

CHAPTER 3

WHOLESALE SALES TAX

Introduction

3.1 Wholesale Sales Tax (WST or simply 'sales tax') is an indirect tax levied since 1930 on the wholesale value of a commodity. It is imposed as an *ad valorem* tax; that is, it is expressed as a percentage of the value of the goods taxed. It is paid by the wholesale customer at the time of purchase and is passed on as part of the retail price. There are many exemptions, including foodstuffs.

3.2 The basic principle of sales tax is to impose tax on the last wholesale sale of goods going into use for the first time in Australia, that is, goods imported into Australia and goods which are manufactured and go into consumption in Australia. If the goods are not subject to a wholesale sale, then tax is imposed on a retail sale, if any, or on the use of goods. Tax is imposed on the wholesale selling price of the goods or an equivalent notional wholesale alternative. The general rate is 21%, which will increase to 92% on 1 July 1995, unless goods are exempted or taxable at another rate.

Streamlined Sales Tax

3.3 Following recommendations by the Beddall Committee inquiry into small business in Australia, the Treasurer announced in the 1990 Budget that the Government would undertake a review of the wholesale sales tax with the aim of improving the efficiency of the system by reducing compliance costs. The streamlined sales tax legislation which eventuated from this review and constitutes the current legislation governing sales tax, came into effect on 1 January 1993 and replaced a multitude of sales tax legislation that had accumulated over half a century.

3.4 Streamlining the sales tax legislation did not alter the basic rationale for sales tax which is to impose tax on the last wholesale sale of goods going into use for the first time in Australia. The legislation was redrafted in to be more readable and reduced the number of anomalies which had accrued under the old regime, although many of the complexities still remain. According to CCH's *Australian Sales Tax Guide*, streamlining measures included:

- (a) removing certain inconsistencies in terms of classification;
- (b) standardising the language used,
- (c) clarifying the treatment of exemption certificates;
- (d) broadening small business exemptions so that people who have a sales tax liability of less than \$10,000 per annum pay tax on inputs but do not pay tax on outputs;

- (e) removing some of the Tax Commissioner's discretions, although new discretions appear to have been added; and
- (f) removing difficulties associated with liabilities arising from leases.'

3.5 The recommendations of the Beddall Committee, also resulted in the introduction of quarterly payment arrangements for businesses whose sales tax liability was \$50,000 or less. Evidence before the Committee, however, indicated that some further refinements to the sales tax system were appropriate.

Sales Tax Rates

3.6 The Committee's second term of reference concerns 'changes in the overall burden of tax on small business, in particular the impact of changes introduced by and since the 1993 Budget, including increases in excise and wholesale sales tax'. A total of seven Acts to amend sales tax were passed in 1993 which increased the rates of sales tax, both generally, and specifically in relation to wine.

3.7 The tax rates depend upon the classification of the goods that are sold. They are classified under Schedules 1 to 7 of the *Sales Tax (Exemptions and Classification) Act 1992*.

- (a) Schedule 1 exempts the goods listed, and hence a 0% rate applies.
- (b) Schedule 2 - 11% until 1 July 1995 when it increases to 12%
- (c) Schedule 3 - 16% until 1 July 1995 when it increases to 17%
- (d) Schedule 4 - 21% (the general rate) until 1 July 1995 when it increases to 22%
- (e) Schedule 5 - 31 % until 1 July 1995 when it increases to 32%.
- (f) Schedule 6 - 45%
- (g) Schedule 7 - 24% until 1 July 1995 when it increases to 26%.

Sales Tax Payments

3.8 Sales tax is payable within 21 days after the end of the month in which a transaction occurs, unless a taxpayer is eligible to be a quarterly remitter, defined under subsection 62(2) of the *Sales Tax Assessment Act 1992* as a person:

- (a) whose tax liability for the previous financial Year did not exceed a threshold for the current year (which for 1994/95 is \$52,643); and
- (b) who has no outstanding liability to lodge returns (or pay tax) for assessable dealings that happened before the current quarter or the person was a quarterly remitter for the quarter before the current quarter.

3.9 About 83% of businesses in Australia are eligible to be quarterly remitters. About 95% of businesses in Australia are classified loosely as small businesses. Evidence suggests that a significant number of small businesses are not eligible to be quarterly remitters, and are consequently experiencing cash flow problems. This is discussed below.

3.10 Late payment penalties apply at 16% p.a. Non lodgement of forms and for false statements resulting in underpayment of sales tax can result in penalties amounting to 200% of the tax payable.

Sales Tax Issues

Taxpayers as Tax Collectors

3.11 Apart from the requirement to pay some of the tax owing before income has been received, a number of witnesses were unhappy with the requirement that sales tax payers act as unpaid tax collectors. In the words of Mr Robert Glynn, of Tucker, Glynn and Co:

Sales tax is paid 21 days from the end of the month in which the sale was made. in many cases the taxpayer is required by market pressures to provide 90 to 120 days credit.

It is obvious that in these cases tax is required to be paid well before it is collected. When we consider the taxpayer is in essence collecting the tax (without any form of commission from the ATO for doing so) it is a strange situation to have an agent account for the cash before it has been collected .

3.12 The Beddall Committee had considered this to be a legitimate complaint by small business, commenting that:

A system of compensation for small businesses which recognises the service they provide to the ATO in collecting and remitting sales tax, is strongly recommended on the grounds of equity. It would be seen as a significant step by the Government and ATO in improving its standing with the small business community.⁴

3.13 The Beddall Committee had accordingly recommended that-

... compensation in some form be provided to qualifying small businesses (ie small sales tax remitters) for the cost of sales tax collection and remittance to the Australian Tax Office, possibly by providing a tax credit based on an agreed reasonable 'compliance time' spent dealing with sales tax paperwork

3.14 This measure was not implemented by the Government on the grounds that changes in sales tax remittance arrangements and streamlining should lead to a reduction in the burden of sales tax collection on small businesses .

3.15 While these measures undoubtedly relieved some of the burden of sales tax compliance and collection, evidence indicated that there are still a considerable number of small businesses which do not come under the threshold needed for quarterly remittances. In addition, although streamlining simplified the legislation, a number of complexities remain, particularly within the exemptions and classifications rules. Furthermore, the costs of collecting sales tax was cited as still being a significant compliance burden with many small businesses.

3.16 The Beddall Committee had recommended that compensation be provided to small businesses for the cost of sales tax collection and remittance to the ATO, possibly by providing a tax credit based on an agreed reasonable 'compliance time' spent dealing with sales tax paperwork. The Committee does not at this stage endorse the Beddall Committee recommendation because of the broader implications involved in compensating businesses of all sizes for acting as tax collectors. Nevertheless, it recognises

the disparity between the relative burden of compliance costs for small business vis-a-vis large business and considers that it would be appropriate for the Government to address this issue at some future stage.

Timing of Sales Tax Payments

3.17 Many small businesses which are above the quarterly remittance threshold objected to the requirement that remittances of sales tax be made monthly. These enterprises expressed concern that the 21 day rule adversely affected their operations because of the need to fund tax liabilities before the income from which these liabilities are derived is actually received. Businesses affected generally recommended extending the payment period to 60 or more days after the end of the month of invoicing.

3.18 The Furnishing Industry Association of Australia (FLAA) and the Council of Small Business Organisations of Australia (COSBOA) expressed particular concern that sales tax frequently fell due well before income had 'been received'.⁸ The opening comment by Mr Matthew Hughes-Gage of the FLAA was succinct:

Our fundamental argument is that we should not have to forward on taxes which we have not received from our debtors."

3.19 The FLAA's dissatisfaction was further explained in the following comment:

a sale is not a sale until the goods are both delivered and paid for. The government is actually seeking payment on an intention to buy rather than on the sale itself. This is the fundamental part of our argument: that we are being asked to pay taxes on a sale that is yet to be completed. In some cases, it drags off into a bad debt that may never be completed, but it is only at the end of the legal process that we are able to make adjustment to that sales tax question.^{1c)}

3.20 The FLAA advocated paying sales tax on the seventh day following the month of collection rather than on the 21st day following the month of invoice. While the Committee is sympathetic to this proposal, it raises two major issues which are probably unresolvable:

- the question of shifting to cash based accounting; and
- the scope for tax avoidance through deferring receipts.

3.21 FLAA's proposal essentially advocates a move to cash based accounting. It is difficult to see how such a move could be limited to sales tax, especially since tax law is now firmly entrenched in accrual accounting. In any event, a movement to cash based accounting invites tax avoidance either through -an arrangement whereby cash receipts are deferred until the original value of the transaction has been devalued through the passage of time, or through bartering arrangements which do not readily lend themselves to cash accounting.

3.22 The ASCPA commented that businesses involved in manufacturing, wholesaling or some service providers will derive the majority of their sales on credit, with the average collection time being probably around 50 days from the end of the month of sale'."

3.23 The ASCPA also submitted that the requirement that sales tax be paid about a month before collection of sales proceeds requires large funding costs to small business. More specifically, the volume of sales tax being paid before receipt of income withdraws significant amounts of working capital.

3.24 The Printing and Allied Trades Employers' Federation of Australia (PATEFA) explained that their research had shown that in the printing industry, 89 per cent of printers surveyed in a trade debtor survey have a trading term of 30 days. Most of their customers (98 per cent) took over 21 days to pay

their debts, with over three quarters (76.3 per cent) taking longer than 35 days, and slightly over two in five (41.6 per cent) taking over 50 days.'

3.25 When asked about PATEFA's survey results, Treasury responded that the way the sales tax system worked for small businesses that are quarterly remitters is that they get, on average, 66 days credit from the Government on their sales tax liabilities. This was calculated by taking the midpoint of a quarter, that is day 45, and adding the 21 days by which the liability must be discharged.

3.26 Of the total sales taxpaying population, 80 per cent are quarterly remitters. However, these sales taxpayers contributed only 4.5 per cent (\$461 million) of total sales tax collections (\$10,170 million).

3.27 The other 9.5.5 per cent of sales tax remittances were therefore paid by 20 per cent of sales tax remitters. Although, as Treasury put it: 'They are less likely to be small businesses.'

3.28 The Committee does not doubt that a business chosen at random from the top 20 per cent of sales tax remitters is less likely to be a small business. Nevertheless, a substantial number of the monthly remitters are likely to be small businesses. Statistics reveal that at the bottom end of that 20 per cent of sales tax remitters, there were 4,597 businesses that remitted between \$50,000 and \$99,000 in sales tax, contributing a further 3.2 per cent (\$786 million) of total sales tax remittances. 14 In contrast, and at the other end of the 20 per cent group, 1,348 (or just over 2 per cent of all sales tax remitters) contributed \$7,538 million (or nearly 75 per cent) of net annual remittances during 1993-94.

3.29 Monthly remitters receive an average sales tax credit of about 36 days ($15 + 21$).¹⁵ However, many businesses dispatch their sales invoices at the end of the month of transaction. This effectively reduces their credit time to 21 days, if they are monthly remitters, on tax on earnings that they have not yet received. Evidence suggests that very few invoices are paid within that 21 days, particularly as terms of credit are usually at least 30 days, frequently being much longer, depending on the state of the market.

3.30 The evidence indicates that by their very nature, small businesses that are caught up within the sales tax system would more frequently than not be 'trading term takers' ¹⁶ in the market and that their terms of credit would frequently be 60 or 90 days, sometimes longer. While most small businesses within the sales tax system are quarterly remitters, there seems little doubt that a considerable number do not come within the requisite \$50,000 plus threshold

3.31 Pointing to the incidence of bad debts, extended terms of credit, and payments delayed for extended periods of time, a number of submissions stated a preference that sales tax become payable following receipt of income so that payment of tax be aligned as closely as possible to the actual receipt of income.

3.32 COSBOA and the FIAA submitted that the requirement to finance tax liabilities in advance of the receipt of income had particular impact on small to medium enterprises that were too large to qualify as quarterly remitters, but who were relied upon to enhance Australia's export base. The diversion of finances from working capital to finance tax bills retarded their opportunities to apply that capital to improve their export opportunities. COSBOA suggested the access thresholds of quarterly sales tax collections be raised from \$50,000 to \$100,000.

3.33 The issue of sales tax thresholds is a difficult one because of the difficulty in establishing correlation between sales tax liabilities and business size. While it seems likely that most businesses with sales tax thresholds of less than \$50,000 are small businesses, evidence given by PATEFA indicates that sales tax liabilities also depend upon the nature of the business:

Some people in our industry are very lucky; they have very little work which involves sales tax. Those people producing for stock like paper merchants, paper and board and ink manufacturers usually have no sales tax involved because it all goes into the cost of production, as is the case for many printers. You might be producing foods which are an aid to manufacture, but probably out of the printers there, about half of the goods invoiced across the board attracts wholesale sales tax.....

3.34 For this reason, the Committee does not consider that it would be appropriate to consider recommending a change to the \$50,000 threshold for quarterly payments until further information is available to establish the number of small businesses which fall within the monthly remittance regime. In this context, it is not entirely self-evident that every sales tax remitter with an annual sales tax of below \$50,000 is necessarily a small business. Therefore, consistent with the need to redress the imbalances caused by economies of scale available to large businesses, the Committee considers that an alternative measure could be adopted which directly relates to business size.

3.35 As an alternative, and consistent with the notion that small businesses are generally price takers in the market with their terms of credit generally being well over 21 days or even the 35 day average sales tax credit calculated by Treasury for monthly remitters, the Committee considers that the sales tax remittance deadline of 21 days after the month in which the transaction was made should be extended by 25 days to the middle of the second month following the transaction. Although this produces a notional average sales tax credit of 60 days (35 + 25), it is more consistent with the actual terms of credit extended to debtors by small businesses, who are not in a position to absorb the costs and cash flow restrictions generated by credit arrangements through the application of economies of scale.

Recommendation 3.1:

The Committee recommends that, in addition to the current threshold which enables quarterly remittances, businesses defined as 'small' by the Australian Bureau of Statistics in ABS Catalogue No. 1321.0 (Small Business in Australia 1993) be permitted to remit sales tax either:

- (i) on a quarterly basis; or
- (ii) 45 days after the end of the month in which the transaction occurs.

Exemptions and Classifications

3.36 Sales tax exemptions and classifications are listed in the *Sales Tax (Exemptions and Classifications) Act 1992* (the Act). As described in paragraph 1.7, tax rates depend on the classifications under Schedules 1 to 7 of the Act. Schedule 1 exempts goods and Schedule 4 applies the general rate (rising from 21 per cent to 22 per cent on 1 July 1995) to all goods not elsewhere listed.

Problems with Exemptions and Classifications

3.37 A number of submissions regarded the current system as too complicated and frequently ambiguous. SBP State Council asserted that there '...is the major problem of the uncertainty of classifications of goods for the determination of the appropriate tax rates', and recommended a single rate of sales tax for taxable goods.¹⁹ This recommendation was echoed by the Australian Earthmovers & Road Contractors Federation, the QCCI and COSBOA.

3.38 The Motor Trades Association of Australia (MTAA) submitted that, significant cascading effects of the current WST arrangements produced price distortions in the domestic market and undermined export opportunities. The MTAA commented in evidence

There is a particular view amongst small traders that the current wholes sales tax system, with its different level on many items, is extremely complex. It runs the risk of significant mistakes being made in the calculation and for that to cause additional work when the mistakes are discovered ... there does not seem to be any rhyme or reason as to what attracts what rates ... The view has been put by our members is that they would prefer a simpler system.

The MTAA called for a review of the system which would examine equity and efficiency questions as well as revenue matters. The Australian Society of Certified Practising Accountants also called for a review of sales tax to broaden the revenue base.

3.39 The Small Business Development Corporation of Western Australia considered that sales tax and the FBT were primary areas of tax concern for small businesses because of their complexity and the time consuming compliance requirements. The inconsistency of the assessment of some sales tax items when establishing rates was also a concern. The corporation did not call for a review but recommended that the legislation be clarified through tax rulings.

3.40 The South Australian Employers' Chamber of Commerce and Industry was appreciative of the improvements brought by streamlining the sales tax legislation but expressed concern about the classification of some items which are 'borderline between classes'.

3.41 The difficulties which arose with particular items was the subject of some discussion in evidence given to the Committee. Mr Brian Harmer of Bowman Manser and Associates offered the following example:

.....there are some crazy anomalies. If you go and buy a mat for your bathroom and put it on your car floor, you do not pay sales tax on it, whereas if you go into the vehicle accessories department you do.

Example of Ambiguity - Rice Milk

3.42 There are numerous instances where sales tax classifications are confused by ambiguities in product description. In many cases, the ambiguities lead to disputes between the ATO and small businesses which are time consuming and costly. An example which came to the attention of the Committee was of a Melbourne based distributor of organic food which was attempting to gain a sales tax exemption on rice milk.

3.43 Mr Don Lazzaro, managing director of the distributor, PureHarvest, submitted that rice milk should be classified as food for human consumption and therefore exempt from sales tax, or that item 71 of Schedule 1 of the *Sales Tax (Exemptions and Classifications) Act 1992* should be amended to allow for rice milk to be exempt for exactly the same reason that plain milk and soy milk are exempt. He made the following points in his submission to the Committee:

- when the Government exempted soy milk from sales tax in the 1988/89 Budget, it stated that plain milk was currently exempt from sales tax, and that soy milk was sold in competition with milk and in many cases used as a substitute;
- like soy milk, rice milk is consumed by people who are lactose intolerant and
- rice milk can be consumed by people who are allergic to soy products and is made the same way as soy milk except with rice as the basic ingredient.

3.44 An approach by Mr Lazzaro to the Cheltenham office of the ATO for a ruling on whether rice milk was exempt resulted in advice that it was taxable at the general rate of 21 per cent, apparently on the basis that it was not food for human consumption but a recreational drink. It also resulted in an audit and a consequent demand for payment of arrears of sales tax. Further approaches to the ATO and to various Ministers have also produced no result.

3.45 Mr Lazzaro provided the Committee with copies of correspondence sent to Ministers, endorsements from medical practitioners, including a consultant allergist, and letters from consumers. The Committee has also received correspondence and petitions from consumers, a clinical nutritionist, and other distributors of natural foods protesting at the sales tax treatment of rice milk.

3.46 This example raises a number of issues. The Committee considers that a taxpayer seeking advice or a ruling should not fear that their action will precipitate an audit. Many taxpayers find the complexity of the tax system combined with the enforcement function of the ATO to be an unpalatable mixture. Notwithstanding the ATO's efforts in formulating and implementing practical education and consultation strategies, the Committee considers that a considerable amount of progress could be made to encourage voluntary compliance if the provision of advice by the ATO was separate, *and seen to be separate*, from its audit function.

3.47 Other, larger issues raised by the PureHarvest experience include:

- the need to clarify procedures used to determine the sales tax classification of a product, especially a new product;
- the need to eliminate, as far as practicable, ambiguities and complexities in the classification regime.

Consequences of Technological Innovation

3.48 There are some areas of sale tax which have become complicated by the advent of new technology. The Printing Federation (PATEFA) gave evidence that changes in printing technology have outpaced changes in the sales tax regime causing the printing industry some problems, not the least being inconsistencies in the advice proffered by the ATO. An example was inconsistent rulings by various branches of the ATO concerning the need to collect exemption declarations for artwork. Confusion arises because print production is becoming more technologically integrated. This creates problems when the assumptions underlying sales tax classifications are based on outdated technology and separation of activities which may no longer occur.

3.49 Mr Jordan Reizes of PATEFA spoke of the example concerning artwork:

There is no separation any more between someone who creates the artwork in terms of design and someone who creates the final product. It is the final product which is exempt there, but at the moment people are doing it on one Macintosh computer. The sales tax office said to us, 'Look, there is a way to overcome that. Tell people to buy two. They use one for design which they pay tax on and they can use the other one to do the final artwork and composition which is non-taxable.

3.50 The Committee agrees with Mr Reizes' evaluation that the purchase of two computers is not a practical solution, especially for a small operation. What is required is not merely upgraded legislation but a process for expeditiously upgrading that legislation before such anomalies are seriously compounded. The Committee was advised by the Federation that the ATO was aware of the problem and had formed a print focus group, although this was an internal group which, the Federation believed, did not consult with industry for input on the application of the goods it was discussing.

Conclusion

3.51 The Committee considers that there are serious problems and ambiguities inherent in the current application of the *Sales Tax (Exemption and Classifications) Act 1992* in relation to the classification of various goods, particularly new products emerging on the market. The above examples of car mats, rice milk, and printed artwork exemplify the variety of goods which do not neatly fall into the classifications listed in the Schedules to the Act. The evidence suggests that there are many more examples which arise on a regular basis. Furthermore, the PureHarvest experience and the problems confronting the print industry demonstrate that the procedures for resolving these anomalies are somewhat haphazard.

3.52 It is clear that the Exemptions and Classification legislation and its associated processes require clarification. The Committee acknowledges that simplification of this legislation to achieve greater efficiency raises considerations of equity. Nevertheless, equity and efficiency are not mutually exclusive notions, particularly when it can be demonstrated that the current inefficient and complex system of sales tax exemptions and classifications generates inequities which require time consuming and expensive remedies. It is a question of balance.

Recommendation 3.2:

The Committee recommends that the Government conduct a comprehensive view to:

- (i) removing the ambiguities and complexities within and between the sales tax classification schedules: and
- (ii) establishing a simple, effective process whereby the classification of new products can be quickly and simply achieved, thereby lessening reliance on the general rate sales tax as a default rate.

Small Business Exemptions

3.53 Small business exemptions are generally available to persons whose sales tax liability, over a 12 month period, is \$10,000 or less, and who pay tax on taxable inputs. As this is clearly intended to alleviate the administrative burden upon very small businesses, the threshold should be indexed in line with indexation of the quarterly remittance threshold.

Recommendation 3.3:

The Committee recommends that the \$10,000 sales tax threshold for the small business exemption be indexed annually.

The Wine Industry

3.54 The Winemakers' Federation of Australia forwarded a lengthy submission expressing considerable concern at the impact of the sales tax increases resulting from the August 1993 Budget on the industry. That Budget resulted in legislation which progressively increased the rate of sales tax on wine to 22% from 1 November 1993, to 24% from 1 July 1994, with a further increase to 26% to come into effect on 1 July 1995. The Committee believes that the problems encountered by the wine industry provide a good example of the types of difficulties faced by many other industries in Australia which have a large number of small businesses as their base.

Wine Industry Inquiry

3.55 In October 1993, the Commonwealth Government announced that a Committee would be formed to inquire into the Australian winegrape and wine industry. The matters to be taken into consideration under the terms of reference include the appropriate form and level of taxation and cash grants for the industry, taking into account, amongst other issues, the ability of the industry to achieve its domestic and export potential. In March of this year, that Committee published a Draft Report, *Winegrape and Wine Industry in Australia*.

3.56 The Report proposed that the form of tax on wine should be changed through the imposition of a composite tax comprising an *ad valorem* component (the sales tax) for revenue raising purposes, and a volumetric tax levied on the alcohol content to address the external costs associated with alcohol consumption.

3.57 While a majority of the Committee proposed that the average level of such a composite tax be maintained at the 26% rate of sales tax to come into effect on 1 July 1995, the Chairman disagreed. He considered that there was evidence of some substitution between wine and other alcoholic beverages, especially beer. Accordingly, he suggested that there would be gains in economic efficiency from reducing the present disparities in tax treatment between wine and other alcoholic beverages and proposed that wine be subject to a sales tax of 32 per cent and a volumetric tax, lifting the composite rate of tax from 26 per cent to 50 per cent. He also proposed a five year transition to reduce adjustment costs.

3.58 The Committee received submissions from the Winemakers Federation of Australia (WFA) on the subject and heard evidence at its public hearing in Adelaide on 20 April 1995.

3.59 The WFA objected to both the minority and majority draft recommendations, taking particular exception to the volumetric component of the proposal, principally because of the atypically strong demands for working capital due to long lead times in production and delays in maturation. Although the WFA contended that wine is no more a substitute for beer than for non-alcoholic beverages, it conceded that there were some external costs of alcohol abuse from all forms of alcohol, including wine. Nevertheless, the Federation argued that these costs were cancelled by substantial health benefits from the consumption of wine in moderation.

3.60 The WFA also argued that the industry's funding requirements were compounded by full absorption trading stock valuation arrangements on long stock holdings which result in understated expenses for the income year, which in turn results in overstated profits. Consequently, taxation is paid in advance of sales which calls upon additional working capital. The WFA stated that Coopers and Lybrand had estimated that this treatment of wine stocks represented a four per cent increase in the rate of WST. Application of Own Use (AOU) charges on cellar-door wine tasting represented another one per cent equivalent increase in WST which apparently results in small wineries attempting to recoup this cost by charging for wine tasting. Finally, the \$10,000 small business exemption has been eroded by the progressive increases in the sales tax rates on wine which have brought previously exempt operators into the WST regime.

3.61 The WFA also objected to the automatic application of the FBT to business meals at which wine is served, which impacts on the wine industry's promotional activities and wine sales to restaurants.

3.62 Citing ABS data, the WFA argued that winemakers have lost volume in recent years as a result of tax, price and cost rises. The Federation considers it unlikely that winemakers will pass on the added costs to the consumer, but will attempt to partially absorb the added costs through taking reductions in profits, and to pass the remainder on to the suppliers, the growers.

3.63 The Federation considers that the industry is now very exposed, as this flowthrough effect has occurred a number of times in the past and because it has a major capital problem in replacing old vines. Although these expenses can be written off by the property owners, and the draft Industry Commission report recommends extending this provision to leased properties, the Winegrape Growers' Council contended that many independent growers do not '...have the luxury of the ability to write it off, they do not have the ability to raise the borrowings in the first place. The Council advised that banks would require a borrower to have 65 to 75 per cent equity in the property and to demonstrate the ability to survive with sharply reduced income during the period of development of the vineyard.

The Wine Industry Position

3.64 When asked by the Committee to nominate the most important issues, the wine industry representatives wanted:

- the establishment of a predictable tax environment free of the constant risk of change; and
- recognition that the normal taxation arrangements that are levied on the industry have a 'disproportionate and probably unintended' impact because of the peculiarities of the wine industry.

3.65 In relation to the latter point, be **the WFA considered the trading stock valuation arrangements to crucial** because the wine industry's future opportunities lie in having a quality

advantage. The wine industry could only sustain a quality advantage by investing in considerable maturation of wine stocks. The Federation pointed out that in the draft Wine Inquiry report, there was '...some discussion about whether the wine stocks are not in fact more akin in nature to investment than production for income'. If wine stocks were considered an investment, the required tax treatment would be different:

It requires a tax treatment whereby there is an immediate write-off of **all** costs associated with the stock investment - in other words, it is really taking an appreciation regime concept but giving it a very short time frame and bringing it into the one year in which stocks are built up. Alternatively, it requires some depreciation treatment which had the desired effect...

3.66 The wine industry representatives commented that there were two elements to this approach, namely:

- valuation element on the stock itself; and
- a timing issue concerning the time frame within which the expenses associated with achieving that valuation are recognised.

3.67 The Growers Council was, however, extremely concerned about the possible impact of a volumetric tax, both in terms of its direct impact on the industry, and because it threatened to distract from other, important tax issues. The Council considered it the single most dangerous issue that has changed since it forwarded its submission to this inquiry. It agreed that the grape growers would probably end up bearing the brunt of a volumetric tax, particularly if the majority recommendations which recommended loading a greater tax rate on nonpremium wines, were adopted.

3.68 Finally, representatives were concerned that the brandy industry, which has traditionally used surplus non-premium grapes, will effectively cease to exist, resulting in surplus grapes being physically dumped.

Conclusion

3.69 The tax treatment of the wine industry is complex, involving close scrutiny and assessment of a number of contentious issues to which there is plainly little agreement between the Committee of Inquiry into the wine industry and the industry itself. The Committee is not in a position at this stage to fully evaluate even the major issues of contention that have arisen in the course of the Inquiry into the Winegrape and Wine Industry, and therefore has not attempted to influence the outcome of the Inquiry by making recommendations concerning the substantive tax issues. However, the Committee considers it of great importance that the key issues involving this important, successful and expanding export industry be properly addressed. Clearly, those key issue of contention remain the proposed imposition of a volumetric tax, trading stock valuation arrangements involving long term wine stocks, and the FBT.

3.70 *The Committee of Inquiry and the wine industry are at odds over that Committee's draft recommendations. Clearly, it is unrealistic to expect agreement in relation to all the issues. However, if the winegrape and wine industry's long term development potential is to be realised, an important consideration must include the attitude of the industry itself towards the measures that the Committee of Inquiry will recommend for implementation in its final report.*

3.71 *The Committee considers that the successful resolution of this long, thorough and heavily committed inquiry into the winegrape and wine industry will not be achieved until the major protagonists find common ground.*