

Henry Review into Australian Taxation

Submission from Independent Distillers Australia

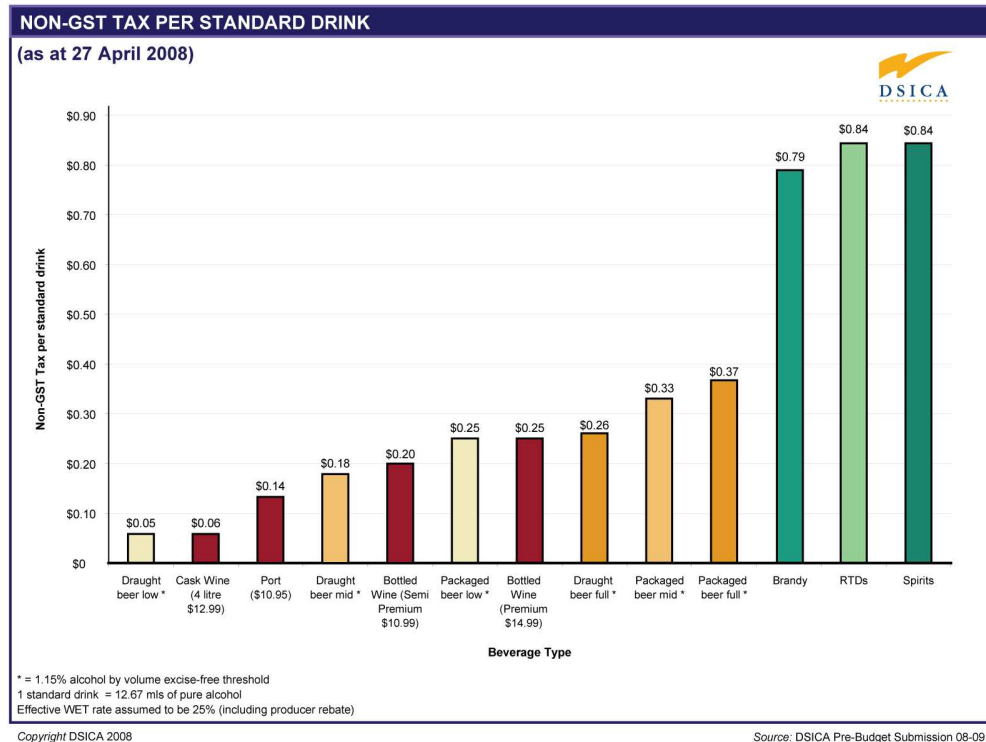


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Introduction

As has been clearly demonstrated in the months since April 27 2008, when the Government increased taxes on spirit based Ready to Drink products by almost 70 per cent, price plays an important role in the path to purchase for many products, including alcoholic beverages. At its simplest, the more expensive a product, the less accessible it is for a certain population of drinker.



As indicated in the chart above from the Distilled Spirits Industry Council of Australia, the current system of taxation is a confusion – arguably the most complex method of taxation for any consumer or manufactured good in Australia. Many agree the current excise system – a combination of excise on some alcohol products which taxes products based on both from what it is manufactured and where it is intended to be consumed, and a value-based tax on wine sales – is flawed and requires a full detailed review. We believe that review to be long overdue and welcome the opportunity to contribute through the government’s review of the tax-transfer system, the Henry Review.

An administrative note – Throughout this document, we have used the same excise levels as those included in the “Architecture of Australia’s tax and transfer system” paper – that is, those that applied as at 1 July 2008.

About Independent Distillers Australia

Independent Distillers Australia (IDA) is a private Australasian company that predominantly manufactures ready-to-drink (RTD) products (including Vodka Cruiser, Woodstock Bourbon and Cola) with minor activity in beer and spirits. IDA is the market leader in New Zealand and have the third-largest share of the RTD market in Australia. RTDs comprise 94% of IDA’s net sales and 97% of profit.

IDA was acquired from the family of the entrepreneur who started the business, effective January 2007. Ownership is held by two private equity firms, Sydney's Pacific Equity Partners and CCMP. In addition, the founding family have retained a small stake, and management also have a small investment.

The Taxation of Alcohol Today

Currently, consumers are incentivised by the tax system to purchase higher alcohol products. The complexity of 12 different excise rates in addition to a separate Wine Equalisation Tax (WET) does not encourage or support the development of lower alcohol products by industry.

Excise has evolved over time in response to a mix of revenue, health and political agendas. The taxation system today sends confusing signals to both the manufacturer and the consumer and, with the antiquated 12 tier tax system, it is clearly very expensive to administer.

The "Architecture of Australia's tax and transfer system" paper covers off – in some detail – the way alcohol is currently taxed so it is not our intention to cover this in detail, but in short, there are, broadly speaking, three different types of alcohol sold (and taxed) in Australia –

- Distilled (which include spirits),
- Fermented (such as wine, cider and port); and
- Brewed (most notably in Australia beer).

Alcohol content – even within a specific category – varies significantly by product. However, broadly speaking they break down in the following way –

Distilled	
Spirit based RTDs	3-9 %
Liqueurs	17%+
Full strength spirits	37%+
Fermented	
Wine	11-14%
Fortified Wine	17%+
Brewed	
Light strength	0-3%
Mid strength	3-3.5%
Full strength	3.5-6.5%

Today, full strength spirits are taxed as one category and the tax paid is a measure of Litres of pure alcohol (LAL). Beer however uses a combination of LAL content and whether it is sold in a volume of 48 litres or more (that is, whether or not is intended for sale at a hotel or for home consumption).

As underlined by Henry:

Wine is not subject to excise. It is subject to a separate wine equalization tax (WET) which applies as a percentage of the price of wine products. This is normally 29% of the wholesale price of wine, cider, perry, mead and sake, and certain other wine-based products. Unlike the excise on beer and spirits, the amount of tax payable on wine is independent of alcohol volume. There is a \$500,000 WET producer rebate that reduces the WET paid by wine producers, often to zero in the case of smaller producers of wine.

IDA believes the current system of alcohol excise is a confusion, established and maintained under a system of (at best) historic deals and (at worst) out-dated policies of protectionism. Beer is taxed, not only according to strength but also according to delivery method. In reality that means a low strength beer purchased for home consumption attracts a tax of \$33.80 per litre of alcohol. Compare that same product if purchased at a pub where excise is just \$6.70 a

litre. As an example of this flawed pricing model mid-strength beer sold in a pub pays a lower rate of tax than a light beer sold for home consumption.

We are not alone in our belief that other than for reasons of protectionism, there is simply no justification for government to subsidise one product (wine) while forcing other products to pay excessively.

In the 2006-07 tax year excise on beer (50 per cent of the total alcohol volume consumed) bought in 3 per cent of all tax revenue on goods and services, excise on spirits (which represents just 10 per cent of total alcohol consumption) also bought in 3% and excise through WET bought in just 1%.

In total, all excise duties on fuel, alcohol and tobacco bought in \$22.734 billion, while the wine equalisation tax (WET) brought in \$651 million¹.

It is IDA's view that it is both morally and fiscally appropriate that manufacturers should be incentivised to provide lower strength alcohol products to the market though a taxation regime that taxes higher strength alcohol at a higher rate irrespective of what the product is made from, packed in or where it is consumed.

The Taxation of Alcohol Tomorrow

There is wide agreement from both industry and the public health lobby that a system of taxation which provides for tax on products based on their alcohol content (what is known as a volumetric tax) is not only more equitable to manufacturers but also gives the flexibility for government to, in effect, promote lower alcohol products by reducing their tax imposition, resulting in better health outcomes.

There are a number of different ways a volumetric tax can be introduced but the choice basically breaks down to whether or not government takes a decision to impose a flat tax model across all forms of alcohol or a stepped version, where higher strength beverages attract a higher rate. In this stepped model, the number of steps and the difference in price between each step become the key points for debate.

Clearly there are benefits for both versions. Some groups have publicly argued for a pure volumetric tax (known as a flat tax) where all alcohol would be taxed under one price.

For government, this option would provide administrative savings and does not favour any one particular alcoholic beverage. However, this would result in significant structural change to the existing system and our belief is that it would be difficult for any government to garner political support. Importantly from a health policy perspective it does not provide the required flexibility to allow for tax incentives for low alcohol products.

The second option is a progressive (or sliding) volumetric tax, where tax rates are adjusted according to alcohol strength of any particular product. This allows for government, through the pricing mechanism, to incentivise the sale and consumption of low strength products like RTDs and beer over the higher alcohol categories like wine, full strength spirits and liqueurs.

Independent Distillers has asked consulting firm Allen Consulting to model a variety of forms of volumetric tax. The full version of this paper is attached as Appendix 1. In doing so, we asked them to keep in mind two very important assumptions:

¹ Architecture of Australia's tax and transfer system (August 2008)

1. That any new taxation regime should be cost neutral – that is, the new tax neither increases nor decreases government revenues. Target numbers were based on the increased revenue expected out of Treasury forecasts from the 2008-09 budget papers.

2. That for the sliding, stepped taxes we have retained the upper (\$66.67 per LAL for spirits) and lower ends (\$6.70 for low strength kegged beer).

Option 1 – A flat tax

To achieve cost neutrality, a flat tax would need to be installed at \$30.62 per litre of pure alcohol. This has a severe impact on many categories of alcohol and as we have already mentioned, would be very difficult for government to sell. Not least of which because clearly under a flat tax model, spirits (currently taxed at \$66.67 per litre of pure alcohol) would significantly reduce in price. Given the widely accepted point that price contributes as one of a number of influencers toward the decision to buy, reducing the tax rate for full strength spirits (and therefore reducing the retail price) would push demand up – far from a satisfactory health policy outcome given the high 37% plus ABV content of spirits.

We have asked Allen Consulting to build tables demonstrating how prices change as a result of each of the various options. These tables use the most common size and average alcohol content and average retail price by product category.

For a flat tax at \$30.62 per litre of pure alcohol, changes prices in the following way –

Beverage	Size	ABV	Current price (includes GST)	Volumetric tax (includes GST)	Change
Full Strength Spirits	700 ml	40%	\$35.00	\$22.45	down \$12.55
Liqueur	700 ml	17%	\$34.50	\$29.17	down \$5.33
RTD 3.5%	375 ml	3.50%	\$2.80	\$2.19	down \$0.61
RTD 5%	375 ml	5%	\$3.30	\$2.42	down \$0.88
RTD 7%	375 ml	7.00%	\$5.00	\$3.77	down \$1.23
Wine cask	4,000 ml	12.5%	\$14.00	\$31.07	up \$17.07
Wine bottle \$8	750 ml	12.5%	\$8.00	\$9.99	up \$1.99
Wine bottle \$13	750 ml	12.5%	\$13.00	\$13.87	up \$0.87
Wine bottle \$18	750 ml	12.5%	\$18.00	\$17.74	down \$0.26
Wine bottle \$30	750 ml	12.5%	\$30.00	\$27.05	down \$2.95
Fortified Wine	375 ml	18%	\$32.00	\$27.53	down \$4.47
Light beer (pot/middy)	285 ml	2.70%	\$3.00	\$3.36	up \$0.36
Light beer (schooner)	425 ml	2.70%	\$4.00	\$4.54	up \$0.54
Light beer (stubby)	375 ml	2.70%	\$1.50	\$1.64	up \$0.14
Mid beer (pot/middy)	285 ml	3.50%	\$3.20	\$3.49	up \$0.29
Mid beer (schooner)	425 ml	3.50%	\$4.00	\$4.43	up \$0.43
Mid beer (stubby)	375 ml	3.50%	\$1.80	\$1.87	up \$0.07
Full beer (pot/middy)	285 ml	4.90%	\$3.50	\$3.73	up \$0.23
Full beer (schooner)	425 ml	4.90%	\$5.00	\$5.35	up \$0.35
Full beer (stubby)	375 ml	4.90%	\$2.00	\$2.01	up \$0.01

Option 2 – 2 step tax

The concept of a tiered approach was a popular suggestion in submissions to the enquiry by the Senate Standing Committee on Community Affairs earlier this year. Many in the public health sector believe it is warranted to provide more incentive for consumers to consume low strength alcoholic beverages and for manufacturers to produce them.

By building additional steps into a volumetric tax, you provide a progressive system which gives a level of flexibility that is required if you want to provide an incentive for low alcohol products. As discussed above, the issue for debate is how many steps and how those specific tax rates are arrived at.

In options two, three and four, we asked Allen Consulting to look at how the various number of steps impact different types of alcohol. A two step model – like the one used in New Zealand where spirits are taxed at NZ\$43.59 per litre of alcohol and all other products at NZ\$23.94 per litre of alcohol (including wine, beer and RTDs) – taxes spirits at one price and all other products at another.

In order for the tax in Australia to be revenue neutral (assuming full strength spirits remain at \$66.67) tax rates would look like this –

Alcohol Content	Type of Beverage	Tax rate per litre of alcohol
0-37%	All alcohol other than full strength spirits	\$29
37%+	Full strength spirits	\$66.67

These rates affect price in the following way –

Beverage	Size	ABV	Current price (includes GST)	Volumetric tax (includes GST)	Change
Full Strength Spirits	700 ml	40%	\$35.00	\$35	\$0.00
Liqueur	700 ml	17%	\$34.50	\$34.50	\$0.00
RTD 3.5%	375 ml	3.50%	\$2.80	\$2.16	down \$0.64
RTD 5%	375 ml	5%	\$3.30	\$2.38	down \$0.92
RTD 7%	375 ml	7.00%	\$5.00	\$3.72	down \$1.28
Wine cask	4,000 ml	12.5%	\$14.00	\$30.00	up \$16.00
Wine bottle \$8	750 ml	12.5%	\$8.00	\$9.79	up \$1.79
Wine bottle \$13	750 ml	12.5%	\$13.00	\$13.67	up \$0.67
Wine bottle \$18	750 ml	12.5%	\$18.00	\$17.54	down \$0.46
Wine bottle \$30	750 ml	12.5%	\$30.00	\$26.85	down \$3.15
Fortified Wine	375 ml	18%	\$32.00	\$27.39	down \$4.61
Light beer (pot/middy)	285 ml	2.70%	\$3.00	\$3.34	up \$0.34
Light beer (schooner)	425 ml	2.70%	\$4.00	\$4.51	up \$0.51
Light beer (stubby)	375 ml	2.70%	\$1.50	\$1.62	up \$0.12
Mid beer (pot/middy)	285 ml	3.50%	\$3.20	\$3.46	up \$0.26
Mid beer (schooner)	425 ml	3.50%	\$4.00	\$4.49	up \$0.49
Mid beer (stubby)	375 ml	3.50%	\$1.80	\$1.84	up \$0.04
Full beer (pot/middy)	285 ml	4.90%	\$3.50	\$3.69	up \$0.19
Full beer (schooner)	425 ml	4.90%	\$5.00	\$5.29	up \$0.29
Full beer (stubby)	375 ml	4.90%	\$2.00	\$1.98	down \$0.02

Option 3 – 3 step tax

It is clear from option 2 that limiting a progressive tax to just two tiers does not really allow for incentives for low alcohol products such as light beer. A more stepped approach provides further incentives for consumers to purchase and consume lower alcohol beverages.

Option 3 is a 3 step model, with tax rates breaking down fairly simply. The rate for spirits remains constant and the rate for 10-20% band was chosen to be higher than the rate for 0-10% band reflecting its higher alcohol content.

Alcohol Content	Type of Beverage	Tax rate per litre of alcohol
0-10%	Beer and RTDs	\$26.53
10-20%	Wine	\$32.00
20%+	Full strength spirits	\$66.67

This affects price to consumers in this way –

Beverage	Size	ABV	Current price (includes GST)	Volumetric tax (includes GST)	Change
Full Strength Spirits	700 ml	40%	\$35.00	\$35	\$0.00
Liqueur	700 ml	17%	\$34.50	\$34.50	\$0.00
RTD 3.5%	375 ml	3.50%	\$2.80	\$2.12	down \$0.68
RTD 5%	375 ml	5%	\$3.30	\$2.32	down \$0.98
RTD 7%	375 ml	7.00%	\$5.00	\$3.63	down \$1.37
Wine cask	4,000 ml	12.5%	\$14.00	\$31.97	up \$17.97
Wine bottle \$8	750 ml	12.5%	\$8.00	\$10.16	up \$2.16
Wine bottle \$13	750 ml	12.5%	\$13.00	\$14.04	up \$1.04
Wine bottle \$18	750 ml	12.5%	\$18.00	\$17.91	down \$0.09
Wine bottle \$30	750 ml	12.5%	\$30.00	\$27.22	down \$2.78
Fortified Wine	375 ml	18%	\$32.00	\$27.65	down \$4.35
Light beer (pot/middy)	285 ml	2.70%	\$3.00	\$3.31	up \$0.31
Light beer (schooner)	425 ml	2.70%	\$4.00	\$4.46	up \$0.46
Light beer (stubby)	375 ml	2.70%	\$1.50	\$1.59	up \$0.09
Mid beer (pot/middy)	285 ml	3.50%	\$3.20	\$3.41	up \$0.21
Mid beer (schooner)	425 ml	3.50%	\$4.00	\$4.32	up \$0.32
Mid beer (stubby)	375 ml	3.50%	\$1.80	\$1.80	up \$0.00
Full beer (pot/middy)	285 ml	4.90%	\$3.50	\$3.63	up \$0.13
Full beer (schooner)	425 ml	4.90%	\$5.00	\$5.20	up \$0.20
Full beer (stubby)	375 ml	4.90%	\$2.00	\$1.92	down \$0.08

Option 4 – 5 step tax

The model we believe to be the preferred option, and the one we believe to be most effective in terms of delivering on the Government's commitment to both health policy and income through taxation, is option four.

Using the same logic as the three step model, but with more detail, it operates on the simple assumption that the greater the alcohol content, the higher the tax rate. It is a five step model that anchors the upper end (full strength spirits) and the lower end (low strength beer) and spaces the product categories across a total of five equitable tax brackets.

Alcohol Content	Type of Beverage	Tax rate per litre of alcohol
0-3%	Light beer	\$6.80
3-3.5%	Mid strength beer and some RTDs	\$19
3.5-6.5%	Full strength beer and majority of RTDs	\$24
6.5-15%	Wine and some RTDs	\$35.11
15%	Fortified wine, Liqueurs and Full Strength Spirits	\$66.67

Option four affects prices in the following way -

Beverage	Size	ABV	Current price (includes GST)	Volumetric tax (includes GST)	Change
Full Strength Spirits	700 ml	40%	\$35.00	\$35.00	\$0.00
Liqueur	700 ml	17%	\$34.50	\$34.50	\$0.00
RTD 3.5%	375 ml	3.50%	\$2.80	\$2.26	down \$0.54
RTD 5%	375 ml	5%	\$3.30	\$2.26	down \$1.04
RTD 7%	375 ml	7.00%	\$5.00	\$3.02	down \$1.98
Wine cask	4,000 ml	12.5%	\$14.00	\$33.98	up \$19.98
Wine bottle \$8	750 ml	12.5%	\$8.00	\$10.54	up \$2.54
Wine bottle \$13	750 ml	12.5%	\$13.00	\$14.41	up \$1.41
Wine bottle \$18	750 ml	12.5%	\$18.00	\$18.29	up \$0.29
Wine bottle \$30	750 ml	12.5%	\$30.00	\$27.59	down \$2.41
Fortified Wine	375 ml	18%	\$32.00	\$30.74	down \$1.26
Light beer (pot/middy)	285 ml	2.70%	\$3.00	\$3.04	up \$0.04
Light beer (schooner)	425 ml	2.70%	\$4.00	\$4.06	up \$0.06
Light beer (stubby)	375 ml	2.70%	\$1.50	\$1.35	down \$0.15
Mid beer (pot/middy)	285 ml	3.50%	\$3.20	\$3.28	up \$0.08
Mid beer (schooner)	425 ml	3.50%	\$4.00	\$4.13	up \$0.13
Mid beer (stubby)	375 ml	3.50%	\$1.80	\$1.68	down \$0.12
Full beer (pot/middy)	285 ml	4.90%	\$3.50	\$3.57	up \$0.07
Full beer (schooner)	425 ml	4.90%	\$5.00	\$5.10	up \$0.10
Full beer (stubby)	375 ml	4.90%	\$2.00	\$1.86	down \$0.14

Volumetric Taxation – The Popular View

Support for a volumetric taxation model is strong and wide ranging. Many in the public health sector and in the beverages industry believe it is the way forward, not only for the important reasons of public health but because it provides a solid framework for the industry to plan for the future, safe in the knowledge that government policy is being driven by commonsense and evidence, not backroom deals and populism. Those on the record with their support are vocal and from a wide range of sectors – including Government, public health and the beverages industry itself:

“AGPN considers a volumetric tax for all alcohol products should [be] adopted in the long term and that planning, research and consultation directed towards adoption of a volumetric tax should commence immediately.”

Australian General Practice Network²

“Taxation on alcohol should be based on the alcohol content of drinks (a volumetric tax) rather than the cost of manufacture or the method used to produce the alcohol.”

Australasian Therapeutic Communities Association³

“AER argues that all alcohol should be taxed under one, consistent volumetric regime, saving administrative costs for government and not favouring alcohol beverage over any other.”

Alcohol Education and Rehabilitation Foundation⁴

“Under a ‘tiered’ volumetric tax system, the base tax is determined according to alcohol content. This approach can result in incentives for industry to produce lower alcoholic beverages, for individuals to consume such beverages and for an overall reduction in per capita consumption and related problems.”

National Drug Research Institute⁵

² http://www.aph.gov.au/Senate/committee/clac_ctte/alcohol_beverages/submissions/sub11.pdf

³ http://www.aph.gov.au/Senate/committee/clac_ctte/alcohol_beverages/submissions/sub12.pdf

⁴ http://www.aph.gov.au/Senate/committee/clac_ctte/alcohol_beverages/submissions/sub14.pdf

⁵ http://www.aph.gov.au/Senate/committee/clac_ctte/alcohol_beverages/submissions/sub15.pdf

" There is good evidence to suggest that price has a direct impact on consumption. VAADA is of the view that taxation on alcohol should be based on alcohol content through a system of volumetric taxation."

Victorian Alcohol and Drug Association⁶

The above quotes are certainly not an exhaustive list. Many other organisations in their submissions to the recent Senate Community Affairs Committee Inquiry into RTD Alcoholic Beverages indicated their support for a volumetric system of taxation including The Australian Psychological Society (submission 20), the Public Health Association of Australia (24), the Royal Australasian College of Physicians (25), The Distilled Spirits Industry Council of Australia (27), the Australian Drug Foundation, Cancer Council Victoria and Vic Health (28).

And the community believes Volumetric Tax is the way to go. Research carried out by Galaxy on behalf of Independent Distillers Australia on the weekend of 26, 27 and 28 September indicates there is public support for a volumetric taxation even before any public education or a policy debate has begun. The research shows that most Australians (69%) believe that ready to drink spirits with a similar alcohol content to beer should be taxed at the same rate as beer.

Opposition to a Volumetric Tax

However, it would be wrong to assume that everyone believes that a volumetric tax is the way forward. The wine industry is a vocal opponent of the more equitable, alcohol content based taxation regime primarily because their industry is currently being subsidised by government, consumers and other parts of the sector. And they use many arguments to counter it.

Most notably, their arguments centre around jobs, particularly in areas already hit by drought. While this jobs argument would certainly been the case 20 or 30 years ago, the advent of mechanical harvesters and automatic watering and weeding systems means this argument has largely been debunked. The actual number of people whose employment would be endangered by a volumetric tax in the wine industry is claimed to be about 3,500 by the industry itself, but this is at best a guesstimate and would include a very strong percentage of seasonal, itinerant workers.

The industry also argues that the wine industry is largely made up of small businesses. This is very far from the truth. Two thirds of the Australian wine market production is sold and marketed by two organisations: Fosters Group and the foreign owned Constellation Wines. The remaining third is in the hands of a very diverse group of corporations. Of the roughly 2,000 wineries in Australia, approximately 1,000 run at a loss each year and are generally owned by hobby wine-makers, current and semi-retired city professionals who see these farms as something other than an investment.

Other than at a regional grower level, the Australian wine industry is no longer about small business. Drought has proven that many of these small businesses are marginal at best and will require significant Government subsidy and assistance to be kept afloat – hardly in the best interests of a strong economic rationale.

It could be argued that the Australian Government's historical 'protected species' treatment of the Australian wine industry, particularly at the cask wine end, constitutes a protective tariff, which is in direct contravention of WTO trading standards. It would also be at direct odds with the stated policy direction of the Commonwealth in relation to industry development as exemplified by policy toward the automotive industry, where subsidies have been reduced over the past number of years. It would be fair to say that the wine industry has received favourable tax treatment over the last two decades which has given it a level of protection substantially out of proportion to its economic value to the Australian economy.

⁶ http://www.aph.gov.au/Senate/committee/clac_ctte/alcohol_beverages/submissions/sub16.pdf

In short, drinkers of beer, RTDs, cider, spirits – as well as those who do not drink – have been subsidising drinkers of wine over the last 20 years.

Recommendations and Conclusions

The current system of alcohol taxation is inequitable, sends conflicting messages to both manufacturer and consumer and is based on nothing but historical, protectionist deals with industry. There are clear conflicts between health and taxation objectives. Australia must take similar action to NZ in the 90s when they restructured their method of alcohol taxation to better reflect the view of the community around healthcare. While many of the challenges that have confronted previous governments (including the Keating Government in 1993) still remain, the time has come for evidence based decisions to be made on health policy.

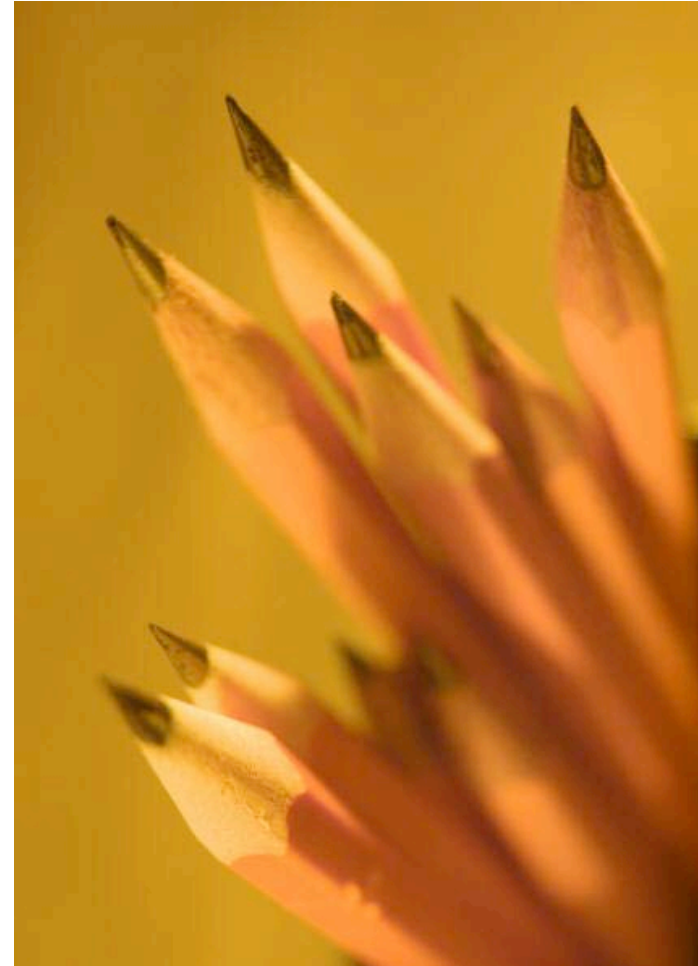
We – and many in the public health system – believe the way forward is through a system of volumetric taxation. A system that locks in government revenues but also provides the right strategic policy platform for better health outcomes.

Modelling a volumetric excise tax

Report to Independent Distillers (Aust) Pty Ltd

Our presentation

- Purpose
- Government revenue projections
- Models and price effects
 - Flat tax
 - Progressive two step
 - Progressive three step
 - Progressive six step
- Definitions and assumptions



Purpose

- ➔ This presentation considers the volumetric excise rate/s that would be required to maintain alcohol excise revenue neutrality based on 2008-09 Budget Forward Estimates under two broad scenarios:

Scenario 1 - Flat tax

Scenario 2 - Progressive tax

2a - Two step tax

2b - Three step tax

2c - Six step tax



Volumetric excise rate

- A volumetric excise rate is a rate applying to the alcohol content of alcoholic beverages.
- Alcohol content varies significantly across categories.

Alcohol content

Light strength beer = 0–3%

Mid strength beer = 3–3.5%

Full strength beer = 3.5–6.5%

RTDs = 3–9%

Wine = 11–14%

Fortified wine/liqueur = 15%–37%

Spirits = 37% +

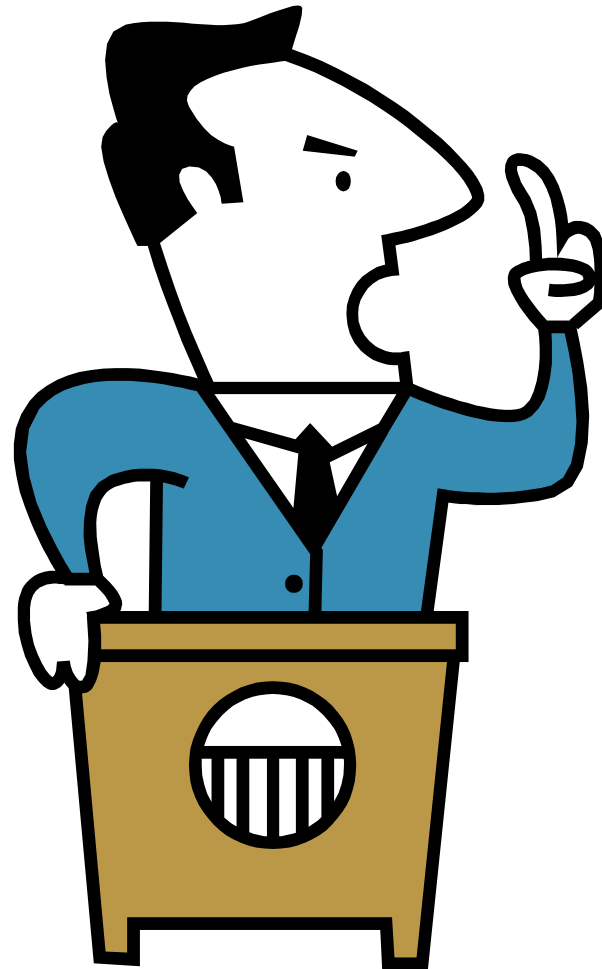
What is revenue neutrality?

- Tax rates are changed but total tax revenue does not change.



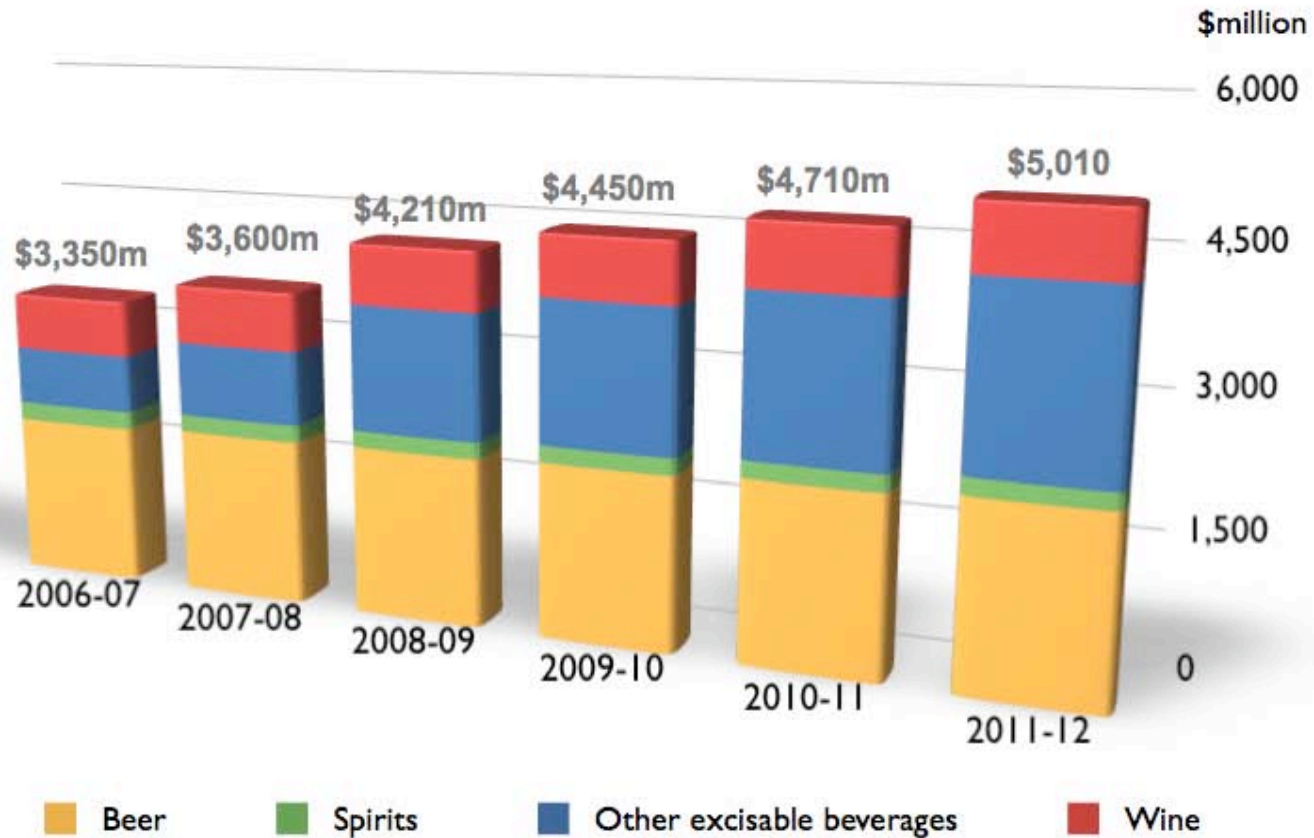
What is the Government projecting?

- ➔ On 27 April 2008 the tax rate applying to RTDs was increased from \$39.36 to \$66.67 per litre of alcohol.
- ➔ The Government said that this measure 'closed a loophole' created with the introduction of the GST.
- ➔ The Government advised that the measure will result in an estimated gain to revenue of approximately \$3.1 billion over the forward estimates period.



2008-09 Government revenue projections

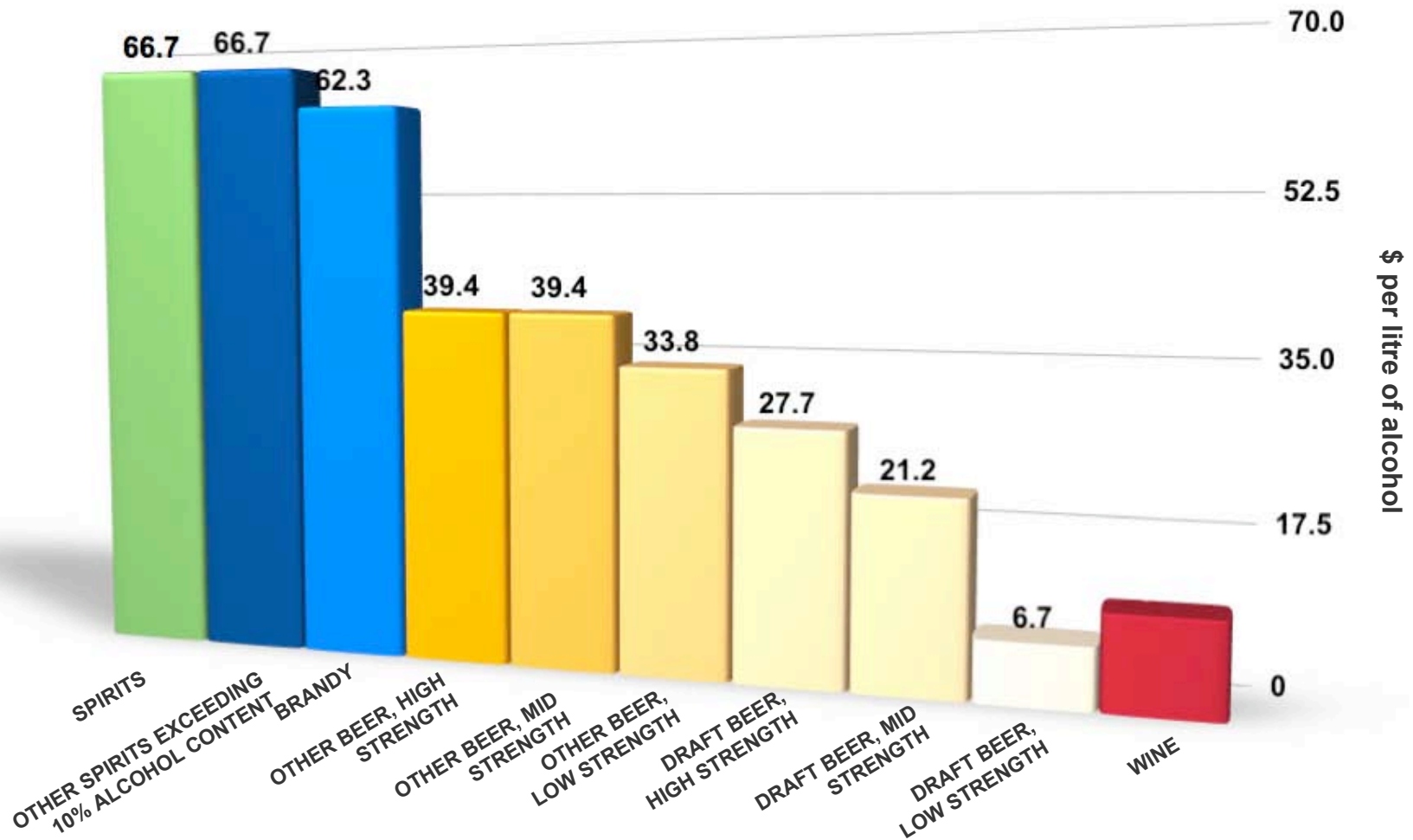
(alcohol excise plus wine equalisation tax excluding customs duty and GST)



Source: Treasury budget papers 2008-09

Note: Projections from 2007-08 onwards include the additional \$3.1 billion collected as a result of the RTD excise change.

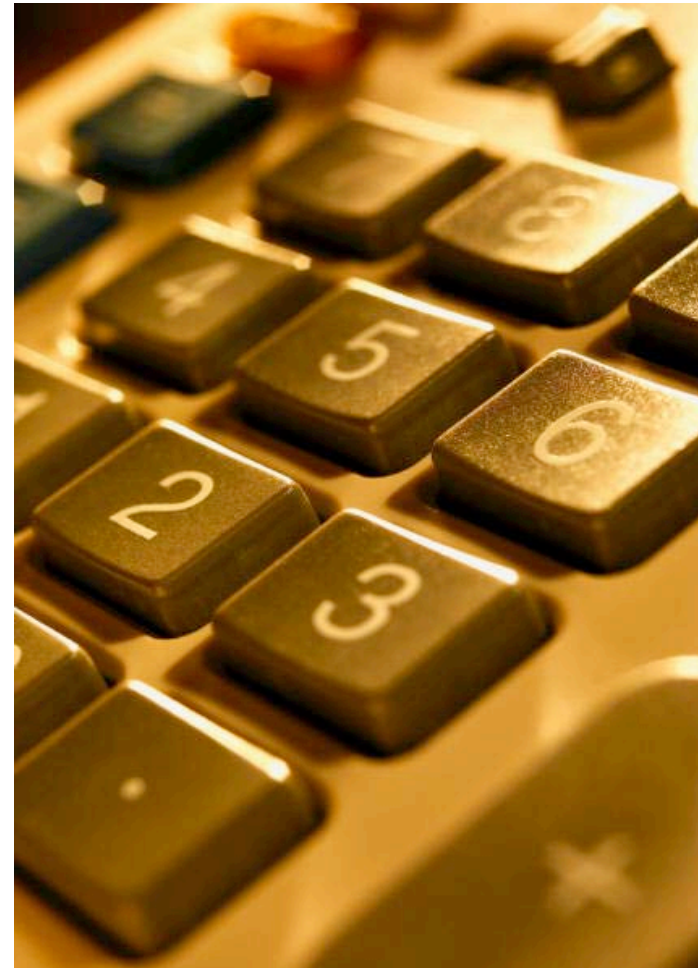
April 2008 excise rates



Source: Treasury budget papers 2008-09
Note: Wine equivalent excise

Treasury modelling

- Treasury assumed a 4% slowdown in RTD sales resulting in a reduction in growth by 42.7 million 375ml bottles in 2008-09. They used a known price elasticity of demand at minus 0.4 which was derived from a number of academic studies.
- Treasury assumed zero substitution of other alcohol products. Treasury argued that with different alcohol beverages some are substitutes and some are complements and there was no evidence that substitution effects would dominate.



ACG modelling

- For consistency, we have adopted Treasury's assumptions in our modelling.

Aspects of the current system

Many anomalies exist in the current alcohol tax system:

- Australian produced beer, spirits and RTDs are subject to excise duty collected by ATO
- Imported beer, spirits and RTDs are subject to customs duty collected by ACS
- Imported spirits and RTDs but not beer are subject to an additional 5% *ad valorem* customs duty/protective tariff
- All wine is subject to the Wine Equalisation Tax which generally applies at the rate of 29% of the last wholesale selling price.

Why a volumetric flat tax?

- A number of submissions to the Standing Committee on Community Affairs inquiry into 'ready to drink alcohol beverages' called for a *full* volumetric based taxation regime. Health associations such as the Australian Drug Foundation and the Public Health Association of Australia argued that the current approach facilitated the sale of high-alcohol products at cheap prices.
- Some groups such as the Alcohol Education and Rehabilitation Foundation argued that all alcohol should be taxed under one, flat volumetric regime which would save administrative costs and not favour any particular alcoholic beverages.

Calculating the flat tax

- Alcohol litres \times Flat tax = Revenue
- Holding everything else constant, what tax is required to achieve alcohol revenue estimates (alcohol excise + WET) of \$4,210 million in 2008-2009?
- Assumptions discussed later in presentation

What would a flat tax look like?

- To achieve revenue neutrality the flat tax would be

➔ \$30.62 per litre of alcohol

- This rate would apply in 2008-09 and then be indexed for CPI inflation.

Price effect of a flat tax

Beverage	Current price (including GST)	Flat tax (including GST)	Change
Spirits	\$35	\$22.45	-\$12.55
Liqueur	\$34.50	\$29.17	-\$5.33
RTD 3.5% ABV	\$2.80	\$2.19	-\$0.61
RTD 5%	\$3.30	\$2.42	-\$0.88
RTD 7%	\$5	\$3.77	-\$1.23
Wine cask 4 litre	\$14	\$31.07	\$17.07
Wine bottle \$8	\$8	\$9.99	\$1.99
Wine bottle \$13	\$13	\$13.87	\$0.87
Wine bottle \$18	\$18	\$17.74	-\$0.26
Wine bottle \$30	\$30	\$27.05	-\$2.95
Fortified wine	\$32	\$27.53	-\$4.47
Light beer pot/middy	\$3	\$3.36	\$0.36
Light beer schooner	\$4	\$4.54	\$0.54
Light beer bottle	\$1.50	\$1.64	\$0.14
Mid beer pot/middy	\$3.20	\$3.49	\$0.29
Mid beer schooner	\$4	\$4.43	\$0.43
Mid beer bottle	\$1.80	\$1.87	\$0.07
Full beer pot/middy	\$3.50	\$3.73	\$0.23
Full beer schooner	\$5	\$5.35	\$0.35
Full beer stubby	\$2	\$2.01	\$0.01

Why a progressive two step tax?

- A number of submissions to the Standing Committee also argued that a tiered approach was warranted to provide more incentive for consumers to consume low-strength alcoholic beverages and for manufacturers to produce them.
- New Zealand has a two-step model whereby spirits are taxed at NZ\$43.59 per litre of alcohol and all other products at NZ\$23.94 per litre of alcohol, including wine.

Calculating the two step tax

➡ The NZ rates would not result in revenue neutrality for Australian revenue projections. Thus new rates were chosen to preserve revenue neutrality.

➡ Calculation

Alcohol litres (non-spirits) ✖ Tax rate 1

+ Alcohol litres (spirits) ✖ Tax rate 2

= Revenue

What could a two step tax look like?

- ✦ Under a two step progressive tax, the excise schedule could be:
 - ➔ \$29 per litre of alcohol for all other beverages
 - ➔ \$66.67 per litre of alcohol for spirits (April 2008 rate)

- ✦ These rates would apply in 2008-09 and then be indexed

Price effect of a two step tax

Beverage	Current price (including GST)	Two step tax (Including GST)	Change
Spirits	\$35	\$35	\$0.00
Liqueur	\$34.50	\$34.50	\$0
RTD 3.5% ABV	\$2.80	\$2.16	-\$0.64
RTD 5%	\$3.30	\$2.38	-\$0.92
RTD 7%	\$5	\$3.72	-\$1.28
Wine cask 4litre	\$14	\$30.00	\$16.00
Wine bottle \$8	\$8	\$9.79	\$1.79
Wine bottle \$13	\$13	\$13.67	\$0.67
Wine bottle \$18	\$18	\$17.54	-\$0.46
Wine bottle \$30	\$30	\$26.85	-\$3.15
Fortified wine	\$32	\$27.39	-\$4.61
Light beer pot/middy	\$3	\$3.34	\$0.34
Light beer schooner	\$4	\$4.51	\$0.51
Light beer bottle	\$1.50	\$1.62	\$0.12
Mid beer pot/middy	\$3.20	\$3.46	\$0.26
Mid beer schooner	\$4	\$4.49	\$0.39
Mid beer bottle	\$1.80	\$1.84	\$0.04
Full beer pot/middy	\$3.50	\$3.69	\$0.19
Full beer schooner	\$5	\$5.29	\$0.29
Full beer stubby	\$2	\$1.98	-\$0.02

Why a progressive three step tax?

- A more stepped approach could provide further incentives for consumers to consume lower alcohol beverages and manufacturers to produce them.
- The risk is that it moves away from the argument that 'alcohol is alcohol'.
- It also maintains, to some degree, the current system's complexity, though to a lesser extent.
- This approach creates tax bands based on alcohol content
 - 0-10% ABV
 - 10-20%
 - 20%+

Calculating the three step tax

➔ Calculation

$$\begin{aligned} & \text{Alcohol litres (0-10\%ABV)} \times \text{Tax rate 1} \\ + & \text{Alcohol litres (10-20\%)} \times \text{Tax rate 2} \\ + & \text{Alcohol litres (20\%+)} \times \text{Tax rate 3} \\ = & \text{Revenue} \end{aligned}$$

What could a three step tax look like?

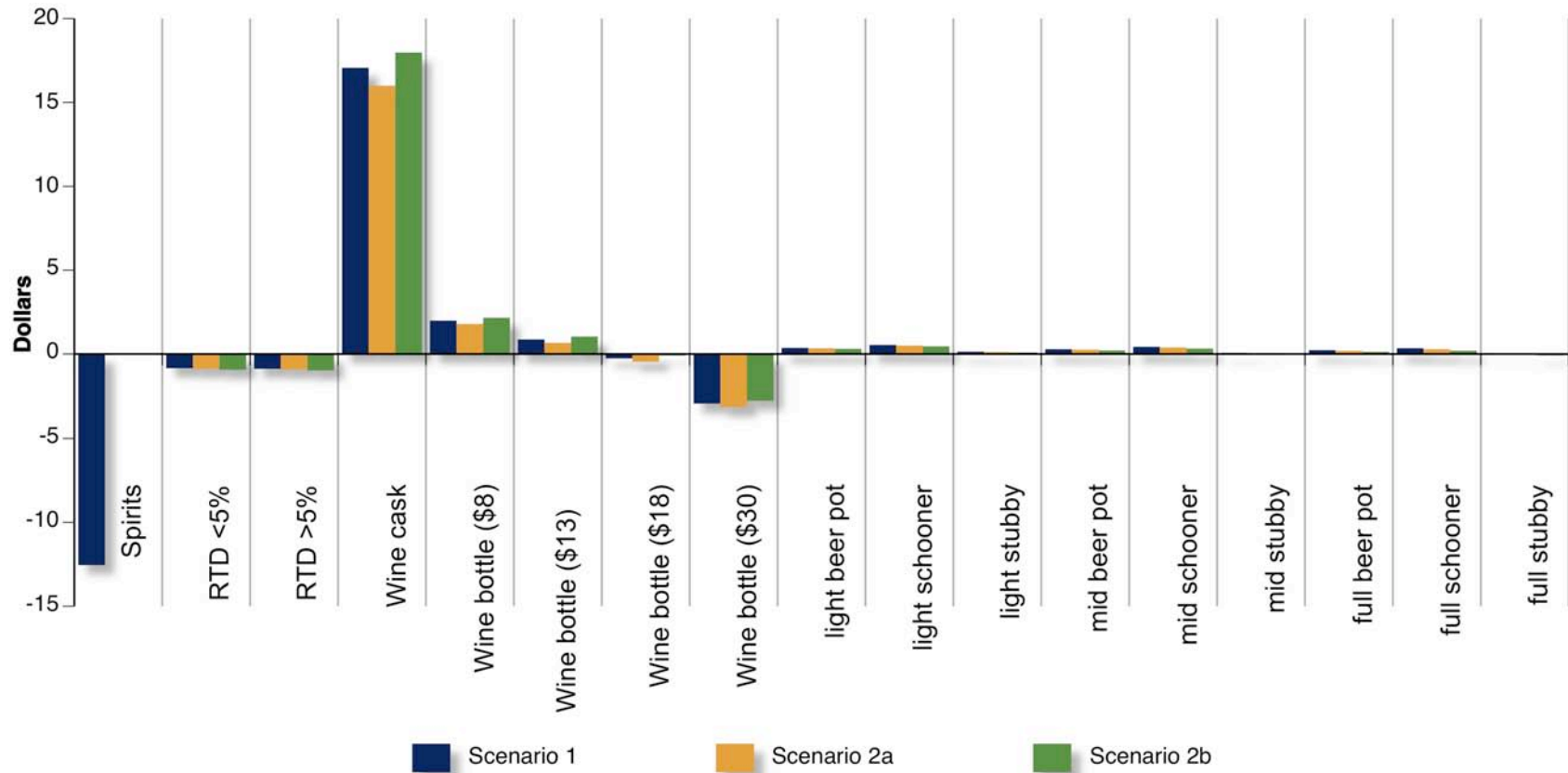
- Under a three step progressive tax the excise schedule could be:
 - ➔ \$26.53 per litre of alcohol for 0-10%
 - ➔ \$32 per litre of alcohol for 10-20%
 - ➔ \$66.67 per litre of alcohol for 20%+
- In this model, the rate for '20%+' has been kept consistent with the April 2008 excise rate for spirits at 66.67.
- The rate for the '10-20%' band was chosen to be higher than the rate for the '0-10%' band, reflecting its higher alcohol content. Given these two bands, the tax on the '0-10%' band was chosen to achieve revenue neutrality.

Price effect of a three step tax

Beverage	Current price (including GST)	Three step tax (including GST)	Change
Spirits	\$35	\$35	\$0.00
Liqueur	\$34.50	\$34.50	\$0.00
RTD 3.5% ABV	\$2.80	\$2.12	-\$0.68
RTD 5%	\$3.30	\$2.32	-\$0.98
RTD 7%	\$5	\$3.63	-\$1.37
Wine cask 4 litre	\$14	\$31.97	\$17.97
Wine bottle \$8	\$8	\$10.16	\$2.16
Wine bottle \$13	\$13	\$14.04	\$1.04
Wine bottle \$18	\$18	\$17.91	-\$0.09
Wine bottle \$30	\$30	\$27.22	-\$2.78
Fortified wine	\$32	\$27.65	-\$4.35
Light beer pot/middy	\$3	\$3.31	\$0.31
Light beer schooner	\$4	\$4.46	\$0.46
Light beer bottle	\$1.50	\$1.59	\$0.09
Mid beer pot/middy	\$3.20	\$3.41	\$0.21
Mid beer schooner	\$4	\$4.32	\$0.32
Mid beer bottle	\$1.80	\$1.80	\$0.00
Full beer pot/middy	\$3.50	\$3.63	\$0.13
Full beer schooner	\$5	\$5.20	\$0.20
Full beer stubby	\$2	\$1.92	-\$0.08

Change in prices

Scenario 1 (flat tax), Scenario 2a (two step tax) and Scenario 2b (three step tax)



Why a six step tax?

➤ A six step tax uses the same logic as the three step tax but with more detail. That is, the higher the alcohol content, the higher the tax rate.

The steps:

Alcohol content

- ➔ 0-3% ABV
- ➔ 3-3.5%
- ➔ 3.5%-6.5%
- ➔ 6.5-15%
- ➔ 15-37%
- ➔ 37% +

Calculating a six step tax

➔ Calculation

Alcohol litres (0-3% ABV) ✖ Tax rate 1
+ Alcohol litres (3-3.5%) ✖ Tax rate 2
+ Alcohol litres (3.5-6.5%) ✖ Tax rate 3
+ Alcohol litres (6.5%-15%) ✖ Tax rate 4
+ Alcohol litres (15%-37%) ✖ Tax rate 5
+ Alcohol litres (37%+) ✖ Tax rate 6
= Revenue

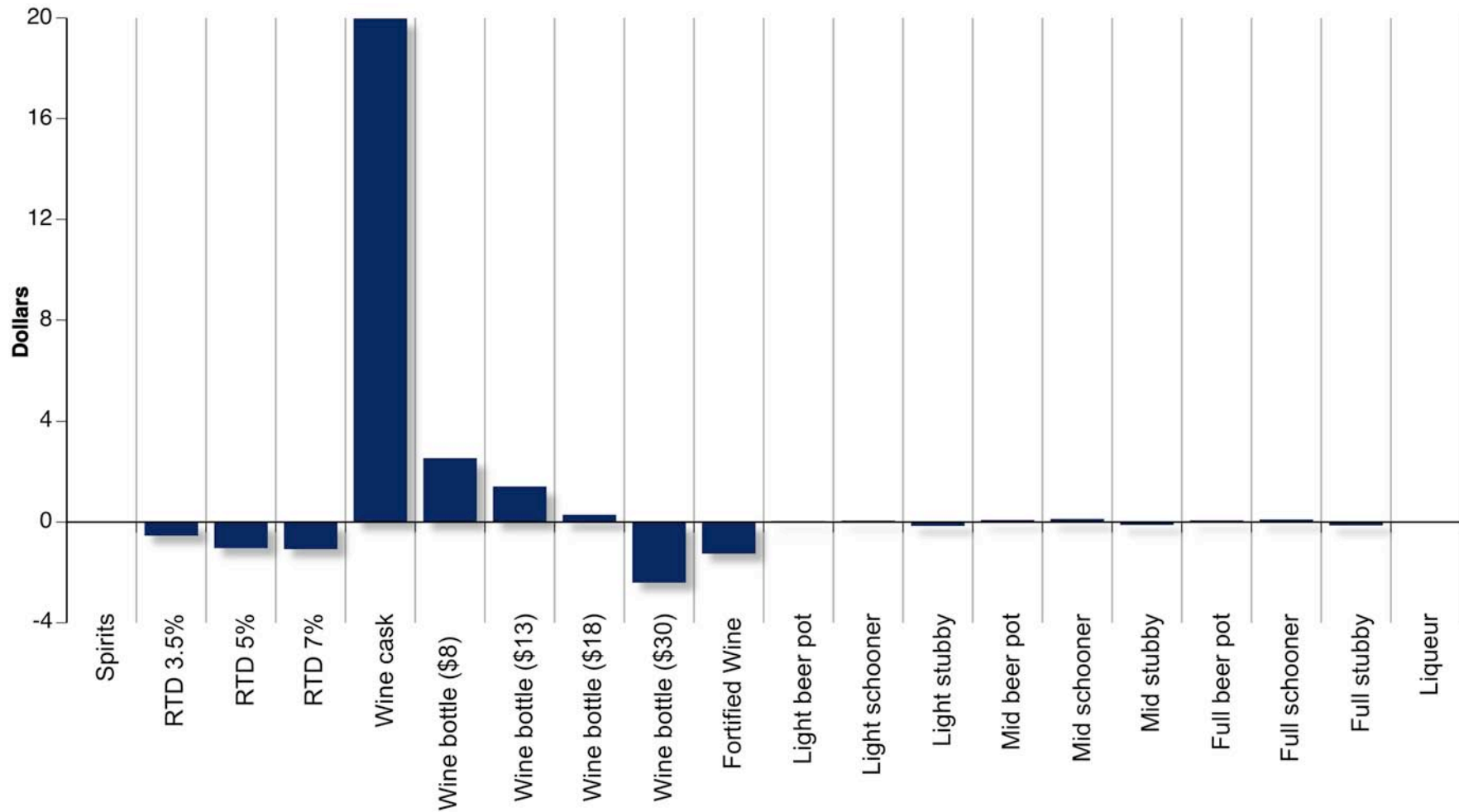
What a six step tax could look like

Alcohol content	Tax rate per litre of alcohol	Type of beverage in band
0-3%	\$6.80	Light beer
3-3.5%	\$19	Mid beer and some RTDs
3.5-6.5%	\$24	Full beer and majority of RTDs
6.5-15%	\$35.04	Wine and some RTDs
15-37%	\$66.67	Fortified wine and liqueurs
37%+	\$66.67	Spirits

Price effect of a six step tax rate

Beverage	Current price (including GST)	Six step tax (including GST)	Change
Spirits	\$35	\$35	\$0.00
Liqueur	\$34.50	\$34.50	\$0.00
RTD 3.5% ABV	\$2.80	\$2.26	-\$0.54
RTD 5%	\$3.30	\$2.26	-\$1.04
RTD 7%	\$4.10	\$3.02	-\$1.08
Wine cask	\$14	\$33.98	\$19.18
Wine bottle \$8	\$8	\$10.54	\$2.54
Wine bottle \$13	\$13	\$14.41	\$1.41
Wine bottle \$18	\$18	\$18.29	\$0.29
Wine bottle \$30	\$30	\$27.59	-\$2.41
Fortified wine	\$32	\$30.74	-\$1.26
Light beer pot	\$3	\$3.04	\$0.04
Light beer schooner	\$4	\$4.06	\$0.06
Light beer bottle	\$1.50	\$1.35	-\$0.15
Mid beer pot	\$3.20	\$3.28	\$0.08
Mid beer schooner	\$4	\$4.13	\$0.13
Mid beer bottle	\$1.80	\$1.68	-\$0.12
Full beer pot	\$3.50	\$3.57	\$0.07
Full beer schooner	\$5	\$5.10	\$0.10
Full beer stubby	\$2	\$1.86	-\$0.14

Change in price associated with a six step tax rate



Taking a step back...the current alcohol tax regime

Alcohol excise

- Manufacturers of alcohol not subject to WET have a responsibility under the *Excise Act 1901* and *Excise Tariff Act 1921* to pay excise duty on certain goods. Excise duty applies to:
 - beer (except home brew)
 - spirits such as brandy, rum and vodka (unless the spirit is purchased for an approved purpose under the concessional spirits scheme)
 - liqueurs
 - other alcoholic beverages not subject to WET
- Excise is calculated per litre of alcohol
- Excise duty rates applying to beer vary according to alcohol content and container size. The duty-free threshold for beer is 1.15% alcohol content.
- Section 61 of the Excise Act provides that excisable goods remain under the Tax Office's control until delivered for home consumption or for export.

Source ATO Alcohol Industry Excise Technical Guidelines 2006

Taking a step back...the current alcohol tax regime

Wine equalisation tax

- All wines, meads, perries, ciders and sakes are subject to WET. Unlike alcohol excises, the WET is an *ad valorem* tax. It is calculated at a rate of 29% of the final wholesale price or, in certain other permitted circumstances, of a nominal wholesale value calculated as 50% of the retail price, or alternatively at the average wholesale price for identical wine.
- The WET is a value-based tax which is applied to wine consumed in Australia. It applies to assessable dealings with wine (unless an exemption applies) which include wholesale sales, untaxed retail sales and applications to own use.
- Australian wine manufacturers, wine wholesalers and wine importers are usually liable to pay WET and they make their payment to either the Australian Tax Office or Australian Customs Service.
- From 1 July 2006, a rebate has been payable on the first \$50,000 in wine equalisation tax paid annually by any producer or producer group.

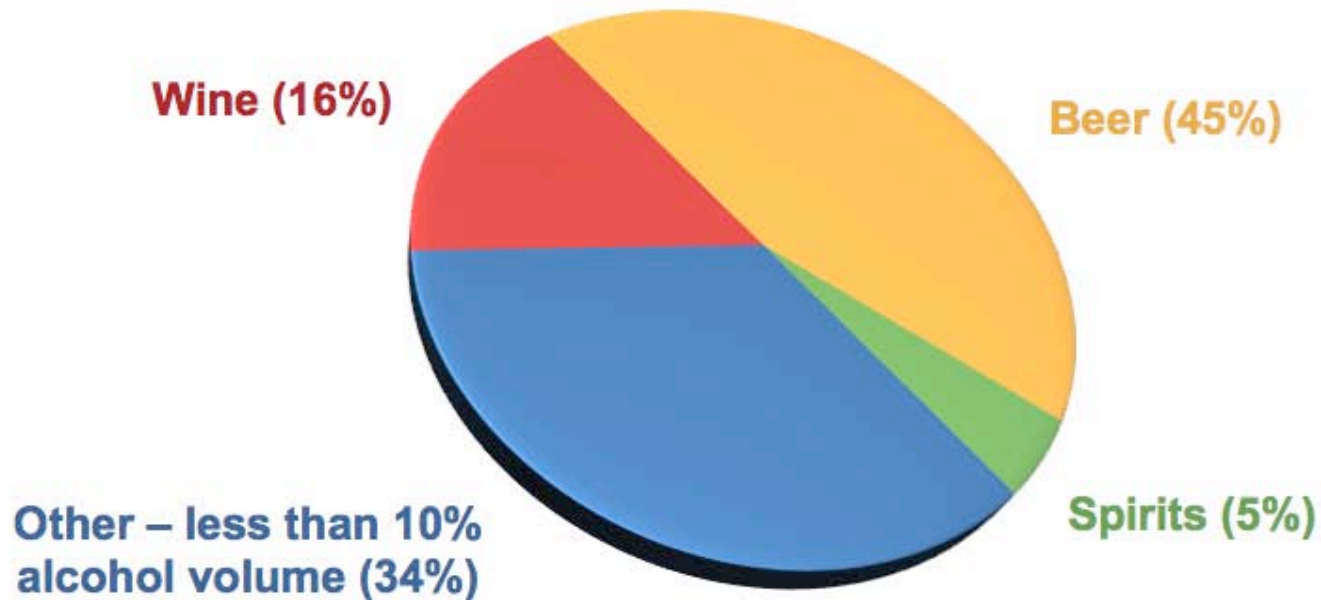
Source: ATO website accessed July 2008

Alcohol excise/WET as a proportion of the total

	Revenue estimates 2008-09	% of total government revenue
Total government revenue	\$366 billion	100%
Total excise revenue (petroleum, tobacco, beer, spirits, crude oil)	\$25 billion	6.86%
Total alcohol revenue (alcohol excise + WET)	\$4.2 billion	1.12%

Source: Treasury Budget paper 2008-09

Proportion of 2006-07 revenue (WET/ alcohol excise) by alcohol product by alcohol litres



Source: ATO Taxation statistics 2005-06

What about spirits?

- Spirits generate more revenue through customs duties and GST than through excise: customs duty levied from spirits comprises around 87 per cent of the total revenue from spirits, excluding GST.
- GST revenue from spirits is also significant comprising 40.4% of total GST revenue from all alcohol.

Source: DSICA pre-budget submission 2008

Implementation considerations

- Government revenue on alcohol is derived from GST, customs duty, excise and WET. Removing the WET and changing the excise has flow on implications for GST so therefore decreasing the excise rate on spirits for example, decreases the price of spirits and therefore also decreases the GST derived from the sale of spirits.
- As the WET is applied to some imports (rebates apply in the case of NZ for example) and excise tax does not apply to imports, then a new duty may need to be considered for some imports.
- The model has *removed the 1.15% duty-free threshold for beer*. This had the effect of increasing the amount of excisable beer.

Sources/assumptions - revenue, quantity, excise

- Revenue (actual, estimates, projections)
 - Australian Government general government revenue (source: Treasury budget papers 2008-09)
- Quantity
 - Alcohol megalitres: (source: ATO Taxation statistics 2006-07)
 - Quantity projections determined by revenue projections and CPI (source: Treasury budget papers 2008-09)
 - Proportion of beer market segmented into low, mid and full strength beer (source: Independent Distillers advice)
 - 'Non-commercial beer' is an insignificant proportion of beer market (source: Independent Distillers advice)
- Excise
 - Excise schedule (source: Treasury budget papers 2008-09)
 - Projected excise calculated assuming 3% inflation (source: Treasury budget papers 2008-09)
 - Volumetric tax rates under four scenarios chosen to ensure revenue neutrality

Source/assumptions - wine

➤ Wine

— Wine equivalent excise estimated in two ways to cross check results:

- 1) Quantity of wine produced domestically less exports (source: ABS 2007 Wine and Grape Industry data)
- 2) Using estimates for tax per standard drink of wine = weighted 50% cask (6c per standard drink) 48% semi premium (20c for per standard drink), 2% premium (25c per standard drink) (source: ABARE, Winemakers Association of Australia and DSICA pre-budget submission)

= both calculations yielded equivalent wine excise rate of \$10.33 in 2007

Source/assumptions - retail

➤ Retail markup

— Estimates of average markup per class of beverage provided by Independent Distillers

Product	Retail markup %
Spirits	13
RTD	18
Wine	20
Draught beer	60
Packaged beer	10

Markup calculations

➤ Markup calculated as follows:

➤ For all beverages other than wine:

$$\text{Selling price} = (\text{Wholesale} + \text{tax}) \times (1 + \text{Markup}\%) + \text{GST}$$

➤ For wine:

$$\text{Selling price} = (\text{Wholesale} \times 1.29) \times (1 + \text{Markup}\%) + \text{GST}$$

➤ Current price

Current price data taken from retail websites and hoteliers by phone

Summary

- Four volumetric tax scenarios which achieve revenue neutrality

Scenario	Tax rates per litre of alcohol
Scenario 1: Flat tax	\$30.62
Scenario 2a: Two step tax	\$29 for all other beverages \$66.67 for spirits
Scenario 2b: Three step tax	\$26.53 (0-10% ABV) \$32 (10-20%) \$66.67 (20%+)
Scenario 2c: Six step tax	\$6.80 for (0-3% ABV) \$19 for (3-3.5%) \$24 for (3.5-6.5%) \$35.04 for (6.5-15%) \$66.67 for (15-37%) \$66.67 for (37%+)

Conclusions

- The current system contains significant anomalies
- We have provided four volumetric models that tax alcohol according to alcohol content
- Our modelling demonstrates it is possible to achieve revenue neutrality under a less complex tax regime and potentially achieve health policy objectives