional amendments.

The conversion of New England molasses into West Indian rum was an important part of the colonial American economy. The British attempt to tax this commerce through the Molasses Act was a factor in the colonists' desire for independence. By 1770, the New World brewing industry was so well established that patriots argued for a boycott of English beer imports. The Boston Tea Party could just as easily have been the Boston Beer Party.

### ***Temperance Movement Leads toward Prohibition***

From the mid-18th century until World War One, the issue of temperance was the loudest public policy question related to alcoholic beverages. The American Temperance Society was organized in 1826 and by 1835 the group had 8,000 local auxiliaries. In 1843, the Oregon Territory approved Prohibition (it was repealed five years later). Soon, nine other states enacted similar laws only to see them overturned thereafter.

In 1907, Illinois passed a local option law which fostered conflict over legalizing liquor throughout the state. This act allowed individual precincts and wards to enact their own prohibition laws and led to the forced closure of saloons in two-thirds of the city of Chicago.

### ***Industry Grows, Social Debate Grows, Too***

At the turn of the last Century, the beverage alcohol business in America was a free-wheeling, free-market system comprised of suppliers and retailers. Producers frequently owned their own retail outlets, extending credit, furnishing equipment and supplies and thoroughly dictating the terms of their relationship with retailers. Retailers were often pressured to maximize sales without regard to customers or society. As with any free-market system, low prices and high consumption resulted.

## ***Prohibition: Repeal Leads to Reform***

These economic and social issues collided with the uncertainty of World War One to produce the Volstead Act, which became the 18th Amendment to the U.S. Constitution, or Prohibition.

The fourteen-year social experiment known as Prohibition was a tragic failure, resulting in unprecedented disrespect for the law. In 1921, 95,933 illicit distilleries, stills and fermenters were seized. Convictions for liquor offenses in federal courts swelled from 35,000 in 1923, to 61,383 in 1932. Personal consumption of alcohol by Americans was at an all-time high during this period of forced abstinence.

When Congress ended the failed Prohibition experiment with the adoption of the 21st Amendment in 1933, federal and state lawmakers made a conscious decision to create a regulatory structure that would protect citizens. Recognizing that alcoholic beverages are a special category of products deserving specific regulatory controls, Congress gave states the authority to regulate the production, importation, distribution, sale and consumption of alcohol within their own borders.

## ***Government Regulation Strengthened Under the Three-Tier System***

Government's interest in the orderly regulation of alcohol distribution is strengthened under the three-tier system.

The three-tier system ensures that wine, beer and spirits are sold responsibly, through lawful and accountable channels. The tax revenue from the sale of beverage alcohol is a strong incentive for state and local governments to license its sale. In Illinois, excise taxes on beer, wine and distilled spirits annually produce more than \$230 million in revenue to the state. License fees, sales taxes and other alcohol-related revenue account for millions more in public funds.

The three-tier system in Illinois provides a 100% verifiable and reliable method of collecting this revenue. Wholesalers pay excise taxes as the goods leave their warehouses. The three-tier system guarantees that every penny of state and local tax revenues is accounted for.

## ***Licensing Under the Three-Tier System***

Illinois law requires producers, wholesalers and retailers to have a state license that must be renewed annually. To gain renewal, licensees must demonstrate their fitness to engage in the business of marketing beverage alcohol.

The Illinois Liquor Control Commission licenses and regulates approximately 24,300 permits for the manufacture, operation or sale of alcoholic beverages throughout the state. It has only 20 enforcement agents to regulate those licenses. Without the safeguards provided by Illinois' wholesalers, many more enforcement agents would be needed to ensure that alcohol is lawfully and safely sold in our state.

The Three-Tier System:

## ***Producers, Wholesalers & Retailers***

Having learned the lessons of history from pre-Prohibition America, Illinois, like most other states, established by law a highly structured and regulated three-tier system for producing, marketing, and selling beverage alcohol products. Chief among Illinois legislators' concerns was the desire to maintain societal control over the distribution and availability of beverage alcohol.

Under this system, producers, wholesalers and retailers remain independent of each other, and the commodity is strictly controlled and heavily taxed. Producers sell to licensed wholesalers, who sell to licensed retailers who, in turn, sell alcoholic beverages to the public.

To ensure the economic independence of each tier, distributors and retailers alike are free of ownership or financial control by manufacturers. Wholesalers are strictly prohibited from having an ownership interest in the business of retailing or supplying. This system, with a few minor modifications, has stood the test of time and exists today largely as it was enacted in the late 1930s.

**Producers** such as distilleries, breweries and wineries manufacture products and ship to wholesalers. Importers and brokers also are considered suppliers in certain situations. Producers are regulated by the U.S. Alcohol & Tobacco Tax & Trade Bureau, U.S. Customs, the Illinois Department of Revenue, the Illinois Liquor Control Commission, and the city or county where they are located. They pay federal excise taxes, customs duties, permit and license fees, corporate income and property taxes.

**Wholesalers** include distilled spirits, wine and beer distributors. They buy in bulk and include thousands of brands in their inventories. Wholesalers sell to retailers by the case or bottle and assist with product promotion. Wholesalers are regulated by the U.S. Alcohol & Tobacco Tax & Trade Bureau, U.S. Customs, the Illinois Liquor Control Commission, the Illinois Department of Revenue, and the city or county where they are located. They pay federal excise taxes, customs duties, state excise and sales taxes, permit and license fees, corporate income and property taxes.

**Retailers** are comprised of two groups: off-premise sites (package stores, pharmacies or food stores), and on-premise sites (restaurants, bars, clubs and other recreational venues). Retailers buy by the case or bottle and sell to consumers by the package, bottle, or by the drink. They are regulated by the Illinois Department of Revenue, the Illinois Liquor Control Commission, and the city or county in which they are located. Retailers pay sales taxes, license fees, corporate or personal income taxes and property taxes.

### **Four Primary Goals of Illinois' Three-Tier System**

- ◆ To ensure and maximize verifiable tax revenues that can be collected efficiently from the beverage alcohol industry.
- ◆ To facilitate state and local control of alcoholic beverages.
- ◆ To encourage moderate, legal consumption.
- ◆ To provide an orderly, effective market.

The Three-Tier System:

## **Wholesalers Add Value**

While each state has its own set of laws governing the three-tier system, the separation of the three tiers by interposing an independent distributor between the producer and the retailer is a common thread. That system has endured because it **assists government in the regulation and control** of beverage alcohol, because it furthers the goal of industry **accountability**, and because of the **value** it provides for our citizens and for our communities.

Illinois wholesalers are **family-owned businesses**, with deep roots in their communities. As such, they are an important part of our economy, providing **thousands of jobs** for Illinois citizens throughout the state and **tens of millions of dollars in state and local tax revenue** annually.

Wholesalers play an essential role in the marketing and merchandising of beverage alcohol. Wholesalers buy products from the manufacturers and importers, and then distribute them to retailers by the case or by individual containers. Retailers, both large and small, are provided access through their distributors to the products of all suppliers.

One important by-product of our three-tier system that is of significant value to Illinois consumers is the rich variety of products and brands available for purchase. On-premise businesses, such as restaurants and bars, buy in limited quantities and rely on wholesalers to provide and maintain their inventories. Because of our efficient distribution system, retailers don't need a huge investment in inventory.

Wholesalers provide a broad spectrum of other valuable services to retailers, including merchandising of brands, **reducing distribution costs** to licensed retailers, **exposing new brands** to retailers and staff, **expanding selection** by carrying popular and rare products, providing rapid delivery, training and education, **regulatory guidance** for retailers, and providing **marketing expertise** and advertising and promotional materials.

Illinois wholesalers are responsible for the products they distribute and accountable for the quality of their merchandise. Because wholesalers take on this responsibility, they lighten the load borne by the State of Illinois and help protect all Illinoisans by making sure their products are safe. Many wines, for example, have limited shelf lives, and quality control is an important issue.

Wholesalers in Illinois take their responsibilities seriously. They live here. They work here. They recognize the vital role they play in protecting consumers, their obligations to state and local government, and are committed to continuing the success of the three-tier system of alcohol distribution and regulation.

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<sup>i</sup> In some states, Illinois included, small production wineries or breweries may obtain licenses exempting them from the three-tier system and permitting them to sell directly to consumers.

For more information on the three-tier system, please contact us at 312-782-7820.

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