Using the Wine Equalisation Tax rebate to build a stronger and more profitable Australian wine industry

Submission to Discussion Paper

Treasury Wine Estates & Pernod Ricard Winemakers

September 2015

The views on the WET rebate contained in this document are consistent with the companies' stated positions on wider taxation reform outlined in responses to the *Re:Think* tax consultation process. Copies of both companies' submissions to that process can be found at http://bettertax.gov.au/files/2015/06/Treasury-Wine-Estates.pdf and http://bettertax.gov.au/files/2015/06/Pernod_Ricard_Winemakers.pdf .

Executive Summary

- Urgent reform of the Wine Equalisation Tax (WET) rebate is essential to redress the structural issues that have been undermining the profitability and sustainability of the wine industry over the last decade.
  - The status quo is not an option.
- Both Treasury Wine Estates and Pernod Ricard Winemakers are on record as supporting the ultimate abolition of the rebate; however we recognise that eliminating it overnight would cause significant harm to small winemakers and regional communities that legitimately access the rebate currently, and therefore alternatives, and a phased approach to reform is required.
- We support the Winemakers' Federation of Australia proposal to remove rebate accessibility for bulk and unbranded wine and for non-Australian winemakers, and believe it would make a demonstrable difference to reducing the distortionary impact of the WET rebate.
  - Both companies would welcome implementation of these reforms.
  - Our companies, however, believe there is an opportunity for the Government to go further with rebate reform, and we encourage the Government to do so.
- It is in the interests of both the industry and Government to reduce the annual cap of financial assistance to individual businesses to $150,000 as quickly as possible.
  - This would have little impact for genuine small winemakers, who currently claim well below this threshold;
    - three quarters of WET rebate claimants access it below $100,000.
  - It would, however, strongly reduce the financial incentive to engage in distortionary and inefficient behaviours to maximise a rebate claim.
  - The cap could continue to be reduced over the forward estimates, taking into account the need to maintain support for regional communities and small winemakers.
- There are sound policy benefits in separating any financial assistance from the WET liability of claimants.
  - Linking the rebate to the WET has perverted market decisions and created undue complexity, resulting in businesses inefficiently structuring operations to maximise their WET liability and rebate.

  - It also links the rebate only to domestic sales and ignores export performance, which is two thirds of Australian production and offers the greatest growth opportunities.
  - Replacing the rebate with a direct grant may also provide a way of better targeting intended recipients.
- Additionally, the Government should consider restricting eligibility of the rebate by tightening the definition of a wine producer.
  - Eligibility should focus on winemakers who create branded products packaged for final sale, assume the financial risk of the winemaking, and have invested in viticulture assets.
- These proposals would significantly address the negative behaviours identified in the Discussion Paper, while restoring efficient market signals and removing barriers to industry restructuring. These measures would:
  - improve integrity measures and reduce the unintended and harmful consequences of the rebate in its current form;
  - return the rebate to its original intent of supporting small winemakers and regional communities; and
  - restore profitability and sustainable growth to the industry.
- Some of the savings from rebate reform should be used to help the industry restructure, including through extended eligibility for export market development grants and other forms of both ongoing and transitional support.
- We urge the Government to move quickly on implementing WET rebate reform, given the high levels of unprofitability currently facing the wine and grape industry.
- This reform should be a part of broader wine tax reform, necessary to better support an industry whose future growth and sustainable profitability is linked to addressing significant structural issues and producing, promoting and exporting premium wine.

About Pernod Ricard Winemakers

Pernod Ricard Winemakers is the premium wine division of Pernod Ricard, the world's co-leader in wine and spirits. Our global wine business is headquartered in Australia, with wine production businesses located in Australia, New Zealand, Spain, Argentina, the United States and China. In Australia, we are the owner of many historic wine brands, including Jacob's Creek, George Wyndham, Morris Wines, Richmond Grove Wines and Gramps. Pernod Ricard acquired the Barossa Valley's Orlando Wines, producer of Jacob's Creek, in 1989, and a year later, purchased Wyndham Estate in the Hunter Valley to create the Orlando Wyndham Group. In 2013, the business was re-named Pernod Ricard Winemakers, with the vision of "Leading Wine Innovation", and with the aim to become the world leader in premium wine. In 2014, Jacob's Creek was the world's most awarded winery, and since the label was launched in 1976, has won more than 7,000 international wine awards. Jacob's Creek is the number one premium Australian wine brand in 17 countries, selling 6.2 million cases annually, and it is exported to 65 countries.

About Treasury Wine Estates

Treasury Wine Estates is one of the world's largest wine companies, listed on the Australian Securities Exchange. The company has a rich heritage in Australia, with its headquarters in Melbourne, and operations spanning five states. We are active promoters of 'Brand Australia' internationally. Exporting to more than 70 countries, we are an example of an Australian business that is winning in markets all over the globe. It is a task made easier by our portfolio of some of the most recognised and awarded wine brands in the world, including Australia's oldest and most iconic wine brands such as Lindeman's, Penfolds, Wolf Blass, Pepperjack, Devil's Lair, Seppelt, and Wynns Coonawarra Estate. We own or lease more than 9,000 hectares of prime winegrowing land in Australia across 84 vineyards. We sell more than 30 million cases of wine each year, with more than 60 per cent of our Australian produced wines exported. We directly employ over 3,000 people - winemakers, sales, viticulturists, distribution and support staff - over 2000 of which are based in Australia. In addition, we support thousands of jobs through our supply chain, many of which are in the 71 regional areas involved in the Australian wine industry.

Introduction

In our respective submissions to the Government's discussion paper *Re: Think*, calling for a better, simpler, fairer tax system, we noted that although the Australian wine industry is a global success story, it has been facing significant challenges relating to structural oversupply for the past decade, which has resulted in falling prices and reduced industry profitability.

Winemakers operating in both the commercial and premium segments have been hurt by excess, subsidised wine entering the domestic market, driving down local prices. In addition, the sale of excess commercial wine on the global market at unprofitable margins has in turn undermined perceptions of our export quality and the government's own promotion of premium agricultural exports.

While there is no single measure that will restore profitable growth, significant reform of the Wine Equalisation Tax (WET) rebate is both necessary and urgent to provide a better future for the Australian wine industry and the regional communities it supports.

The Australian wine industry needs reform to secure its future

The Australian wine industry is one of our country's great agricultural successes on the global stage. Wine is now Australia's sixth largest agricultural export, behind large commodity exports such as beef and wheat, and is the only alcoholic beverage industry that is a net exporter.

We are also world class winemakers, being the world's sixth largest wine producing nation, exporting some of the best wines in the world. The wine industry is a significant contributor to the national economy, directly employing more than 16,000 people, earning $1.8 billion in export revenue and contributing more than $8 billion to the tourism industry. The industry enjoyed rapid growth from 1997 to 2007, reaching $5 billion in annual sales at its peak.

After 2007, domestic demand growth slowed, with larger volumes of foreign produced wine being imported into Australia. The past decade has seen domestic wine sales remain relatively stable, but the value of those sales has declined. Industry estimates that in Australia, 70 per cent of wines sold at less than $10 per bottle are sold through major retail chains, and over the last decade there has been a steady growth of private label brands sold and sourced through these retailers.

At the same time, export volumes have stalled – sales value plunged for Australian wine with a collapse of prices in key export markets. A strategy of volume growth and rapid vineyard expansion saw enormous increases in domestic wine production (which more than tripled between 1993 and 2007), in part incentivised by federal tax benefits. However, the push to achieve market volume came at the expense of market value, with the overproduction of lower quality wines flooding the export market and pushing down the average price. The strategy was production-driven rather than market-driven, and meant Australian winemakers had to use price to move volumes of wine through distribution channels to recover fixed costs. Australia's wine production capacity far exceeds domestic consumption, and a profitable industry must rely on a successful export strategy.

The fall in value and volume of Australian exports occurred simultaneously with the growth in bulk wine exports from New World wine producers such as Argentina, Chile and South Africa, which saw a cumulative increase in bulk wine exports of 100 per cent in the decade from 2001-2010 (from 23 per cent to 46 per cent of total wine exports).

By the end of that period, in 2011, Australia's production costs per tonne were higher than each of those countries. Additionally, some of our key wine competitors have achieved free trade agreements that put the Australian industry at a disadvantage. Overall, Australia's competitiveness in commercial wines has deteriorated over time. These factors contributed to the weighted average price for Australian wine grapes declining by 50 per cent between 1999 and 2014.

The industry's structural issues have been well recognised for some time. In 2005, the Senate Standing Committee on Rural and Regional Affairs and Transport documented significant structural issues in the wine industry, yet did not recommend structural adjustment as the Committee considered there was a chance for long term growth and price stabilisation. This has not occurred. In 2015, the same Committee commenced another inquiry into the wine and grape industry.

Government and industry have long recognised this as a structural problem, with all key stakeholders agreeing in 2009 that:

> *"Structural surpluses of grapes and wine are now so large that they are causing long-term damage to our industry by devaluing the Australian brand, entrenching discounting, undermining profitability and hampering our ability to pursue… industry strategy."*
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> (Statement by Winemakers' Federation of Australia, Wine Grape Growers Association, the Australian Wine and Brandy Corporation and the Grape and Wine Research and Development Corporation, November 2009.)

In 2006 and again in 2013, ABARES highlighted the need for restructuring and the high levels of unprofitability in the industry. In 2009, the industry released a *Wine Restructuring Action Agenda Statement* outlining the structural surpluses of grapes, decreasing competitiveness, and reduced profitability in the industry. In 2010, the NSW Parliament reported on the oversupply and its impact on wine makers and growers. These reviews were in addition to numerous academic and financial institution analyses of the industry. All recognised the need for wide-ranging reform.

As significant players in the Australian wine industry, Treasury Wine Estates and Pernod Ricard Winemakers advocate policy reform so the industry can recapture its position as a world-leading producer of premium wines. The industry has the key success factors of premium grape growing regions, passionate industry ambassadors, skilled winemakers, diverse grape varieties and wine styles and brands with provenance. But it cannot achieve success or overcome its current challenges without the right regulatory settings.

The distortionary impact of the rebate

The challenges facing the Australian wine industry are aggravated by the current structure, size and scope of the Wine Equalisation Tax rebate. It has been used by some participants – contrary to the rebate's original intent – to subsidise production which, in turn, has contributed to the reduced price of Australian wine and grapes, discouraged industry consolidation, stimulated oversupply, and resulted in a glut of low-quality Australian wine being sold on the global market. This has been a poor and inefficient use of taxpayer funds, which could be better allocated to deliver the original intent of the rebate's policy goals.

As shown in the Federal Government's Discussion Paper, the current structure of the rebate has left the program open to abuse, both legal and illegal. It is unnecessarily complex in its scope, and any reform should aim to simplify rebate eligibility, calculation and administration. Moving well beyond its original intent to assist small winemakers and their regional communities, the rebate has become a damaging subsidy that has negatively affected the profitability and productivity of the entire industry.

The WET rebate is a subsidy aimed at neutralising the impact of the WET for small wineries. The WET rebate means that the first $1.72 million of domestic wholesale wine sales for each wine producer is exempt from the WET, and as a result, only the largest wine producers pay any net wine tax.

The current rebate cap is a significant hurdle that discourages winery operations to increase (via growth or merger/acquisition) beyond the $1.72 million sales threshold. This is despite the clear benefits of economies of scale that would be evident across most businesses. In addition, the barriers to entry for new producers – including 'lifestyle' producers – are substantially lower as a result of the WET rebate. It is notable that although the value of the industry has contracted by 25 per cent since 2007, the total number of wine producers has remained consistent, and the size of the rebate paid by Government has increased significantly.

The rebate has also undermined broader economic growth. Modelling undertaken by ACIL Tasman in 2009 estimated that if the WET rebate had not been introduced in 2004/05, Australia's GDP would have been $65 million higher by 2008/09.

Commercial wine producing regions, particularly warmer inland regions, have been particularly impacted with the rebate causing distortions to market signals and propping up a proportion of otherwise economically unsustainable bulk wine production. This has contributed to a significant deterioration in the profitability of commercial grape growing and wine production and further strengthened the prevalence of retailer private label wines.

There is strong evidence that the WET rebate is driving down grape prices, which has contributed to the resulting 85 per cent of grape production now sold at a loss, as estimated in the WFA 2015 Vintage Report. The rebate acts as a subsidy to the real market value of the wine product, the margin of which may be at the expense of grape growers. For commercial, non-premium wine that competes primarily on price, the process is as follows:

For a winemaker with a strong brand, whose sales far exceed the $1.72 million cap for the rebate, with traditional production assets and expenses, including brand equity and marketing, the cost of viticulture may result in a price point of $1 a litre of wine, plus non-operational fixed costs (say $0.20 per litre), resulting in a wholesale price of $1.20. For these winemakers, the rebate does not subsidise the price of the wine, given the quantities sold.

For a winemaker producing bulk, unbranded wine sold domestically, the cost of viticulture may be $1.10 a litre of wine (more expensive because of reduced economies of scale), but they do not incur the same fixed costs relating to brand equity and marketing, and their final price is fully subsidised by the rebate ($0.32 at 29 per cent of the invoiced wholesale price), resulting in an actual wholesale price of $0.78.

As the brand winemaker is producing commercial wine competing on price, it forces the company to reduce the wholesale price to compete at $0.78 a litre, which in turn drives down the prices paid to grape suppliers. This cycle over time has resulted in prices paid to grape growers being less than the cost of production, directly as a result of the rebate.

In turn, grape growers have turned to using the WET rebate by becoming bulk winemakers, processing their grapes into wine before selling the bulk wine to another winemaker, and making them eligible for the rebate, as a way of recapturing some of the lost revenue described above. The process undermines the free market, discourages brand winemakers from pursuing economies of scale and results in the taxpayer subsidising cheap wine.

Lower priced wine in Australia contributes to lower price expectations for exports. Although exports do not attract the rebate, overseas markets, particularly retailers in Europe and the United States, will only pay prices linked to domestic prices. In order to move excess volume and reduce fixed costs, Australian producers end up being price takers on the global market, with the added burden of higher cost structures than low priced producers in South America and South Africa.

Reforms proposed by the Winemakers' Federation of Australia

The Winemakers' Federation of Australia has advocated for reforms to the WET rebate along the following lines:

1. Stop the WET rebate going to unintended recipients and shut down the schemes.

2. Keep the WET rebate within the original policy intent of delivering long term benefits to industry and tourism in regional Australia.

3. Phase out the WET rebate on bulk and unbranded wine over four years.

4. Abolish the separate New Zealand rebate scheme and its preferential treatment of NZ producers and create a 'level playing field' for all rebate claimants regardless of nationality.

5. Encourage consolidation by introducing transitional rebate measures to allow the second rebate on a merger of two businesses which are entitled to the rebate to remain with the new entity but be phased out at 25 per cent per year over 4 years.

6. Provide assistance to growers impacted by the WET rebate changes by boosting R&D activities that will deliver lower exit cost and lower transition costs to alternate land uses.

We support the reforms proposed by the Winemakers' Federation of Australia and believe they will make a demonstrable difference to reducing the distortionary impact of the WET rebate. We would welcome implementation of these reforms.

Our companies, however, believe there is an opportunity for the Government to go further with reform, in order to address the unintended behaviours identified in the discussion paper, and better restore profitability across the industry; and encourage the Government to consider these broader reforms seriously.

Reform elements

The Government has an opportunity to undertake broader rebate reform, which would:

- improve the integrity of the scheme, and reduce the unintended consequences of the rebate in its current form;
- return the rebate to its original purpose of supporting small winemakers and regional communities; and
- improve profitability to the industry, including by supporting export promotion.

We outline below a course of action that would achieve these goals and provide assistance to small and medium sized producers to be more export-oriented, funded through savings delivered by rebate reform.

Reduce the cap paid to individual entities

The WET rebate is operating as a subsidy to otherwise unprofitable industry participants. For example, in 2013, Wine Victoria calculated that 95 per cent of its 739 wineries would be unprofitable if the rebate was eliminated. It also calculated that approximately 38 per cent of total producer revenue for Victoria was from the WET rebate. That is why the rebate should be continued to support genuine small winemakers.

There are sound policy reasons to reduce the total cap payable to any one eligible entity to $150,000, effective as quickly as possible. This would not affect the genuine, small regional winemakers the rebate was first intended to assist; however, it would immediately address many of the inappropriate behaviours and unintended consequences outlined in the Discussion Paper, and help restore integrity to the program.

Three quarters of WET credit claimants access the rebate below the $100,000 threshold, meaning an automatic reduction of the cap to $150,000 would not affect the cash flow of the bulk of the industry including small winemakers. It would, however, immediately impact those businesses which have structured themselves to maximise their rebate entitlement and whose production may be actively contributing to both surplus production and diminished profitability within the commercial wine segment. We believe many of these latter entities are claiming around 70 to 100 per cent of the cap, and in many instances these are virtual winemakers and/or entities designed solely to capture the rebate.

The thresholds at which claims are being made are as follows:

Rebate claim	2007/08 claimants	2011/12 claimants
$0 - $100,000	1,258	1,411
$100,000 - $250,000	169	224
$250,000 - $350,000	46	64
$350,000 - $500,000	142	190
> $500,000	17	24
Total	1,632	1,912

Centaurus Partners, 2013 based on ATO data.

We recommend the Government consider lowering the cap in increments to at least $100,000, to further reduce the distortionary effect of the subsidy. Additionally, we propose that the existing rebate claims should be grandfathered to the last available financial year, and then reduced when affected by the reduction in the cap. (A separate calculation may have to be determined for new industry entrants.)

The subsidy would be paid through a direct grant administered by the Department of Agriculture. The Government could also consider replacing some percentage of the rebate with a grant directed specifically towards export promotion. These points are discussed further below.

The following scenarios are based on our proposal:

	CAP	Producer A	Producer B	Producer C	Producer D
Current	$500,000	$400,000	$200,000	$110,000	$80,000
Year 1	$150,000	$150,000	$150,000	$110,000	$80,000
Year 2	$125,000	$125,000	$125,000	$110,000	$80,000
Year 3	$100,000	$100,000	$100,000	$100,000	$80,000

We note that this would have an immediate impact on large winemakers like Treasury Wine Estates and Pernod Ricard Winemakers, as both companies currently claim the full $500,000 entitlement. However, reducing the cap is in the best interests of the longer term viability of the industry, and will prevent other claimants from rorting the system and distorting the market to maximise their rebate.

Remove the link between government assistance and WET liability

There are sound public policy reasons for removing the WET rebate from the tax regime and replacing it with a direct grant from the Government to genuine producers.

Currently, the Australian Taxation Office does not keep data to estimate accurately the size and scope of the WET rebate, as the rebate is recorded in Business Activity Statements with other types of WET credits and refunds, and the data is not separated for cost reasons. This limitation means there is incomplete information about how the rebate is being claimed, by whom, and to what degree.

Removing the link between the rebate and the tax system, particularly if the industry cap was reduced, would mean that production, operations and sales decisions would not be distorted because of attempts to maximise rebate claims. For example, the rebate currently skews sales towards the domestic market, as exports do not qualify. It also has the potential to inflate the invoiced wholesale price to achieve a larger rebate at the taxpayers' expense, camouflaging the actual wholesale value of the wine.

The proposed approach would also reduce complexity and compliance costs for industry and government, and reduce the practice of obtaining multiple rebates through bulk wine arrangements, blending and other manufacture. It would better ensure that the money was being targeted to specific policy outcomes, such as the promotion of regional industry development and employment tourism or export development.

A direct grant could be grandfathered to the recipient's last claim, and then capped. If the producer was eligible (see below), it could be paid in full unless it exceeds the relevant industry cap. We would recommend the grant be administered by the Department of Agriculture.

A direct grant may also provide a better way of targeting assistance without breaching our international obligations. As noted in the discussion paper, WET rebate costs to the Government for New Zealand producers has increased each year, to $25 million in 2013/14,

both a result of, and contributor toward, the rise in New Zealand wine exports to Australia. By removing the rebate from the taxation system and applying it as a grant linked to regional industry development and employment, tourism or export development, the assistance could be targeted to intended recipients.

Target eligibility of assistance to genuine winemakers

In addition to the above recommendations, there may be merit in explicitly addressing the issue of producer eligibility for assistance. Assistance should be restricted to those who are contributing to regional industry development, employment, tourism or export development, and who are genuine industry participants whose characteristics may include criteria such as:

- ownership of physical viticulture assets;
- production of a unique, branded product, packaged for final sale to consumers; and/or
- assumption of the financial risk of the production of wine.

Eligibility could be better controlled if the financial assistance was separate to the taxation system and managed through a direct grant, eliminating entities created solely to obtain or maximise the WET rebate, as described above.

Currently, producers qualify for the WET rebate if they manufacture wine as defined in the WET Act. The WET Act includes a broad definition of "manufacture" in order to ensure the primary imposition of WET can be applied to a wide variety of situations and supply chain structures.

While this may make sense from a revenue collection perspective, it means that the embedding of the WET rebate entitlements of producers in the WET Act allows blenders, virtual winemakers, growers having their grapes made into bulk wine and other participants to claim the WET rebate. This has resulted in a quarter of government WET revenue being returned to a wide variety of industry stakeholders, some of whom have entered the industry with the primary purpose of obtaining the rebate and maximising their entitlement.

Summary of our proposals

At a minimum, we would welcome the implementation of the proposals by the Winemakers' Federation of Australia to remove the rebate from bulk and unbranded wine, and limit it to Australian producers.

Further, by reducing the distortionary impact the WET has on the retail price of wine made under the full subsidy, by restricting eligibility and discouraging manipulation of the WET liability by removing assistance from the tax system, integrity will be restored to the program and improve market signals and fairer pricing for grapes and wine.

Implementation of these wide-ranging reforms would address many of the abuses and unintended consequences identified in the Government's rebate Discussion Paper. It would help reduce the cycle of discounting that causes grape prices to fall below the cost of production. It would help reduce the surplus of low priced Australian wine that floods both the domestic and overseas market, which undermines 'Brand Australia's' reputation and equity in key markets.

The Government should consider early adoption of these broad rebate reform proposals, instead of folding them back into the broader tax reform process. The structural issues facing the industry are urgent, and delaying change will mean a lost opportunity to restore growth and profitability.

The need for industry assistance

Reform of the WET rebate provides a significant opportunity for the wine industry to restructure. However, as was the case in some previous agricultural industry restructures, there is no longer a suite of general agricultural assistance programs available to producers who might be affected by WET rebate changes. Consequently, we recommend the establishment of specific programs for the wine and wine grape industry to complement direct assistance mechanisms outlined above.

These assistance programs could be funded by savings made by changes we have proposed to the WET rebate without imposing a levy, as was necessary for other industries such as sugar and dairy.

Export Market Development Grants (EMDG)

As outlined in our previous submissions, opportunities for growth in domestic demand for wine are limited. However there are significant opportunities in our 123 export markets.

A recent review of EMDGs found that the grant scheme is effective in increasing the number of exports, increasing the sustainability and growth in export markets and developing the export culture in Australia. The review also found that each dollar of an EMDG scheme grant generates an economic benefit of $7.03 when industry spill-overs and productivity grants are taken into account. That review noted that:

> *The Australian wine industry is a commonly quoted example of the spill-over effect, whereby the sustained efforts of a few pioneers in penetrating overseas markets make it easier for other firms to secure sales – with less effort, and therefore cost, than that borne by the initial entrants.*

However, many winemakers exhausted their eight year eligibility for EMDGs during the mid-2000s when they were also struggling with unprofitability, and competing against exports of cheap bulk products which were pulling down the value and price perception of Australian wine. This effect was caused in part by the tax structure, which must now be remedied. While the industry restructures, we recommend that EMDG eligibility for the wine industry is expanded for an additional five years.

The Winemakers' Federation of Australia considers that it takes up to five years to grow an export market to a sustainable level of profitability, and an expansion of the grants for this period would provide essential assistance to cement profitable export markets while the industry undertakes other activities to address price perceptions and while the Australian dollar can aid the establishment of markets.

Funding for Wine Australia marketing activities

The Australian Grape and Wine Authority (Wine Australia) has had a steadily eroding revenue base since 2005/06. This erosion in industry marketing funds is directly linked to industry unprofitability, as the funding is collected through an industry levy. In 2012/13 Wine Australia's marketing activity was less than $9 million. This is significantly less than other wine exporting competitors. For example, the EU spent approximately €143 million in 2012, and an additional €228 million in 2013 promoting wine exports of countries such as France, Italy and Spain.

There has been significant damage to 'Brand Australia' from low value wine being exported to key markets, being effectively dumped, the production and export of which was aided and encouraged by the WET rebate. Therefore, at a minimum, we support the WFA recommendation that Wine Australia receive additional funding of $43 million.

In addition, we recommend that the Government allocate $5 million to Wine Australia for expenditure in specific export markets when any Free Trade Agreement which includes gains on wine is ratified.

Additional rebate savings could be used to fund Wine Australia longer term for the establishment and maintenance of key in-market presence, education campaigns, increasing presence at international trade shows, expanding the visitors program, enhanced partnership with Tourism Australia, and supporting domestic wine-tourism and region-based initiatives.

Research and Development

Both companies also support additional investment in research and development, as proposed by the Winemakers Federation of Australia (WFA).

Conclusion

> *"For Australian wineries to achieve sustainable and profitable growth, they must continue to pursue competitive advantages on the global stage, based on the delivery of quality."*
>
> *(Wine Australia: Directions to 2025, AWBC & WFA, 2007, p 10)*

WET rebate reform has an important role in addressing the structural problems presently threatening a sustainable and profitable future for the Australian wine industry. But it is only one part of a solution which must include broader WET reform. The case for amending the existing WET legislation to provide for a flat volume-based tax can be found in both companies' submission to *Re: Think*.

The purpose of any reform must be to return the industry to a sustainable and profitable future, with a future focus on the production of premium wines. For this reason, we consider that the new Agriculture Commissioner may have a role in overseeing and assessing the impact of any changes to wine taxation along the supply chain, ensuring any changes to wine tax have the intended impact.

Summary of discussion questions and answers

1. Is the WET rebate delivering benefits to the wine industry and/or contributing to distortions in the wine industry? How?

- The WET rebate contributes to distortions in the industry as it acts as a subsidy, which in turn drives down the price of Australian wine and grapes, discourages industry consolidation (and undermines economies of scale), stimulates oversupply, keeps unprofitable producers in the industry, and undermines the interests of genuine winemakers and grape growers.

2. Is the future sustainability of the Australian wine industry linked to the production of high quality wine? How?

- Yes. In Australia, the commercial segment of the industry faces a cycle of price discounting reflecting factors such as oversupply, retailer power and increased global competition. Australia does not have the cost structure to compete on price against producers from Chile, Argentina and South Africa, and relies primarily on favourable exchange rates to capture margin. However, the Australian price segments enjoying demand growth, both domestically and in key markets including China and the United States are in the premium segment, are $10 a bottle and above. This is supported by ACIL Tasman's 2009 report on the competitiveness of the Australian wine industry, which concluded that the industry's future was in a higher value-added strategy, and that the focus on price competitiveness was unsustainable.

3. Is there a policy case to be made for the WET rebate continuing to operate in its current form?

- No, the status quo is not an option. A continuation of the WET rebate in its current form would consolidate the prolonged period of unprofitability experienced by winemakers and grape growers over the last decade, and continue to encourage the production of surplus low value wine which harms the sector in both domestic and export markets.

4. How could the WET rebate be redesigned to better support the wine industry?

- At a minimum, the Government should implement the reforms proposed by the Winemakers Federation of Australia to remove the rebate from bulk, unpackaged and unbranded wine. In addition, the Government could better

support the industry by reducing the cap paid to individual winemakers, replacing the rebate with a direct grant, and tightening eligibility to claimants who are genuine industry players who support regional industry development and employment, tourism or export development.

5. Should the purpose of the WET rebate be to support rural and regional winemakers only? How could this be achieved?

- There is a role for government in providing assistance to genuine producers who support regional industry development and employment, tourism or export development.

6. What other policy goals should the WET rebate pursue? Why?

- WET rebate reform is an opportunity for the government to assist the industry in export promotion, both for individual companies and the industry more broadly. Two thirds of Australian production is exported, there is increased value and volume growth in emerging markets, particularly in Asia, and domestic wine demand growth is flat.

7. Should the WET rebate be abolished? Why?

- The WET rebate should be fundamentally reformed by reducing the cap paid to individual winemakers, replacing the rebate with a direct grant, and tightening eligibility to claimants who are genuine industry players who support regional industry development and employment, tourism or export development. While abolition of the rebate is ultimately in the long term interests of the industry, immediately removing the rebate in its entirety would have severe consequences for many small winemakers and their regional communities, who currently access the rebate according to its original intent. Therefore policy alternatives and a phased approach to reform are recommended.

8. If the WET rebate was removed, what would be the likely effects for the wine industry?

- If the rebate was removed overnight without transitional restructuring assistance, we would expect a large proportion of small winemakers would immediately become unviable. We note, for example, that according to Wine Victoria, 95 per cent of Victorian winemakers in 2013 would have been unprofitable without the rebate.

9. Should the WET rebate be replaced with a grant scheme that would phase out over a defined period of time? Why/not?

- We support replacing the rebate with a direct grant scheme for genuine producers. By decoupling the rebate from an entity's WET liability, the Government stops the current incentive for producers to make inefficient and distortionary behaviour decisions, including false invoicing and corporate structuring, to maximise their rebate claim. A direct grant can better target genuine winemakers. Also, the current rebate is based solely on domestic sales, and ignores export performance. Support for export promotion, potentially through the EMDG program could also support the industry, given the Australian market consumes only one third of domestic production.

10. Over what period of time should the grant phase out? What transitional arrangements should apply?

- We do not recommend a timeframe by which to phase out grants, noting that an immediate withdrawal of the rebate would significantly harm small winemakers and their communities. Instead, we advocate for a significant reduction in the annual cap as quickly as possible to $150,000, with a gradual reduction beyond that in future years.

11. Are there other ways that the wine industry could be supported to restructure? What are they?

- The current WET calculation, made on the basis of the wholesale value of the wine is complex, open to manipulation, and undermines broader government strategies around the promotion of Australian agri-business as a first-class industry, by incentivising low-priced, low-margin wine over premium products. It has been recognised by most industry stakeholders for the last decade that future sustainable growth of the industry is inextricably linked to the production of premium wine with strong brand equity.
- Broader WET reform is necessary for the industry to restructure, and we continue to prosecute the case that such reform is best delivered through a category based volumetric tax system within the existing WET regime (i.e. without resorting to a complex excise-based approach). We do not support an excise based approach with wine taxed at a comparable rate to beer, or for a single volumetric tax on all forms of alcohol, both of which would be immensely damaging to the Australian wine industry.

- We believe there is merit in considering other forms of temporary structural assistance for the wine industry, similar to adjustment programs provided to other agricultural industries during restructures. This support could include business planning grants, operational restructuring grants and projects developing routes to market. This structural adjustment assistance could be delivered as part of broader tax reform.

12. Should eligibility to the WET rebate be restricted by excluding bulk, unpackaged and unbranded wine?

- Our companies support the reforms proposed by the Winemakers' Federation of Australia to remove rebate eligibility by excluding bulk, unpackaged and unbranded wine.

13. Should the definition of 'producer of wine' be amended to restrict claims for the rebate?

- At present, rebate eligibility is broad under the definition of manufacturer currently in the WET Act. It has resulted in entities being eligible for rebate access outside the original intent, and despite the contraction in the size of the industry over the last decade, there has not been a corresponding drop in the number of WET rebate claimants. Tightening the definition of wine producer is justified to return the rebate to its original intent.

14. Should the WET rebate only be allowed for wine on which WET has been paid? Why?

- No. As outlined in this submission, we are of the view that support should be provided to the industry outside of the tax system. However, should the Government choose the keep the rebate linked with taxation, we believe that introducing a requirement that the rebate only be allowed for wine on which WET has been paid would create significant administrative complexity, and have substantial cash flow implications for small winemakers.

15. If the cap was reduced, what should the maximum WET rebate be?

- We believe that the Government could immediately reduce the maximum cap to an entity to $150,000. As three quarters of all claimants currently access less than $100,000, such a move would have no immediate effect on genuine small winemakers. It would, however, have an immediate impact of businesses which have restructured their affairs simply to maximise their rebate claims. Further, we believe that the Government could reduce the cap in instalments to $100,000

to further minimise distortionary behaviour, without undermining the viability of the small winemaking sector.

16. If the rebate was only available for a proportion of the WET, what should that proportion be?

- We believe that reducing the rebate through proportional calculation only increases the complexity of its administration, while not addressing the incentives for behaviour change to maximise entitlements. Reducing the cap (as per above) is a better alternative.

17. Should New Zealand producers' access to the rebate be changed? If so, how?

- The original intention of the rebate was not to support foreign wine producers, who compete with the Australian industry. We support any changes to the WET rebate that will refocus assistance in line with its original intent. This could be achieved by replacing the rebate with a grant that is targeted at industry participants who support regional industry, employment or tourism.

18. Should the WET rebate be replaced by a small rebate for independent Australian alcohol producers such as wineries, distilleries and breweries?

- Wine should continue to be taxed through the WET, and at a preferential rate to other alcohol categories. It would be difficult to maintain these separate tax systems and provide one rebate that applies equally. However, our companies are neutral towards a proposal for all alcohol categories to be rebated similar taxation amounts.

19. Would any significant changes to the rebate require transitional arrangements to help the wine industry restructure? How should transitional arrangements be designed?

- Transitional structural assistance should be designed on the basis that sustainable future growth for the industry lies in the production of premium wine, which is able to compete on quality and attract viable margins and profitable producers for all members in the supply chain. Broader tax reform should be undertaken with this aim.