Submission No: 34
Small Business Employment
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Winemakers' Federation of Australia

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30 May 2002

The Secretary
Senate Employment, Workplace Relations
and Education References Committee

By Email: eet.sen@aph.gov.au

Dear Sir or Madam

Inquiry into small business employment

The Winemakers' Federation of Australia Incorporated (WFA) is the national peak body for the wine industry with voluntary membership representing more than 95 percent of the wine produced in Australia and 90 percent of Australian winemakers. The Federation consists of two electoral colleges: The Australian Wine and Brandy Producers' Association, and The Australian Regional Winemakers' Forum.

The Australian Regional Winemakers' Forum (ARWF) is the Electoral College of the Winemakers' Federation of Australia (WFA) that focuses on representation of small and medium sized wineries. The ARWF makes up half of the Federation, driving policy and strategy on issues at the federal level on behalf of members and the Australian wine industry. Every State Wine Industry Association has a representative on the management committee of the Forum, thus ensuring a national approach to matters affecting small and regional wineries.

The ARWF and WFA have a heavy advocacy involvement across virtually all areas of winery and industry operation. Key portfolio areas include Trade, the Environment, Wine Tourism, Wine and Health, Education and Training, Research and Development and Taxation as well as technical and packaging matters.

A significant area of effort for the Winemakers' Federation of Australia, and one that directly or indirectly impacts on all facets of industry affairs, is that of environmentally sustainable management practices. The Federation has just formed a national committee to focus efforts in this area, and the industry's national strategic plan for the environment will be launched in mid-2002.

In dealing with the Terms of Reference for this Inquiry, the key portfolio areas and major platforms that have been raised by members focus on taxation, with a particular emphasis on compliance matters, wine tourism and the broader implications of these on regional development.

Taxation

The Winemakers' Federation of Australia has developed over the past 24 months a detailed and well-researched taxation policy specifically directed towards relieving viability pressures for smaller and regional wineries.

This taxation policy has the support of both electoral colleges of the WFA, including the four major companies and all State Wine Industry Associations.

The policy and supporting arguments was detailed in the WFA Pre-Budget Submission 2002 (*attachment 1*). An extract from the Executive Summary of that submission follows:

> *Executive Summary*
>
> *Australian wineries face significant challenges over the next 5 years, as international competition intensifies and globalisation forces a paradigm shift in the marketplace.*
>
> *The rapid increase in vineyard areas in Australia over the last decade has been repeated in most competitor countries – the US, Chile, South Africa, France, Italy and Spain. Ongoing international success will rely on improved quality, lower cost, better marketing and an ordered/sustainable increase in wine supply. Rapid plantings of recent years threaten ordered growth, because new and existing brands will not be developed quickly enough to absorb all available supply. Sectors of the wine industry therefore face acute viability pressures for at least the next 3 years.*
>
> *Retailer and wholesaler consolidation is forcing wineries – large and small – to address the implications of a global marketplace and to find strategic solutions. As consolidation and competition intensifies, significant market power is shifting from producers to retailers. Retailers are choosing to stock only those wineries with a wide range of brands across key price points – the domain of the large companies – and small wineries with strong brands. Increasingly, small and medium wineries are finding that they can no longer rely on the traditional route to market. Whilst other opportunities such as cellar-door sales exist, for many, viability is seriously threatened.*
>
> *Research undertaken by Deloitte Touche Tohmatsu (Deloitte) demonstrates that the financial performance of the Australian wine industry has declined considerably since 1997. Profits have fallen, shareholders' equity in the industry was replaced by an increase in long term debt, liquidity fell substantially and the cost of sales increased. Compared with other sectors of the Australian economy winemaking's relative financial performance ranking worsened markedly over 1997-2000. The most acute profitability pressure is in the small winery sector. Viability pressures on small wineries has prompted the Minister for Agriculture, Fisheries and Forestry to announce an Independent Review of Wineries. This Review will focus on the viability*

pressures on wineries and provide recommendations to assist in creating a viable future for small wineries.

Against this challenging background, the Winemakers' Federation of Australia has developed a number of key policies aimed at keeping the Australian wine industry at the forefront of international competition, and of providing a sustainable operating environment for the small and medium wine sector.

Policies targetted at the small winery sector are:

- *Wine Equalisation Tax (WET) exemption on the first 600,000 litres per annum of domestic sales and 29% WET on all domestic sales after that.*
- *Remove WET from applications to own use, thereby ensuring taxation consistency between WET and GST*
- *Institute a more equitable and efficient system of valuation of stock on hand at wineries for tax purposes by adopting realistic nominal values.*
- *Support for the National Wine Tourism Strategy as outlined in the Government's commitment of $450,000 over three years.*

The proposal to apply a WET exemption on the first 600,000 litres per annum of domestic sales is targetted at small wineries. Large companies will receive negligible benefit, and will therefore be unable to compete away any tax-cut. This aspect of the policy is crucial if smaller wineries are to improve viability, thus retaining the investment and employment impetus in regions. Furthermore, the proposal will reduce compliance costs for the wineries that fall below the threshold – the majority of wineries in Australia.

Other policies, aimed at competitiveness and sustainability of the wine and winegrape industry include:

- *Support for the development and promotion of the National Wine Industry Environment Strategy demonstrating and increasing the wine industry's commitment to responsible environmental management practice.*
- *Maintain the existing Commonwealth commitment to match industry contributions to the Grape and Wine Research and Development Corporation up to a maximum of 0.5% GVP.*

Australia's winemakers and grapegrowers are making an unprecedented contribution to Australian regional economies.

The viability of many regional winemakers is seriously threatened under the burden of tax increases which now leave Australia as the highest taxed major international wine producer.

As outlined in the above Executive Summary, and more detailed submission (*attachment 1*), compliance is a major consideration for smaller and regional wineries in dealing with the current taxation system. The WFA taxation policy is specifically designed to eliminate this compliance problem through the exemption proposal.

A further explanation and example of the compliance difficulties is outlined in *Attachment 2* provided by Stuart Bryce, Tasmanian small winemaker, President of the Vineyards Association of Tasmania and member of the Management Committee of the Australian Regional Winemakers' Forum.

Wine Tourism

Table 1 at *attachment 3* outlines the significant contribution of wine tourism with a total spend in regional Australia of nearly $1 Billion by winery tourists - $412 million at wineries and $553 million elsewhere in the district.

Tourists purchase wine and other products from cellar door outlets as well as contributing substantially to local communities and regions through added expenditure on accommodation, food and other goods and services.

The Australian wine industry developed the National Wine Tourism Strategy and Implementation Plan as a complimentary strategic approach to that first embedded in the industry's 30 year strategic plan *Strategy 2025* released in 1996.

During the 2001 Election, the Federal Government announced a $450,000 grant over 3 years to drive this National Strategy and Implementation Plan, as well as a comprehensive review into profitability for the wine industry with a particular focus on tourism and exports.

The wine tourism grant is expected to be appropriated to the Winemakers' Federation within sufficient timeframe to employ a wine tourism development officer by 1 July 2002.

This position will contribute greatly to a national co-ordination of projects and strategic development of the wine tourism effort. The emphasis for this position will be on product enhancement through training and education programmes and promotion and awareness efforts in collaboration with such groups as the Australian Tourist Commission and Australian Wine Export Council.

Review of Wine Tourism and Exports by the Department of Agriculture, Fisheries and Forestry has just commenced with the announcement on 27 May 2002 of the successful consultant chosen from the tender process.

It is expected this analysis of the wine industry will lead to further significant policy recommendations for Government that will impact on small winery profitability.

Urban / Rural Interface

An issue of growing importance for the wine industry, indeed for many agricultural industries, is the increasing interaction between rural enterprises and urban development.

There are several examples in the wine industry of significant urban development in the immediate proximity of existing viticultural land and wineries that has lead to conflict between neighbours and threatens the industry that has been responsible for developing the local area in the first place.

A further consideration is the use of scarce of prime agricultural resources for urban requirements which are therefore unavailable for consolidation and growth of the industry. Without the continued growth of the wine industry, many regional communities would face economic downturn across Australia.

The availability of prime agricultural land for growth of the industry and the ability to carry out common agricultural practices that is not in conflict with neighbouring properties is essential if Australia is reach and maintain its potential as one of the pre-eminent global wine suppliers.

World-renowned Australian wine regions including the McLaren Vale, Hunter, Barossa, Margaret River and the Adelaide Hills have experienced land use conflicts and to find a balance between these legitimate and competing interests is a difficult task.

Conclusion

The wine industry holds to the Government axiom that expanding employment opportunities and regional development goes hand in hand with strong economic performance.

The wine industry is directly responsible for some of the most enlivened regional communities in Australia, providing revenue, regional employment, investment and growth opportunities in 61 of Australia's often economically depressed regional areas.

In regions where the wine industry is prominent, it is strongly linked to the economic well-being and social fabric of the local community.

This positive situation is under threat through a number of different factors, as outlined in the Executive Summary of the Pre-Budget Submission above.

There is little doubt the Australian wine industry will continue to grow, driven by the major companies and continued strength of established brands in export markets.

The potential impact of small winemakers going out of business is serious for regional communities in terms of the loss of industry value-added activities for the local economy, as well as the decline in tourism revenue. Added to this is the potential loss of the variety and uniqueness that so many small winemakers contribute to the Australian wine offer.

While there are a number of aspects of the challenging business environment that is both difficult and inappropriate for Government to impact, specific aspects of the current taxation regime are within the parameters for streamlining and simplification.

Further policy initiatives and recommendations will develop from the Agriculture, Fisheries and Forestry Review to be conducted in the coming months.

The Winemakers' Federation of Australia will be happy to present more detail on the matters raised in this submission and provide any further information required.

Thank you for the opportunity to provide this submission.

Yours sincerely

Dominic Nolan
Executive Officer

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Attachment 1

WINEMAKERS' FEDERATION OF AUSTRALIA

PRE-BUDGET SUBMISSION

JANUARY 2002

TABLE OF CONTENTS

WFA PRE BUDGET SUBMISSION

1. Executive Summary

Australian wineries face significant challenges over the next 5 years, as international competition intensifies and globalisation forces a paradigm shift in the marketplace.

The rapid increase in vineyard areas in Australia over the last decade has been repeated in most competitor countries – the US, Chile, South Africa, France, Italy and Spain. Ongoing international success will rely on improved quality, lower cost, better marketing and an ordered/sustainable increase in wine supply. Rapid plantings of recent years threaten ordered growth, because new and existing brands will not be developed quickly enough to absorb all available supply. Sectors of the wine industry therefore face acute viability pressures for at least the next 3 years.

Retailer and wholesaler consolidation is forcing wineries – large and small – to address the implications of a global marketplace and to find strategic solutions. As consolidation and competition intensifies, significant market power is shifting from producers to retailers. Retailers are choosing to stock only those wineries with a wide range of brands across key price points – the domain of the large companies – and small wineries with strong brands. Increasingly, small and medium wineries are finding that they can no longer rely on the traditional route to market. Whilst other opportunities such as cellar-door sales exist, for many, viability is seriously threatened.

Research undertaken by Deloitte Touche Tohmatsu (Deloitte) demonstrates that the financial performance of the Australian wine industry has declined considerably since 1997. Profits have fallen, shareholders' equity in the industry was replaced by an increase in long term debt, liquidity fell substantially and the cost of sales increased. Compared with other sectors of the Australian economy winemaking's relative financial performance ranking worsened markedly over 1997-2000. The most acute profitability pressure is in the small winery sector. Viability pressures on small wineries has prompted the Minister for Agriculture, Fisheries and Forestry to announce an Independent Review of Wineries. This Review will focus on the viability pressures on wineries and provide recommendations to assist in creating a viable future for small wineries.

Against this challenging background, the Winemakers' Federation of Australia has developed a number of key policies aimed at keeping the Australian wine industry at the forefront of international competition, and of providing a sustainable operating environment for the small and medium wine sector.

Policies targetted at the small winery sector are:

- Wine Equalisation Tax (WET) exemption on the first 600,000 litres per annum of domestic sales and 29% WET on all domestic sales after that.
- Remove WET from applications to own use, thereby ensuring taxation consistency between WET and GST
- Institute a more equitable and efficient system of valuation of stock on hand at wineries for tax purposes by adopting realistic nominal values.
- Support for the National Wine Tourism Strategy as outlined in the Government's commitment of $450,000 over three years.

The WFA tax policy seeks to redistribute the $87M in extra tax collected when the Wine Equalisation Tax was introduced, without compromising on the main platform of the Government's ANTS package – the 1.9% retail price increase on a 4 litre cask.

The proposal to apply a WET exemption on the first 600,000 litres per annum of domestic sales is targetted at small wineries. Large companies will receive negligible benefit, and will therefore be unable to compete away any tax-cut. This aspect of the policy is crucial if smaller wineries are to improve viability, thus retaining the investment and employment impetus in regions. Furthermore, the proposal will reduce compliance costs for the wineries that fall below the threshold – the majority of wineries in Australia.

Other policies, aimed at competitiveness and sustainability of the wine and winegrape industry include:

- Support for the development and promotion of the National Wine Industry Environment Strategy demonstrating and increasing the wine industry's commitment to responsible environmental management practice.
- Support for the Restaurant and Catering Australia policy of removing Fringe Benefits Tax (FBT) from business meals.
- Maintain the existing Commonwealth commitment to match industry contributions to the Grape and Wine Research and Development Corporation up to a maximum of 0.5% GVP.

Australia's winemakers and grapegrowers are making an unprecedented contribution to Australian regional economies.

The viability of many regional winemakers is seriously threatened under the burden of tax increases which now leave Australia as the highest taxed major international wine producer.

The 2002 Federal budget provides an ideal opportunity to implement strategies to safeguard the viability of small wineries, and contribute to ongoing regional development in wine regions.

2. Contact Information

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3. Winemakers' Federation of Australia

The Winemakers' Federation of Australia's Mission Statement is " to develop policies and programmes to increase the nett returns to Australia's Winemakers".

Through direct and affiliate membership, the Winemakers' Federation of Australia represents over 95% of Australian wine industry production and over 90% of Australian wineries.

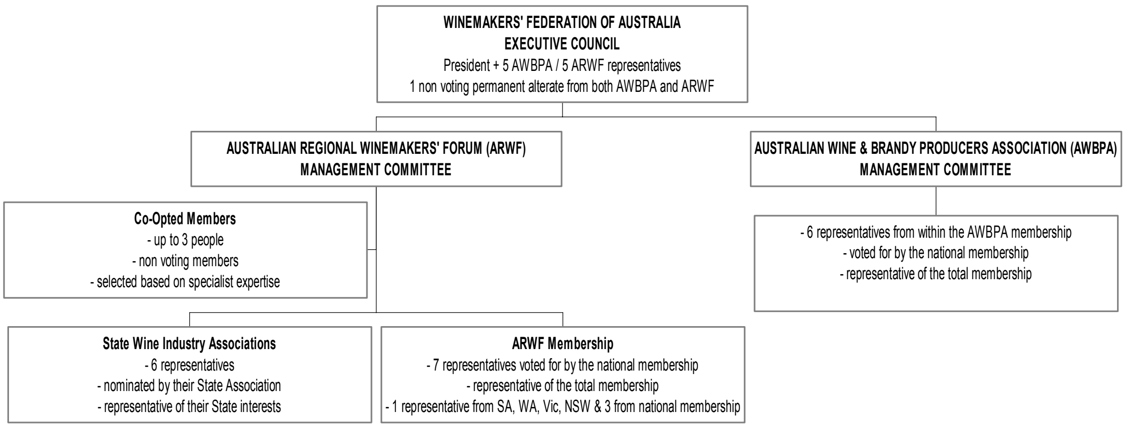
In December 2000, WFA altered its structure to ensure that all state wine industry associations were represented. In doing so, WFA broadened its consultative process on policy development beyond its 400 direct members, to include all wineries in Australia represented by a state association. The combined representation of direct membership and state membership is estimated at 1,200 wineries nationally.

The states now play an integral role in WFA policy and strengthen the grass-roots link between WFA and wineries across Australia.

The WFA structure is presented below:

WINEMAKERS' FEDERATION OF AUSTRALIA

BOARD STRUCTURE



The electoral colleges of WFA each provide 5 members of the Executive Council, with an alternating chairperson.

The Australian Wine and Brandy Producers' Association (AWBPA) focuses attention on larger companies, whilst the Australian Regional Winemakers' Forum (ARWF) represents the interest of smaller and medium sized wineries. The ARWF Committee is comprised of 6 State Industry Association appointees, a further one representative from each of WA, SA, NSW & VIC elected by the National membership, and 3 further representatives from any state elected by the national membership.

4. 2002 Federal Budget Recommendations

Policy Recommendations

Wine Tax Policy

- Wine Equalisation Tax (WET) exemption on the first 600,000 litres per annum of domestic sales and 29% WET on all domestic sales after that.
- Remove WET from applications to own use, thereby ensuring taxation consistency between WET and GST.

Stock Valuation

- Institute a more equitable and efficient system of valuation of stock on hand at wineries for tax purposes by adopting realistic nominal values.
- Determination of the nominal value requires detailed analysis of average stock values by winery. This data is collected by the ABS and aggregated under ANZSIC code 2183 – Wine Manufacturing. The data would need to be disaggregated according to pre-determined unit values of stock to provide the relevant information for estimations of cost. It is therefore recommended that Treasury undertake the appropriate analysis of the ABS data to assist in determining an appropriate designated stock value.

Environment

- Support for the development and promotion of the National Wine Industry Environment Strategy demonstrating and increasing the wine industry's commitment to responsible environmental management practice.

Fringe Benefits Tax

- Support for the Restaurant and Catering Australia policy of removing Fringe Benefits Tax (FBT) from business meals.

Tourism

- Support for the National Wine Tourism Strategy as outlined in the Government's commitment of $450,000 over three years.

Research & Development

- Maintain the existing Commonwealth commitment to match industry contributions to the Grape and Wine Research and Development Corporation up to a maximum of 0.5% GVP.

4.1 Wine Tax Policy

Recommendation:
Wine Equalisation Tax (WET) exemption on the first 600,000 litres per annum of domestic sales and 29% WET on all domestic sales after that.

The WFA wine tax policy is motivated by three important contributing factors:

- Australian wineries are now the highest taxed of any major wine producing countries in the world; (see Section 7)
- Winery profitability has declined dramatically since 1996; (see Section 5.2) and
- The Wine "Equalisation" Tax increased tax on wine by $87M with the implementation of tax reform (Econtech, WFA, Appendix 2)

The wine industry sought tax revenue neutrality through the tax reform process, in recognition of the Government's intention of broadening the tax base, thereby enabling a reduction in the rate on the existing narrow base of taxed goods.

The Government introduced an effective 12% increase on wine tax with the ANTS package, despite claiming that there would not be any "significant" revenue implications in the Explanatory Memorandum to the WET Bill.

Econtech (Appendix 2) have demonstrated that Tax Reform delivered a $102M wine tax increase. Deducting the Commonwealth rebate of $15M, the net tax increase on wine was $87M. The separate increase in tax for on-premise sales is excluded from the $87M.

The WFA policy (above) seeks to redistribute the $87M in over-tax without compromising on the main platform of the Government's ANTS package. WFA acknowledges that the ANTS policy was to increase the retail price of a four litre cask of wine by 1.9% and accepts that the WET rate to deliver the 1.9% retail price increase is 29%, as demonstrated by Econtech.

The motive for redistributing the extra tax via an exemption on the first 600,000 litres of domestic sales is based on the acute viability pressures facing Australia's small and medium wine sector (Appendix 1).

These viability pressures are caused by a range of factors including the taxation burden, structural changes in the international and domestic wine business and the normal business cycle.

Importantly, the WFA proposal is targeted at small wineries. This means that large companies (that sell around 85% of domestic wine sales) will receive negligible benefit, and will be unable to compete-away any tax cut, thereby allowing the smaller wineries to retain tax cuts as margin. This is paramount to their ongoing viability and continued investment and employment in regions. The larger companies are fully supportive of this policy in the interests of the ongoing viability of all industry sectors.

4.2 WET on samples

Policy:
Remove WET from *applications to own use,* thereby ensuring taxation consistency between WET and GST.

WET currently applies to all *applications to own use*, including cellar door tastings and show / exhibit wine. This policy is a legacy of the former Wholesale Sales Tax (WST) system, and has no justification on public policy, compliance or anti-avoidance grounds.

Under the WST system, WST was applied to *applications to own use* on wine on the basis that its removal would precipitate avoidance in other sectors, most notably the perfume industry. As WST no longer applies, and WET applies only to wine, avoidance issues for other industries no longer apply.

Whilst the rebate on cellar-door sales allows most wineries to avoid paying WET on goods applied to own use, those wineries without cellar-doors, or those wineries above the $300,000 threshold must still pay WET on applications to own use.

No GST applies to wine, or any other goods or services given away. Removal of WET on *applications to own use* would ensure policy consistency between the two taxes and would reduce compliance costs of both wineries and the ATO.

4.3 Trading Stock Valuation

Policy:
Institute a more equitable and efficient system of valuation of stock on hand at wineries for tax purposes by adopting realistic nominal values.
Determination of the nominal value requires detailed analysis of average stock values by winery. This data is collected by the ABS and aggregated under ANZSIC code 2183-Wine Manufacturing. The data would need to be disaggregated according to pre-determined unit values of stock to provide the relevant information for estimations of cost. It is therefore recommended that Treasury undertake the appropriate analysis of the ABS data to assist in determining an appropriate designated value.

The valuation of trading stock for taxation purposes is a disincentive for investing in the wine industry – an industry characterised by high stock levels and low stock turnover.

A better solution to the current discriminatory stock valuation method would enable wineries to capitalise on international quality wine growth opportunities and would assist in diminishing the impending abundant supply of winegrapes.

Most importantly, the proposed solution would only defer taxation – it would not vary the amount of net income on which the winemaker will ultimately pay tax.

The future for Australian wine relies on the industry's capacity to upgrade quality, and maintain or reduce costs. The world market is demanding more super premium and ultra premium wine above A$10, and less inexpensive wine. At a minimum, the Australian wine industry must invest more heavily in storing wine for longer periods to ensure that it meets the market's expectations at the higher price levels.

Australian taxation law for trading stock, however, discriminates against wine by discouraging investment in quality, and adding to costs. In calculating profits, any growth in winery stocks is included as assessable income in the Profit and Loss and is taxable – usually well ahead of the sale of the wine.

An analysis of turnover across a broad range of manufacturing industries indicates that, on average, stock is turned over in most manufacturing industries between 4 and 15 times per annum. By contrast, wine stock is turned over once every 1.5 years, and even less often for high-value producers.

Consequently, a winery in a high-growth phase is penalised far more heavily than a typical manufacturer. Both would pay income tax ahead of sale if they were growing. However, the manufacturer would receive income between 1 and 3 months later, whilst the winery would wait 1.5 years on average. In effect, the winery is paying income tax 1.5 years ahead of receiving any income. WFA has prepared cash-flow projections of a premium winery and compared it with a general manufacturer. The two case studies differ only in the rate of stock turnover and the rate of growth – reflecting current industry practice for the two sectors.

The results reveal that:

- the wine manufacturer is only able to claim 85% to 89% on average of actual costs incurred in each year of production. This compares with 100% for the general manufacturer.

- this illustrates that wineries as opposed to other manufacturers, are incurring production costs for which they are not entitled to a tax deduction in the year the costs are incurred.

- even with no dividend, winery cash-flow is negative.

- the winemaker must be able to fund the growth in stock levels. For the case-study winery, growing at 7% p.a., the annual increase in funding requirements is greater than 25% p.a. the only alternative for the winery is to grow at a slower rate or to release lower quality wine earlier.

The solution is to defer tax liability by introducing a nominal or designated value for stock valuation purposes. Wineries would then select from the existing options available and the designated value. By allowing wineries to select or opt-in, the designated value could be set at a rate that deferred the tax only for those wineries with high unit values of stock on hand, which would be the wineries that typically store wine for lengthy periods. Wineries with values below the designated level could simply opt for the existing alternatives for valuing stock. In this way, the one-off cost to Government would be limited.

Determination of the designated rate requires detailed analysis of average stock values by winery. This data is collected by the ABS and aggregated under ANZSIC code 2183 – Wine Manufacturing. The data would need to be disaggregated according to pre-determined unit values of stock to provide the relevant information for estimations of cost. It is therefore recommended that Treasury undertake the appropriate analysis of the ABS data and work with industry to determine an appropriate designated stock value.

4.4 Environment Strategy

Policy:
Support for the development and promotion of the National Wine Industry Environment Strategy demonstrating and increasing the wine industry's commitment to responsible environmental management practice.

Australian winemakers have identified responsible environmental management as a critical aspect of corporate responsibility and continued economic development for the industry.

WFA endorsed the South Australian Wine and Brandy Industry Association (SAWBIA) to take a lead role in developing the Environment Strategy on behalf of the Australian wine industry. The release of that strategy as a public consultation draft document is scheduled for early 2002.

WFA and SAWBIA have entered into an Agreement with Environment Australia for a broad-scale implementation programme over three years to deliver key components of that strategy. The first 12 months of delivery for the Agreement is a three-way funding arrangement between Environment Australia, WFA and SAWBIA. It is essential support for the Implementation Plan is continued for the subsequent 2 years to ensure the Australian wine industry is able to maintain and extend the strong commitment to responsible environmental management.

4.5 Fringe Benefits Tax

Policy:
Support for the Restaurant and Catering Australia policy of removing Fringe Benefits Tax (FBT) from business meals.

Business meals are a legitimate business expense of many businesses. Taxing them as a fringe benefit is therefore unwarranted.

4.6 Tourism

Policy:
Support for the National Wine Tourism Strategy as outlined in the Government's commitment of $450,000 over three years.

Significant Government and Industry resources contributed to the development of the National Wine Tourism Strategy (launched at Wine Australia 1998) and the accompanying Implementation Plan (September 1999).

The Implementation Plan identified key activities from the strategy and incorporated timelines and roles and responsibilities for stakeholders in wine tourism. While many of the actions listed were adopted and driven at State and Regional level, there has been a marked lack of national co-ordination for the strategy and implementation of initiatives.

The Australian Regional Winemakers' Forum has identified wine tourism as a vital and necessary plank for the continued viability of small and medium wineries. In recognition of this priority, in July 2001 the ARWF established the Australian Wine Tourism Alliance as a reference group to institute national co-ordination for delivery of the Implementation Plan.

The Alliance, operating under the structure of the ARWF, and therefore the Winemakers' Federation, has one representative from each State from either the tourism or wine industry. Other members include Wine Australia, the Australian Wine Export Council, the Tourism Council of Australia, National Wine Centre and Tourism Task Force

Key priorities identified from the Implementation Plan by the Alliance for immediate action include generic wine tourism promotion at significant events such as Wine Australia 2002; publication of training and reference material for winemakers; provision of a one-stop point of reference for data; statistics and other wine tourism related information (through the National Wine Centre website); and, critically, dissemination of information to and from the regions and states to ensure a more co-ordinated approach to activities.

The one aspect that is lacking from this highly proactive and dynamic operation is the provision of an Executive / Development Officer to drive the Implementation Plan, to run the Alliance and to co-ordinate delivery of the projects.

The $450,000 over 3 years promised by the Coalition in the lead-up to the election will employ an Officer for the Strategy, providing on-costs and other associated expenses for delivery of the Implementation Plan

4.7 Research and Development

> ***Policy:***
> Maintain the existing Commonwealth commitment to match industry contributions to the Grape and Wine Research and Development Corporation up to a maximum of 0.5% GVP.

The Commonwealth has demonstrated a strong commitment to rural R&D Corporations by matching industry contributions to R&D up to a maximum of 0.5% GVP.

The Commonwealth commitment to rural R&D Corporations (RDCs) recognises the significant market failure typical in rural industries. Most rural enterprises have insufficient capacity to commission research on their own behalf, and/or cannot prohibit “free-riders” from also sharing in the benefits of the research. Consequently, without Government intervention, there would be an under-investment in rural related research.

The pay-off to government occurs via the increased competitiveness of Australian rural industries, and the consequent economic impact on trade, regional investment and taxation, as well as the social impact on regional communities. R&D investment by the RDCs has achieved average returns of around $7 for every $1 invested (*Innovating Rural Australia*, Agriculture Forestry and Fisheries Australia, 2001).

A prominent example of the benefits of this commitment is in the success of Grape and Wine Research and Development Corporation funding of research into Partial Rootzone Drying (PRD). PRD has had a dramatic impact on improving grape quality, thus improving international competitiveness, and contributing to growth in the Australian viticulture industry. So much so, that PRD was included in the list of 100 most important innovations of the 20th century by the Academy of Technical Sciences and Engineering and Sydney’s Powerhouse Museum.

This Commonwealth commitment, combined with the industry contribution, has facilitated the wine industry in becoming a world leader in viticulture and oenology research.

4.8 Trade

Policy:
Assist the free trade agenda of the wine industry by ensuring that priority is given to a range of initiatives including: more funding for Codex Australia; adequate ongoing resources for the New World Wine Producers Group; finalisation of the EU – Wine Australia Wine Agreement; Government commitment to its ongoing involvement in the Office International de la Vigne et du Vin (OIV) and discussions with the US on a free trade agreement.

Trade and market access issues are of primary importance to the future success of the Australian wine industry. The Winemakers' Federation of Australia (WFA) adopted its Trade Policy in April 2000.

The key principles adopted by WFA are:

The objective of Australia's wine trade policy is to ensure that wine can be traded freely on the international market.

To do this, industry and government must act in partnership to:

- ensure and enhance market access through the removal of trade barriers and harmonisation of import requirements where appropriate
- ensure that the quality perception, the integrity of brand Australia, and industry competitiveness is not compromised through inappropriate government policy and/or regulation.
- promote free trade without subsidies
- remove tariff and non-tariff barriers for wine
- ensure that international standards are set on the basis of sound science and not used as an impediment to trade

- maintain the integrity of the current multilateral trade agreements under the auspices of the World Trade Organisation

Recent Commonwealth government initiatives in these areas are likely to prove extremely beneficial to the Australian wine industry as well as other industries.

In particular, under the National Food Industry Strategy there are a number of key programs that are very timely.

First, there is an increased commitment to pursue Australian objectives in international standard-setting bodies, particularly the Codex Alimentarius Commission, with an additional $2.5 million within AFFA over the next five years. The Winemakers' Federation of Australia has been very active in Codex for the past year, and it is clear that Codex Australia is under resourced. WFA commend this initiative and hope that this funding can be used to enhance industry participation within the Codex process.

Second, WFA believes that initiatives of the New World Wine Producers Group (which has already resulted in a multilateral treaty on oenological practices) need to be adequately resourced. Expansion of this group to include consumer countries and other major producers in Asia and South America should be seen as a priority.

Third, the EU-Australia Wine Agreement is reaching a stage where it can be finalised, if Europe is genuinely committed to an agreement. This needs to be a major policy focus of the government over the next year.

Fourth, the wine industry has elevated its involvement in the Office International de la Vigne et du Vin (OIV) and monitors its activities closely. It is imperative that activities in this forum continue to be adequately resourced.

Fifth, the creation of the Office of Trade Negotiations within the Department of Foreign Affairs and Trade is very positive move and one which will enable WFA to promote the cause of multilateral trade liberalisation. The new round of negotiations under the World Trade Organisation are of fundamental importance to the success of the Australian wine industry and these negotiations need to be fully supported by the government.

Finally, WFA will also actively assist the government in its endeavors to sign free trade agreements. Of particular interest to WFA is the potential agreement with the United

States. WFA has provided technical input to DFAT on the potential benefits to the wine industry of such an agreement. While we understand this is a long-term project, we need to actively promote this agreement.

5. Overview of the Wine Industry

5.1 Economic Contribution

Australian Wine Industry	*Economic Contribution*
Number of Wineries	1,318
Wineries with cellar doors	1,027
Number of Wine Regions	61
Grapegrowing Establishments	5,770
Wine Produced (750ml bottles) (a)	1.1B
Employment: total	66,200
- Retailing and Wholesaling	37,500
- Winemaking / cellar door sales	11,800
- Grapegrowing	12,900
- Local Tourism	3,900
Winery Value added	$1.4B
Tourism: total	$970M
- spend at wineries	$410M
- non-winery in regions	$550M
- visitor numbers	4.4M
Wine Sales in Australia	$2.0B
Exports	$1.6B
Export Countries	91
Taxation:	
- Wine Equalisation Tax	$614M
- Cellar Door Rebate	$15M
- Company Tax	$166M

(a) Total wine production converted to bottle equivalents

Value added

The wine industry takes $1B worth of wine grapes and turns them into $3.6B in wholesale sales, generating $7B in retail sales. It is a classic example of an industry that is able to overcome the commodity cycle and declining long term terms of trade by investing in brands. Most importantly, most of that investment occurs in regional communities.

Employment

In the 1996 Census, there were almost 16,000 Australians employed in Australia's 1100 wineries and 61 grapegrowing regions throughout Australia – a 57% increase in employment since the 1991 Census.

With winegrape vineyard areas growing a further 60% in the four years since the 1996 Census, 200 new wineries, and existing wineries expanding, an additional 9,000 employees are estimated to now work in the Australian wine and winegrape industry, taking the total to 25,000.

Almost 45,000 further jobs are generated in wholesaling, retailing and local tourism taking the total direct employment to almost 70,000.

Adding employment in the 15,000 businesses estimated to rely in-part on the wine industry (e.g. packaging, transportation and financial services), total industry employment is likely to exceed 100,000.

Regional Development

The wine industry has breathed life back into regional communities in all Australian States.

It is one of the few sectors providing revenue, regional employment, investment and growth opportunities in 61 of Australia's often economically depressed regional areas. Furthermore, the wine industry draws the population to sustain regional schools, hospitals and community centres. In the regions where the wine industry is prominent it is strongly linked to the economic well being and social fabric of the local community.

Tourism

Winery related tourism generates almost $1B annually in regional economic development – up more than $500M since 1996.

Australia's 1027 winery cellar door operations in all States share in sales of $410M annually, from wine to food, to merchandise and accommodation.

Wineries attract 4.4 million visitors annually, including 456,000 international visitors.

With wine as the drawcard, the industry reaches into local communities by adding a further $550M in wine tourism related activities such as accommodation, transport and meals.

Export Revenue

Australia now generates in excess of $1.7B in annual export revenue – up from $380M in 1995 and from $118M in 1990.

Existing non-bearing vineyards are expected to deliver an extra 265 million litres of wine for sale by 2005 worth more than $1B in potential export revenue.

At a conservative $2.6B in 2005, Australian wine exports would exceed all rural commodities except Wheat, Beef, Dairy and Wool. By 2010, Australian wine exports could conceivably exceed all rural commodities.

Taxation Revenue

The Australian wine industry pays more than its fair-share in taxation - $600M in Wine Equalisation Tax; $400M in GST (including on-premise) and $166M in Company taxation.

5.2 Viability of Wineries

The financial performance of the Australian wine industry has declined considerably since 1997. Profits have fallen, shareholders' equity in the industry was replaced by an increase in long term debt, liquidity fell substantially and the cost of sales increased. Compared with other sectors of the Australian economy, winemaking's relative financial performance ranking worsened markedly over 1997 – 2000.

These findings are based on a detailed financial analysis of unpublished Australian Bureau of Statistics (ABS) industry survey data carried out on behalf of the Winemakers' Federation of Australia (WFA) by Deloitte Touche Tohmatsu (Deloitte).

The relatively poor financial performance of winemaking occurred despite record employment, capital investment, sales and gains in labour productivity.

In 2000, winemaking's operating profit and return on assets were at their lowest levels for at least five years. Return on equity for 2000 was at its lowest level since 1996.

Operating profit for winemaking ranked 4th best of 16 broad industry sectors in 1997 but by 2000 had slipped back to 8th. Its return on assets ranked 6th best in 1997 but fell to 13th in 2000. Similarly, its return on equity ranked 6th best in 1997 but fell to 11th in 2000. A separate survey of small and medium-sized wineries by Deloitte confirms the downward trend in financial performance evident in the ABS data.

The recent substantial capital expansion in winemaking financed by higher levels of long term debt resulted in a substantial fall in shareholder equity to around 38%. The industry's liquidity fell considerably over the last five years reducing its capacity to pay current liabilities from current assets.

Australian winemaking is in a less favourable financial position now than it was four to five years ago. The substantial increase in long term debt leaves it more exposed to interest rate increases. Continued strong sales growth with adequate margins is an imperative to getting a reasonable payback on recent heavy investment.

Small Winery Profitability

In 1999, Deloitte Touche Tohmatsu and the Winemakers' Federation of Australia conducted a financial benchmarking study of 33 small and mid-sized Australian wine companies. The 33 wineries represented around $550M in annual sales, or around 20% of Australian sales at the time. None of the largest four companies participated.

Wineries were grouped into small (less than 75,000 cases sold annually) and large/medium (more than 75,000 cases sold annually.

DELOITTE BENCHMARKING SURVEY: 1999

	< 75,000 Cases	> 75,000 Cases
Operating Profit (EBT / Total Revenue)	10.4%	12.7%
Return on Assets (EBT / Total Assets)	3.9%	6.3%

Smaller wineries demonstrated lower profit levels, and significantly lower return on assets. The evidence demonstrates that the most acute profitability pressure is manifest in the small winery sector.
The full report from Deloitte's is included in Appendix 1.

5.3. Changed Dynamics of the Global Wine Industry

The decade of the 1990's has seen a generational shift in demand for wine, driven by taste changes, associated health benefits and the complementarity of wine with food and lifestyle activities.

In addition, consumers, buoyed by almost a decade of strong economic growth, have responded by demanding higher quality wine at higher prices.

Australian wineries have capitalised on the structural and cyclical change in the wine market by increasing production, raising prices, and increasing margins from previous low levels. Such prosperity, however, can only ever occur in the short term. Higher margins encourage new entrants, new entrants encourage competition, and competition encourages discounting.

As a consequence, the prospects for wineries have moved full circle since the early 1990's. Structural change is a "once-off" and the benefits have largely been competed away. Cyclical movements, by their nature, go up and down with economic prospects. And most signs point to a downturn at present.

A less buoyant market outlook, combined with more intense international competition and the prospect of an 11% increase in winegrape supply over the next 2 years (ABARE 2002) will challenge the industry's ability to expand market opportunities in Australia and abroad. Further discounting and margin costs are inevitable.

Similarly, rationalization and consolidation of retail stores into larger chains results in less shelf opportunity. These larger chains are opting to deal with larger companies that can offer a wide range of brands covering a range of styles and price points. For smaller companies, opportunities still exist, but primarily for those with strong brands. An increasing number of wineries are finding their brands excluded from the traditional route to market. For the very small wineries (eg up to 50 tonnes), viable alternatives exist in sales through their cellar-door and directly to local restaurants. These operations typically also have off-farm income to supplement their winery income.

However, small to medium sized wineries (50 tonnes to 1000 tonnes), must rely on the mainstream routes to market for their livelihood – off-farm income and cellar-door businesses are typically insufficient to sustain the business.

With international competition intensifying and with a more highly concentrated retail sector, these companies are increasingly relying on discounting to quit stock, particularly on the local (domestic) market.

Domestic market volume growth, which has slowed dramatically since mid-2000, is only being sustained via heavy discounting. High domestic tax levels, which were passed-on to the consumer during the supply shortage period 1993 to 1999, are now being absorbed by wineries as they cut margins to sustain sales.

6. History of Wine Tax in Australia

Pre August 1984	0% + State Tax
August 1984	10% + State Tax
August 1986	20% + State Tax
August 1993	31% + State Tax
October 1993	22% + State Tax
July 1994	24% + State Tax
July 1995	26% + State Tax
August 1997	41% (no State Tax)
July 2000	46% equivalent (*29% WET + 10% GST)*

Wine taxes were progressively lifted throughout the 1990's as successive Governments sought to cash-in on the structural and cyclical (positive) shift in wine demand.

However, when the "once-in-a-generation" structural change finishes, the tax rate will be the same. And when the decade of economic growth ends, the tax rate will still be the same.

Without the benefits of strong wine demand growth, wine tax will again resume the role that it played between 1988 and 1996. It will have a debilitating effect on consumption and apply a brake to prospects of consumption growth. Most significantly there is a very real prospect that many smaller and medium companies will simply not be profitable and go out of business.

7. International Wine Tax Comparisons

	Tax rate relative to Australia (%)
Australia	100%
USA - California	41%
Canada - Ontario	85%
France	59%
Italy	29%
Germany	46%
Spain	46%
Argentina	60%
Chile	92%
South Africa	51%

Global tax comparisons for 750ml bottled wine

The above table compares Australia's wine taxes with the taxes applied in the markets of our major competitors.

On a comparative basis, Australia's tax levels are significantly higher.

Australia's wine tax has gradually risen over the past 15 years, from being below the OECD average, to well above it.

The tax rate, together with the value growth in the market have influenced tax revenue to rise sevenfold in nominal value terms since 1986, or threefold as a percentage of total government revenue (CIES, Policy Discussion Paper No 99/03).

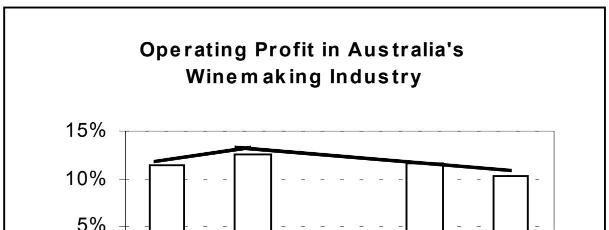
Appendix 1: Financial Performance of the Australian Winemaking Industry – 1996 to 2000

Deloitte Touche Tohmatsu, August 2001

Operating Profit

The decline in the operating profit percentage for winemaking since 1997 indicates a fall in the industry's percentage of revenue available after payment of expenses and interest but before tax.

Operating profit (EBT / Total revenue)	
1996	11.4%
1997	12.5%
1998	not available
1999	11.6%



A comparison of the operating profit for winemaking with other Australian industries shows that winemaking's relative ranking has slipped over the last five years. In 1996, it ranked 7th compared with all ABS 2 digit ANZSIC industries and improved in 1997 to 4th. But it has since slipped in the relative rankings to 8th in both 1999 and 2000.

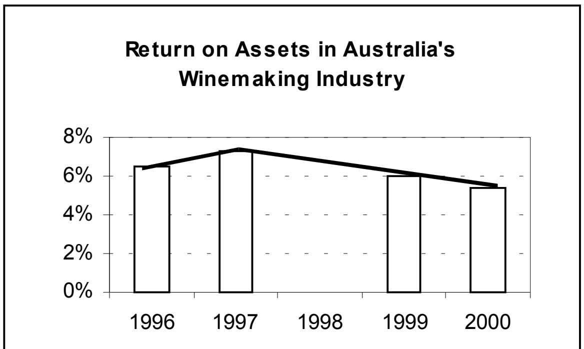
Industry	Operating profit margin (%)				
	1996	1997		1999	2000
Agriculture, forestry and fishing	14.4	11.8		13.5	18.1
Mining	17.6	17.9		15.5	17.6
Manufacturing	6.5	6.0		5.7	6.3
Electricity, gas and water supply	11.7	13.9		17.6	15.2
Construction	4.2	5.1		5.7	5.7
Wholesale trade	3.6	3.2		3.7	4.4
Retail trade	2.5	2.6		3.5	3.6
Accommodation, cafes and restaurants	6.0	6.8		6.0	6.0
Transport and storage	6.0	6.6		6.9	6.3
Communication services	14.4	8.3		20.5	20.9
Finance and insurance	27.2	24.0		26.1	18.3
Property and business services	12.8	12.2		12.1	13.4
Private community services	8.6	10.4		10.6	8.8
Cultural and recreational services	5.8	5.0		13.4	13.6
Personal and other services	8.1	8.2		6.6	9.8
ANZSIC 2183 - Wine Manufacturing	**11.4**	**12.5**		**11.6**	**10.4**
Performance Ranking for ANZSIC 2183	**7**	**4**		**8**	**8**

Sources:
ABS, *Business Operations and Industry Performance*, 8140.0
ABS*, Business Operations and Industry Performance* (Preliminary), 142.0
ABS, unpublished industry survey data for ANZSIC 2183

Return on Assets

This decline in return on assets employed in winemaking since 1997 indicates a fall in the industry's ability to use assets as resources to earn profit.

Return on assets (EBT / Total assets)	
1996	6.5%
1997	7.3%
1998	not available
1999	6.0%
2000	5.4%



A comparison of the return on assets for winemaking with other Australian industries shows that winemaking's relative ranking has declined over the last five years. In 1996, it ranked 8th compared with all ABS 2 digit ANZSIC industries and improved in 1997 to 6th. But it has since fallen substantially in the relative rankings to 10th in 1999 and 13th in 2000.

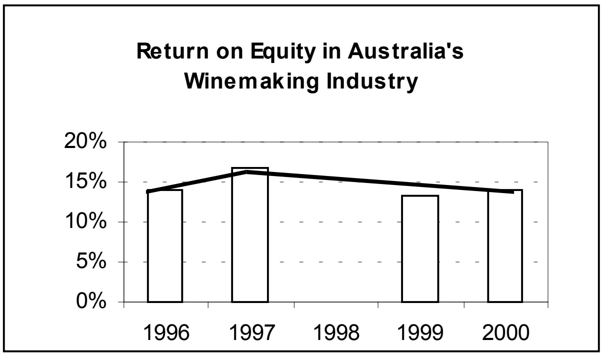
Industry	**Return on assets (%)**				
	1996	1997		1999	2000
Agriculture, forestry and fishing	3.2	2.6		2.9	4.0
Mining	9.1	8.9		7.1	7.4
Manufacturing	7.7	7.1		6.4	7.1
Electricity, gas and water supply	3.1	3.6		5.0	3.9
Construction	9.3	11.2		12.6	11.7
Wholesale trade	8.9	7.8		8.3	9.8
Retail trade	8.9	9.5		11.7	12.7
Accommodation, cafes and restaurants	5.8	5.9		5.7	6.1
Transport and storage	4.6	5.6		5.9	5.5
Communication services	9.4	5.2		15.0	15.1
Finance and insurance	2.9	2.3		2.5	1.5
Property and business services	5.8	6.0		6.4	7.7
Private community services	8.1	11.6		9.8	7.8
Cultural and recreational services	4.6	3.7		9.0	9.0
Personal and other services	5.8	5.8		4.5	9.4
ANZSIC 2183 - Wine Manufacturing	**6.5**	**7.3**		**6.0**	**5.4**
Performance Ranking for ANZSIC 2183	**8**	**6**		**10**	**13**

Sources:
ABS, *Business Operations and Industry Performance*, 8140.0
ABS, *Business Operations and Industry Performance* (Preliminary), 8142.0
ABS, unpublished industry survey data for ANZSIC 2183

Return on Equity

This decline in return on equity employed in winemaking since 1997 indicates a fall in the rate at which profit has been earned on shareholders' equity in the industry.

Return on equity (EBT / equity)	
1996	14.0%
1997	16.7%
1998	not available
1999	13.3%
2000	14.1%



A comparison of the return on equity for winemaking with other Australian industries shows that winemaking's ranking has slipped over the last five years. In 1996 it ranked 8th compared with all ABS 2 digit ANZSIC industries and improved in 1997 to 6th. But it has since fallen substantially in the relative rankings to 11th in both 1999 and in 2000.

Industry	**Return on equity (%)**				
	1996	1997		1999	2000
Agriculture, forestry and fishing	3.8	3.1		3.6	4.8
Mining	22.4	20.9		19.1	18.2
Manufacturing	16.0	15.8		16.6	18.3
Electricity, gas and water supply	5.4	6.2		9.3	8.0
Construction	32.9	37.5		41.1	33.3
Wholesale trade	27.8	23.9		26.0	29.2
Retail trade	30.3	36.1		32.9	33.3
Accommodation, cafes and restaurants	11.5	12.2		12.6	13.5
Transport and storage	9.9	13.0		14.8	15.7
Communication services	19.4	14.0		34.5	35.2
Finance and insurance	12.8	14.5		11.9	8.7
Property and business services	13.5	14.4		14.1	14.7
Private community services	14.6	22.0		18.6	13.0
Cultural and recreational services	10.4	9.4		18.9	17.6
Personal and other services	8.3	8.1		6.4	14.8
ANZSIC 2183 - Wine Manufacturing	**14.0**	**16.7**		**13.3**	**14.1**
Performance Ranking for ANZSIC 2183	**8**	**6**		**11**	**11**

Sources:
ABS, *Business Operations and Industry Performance*, 8140.0
ABS, *Business Operations and Industry Performance* (Preliminary), 8142.0
ABS, unpublished industry survey data for ANZSIC 2183

***Appendix 2** :*

Measurement of Wine Taxation Increase Under Tax Reform

WINE TAXATION UNDER THE NEW TAX SYSTEM

This report was prepared for the Winemakers' Federation of Australia Incorporated by Econtech Pty Ltd

19 June 2001

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Introduction

The Winemakers' Federation of Australia Incorporated (WFA) commissioned Econtech to examine the effects on wine prices and wine tax collections of the changeover to the New Tax System (NTS).

Under the old tax system, wine was subject to wholesale sales tax (WST) of 41 per cent. Under the NTS this was replaced with a wine equalisation tax (WET) set at the lower rate of 29 per cent. This tax reduction was made to compensate for the introduction of the 10 per cent GST on wine.

The main issue for the wine industry is whether the tax reduction from a 41 per cent WST to a 29 per cent WET provides sufficient compensation for the 10 per cent GST. This issue is examined in this report by considering the effects on wine prices and wine tax collections of alternative WET rates, including the current rate of 29 per cent.

Methodology

To undertake this analysis, two types of information were needed.

First, a full picture is needed of the distribution chain for different categories of wine, beginning with the ex-winery price and adding freight, wholesale and retail margins, as well as the wine taxes mentioned above. Econtech constructed these distribution chains by collecting information from wineries and bottle shops. One problem is that retail margins vary widely. To overcome this, retail margins were averaged over four bottle shops covering the spectrum from a discount bottle shop through to an expensive bottle shop, with two supermarket bottle shops in the middle.

Second, estimates are needed of the effects of the New Tax System on costs at each stage of the distribution chain. Econtech's MM600+ model provides estimates of the short-term cost savings in freight, wholesale and retail margins. The saving in winery costs was estimated by applying MM600+ estimates of short-term cost savings to the costs of five wineries as shown by their profit and loss statements. Distribution chains were constructed for eight specific wines covering casks, $8 bottles, $15 bottles, and $25 bottles.

In selecting alternative WET rates to be modelled, the desired price outcomes need to be considered.

Government's Wine Tax Commitment

The original NTS document states that: "the Wine Equalisation Tax will be levied at such a rate that the price of a four-litre cask of wine need only increase by the estimated general price increase associated with indirect tax reform; ie 1.9 per cent" (page 87). A similar promise was made about the price effect for a carton of full-strength beer.

This report finds that this commitment on prices for 4-litre casks has been kept. Specifically, it is estimated that, in the short-term, the changeover to the NTS has added 1.7 per cent to the price of a 4-litre cask, which is less than the target rise of 1.9 per cent. The WET rate to achieve a cask price rise of exactly 1.9 per cent would have been 29.3 per cent (see Chart 2), which rounds to the current WET rate of 29 per cent.

Chart 1
Effect of the New Tax System on the Price of Wine Purchased Off-premise

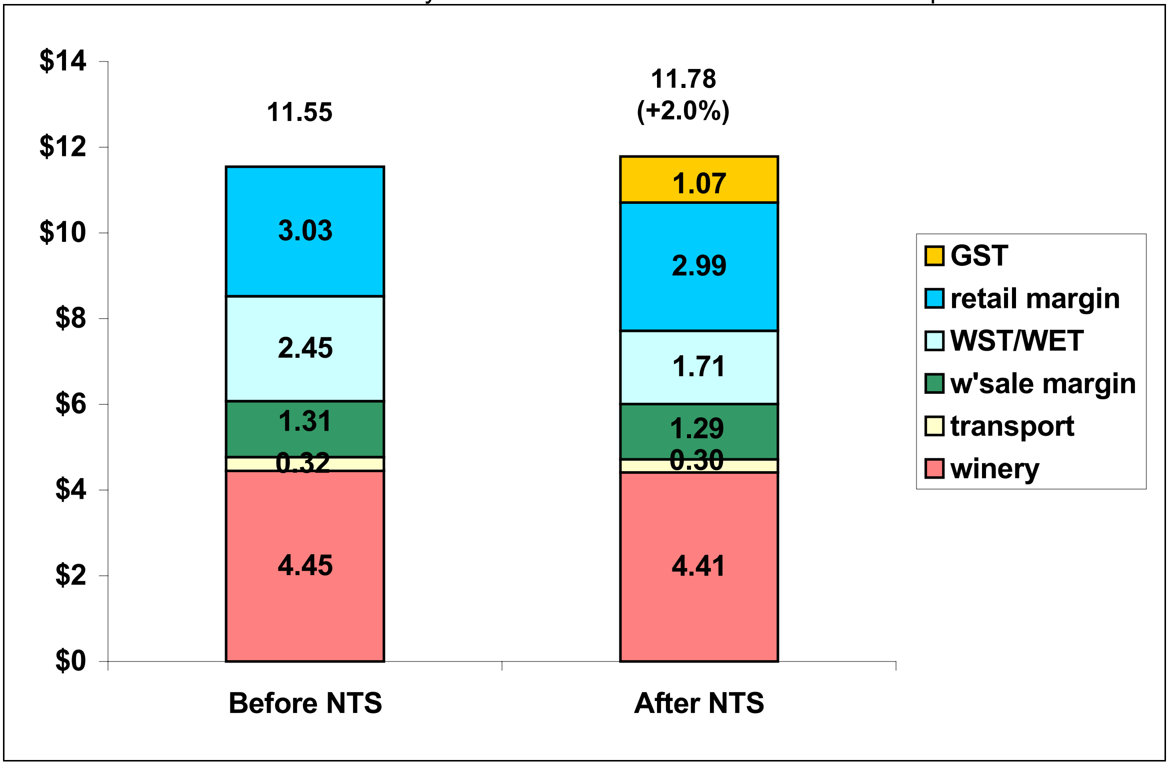
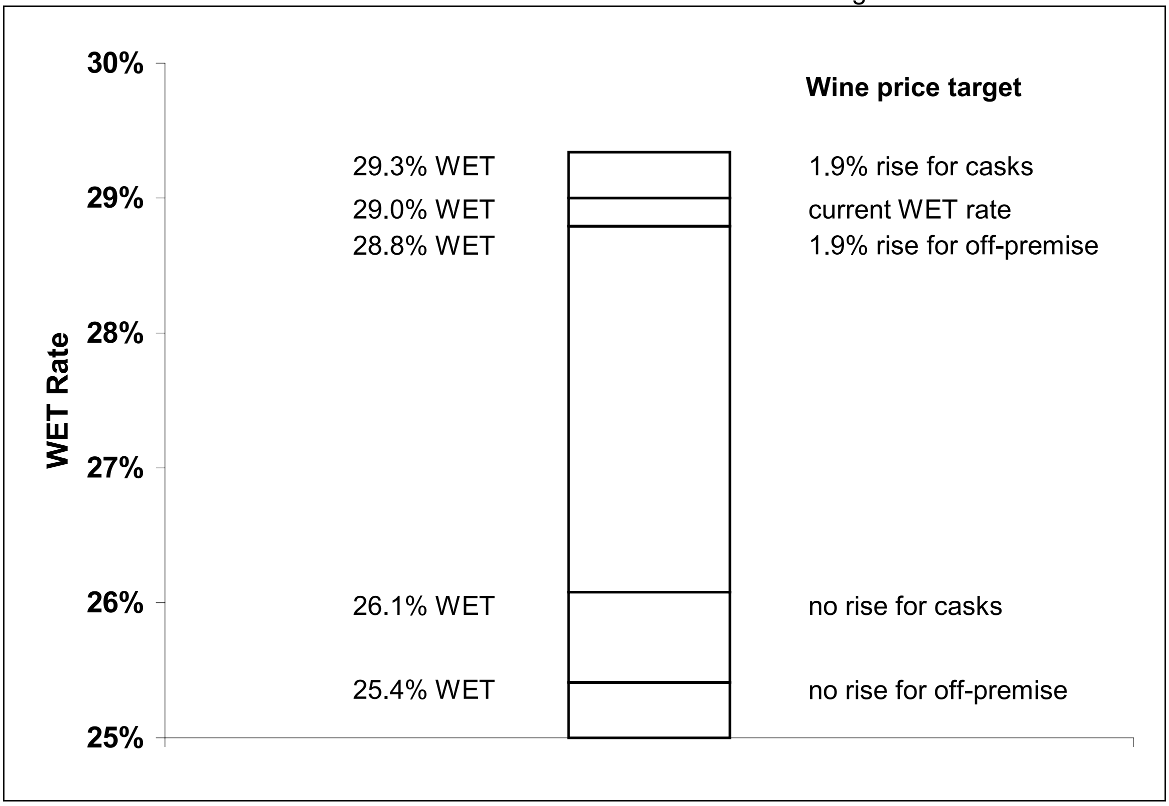


Chart 2
WET Rates to Achieve Alternative Wine Price Targets



Wine consumers and the wine industry are interested in the effects of the NTS not just on wine prices for 4-litre casks, but rather on wine prices for all container types, including casks, bottles etc. This report finds that the changeover to the NTS has added an average of 2.0 per cent to wine prices for all off-premise sales — these are sales where wine is sold in containers for consumption off-premise rather than served for consumption on-premise. As shown in Chart 1, this means that the average price of all off-premise sales has risen from $11.55 to $11.78, a rise of $0.23. This takes into account price rises not just for casks, but also for all bottled wine ranging from popular to premium. Limiting the price rise for all off-premise sales to 1.9 per cent would require a WET rate of 28.8 per cent (see Chart 2), but again this rounds to the current WET rate of 29 per cent.

Thus the current WET rate of 29 per cent is the appropriate rate for meeting the commitment that the NTS should raise wine prices for off-premise sales by 1.9 per cent, irrespective of whether the commitment is assumed to apply to 4-litre casks only or all wines.

Wine Tax Collections

Off-premise sales

This rise in off-premise wine prices due to the NTS reflects an overall increase in wine industry tax.

Under the NTS, annual collections of wine tax on off-premise sales are estimated to be $80 million higher than under the old tax system. This increase in revenue is the net effect of replacing the 41 per cent WST with the 29 per cent WET and 10 per cent GST.

The wine industry does not only pay taxes on wine. It also pays taxes (directly and indirectly) on goods and services it purchases from other industries, including taxes embedded in supply chains. It is estimated that, with respect to off-premise sales, the wine industry has made an annual saving of $25 million in input taxes from the introduction of the NTS. This consists of cost savings in wine production, transport, wholesaling and retailing arising from the abolition of wholesale sales tax and cuts to fuel excise.

Thus in net terms the introduction of the NTS has added $55 million to annual wine industry tax with respect to off-premise sales, with an additional $80 million in wine tax being partly offset by a saving of $25 million in input taxes.

It is this net increase in wine industry annual tax of $55 million that produces the estimated rise of 2.0 per cent in off-premise wine prices.

The WFA seeks a position where there is no rise in wine tax from the changeover to the NTS. In our view, wine taxation cannot be viewed in isolation from wine industry taxation, given the flow-on benefits from input cost reductions. Accordingly, we have modelled no rise in wine industry tax.

For off-premise sales of wine, this would require a reduction in the WET from the current rate of 29 per cent to 25.4 per cent (see Chart 2), which would round to 25 per cent. This would eliminate both the increase in wine industry tax and the associated rise in off-premise wine prices.

A variant of this position would be to eliminate the price rise for casks rather than for off-premise sales generally. This would require a cut in the WET rate to 26.1 per cent (see Chart 2), which would round to 26 per cent.

On-premise sales

The changeover to the NTS has also resulted in additional tax collected from on-premise sales of wine — this refers to wine served for consumption on-premise in hotels, clubs and restaurants.

There is a significant complication in calculating wine tax for on-premise sales. Because of the labour costs in serving wine, prices for on-premise sales are much higher than for off-premise sales, resulting in additional GST. This additional GST is best regarded as a tax on the accommodation, cafes and restaurants industry, not the wine industry, because it arises solely from the costs in serving wine on-premise. So this additional GST should be excluded from our analysis of wine tax. To achieve this, prices for on-premise sales have been adjusted to match off-premise sales, and the reduced amount of GST has then been calculated.

After this adjustment, it is estimated that the introduction of the NTS has meant that annual collections of wine tax from on-premise sales are $22 million higher than under the old tax system. After deducting an estimated saving in input taxes of $7 million, this means that the introduction of the NTS has added $15 million to the annual wine industry tax burden for on-premise sales of wine.

All sales

These tax increases for off-premise sales can be added to those for on-premise sales to estimate the total tax increase for all wines sales. This produces the overall conclusion that the introduction of the NTS has resulted in additional wine tax of $102 million that, after deducting estimated savings in wine input taxes, leaves additional wine industry tax each year of a net $71 million.

Attachment of Tables

The following tables provide more detailed results from the economic modelling.

The tables are based on five scenarios, each of which are referred to in the Executive Summary. The scenarios differ only in the WET rate on which they are based.

Scenario 5 is based on the current WET rate of 29 per cent.

Scenarios 3 and 4 are motivated by the Government's commitment that the changeover to the NTS would add 1.9 per cent to the price of a 4-litre cask. Scenario 4 is based on the WET rate needed to produce this result, which turns out to be 29.3 per cent. Scenario 3 achieves a price rise of 1.9 per cent as an average outcome for all off-premise wine sales (not just 4-litre casks), which requires a slightly lower WET rate of 28.8 per cent.

Scenarios 1 and 2 are comparable with scenarios 3 and 4 respectively, except that they replace the government commitment to a price rise of 1.9 per cent with the industry target of no price rise. This requires lower WET rates of 25.4 per cent and 26.1 per cent respectively.

Table 1 (on the next page) shows for each of the five scenarios, given their WET rates, the short-term price effects for both 4-litre casks and off-premise sales generally. It also shows for both off-premise and on-premise sales the associated effects on annual tax collections from both wine and the wine industry. The latter takes into account the NTS savings to the wine industry from lower costs for its purchases of goods and services from other industries. Annual wine industry cost savings are estimated at $25 million as detailed in Chart 3.

Chart 3
Wine Industry Cost Savings –Off-Premise (short-term)

Table 2 expands on Table 1 to include both the direct and long-term price effects as well as the short-term price effects. Table 2 also shows separate price effects for the various categories of wine that make up the off-premise market, including casks, $8 bottles, $15 bottles and $25 bottles.

Table 1
Scenario Summary

Scenario	Description	WET rate	price: 4-litre cask	price: all off-premise	tax rev. off-prem. ($m): wine	tax rev. off-prem. ($m): wine industry	tax rev. on-prem. ($m): wine	tax rev. on-prem. ($m): wine industry
1	no rise for off-premise	25.4%	-0.4%	0.0%	25	0	7	0
2	no rise for casks	26.1%	0.0%	0.4%	35	10	10	3
3	1.9% rise for off-premise	28.8%	1.6%	1.9%	77	52	21	15
4	1.9% rise for casks	29.3%	1.9%	2.2%	85	61	24	17
5	current WET rate	29.0%	1.7%	2.0%	80	55	22	15

Table 2
Scenario Detail

Scenario	Description	WET rate	price: 4-litre cask	$8 wine	$15 wine	$25 wine	price: all off-premise
		short-term price effects					
1	no rise for off-premise	25.4%	-0.4%	0.0%	0.4%	-0.3%	0.0%
2	no rise for casks	26.1%	0.0%	0.4%	0.7%	0.1%	0.4%
3	1.9% rise for off-premise	28.8%	1.6%	1.9%	2.2%	1.7%	1.9%
4	1.9% rise for casks	29.3%	1.9%	2.2%	2.5%	2.0%	2.2%
5	current WET rate	29.0%	1.7%	2.0%	2.3%	1.8%	2.0%
		direct price effects					
1			0.8%	1.2%	1.5%	0.7%	1.1%
2			1.2%	1.5%	1.8%	1.1%	1.5%
3			2.8%	3.1%	3.3%	2.7%	3.1%
4			3.1%	3.4%	3.6%	3.0%	3.4%
5			2.9%	3.2%	3.4%	2.8%	3.2%
		long-term price effects					
1			-2.4%	-2.0%	-1.6%	-2.2%	-2.0%
2			-2.0%	-1.6%	-1.2%	-1.8%	-1.6%
3			-0.4%	-0.1%	0.2%	-0.2%	-0.1%
4			-0.1%	0.2%	0.5%	0.1%	0.2%
5			-0.3%	0.0%	0.3%	-0.1%	0.0%

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Small Business Employment
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Table 3
Short-term Price Effects of 4-litre Cask Wine – 29 per cent WET rate

	Before NTS ($)	After NTS ($)	Change (%)	Change ($)
Wine Production	4.35	4.31	-0.8%	-0.03
Transport (winery to wholesaler)	0.22	0.21	-4.5%	-0.01
Wholesale mark-up	1.44	1.42	-1.6%	-0.02
WST/Wine Equalisation Tax	2.46	1.72	-30.1%	-0.74
Transport (wholesaler to retailer)	0.25	0.24	-4.5%	-0.01
Retail Margin	2.49	2.47	-1.1%	-0.03
GST	0.00	1.04	na	1.04
Price ($)	11.21	11.40	1.7%	0.19

Table 4
Short-term Price Effects of Off-Premise Wine – 29 per cent WET rate

	Before NTS ($)	After NTS ($)	Change (%)	Change ($)
Wine Production	4.45	4.41	-0.8%	-0.04
Transport (winery to wholesaler)	0.21	0.20	-4.5%	-0.01
Wholesale mark-up	1.31	1.29	-1.6%	-0.02
WST/Wine Equalisation Tax	2.45	1.71	-30.0%	-0.73
Transport (wholesaler to retailer)	0.11	0.11	-4.5%	-0.01
Retail Margin	3.03	2.99	-1.1%	-0.03
GST	0.00	1.07	na	1.07
Price ($)	11.55	11.78	2.0%	0.23

Tables 3 and 4 expand on Table 1 by showing the calculation of the short-term price effects for Scenario 5 (which is based on the current WET rate of 29 per cent).

For example, Table 1 showed a price rise of 1.7 per cent for casks. Table 3 shows how this estimate was constructed from estimated changes in costs and taxes.

Similarly, Table 1 showed a price rise of 2.0 per cent for off-premise prices generally, and Table 4 shows how this estimate was constructed.

APPENDIX 3 : 600,000 LITRES WET EXEMPTION POLICY DETAIL

i. Who is eligible for the 600,000 litre exemption?

The exemption to apply on an entity basis as defined in the GST Act under grouping rules (ie 90% ownership of subsidiaries).

ii. What sales are eligible?

Sales of wine manufactured and sold in Australia and sourced from Australian grapes (to avoid fully imported product receiving the exemption)

iii. How will wineries report tax liabilities?

Wineries that forecast domestic sales above the 600,000 litre threshold will forecast WET liability at the beginning of each reporting year.

At each reporting period, the winery will claim a WET credit in their Business Activity Statement (BAS) based on forecasts, with a statement of actual sales and WET paid. There would be an adjustment based on actual WET in the final reporting period.

Wineries below the 600,000 litre threshold would quote a WET Exemption Number (WEN) and would not pay or report WET. These wineries would be subject to ATO audits as part of the routine enforcement process. Clearly, they would also need to submit their periodic Business Activity Statement (BAS) as part of their GST and PAYG requirements.

Those wineries close to the 600,000 litre threshold would have the choice of either quoting the WEN with a correction in the final quarter based on actual sales if required, or operate as per wineries above the 600,000 litre threshold, again with a final period adjustment.

iv. How is tax calculated for sales above the 600,000 litre threshold?

For wineries selling more than 600,000 litres in a financial year, WET is payable on all sales at the final wholesale price.

A WET tax credit will be claimed each reporting period based on forecasts. The last period (quarterly or monthly) will be the adjusting period.

The following example is provided for illustrative purposes.

Annual sales	a	1.5ML
Ave. wholesale unit value[1]	b	$10/L
Wholesale value	c=a*b	$15M
WET @ 29%	d=.29*c	$4.35M
WET rebate	e=b*.29*600,000L	$1.74M
WET payable	f=d-e	$2.61M
Implied WET rate	g=f/c*100	17.4%

[1. see 8 below]

v. Is all WET now paid by the winery?

No, tax is paid on the last wholesale sale, as per the existing WET legislation.

vi. Do distributors still pay WET if they are making the last wholesale sale?

There will be two types of sale to a distributor.

Those wineries below the 600,000 litre threshold will quote a WET Exemption Number (WEN), thereby relinquishing the requirement of the distributor to pay WET.

Those above the 600,000 threshold **<u>will not</u>** quote, and the distributor will be liable for full WET at 29%.

vii. How will wineries above the 600,000 litre threshold account for the WET rebate in their pricing and budgeting process?

Those wineries above the threshold will need to accurately forecast their annual sales. Prices and budgets can then incorporate the WET rebate at the discretion of the winery.

viii. How does a winery above the 600,000 litre threshold calculate its average wholesale price?

Wineries above 600,000 litres will need to calculate an average unit value to be able to determine the level of the rebate on their exemption.

Wineries will need to calculate the average wholesale price based on the weighted average of their final wholesale sales and notional wholesale sales.

Notional wholesale sales will occur when the winery does not make the final wholesale sale.

For cellar-door sales, the notional wholesale value will be 50% of the tax inclusive retail value.

For distributor sales, the notional wholesale value will be 143% of the sale price to the distributor (which is equivalent to a 30% distributor margin). Note the % rate would need to be predetermined by the ATO and WFA, and based on analysis of distributor margins.

ix. How is imported wine treated?

Imported wine is ineligible for the exemption and the rebate.

Blended wines incorporating 85% or more Australian origin wine are eligible.

x. How are joint venture brands treated?

If the two joint venture companies qualify for the full exemption, including the volume of wine in the joint venture, then no tax is payable.

If one or more of the companies does not qualify for a full WET exemption, then WET is payable on all sales at the highest implied rate of the two parties.

Appendix 2

A New Tax System

Compliance Issues

With the introduction of ANTS in July 2000, wine producers faced a change from the Wholesale Sales Tax (WST) system to the Goods and Services Tax (GST) plus Wine Equalisation Tax (WET). Simply put, WST was replaced by GST and WET.

GST applies to all sales of wine; it does not apply to tasting wines and trade samples (applications for own use) for which the winemaker does not charge a price.

WET, however, does apply to tasting wines and trade samples (applications for own use), as well as to all sales.

WET is calculated either on wholesale price in respect of wholesale sales or on ‘deemed’ wholesale value (or most common wholesale value) in respect of retail sales.

Additionally, there is a rebate of the WET on cellar door sales in respect of the first $300,000 expressed as wholesale value. Wine companies selling in excess of $300,000 (wholesale value) from their cellar door do still receive this rebate up to the threshold. For example: a company selling $600,000 (wholesale value) would be entitled to receive a rebate equivalent to 50% of the WET applicable on those sales.

Acquittal of rebates involves both state and federal taxation agencies, in that at each Business Activity Statement period, wineries acquit the federal component of any WET rebate claimed (that is 14/29ths of the tax collected on the BAS), while, the remaining 15/29ths is acquitted through a claim for subsidy submitted to the relevant state taxation authority.

In South Australia, the state government has imposed an upper limit in respect of each winery as to the amount of WET it will refund, while all other states have no upper limit for the state rebate of 15/29ths.

Wholesale sales (i.e. sales other than mail-order or through the cellar door) are not eligible for the rebate.

Because the system of relief for small wineries is based upon a rebate system, each winery is required to maintain a detailed audit trail for every bottle, including trade samples or tasting wine. This requires maintenance of a number of separate liability accounts.

Tax on wine is applied in four different ways:

- Tax on wholesale sales to an agent (quoting)
- Tax on wholesale sales

- Tax on applications for own use, and
- Tax on retail sales.

Tax on wholesale sales to an agent. In this case, the agent quotes their ABN number and the winery applies GST only to the wholesale sale price. It then becomes the agent's responsibility to apply WET to any subsequent sales to which the tax is applicable (Section (13-5). The winery records tax collected under "GST Collected".

Tax on wholesale sales. The winery applies WET (29%) to the wholesale price of the wine. GST is calculated on the total of the wholesale price plus WET.

Using a computer based accounting package, such as Mind Your Own Business (MYOB), the combined rate of WET and GST is calculated at 41.9% and recorded into two separate accounts as "GST Collected" and "WET Collected".

Note that the effective rate of GST is not 10% on wholesale but 10% on wholesale + WET and is therefore equivalent to a rate of 12.9% of the wholesale price - effectively, a tax on a tax.

Tax on applications for own use. As part of the negotiated rebate package wines used for trade samples and tasting (i.e. provided free of charge) are exempt from GST; WET, however, must be recorded under "WET Collected" (based upon wholesale price). WET attributed to this use can be included in the total rebate calculations. That being the case the WET is treated similarly to that which applies to retail sales.

Tax on retail sales. **Please note that this model only applies to wineries selling less that $300,000 (equivalent wholesale value) retail.** As previously stated, each winery is required to maintain a full audit trail on every bottle of wine sold at retail. This audit trail provides data for the calculation of applicable rebates in respect of retail sales.

In this case, WET is calculated on either deemed wholesale value, which is taken to be 50% of GST inclusive retail price [Subsection 9-35(1)], or on the notional (last wholesale sale) price [Subsection 9-25(1)]. GST, of course, is included in the retail price and expressed as 1/11th of that price.

Tax on retail sales is calculated as "GWR" (GST + WET Retail) and amounts to 30.875% of the retail price. This amount is split into WET (18.9768% of retail price) and GST (11.8977% of retail price). In order not to confuse WET associated with rebate and WET not associated with rebate, separate accounts are required.

The WET applicable to rebate is separated into two accounts, one for calculation of the federal rebate and a second for calculation of the state subsidy.

Notwithstanding that the WET paid on retail sales in this example is fully refundable, through BAS and a claim for subsidy, the additional GST paid on WET is not. Taking the case of a winery selling the maximum retail sales to which the subsidy applies, this amounts to an additional GST of $8,700 paid on WET which is not refundable. This amount must be included in the costs of compliance. Wineries must ensure that the WET paid and refunded through state subsidies must be included as income for taxation purposes.

Invoicing - retail sales

Fortunately, most clients at cellar door are satisfied with a cash register receipt, which states that GST is included. However, because of the requirement to maintain a full audit trail, the WET tax applicable to every sale must be recorded in the accountancy package for calculation of WET collected and WET refundable.

Accordingly, any formal invoice issued would show the amount of WET applicable to the sale - including retail sales. Such invoices, when requested, draw comment regarding the WET, which the retail client assumes does not apply to their purchase. A solution to this problem is to issue the client with an invoice showing GST only, then erasing this invoice and then replacing it with the correct GST/WET invoice in the accounting package. The purpose of the WET rebate is to increase profitability and thus viability of small to medium wineries. Accordingly, that advantage is not passed on to the consumer.

Note that the current rebate system, or any extension thereto, does not address costs of compliance, wholesale sales by small to medium wineries or application for own use.

The advantages of an exemption over a rebate system are summarised as follows:

- there is considerable reduction in administrative effort
- there is a net saving in GST paid on tax that is refundable, and
- perhaps more importantly, the inclusion of wholesale sales in the current policy compensates smaller operators for their lack of economies of scale in this important area of the market.

This paper does not attempt to address other issues in stated WFA policy, such as application for own use, stock valuation or wine tourism.

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Appendix 3

Table 1: Wine tourism numbers and expenditure: By State, 1999-00 (Source: ACIL Consulting, Economic Contribution to Australia of the Australian Wine Industry, A report to the Winemakers' Federation of Australia)

			NSW	Vic	Qld	SA	WA	Tas	Total
International visitors	a	000	2,616	1,113	1,984	319	544	98	4,143
International winery visitors	*b*	*000*	*288*	*189*	*20*	*118*	*136*	*11*	*456*
Domestic winery visitors	c	000	831	1,056	167	821	588	199	3,662
Total winery visitors	d	000	1,119	1,245	187	939	724	210	4,424
Total winery visits	e	000	3,202	2,843	870	4,226	2,319	690	-
Wineries with cellar doors	f	no	232	206	63	201	168	50	920
Ave visits/winery	g	000	13.8	13.8	13.8	21.0	13.8	13.8	-
Spending									
State rebate	h	$000	3,214	4,492	449	8,317	2,602	449	19,522
Implied retail sales	i	$000	42,857	59,888	5,982	110,888	34,698	5,982	260,295
Average spend at wineries									
- wine (per visitor)	j	$	38.31	111	32.01	118.08	47.93	28.51	-
- other (per visitor)	k	$	8	24	7	26	11	6	-
- total winery (per visitor)	l	$	47	135	39	144	58	35	-
Non winery (per visitor)	m	$	63	181	52	193	78	47	-
Total spend at wineries	n	$M	52	168	7	135	42	7	412
Total spend elsewhere	o	$M	70	226	10	181	57	10	553
Total spend	p	$M	122	394	17	316	99	17	966

a. Total visitors to Australia, 1999. Data is not additive due to multiple State visits being categorised as a visit in each State

b. Major source is the Wine Visitor Survey. NSW, national average (119%) assumed; Victoria, 17% of visitors visited the Yarra Valley. Therefore, 17% assumed for Victoria; Qld defined as 1% in International Visitor Survey; SA defined as 37% in International Visitor Survey; WA, Swan Valley 27% and Margaret River 17%; 25% Average 25%; Tasmania assume 11% national average; ACT defined as 3%.

c. National Visitor Survey, 1999

d. d=b+c

e. e=f*g

f. *Winetitles*, except Victoria where data is sourced from the Victorian Wineries Tourism Council. There is a significant discrepency in the Victorian estimates.

g. Victorian data sourced from Victorian Wineries Tourism Council. SA data sourced from SA Tourism Commission. For remaining States Victorian data is used

h. Sourced from the ATO and based on 1999-00 data

i. State rebate is equal to 15% of the wholesale value. Retail value is 2* the wholesale value.

j. j=l/d/1000. Note that all states are derived using the formula stated except Victoria. Victoria has independently calculated the value of spending at wineries at $168M, of which 82% ($138M) is spent on wine. This is more than double the figure derived from the value of the cellar-door rebate in Victoria, and points to a significant discrepancy in the ATO or VWTA data or to a large number of cellar doors that do not receive the rebate.

k. k=l-j

l. VWTC data indicates that 82% of winery cellar door sales are wine, with the remainder including food and accommodation.

m. Non winery includes wine tourism related expenses such as accommodation and food. Multiplier of 2.34, based on VWTC research

n. n=l*d/1000

o. o=m*d/1000

p. p=n+o

Source: WFA