

The Senate

Economics Legislation Committee

Provisions of the Customs Amendment (Fuel
Tax Reform and Other Measures) Bill 2006
and three related bills

June 2006

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Chapter 1

Introduction

Background

1.1 On 11 May 2006, the following suite of bills was introduced into the House of Representatives:

- Customs Amendment (Fuel Tax Reform and Other Measures) Bill 2006
- Customs Tariff Amendment (Fuel Tax Reform and Other Measures) Bill 2006
- Excise Laws Amendment (Fuel Tax Reform and Other Measures) Bill 2006
- Excise Tariff Amendment (Fuel Tax Reform Other Measures) Bill 2006.

Reference of the bills

1.2 Upon their introduction into the House of Representatives, the bills were referred to the Senate Economics Legislation Committee for inquiry and report by 9 June 2006. The reference limited the Committee's inquiry to reviewing the alcohol taxation measures contained in the bills with respect to their likely consumer, social and economic effects and their effect on industry. The Committee tabled an interim report on the bills out of session on 9 June 2006.

Purpose of the bills

1.3 As the Committee's inquiry was limited to the alcohol measures contained in the bills, this report does not go into the other measures or wider purpose of the bills.¹ Suffice it to say, the bills largely simplify and streamline existing regulations governing a range of excisable goods.

1.4 With regard to alcohol products, the bills propose the following:

- A streamlined provision will enable rules to be determined for measuring the volume, weight or alcoholic strength of an excisable good.
- To protect the revenue, bottling of duty-paid bulk beer is considered to be excise manufacture to prevent lower excise liability applying.
- Streamlining the concessional spirits scheme to reduce the administrative burden on users and protect the revenue where concessional spirits are unable to be satisfactorily accounted for.

1 For the purpose of each bill, see the explanatory memorandum for each. See also the Parliamentary Library's bill digests, numbers 139 and 140 for the customs bills (both 22 May 2006) and numbers 143 and 144 for the excise bills (both 24 May 2006).

- Redefining mead, grape wine and wine to conform with their definitions in the *A New Tax System (Wine Equalisation Tax) Act 1999*.
- Maintaining brandy at a lower excise duty rate than that applied to other excisable spirit beverages, and defining brandy as a spirit that has been distilled from grape wine and smells like, and possesses the other characteristics of, brandy (as distinct from so-called fruit brandies, which do not attract the lower excise duty).
- Upon approval, spirits may be used to fortify Australian wine or Australian grape must and will attract a free rate of duty, subject to any conditions imposed in the grant of approval.
- Continuing maturation provisions that brandy, whisky or rum must have 'been matured by storage in wood for a period of not less than two years'.
- Incorporating the provisions from the repealed Spirits Act that make it an offence to misuse the terms 'old' or 'very old' for any spirit unless it has been aged in wood for periods of at least five and ten years respectively.

The inquiry

1.5 Although the inquiry was directed to the alcohol related measures contained in the bills, much of the evidence addressed the wider issue of alcohol tax policy reform. The measures contained in the bills were seen as largely technical and uncontroversial refinements and accepted as improvements to the regulatory framework governing the alcohol industry and its various sectors. Consequently, the Committee's inquiry and report is largely a discussion of proposals for reforming elements of alcohol taxation policy.

Submissions

1.6 The committee advertised its inquiry in *The Australian* on 16 and 24 May 2006. In addition, the committee contacted a number of individuals and organisations in writing alerting them to the inquiry and inviting them to make a submission. A list of submissions received appears at Appendix 1. A list of other evidence received appears at Appendix 2.

Hearing and evidence

1.7 The committee held a public hearing at Parliament House, Canberra on 5 and 6 June 2006. Witnesses who appeared before the committee at the hearing are listed at Appendix 3. Copies of the Hansard transcript from the hearing are tabled for the information of the Senate. It can be accessed on the internet at <http://aph.gov.au/hansard>.

Acknowledgements

1.8 The committee wishes to thank all those who assisted with its inquiry.

Chapter 2

Key issues

2.1 The evidence the Committee received supported the bills. Alcohol industry bodies endorsed the bills' aim of simplifying and modernising the regulatory framework.¹ Some witnesses praised the government for streamlining aspects of the excise tariff regime, protecting the standards for key products (namely brandy) and reducing the amount of red tape in this area.²

2.2 The focus of much of the evidence was not so much on the bills themselves, but on what *further* measures or reforms witnesses believe are required. The tenor of much of the commentary was that the committee's inquiry offered an opportunity to press forward with wider reforms in relation to alcohol policy in general and alcohol taxation in particular.³ The minority view put to the committee, however, accepted that reforms are required at some stage but argued that now was not the time for any additional change.

2.3 The sections that follow canvass these arguments. The first section provides a brief outline of the case for reform of alcohol taxation and its guiding principles. The next two sections address the two key areas that attracted attention before the committee: volumetric taxation of alcohol; and tax equity in relation to packaged ready-to-drink (RTD) beverages.

Alcohol taxation reform

2.4 The majority of the evidence presented to the inquiry urged the committee to seize the opportunity to call for greater reform of alcohol taxation policy. Advocates of reform called for measures to address tax anomalies that favour some products over others. They also called for changes to encourage consumption of lower alcohol strength drinks with expected flow-on benefits in reducing problematic drinking behaviour and community harm.⁴

2.5 Differences existed among these advocates over the extent to which changes should be made, with members of the 'health lobby' calling for wider ranging reforms⁵ while representatives of the distilled spirits industry focused more on tax parity between low and mid strength RTDs and beer.⁶

¹ *Submissions 1-3 and 8.*

² *Submissions 2 and 3.* See also Mr Broderick, *Committee Hansard*, 6 June 2006, E 17.

³ See Mr Crosbie, *Committee Hansard*, 6 June 2006, E 8.

⁴ *Submissions 4-12.*

⁵ *Submissions 4, 7, 9, 10 and 12.*

⁶ *Submissions 5, 6, 8 and 11.*

2.6 Regardless of these differences, a number of common points emerged about some of the key factors that should inform and guide reform in this area. These can be summarised as follows:

- Alcohol strategies need to balance a range of factors including industry needs, the benefits of the alcohol industry to the economy, the health and social costs of alcohol, tax equity and revenue collection;⁷
- Alcohol pricing influences consumption, especially with heavy and binge drinkers;⁸
- Alcohol taxation is a critical instrument in influencing consumption and thus managing alcohol related harm across the community;⁹ and
- Alcohol taxation should be part of a broader strategy that incorporates education, enforcement of licensing laws, policing, detection, treatment and rehabilitation.¹⁰

2.7 The Committee in particular notes the consensus that has emerged in the alcohol research literature on taxation and reducing harmful drinking behaviour and its social costs. The National Drug Research Institute best summed up the interrelationship. It stated:

The evidence consistently indicates that public health and safety can be improved by particular taxation policies and the design and enforcement of liquor licensing regulations. Taxation policy has a critical influence on alcohol related harm across the whole community.¹¹

2.8 Two other considerations need to be noted. The Committee is aware of the level of harm and social and economic cost associated with problematic alcohol consumption within some groups in the community. Avoiding reform simply on the ground that economic, industry or other conditions need to be right is not a sound decision making principle while members of the community are at risk.

2.9 Another factor the Committee has taken into account is the advantage of incremental change over sweeping reform. Targeted adjustments to critical parts of the alcohol tax framework are likely to yield positive results while minimising any unintended consequences for the industry or other parties. Even some advocates of reform indicated that incremental change was to be preferred given the historic difficulty involved with wholesale reform in this area.¹²

⁷ *Submissions 7 and 10.*

⁸ *Submissions 4, 7-12.*

⁹ *Submissions 4, 7-12.*

¹⁰ *Submissions 9 and 12. Mr Crosbie, Committee Hansard, 6 June 2006, E 11-12.*

¹¹ *Submission 9, p.1.*

¹² *Mr Crosbie, Committee Hansard, 6 June 2006, E 12.*

2.10 With these considerations in mind, the Committee in the next two sections focuses on volumetric taxation of alcohol and tax equalisation for lower strength products.

Volumetric taxation of alcohol

2.11 A volumetric approach to alcohol taxation involves taxing beverages on their alcoholic strength – known as alcohol by volume (abv) – rather than on their value or price. Under a volumetric system, the lower the alcohol strength of a product, the lower the tax imposed, allowing these products to be sold at lower prices than higher alcohol strength, higher taxed products.

2.12 The prime reason for a volumetric tax is that it should encourage the consumption of lower alcohol strength products which, in turn, would reduce problematic drinking and associated health and social costs. Lower taxes for lower strength products would also create incentives for the industry to produce and market such products.

2.13 The question of shifting alcohol taxation to a volumetric basis has been debated on numerous occasions, particularly recently in the context of wine taxation policy.¹³ The overwhelming weight of the evidence before the inquiry supported shifting alcohol taxation to a volumetric approach. Significantly, that was the view shared by all witnesses who dealt with the problematic use of alcohol from a health and community services perspective, and who could be taken to be free of any commercial interest in the outcome. These witnesses were able to point in their submissions to a large volume of professional literature giving empirical support to the correlation between alcohol pricing and alcohol abuse; the increase in the preference for low alcohol beverages from volumetric taxation of such beverages; and the resultant reduction in alcohol abuse.

2.14 The Australian Medical Association (AMA) and the National Drug Research Institute strongly advocated moving to a volumetric tax.¹⁴ In the institute's view:

The application of volumetric taxation strategies that influence retail price, resulting in price differentials based on alcohol content, has been shown to be an effective public health strategy. Such strategies should not reduce the overall price of alcohol per capita. Policies that create real price differentials between lower and higher alcoholic beverages have the potential to encourage the consumption of the former, discourage the

¹³ The past decade has witnessed two major reviews of wine taxation: the 1995 inquiry into winegrape and wine industry; and in 1999 the review of measures surrounding the introduction of a new tax system (ie. the GST). The committee also examined different alcohol taxation regimes during an earlier inquiry into customs and excise legislation. See Senate Economics Legislation Committee, *Inquiry into provisions of Excise Tariff Amendment Bill (No.1) 2002 and provisions of Customs Tariff Amendment Bill (No.2) 2002*, 22 October 2002, pp.5-18.

¹⁴ *Submissions 9 and 12.*

consumption of the latter and result in an overall per capita reduction in alcohol consumption and improved public health outcomes.¹⁵

2.15 Mr Crosbie from Odyssey House elaborated on the way in which a volumetric tax strategy would operate to influence consumer and industry behaviour, as well as producing wider public benefits. According to this body:

Such a system would provide clearer incentives for consumers to choose lower alcohol content products. It would also promote the production of better lower alcohol products, raise the price of cheap bulk products, continue to raise high levels of government revenue, save government expenditure on alcohol related problems, and would be administratively simple to apply.¹⁶

2.16 As noted in the previous section of the report, the Committee heard that research demonstrably shows that lowering the price of alcohol products through lower taxes leads to reduced consumption, problem drinking and community harm. The Committee also notes that some in the alcohol industry support, at least in the longer term, a shift to volumetric tax for all alcohol products.¹⁷

2.17 The Committee is much persuaded by the benefits of adopting a volumetric alcohol tax system in principle. On the strength of the overwhelming weight of evidence before it the Committee considers such a system would produce public health benefits

2.18 That said, the Committee is mindful of concerns that major tax reform at this point could be disruptive for sectors of the industry experiencing tough business conditions. The wine sector in particular expressed concern about any further shake up to the tax system during the current period of oversupply, particularly given recent tax adjustments made with and following the introduction of the Goods and Services Tax (GST) Wine Equalisation Tax (WET).¹⁸ The Committee also recognises that a fundamental overhaul of alcohol taxation policy, such as the adoption of a volumetric system, requires adequate consultation and planning. A change of this scale would also require time to develop and implement.

2.19 It is for these reasons that, in the interim, the Committee considers that an incremental approach to alcohol tax reform would be more worthwhile and easily achieved. The area where the Committee considers there is merit for such an approach is in relation to RTD products. The next section examines the case for applying a volumetric tax to lower strength RTD products.

¹⁵ *Submission 9.*

¹⁶ *Submission 4, p.3.*

¹⁷ *Submission 2, p.8.*

¹⁸ *Submission 3, p.4. See also Submission 2, p.8.*

Tax equity for low to mid strength alcohol products

2.20 The issue of reforming the tax structure to provide the same tax level for low to mid strength RTDs as that enjoyed by similar strength beer drew the most discussion during the inquiry. It was also the measure identified as a first step that could be taken in incrementally reforming alcohol taxation policy.

2.21 Currently beer attracts more favourable tax treatment than RTDs. Three features of beer taxation need to be noted:

- Beer has a tax free threshold. Excise is applied on alcohol by volume (abv) of beer above 1.15 percent abv. In other words, the first 1.15 percent abv of beer is excise free.
- The tax or excise on beer is based on the following three-tiered structure:
 - Low strength – 1.15 percent to 3 percent abv;
 - Mid strength – 3 percent to 3.5 percent abv; and
 - Full strength – 3.5 percent to 10 percent abv.
- Taxation favours draught beer over packaged beer.

2.22 RTDs, in contrast, do not attract the concessions applied to beer. There is neither a tiered structure based on different abv levels for RTDs nor a tax free threshold. Instead, RTDs are taxed at the same rate as full strength beer but without the 1.15 per cent abv excise free threshold.

2.23 Reform advocates from the health lobby and distilled spirits industry argue that the current taxation of RTDs provides little incentive for producers to develop low and mid strength products. They note, for instance, that despite the popularity and growth of RTDs generally, mid strength RTDs comprise only two per cent of the mid strength beer and RTD market.¹⁹ The current tax treatment of RTDs is also, they say, at odds with the principle of tax equity.

2.24 The lead industry advocate, DSICA,²⁰ contended that applying the same tax treatment to low and mid strength RTDs would involve a minor change in the alcohol tax regime, affecting a small share of the alcohol market, with a minimal impact on revenue (\$2 million in its first year if implemented).²¹

2.25 DSICA also argued that much of the negative publicity surrounding RTDs is at best impressionistic, if not misplaced, and does not reflect empirical research. DSICA referred to research that suggests, contrary to popular belief, youth and underage alcohol consumption or dangerous drinking is not rising, and that the growth

¹⁹ Mr Broderick, *Committee Hansard*, 6 June 2006, E 18.

²⁰ Distilled Spirits Industry Council of Australia.

²¹ Mr Broderick, *Committee Hansard*, 6 June 2006, E 17-8. See also *Submission 8*.

in RTD sales has been at the expense of beer, wine and higher strength spirits (what is called a 'substitution effect') rather than led to increased consumption.

2.26 Evidence from the health lobby tended to corroborate this view. Mr Crosbie of Odyssey House observed that much of the criticism of RTDs is based on anecdote and personal bias, possibly because RTDs are a recent innovation. More importantly, in terms of research findings he told the Committee:

My understanding is that the biggest growth in ready-to-drink products—and, again, I am sure the Distilled Spirits Industry Council of Australia will provide more concrete evidence and facts—was amongst the older males, the above-20-year-old males, and mostly around brown spirits. The bourbon and Coke type ready-to-drinks have expanded very significantly. There has been an increase in white spirits sales in the below-18-year-old age group, in the younger drinkers, but my understanding is that they have been offset by a reduction in wine consumption and full spirit consumption by young women. So the overall trend is basically that, if anything, young men are bingeing less than we did when we were young, which is sometimes hard for a father to say, and younger women are binge drinking more than their mothers did, which is a good thing for mothers to point out to their daughters.²²

2.27 Mr Crosbie also considered aligning the taxation of low and mid strength RTDs with similar strength beers would be a low risk, positive incremental reform.

2.28 While there was majority support for such a step, Lion Nathan opposed any change in RTD taxation on the ground that it was premature. Lion Nathan argued that the research on drinking behaviours with a new product like RTDs was inconclusive and more time is needed better to understand the impact of these products, particularly on underage and high risk drinkers.²³

2.29 Mr Evans of Lion Nathan also claimed that such products, even at lower strengths, could have the potential to lure younger and new drinkers towards drinking spirits with alcohol strengths in excess of 10 per cent abv. Describing this syndrome as a 'gateway effect', Mr Evans claimed that low and mid strength products generate spin offs for their brands and parent companies. He also argued that because RTDs are more palatable than traditional beverages like beer and spirits, their introduction has lowered the barrier to drinking for young and underage drinkers. Mr Evans provided the Committee with a range of research to support his position.²⁴

2.30 Weighing up the evidence, the Committee considers that the arguments against equalising the tax regime for low and mid strength RTDs are both overstated and overlook the public benefits in promoting consumption of lower strength alcohol

²² *Committee Hansard*, 6 June 2006, E 14.

²³ *Submission 2*. See also Mr Evans, *Committee Hansard*, 6 June 2006, E 21-27.

²⁴ Mr Evans, Lion Nathan, answer to question on notice with attachments, 8 June 2006.

products. The research presented in evidence was consistent in showing that lower pricing through tax adjustments influences consumption patterns and reduces problem drinking. The research also does not show RTDs increasing overall alcohol consumption but rather suggests that youth and younger drinkers have substituted RTDs for other beverages such as beer and wine. The growth of RTD sales has, according to DSICA, slowed of late.²⁵

2.31 The Committee also considers that if youth and even underage drinkers are going to consume RTD style products, it is far better that the pricing of RTDs favours consumption of lower strength RTDs than more powerful RTD beverages. As Mr Lawler of the Alcohol and Other Drugs Council of Australia observed:

The argument could be that if you have something that tastes like cordial, is easy to drink and is five per cent alcohol, then it is going to have an effect. But if you were to make something that was three per cent alcohol or less, then you would still have that same sensation of taste but you would not necessarily get the effect.²⁶

2.32 It should also be noted that problematic youth or underage drinking, to the extent that it exists, is not simply a 'supply' issue in terms of pricing different alcohol products. It also involves, among other things, education and the enforcement of licensing and sales regulations.

2.33 The Committee considers on the basis of the clear weight of evidence and expert opinion before it that there is a strong argument for advancing reform of alcohol taxation by applying the same tax (excise) treatment to low and mid strength RTD products as currently applies to the same strength beer products. This would involve introducing the same three tier structure according to abv for RTDs as that which applies for beer. It would also mean extending the 1.15 per cent excise free threshold that applies to beer but *only* to low and mid strength RTDs. Full strength RTDs (ie. above 3.5 per cent abv) should *not* be eligible for the 1.15 per cent excise free threshold.

2.34 Finally, the Committee notes the evidence that the revenue effect of such a measure would be negligible.²⁷

Conclusion

2.35 The Committee notes that the measures incorporated in the bills were supported without dissent. Accordingly, the Committee considers the bills should be passed.

²⁵ *Submission 8*, p.27.

²⁶ *Committee Hansard*, 5 June 2006, E 5.

²⁷ *Submission 8*, p.32 and appendix 2, 'Revenue, price and market estimates'.

Recommendation 1

2.36 The Committee recommends that the Customs Amendment (Fuel Tax Reform and Other Measures) Bill 2006 and three related bills should be passed without amendment.

2.37 In terms of reform of the alcohol taxation regime, the Committee considers that in principle a volumetric tax for all alcohol products should in the long term be adopted. It considers that planning, research and consultation directed towards this goal should start soon. Any review of the taxation regime for alcohol needs to take into account complementary strategies to address alcohol related problems. These strategies include education, treatment and rehabilitation, licensing and sales, enforcement and policing.

2.38 In the meantime, the Committee considers that some immediate benefits can be achieved by way of incremental reform to the tax treatment of low and mid strength RTDs. These products should be placed on the same tax footing as comparable strength beers. Realigning the excise regime for lower strength RTDs promises to lower the relative price of these drinks, increase consumption of these products and reduce harmful drinking behaviour and related health and social costs. This would be an incremental low-risk step with minimal revenue implications.

Recommendation 2

2.39 The Committee recommends the Government consider the long term adoption of a volumetric tax system for all alcohol products. The Committee also recommends the Government now commence planning and consultations with relevant parties as a step towards this goal.

Recommendation 3

2.40 The Committee recommends the Government apply the same tax and excise treatment to low and mid strength ready-to-drink (RTD) alcohol products as is applied to similar strength beer products. The tax and excise structure for RTDs should incorporate the three tiered structure currently applied to beer, with the 1.15 per cent excise free threshold that applies for beer extended to low and mid strength RTDs but not to full strength (3.5 per cent alcohol by volume and above) RTDs.

Senator George Brandis
Chair

Appendix 1

List of Submissions

1. Australian Associated Brewers Inc
2. Lion Nathan Limited
3. Winemakers' Federation of Australia
4. Odyssey House
5. Beam Global Spirits & Wine
6. Bundaberg Distilling Company
7. Alcohol & other Drugs Council of Australia
8. Distilled Spirits Industry Council of Australia Inc
- 8a. Distilled Spirits Industry Council of Australia Inc
9. National Drug Research Institute
10. Australian Divisions of General Practice Ltd
11. Australian Hotels Association
12. Australian Medical Association Limited

Appendix 2

Tabled documents and answers to questions on notice

Tabled document

5 June 2006

Alcohol and other Drugs Council of Australia

- Modelling Health-Related Reforms to Taxation of Alcoholic Beverages

Answer to questions on notice

8 June 2006

Lion Nathan Limited

- Lion Nathan QON reply
- Alcohol concern fact sheet
- LN miscellaneous clippings
- Ready to drink
- Young People and Alcohol – Taste Perception Study 2006
- LN2 older studies on sweetness
- LN US Treasury proposal 2003
- LN WPRO Draft Regional Strategy 06.5

Appendix 3

Public Hearings and Witnesses

Monday 5 June 2006 – Canberra, ACT

Alcohol and other Drugs Council of Australia

Mr Philip Lawler, Board Executive Director - Administration

Tuesday 6 June 2006 – Canberra, ACT

Odyssey House

Mr David Crosbie, CEO

Distilled Spirits Industry Council of Australia

Mr Gordon Broderick, Executive Director

Mr Warwick Ryan, Director, Government Relations, KPMG

Mr Clayton Ford, Manager, Corporate Relations, Diageo Australia Limited

Lion Nathan Limited

Mr Paul Evans, Director, Government Regulation & Community Affairs