Submission to Senate Economics Legislation Committee

Wine Equalisation Tax (WET)

Amendments to the A New Tax System (Wine Equalisation Tax) Act 1999 ("the WET Act")

1. We write to convey our concerns regarding certain technical aspects of the Tax Laws Amendment (Wine Producer Rebate and Other Measures) Bill 2004.

2. It seems to us that the Bill may have been conceived in haste. In the interests of legislative certainty for taxpayers, we respectfully request that our technical concerns be addressed before the Bill finally becomes law.

3. It is noted that the Bill has already been subject to technical amendments. It is also noted that there are other concerns with the Bill as evidenced by a paper prepared by the Department of Parliamentary Services. This paper addresses concerns that aspects of the Bill may be in breach of Australia's international treaty obligations. The paper is available on the Parliament of Australia website, under Information and Research Services. It is Bill Digest No 9 dated 28 July 2004.

4. Returning to our technical concerns, the Bill consists of four largely autonomous measures. The two measures of concern to us are Schedule 1- Wine Producer Rebates and Schedule 2- Compliance improvement measures.

5. Any delay to the passage of the Bill is unlikely to inconvenience wine producers to any significant degree provided that their entitlement to the wine producer rebate, in whatever form it is finally delivered, is delivered to them from 1 October 2004 as promised.

Wine Producer Rebate

6. This measure is designed to effectively "exempt" from the impact of the 29% WET the first $1 million in wholesale sales value of a producer's sales of wine. This wine is described as "rebatable wine". WET exemption is intended to make it easier for smaller wineries to compete on the domestic market. The measure is also intended to simplify the paperwork for small wineries.

7. To be rebatable the wine must be sold in taxable circumstances, either by the producer or by a wholesaler who has subsequently purchased the wine WET-free.

8. Exemption from WET is achieved by giving the producer an entitlement to a wine producer rebate after the producer or some other party has become liable to pay WET on the wine. Thus, once WET becomes payable (or likely to be payable) the producer becomes eligible to claim from the ATO a wine producer rebate

calculated as 29% of the wholesale selling price of the wine, excluding WET and GST.

9. Our concern is that the draughtsman appears to have overlooked the distinct possibility that, in many cases, especially in relation to sales to wholesalers and retailers (including restaurants), producers who sell rebatable wine may belatedly pass on the wine producer rebate (or part thereof) to their customers. It is strongly arguable that passing on the rebate will amount to a reduction in the price for which the producer sold the rebatable wine – see AD1a in section 5-5 of the WET Act. This, in turn, will lead to a reduction in the producer's entitlement to the wine producer rebate. Where this occurs the producer may be required to reduce its claim or repay the excess rebate to the ATO.

10. Where the producer makes a taxable sale of rebatable wine the liability to repay the excess wine producer rebate claim is offset by the producer's *separate* entitlement to a WET credit under CR1 in section 17-5 of the WET Act. This requires the producer to calculate and keep a record of its WET credit entitlements and revised wine producer rebate entitlements so that it can demonstrate fiscal neutrality to the ATO.

11. **There is a related, but even more serious problem where a producer is dealing with a wholesaler who has purchased rebatable wine WET-free under quotation of an ABN.** Passing on the rebate in these circumstances arguably reduces the price for which the producer sells the rebatable wine. This leads to the conclusion that the wine producer rebate has been overclaimed, which in turn makes the producer liable to repay the excess amount. However, as the producer does not enjoy a corresponding WET credit entitlement (unlike in the circumstances outlined above), the producer will be out of pocket by the amount of the rebate passed on to its customers.

12. As this is clearly the exact opposite of what is intended, it is submitted that the Bill should be urgently reviewed. It is suggested that it would be far simpler and less onerous on producers if the WET Act were to be amended such that any belated 'passing on' of the wine producer rebate is deemed to not constitute a reduction in the price for which rebatable wine is sold.

New Assessable Dealing for Retail Sales

General Comments

13. There appear to be several problems with this measure. They flow from the fact that the measure seems to overlook the body of case law precedents in relation to "containers" under the wholesale sales tax ("WST") system. As you may be aware, the WET Act and related legislation is based on the WST.

14. In addition, the measure is designed to operate counter to, instead of consistently with, the general single-stage scheme of the WET legislation in that the measure operates by imposing a second liability for WET on a dealing in wine that has already had WET imposed on it. Thus, any retailer wishing to purchase bulk wine

and arrange for its packaging will be penalised, albeit temporarily, with double taxation.

15. Double taxation is inherently counter to the general WET scheme. As was the case with the scheme of the WST, WET is intended to operate as a single stage tax on dealings with wine at the wholesale level.

16. Another problem with the proposed amendment is that it may be too reliant on the EM for its intended application. As you may be aware, the courts may not, and in many cases are reluctant to, refer to extrinsic material, such as the EM, unless the wording used in the legislation is vague or ambiguous – see for example the discussion by the Full Federal Court in paragraphs 21 and 26 of *Commissioner of Taxation v The Distribution Group Limited [2003] FCAFC 182.*

Specific Problems with new AD

17. The new ADs (we understand the proposed AD has now been split into two new ADs under an amendment to the amending Bill) apply to wine that is "placed in containers" after WET has become payable by someone other than the retailer of the wine. However, the definition of "container" in division 33 of the WET Act, assuming that it applies, includes "packaging in which, or with which, any property is packed or secured, in the ordinary course of business, for the purpose of the marketing or delivery of the contents". Taken literally, and having regard to WST case law precedents, including *Federal Commissioner of Tax v Kentucky Fried Chicken Pty Ltd (1988) 12 NSWLR 643,* and the broad meaning of "packaging", it is strongly arguable that the definition would apply to a wine glass or carafe into which tax paid wine is poured for retail sale by a restaurant, hotel or club operator. If so, such persons would be liable for WET pursuant to the new AD.

18. It is noted that "house" wine is sometimes sold to retailers such as restaurants and bars in bulk "dispensers" of up to 400 litres. It is not inconceivable that wine dispensed from these bulk containers into glasses and carafes at the point of retail sale are caught by the proposed new AD.

19. In addition, the "container" definition in the WET Act covers paper bags, cartons and carry boxes with handles. Retailers who *place* tax paid bottled wine *into* these *containers* are literally caught by the new AD.

20. Also literally caught are retailers who purchase bottled but unlabelled wine ("cleanskins") which they proceed to label and place into cartons prior to transportation to their retail premises for retail sale.

21. The EM to the Bill distinguishes between packaging used to prepare wine to *reach* the point of retail sale and the packaging of wine *at* the time of retail sale. Examples of the latter category of packaging are said to be putting wine in paper bags and utilising containers of the retail purchaser. However, as stated above, the EM may not be determinative in applying the Bill. Any Bill that relies too heavily on the EM for its application is in our respectful opinion an unsatisfactory Bill.

22. What makes it worse is that the definition of "container" in the WET Act and the WST precedents do not support the distinction made in the EM. It is abundantly clear, for instance, that if a wholesaler puts a bottle of wine in a paper bag at the time of making a wholesale sale the bag would qualify as a container. In this situation, any attempt on the part of the wholesaler to exclude the value of the bag from the taxable value of the bottle of wine would be challenged (successfully) by the ATO – see section 9-65 of the WET Act.

23. Despite the EM, it is difficult to see how a paper bag can be a "container" as defined when a wholesale sale is made, but not a "container" when a retail sale is made. To provide certainty for retailers, the definition of "container" in the WET Act should be amended as part of the Bill now under consideration.

24. Retailers wishing to escape the impact of the proposed new AD will also be tempted to adopt measures which circumvent the new measure, e.g. by selling empty bottles to customers and then filling those bottles as a separate transaction.

Conclusion

25. The WET Act very closely resembles the former WST legislation, but with one important difference- under WST goods used as packaging for other taxable goods were taxed because WST applied to various goods, including packaging. Under WET, however, only wine is taxed. This difference in scope makes it extremely difficult to improve WET compliance in the manner proposed.

26. In relation to containers, the WST scheme was to tax the containers at the same time and at the same rate as their contents. However, according to paragraph 6.22 of the EM to the Bill by which the WET Act was introduced (the Wine Equalisation Tax Bill), the legislative scheme is that: "If assessable wine is the subject of an assessable dealing while it is in a container, then the value of the container will be included in the taxable value of the assessable dealing with the contents."

27. As the proposed amendment runs contrary to this scheme by attempting to double tax wine after being placed in a container, it is submitted that the amendment should be withdrawn and replaced by a measure that is more in accordance with the legislative scheme. An example might be a new assessable dealing under which retailers who purchase wine in bulk (the "bulk" quantity to be specified) and place wine drawn from the bulk supply into bottles, flagons, casks and similar receptacles prior to the retail sale and delivery of the contents will become liable for WET on the notional wholesale selling price of the wine, including the packaging.

28. The new replacement AD would apply where the retailer or an associate of the retailer supplies the receptacle. This would allow specialist wine retailers who purchase small quantities of bulk wine (within the specified limit) or retailers who fill customer-supplied receptacles (not having been purchased from the retailer) to remain outside the scope of the new replacement AD.

29. A quoting ground should be inserted into section 13 of the WET Act so as to permit an affected retailer to purchase the bulk wine free of WET and thereby avoid the penalty of temporary double taxation. Other retailers who are caught by provisions of the WET Act are currently permitted to quote their ABN.

30. It is noted that retail sales via "indirect marketing arrangements" are currently caught by the WET Act. However, affected taxpayers are brought into the net consistently with the overall scheme of the legislation, e.g. see, section 13-5(1)(a) for a quoting ground and AD2d in section 5-5. It would be fair and reasonable to extend the same facility to retailers affected by the AD currently being considered.

31. Section 9-65 of the WET Act should be also revised with a view to catching contrived arrangements under which retailers or their associates supply empty receptacles to customers prior to filling them with wine.

32. This style of amendment would fit more logically into the existing scheme of the WET legislation and would remove the temporary double tax penalty.

33. The new AD will tax a retail sale of wine even though the full wholesale value of the wine at the time of final wholesale sale has already been taxed. It achieves this outcome by, in effect, subjecting the packaging to wine tax. The EM states that the intention of the measure is to bring into the tax base "the costs incurred in the necessary processes to prepare the wine to reach the point of retail sale."

34. In principle we are not opposed to the inclusion of packaging costs in the wholesale value of bulk wine. However, the means by which such costs are to be brought into the tax net should not create uncertainty in relation to the scope of the measure. The Bill as currently drafted in our view fails these tests.

35. The measure by which the "wine producer rebate" is to be introduced is also in need of further technical amendment prior to its implementation.

We would be pleased to elaborate on any of the views expressed above or to assist in any way to help resolve this matter. Please do not hesitate to telephone either John Haig or Anthony Fitzgerald of this firm on 03 9866 8644 or 0400 33 44 81 for further assistance.

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