Murray Valley Winegrowers' Inc

SUBMISSION

Re:think

Discussion paper

June 2015

Introduction

Murray Valley Winegrowers (MVW) is the peak regional wine grape growers' body representing more than 400 growers in the Murray-Darling and Swan Hill wine regions of Victoria and NSW. This is Australia's second-largest production zone, accounting for around 20 per cent of the national annual winegrape crush. The triumvirate of Murray-Darling/Swan Hill, Riverland South Australia and NSW Riverina account for around 60 per cent of Australia's wine grape production – equating to around one million tonnes (subject to seasonal variation).

Headquartered in the regional city of Mildura in NW Victoria near the junction of the Murray and Darling rivers, MVWs principal functions are to provide extension services, inform growers of market and industry intelligence, advocate to protect and promote growers' interests, and assist members in their commercial dealings.

Funding is derived from access to grower levies administered under the Victorian Agricultural Industry Development Act, which are collected and supervised by the statutory Murray Valley Wine Grape Industry Development Committee (IDC). A lesser voluntary levy is collected at the same time. MVW applies to the IDC for project funding through a process that engages growers in an annual poll.

The board of MVW comprises delegates from each of the Mildura Region Winegrowers' Association, Robinvale & District Wine Grape Growers' Association and the Swan Hill Wine Region Grape Growers' Association.

Over the past decade, many wine grape growers have been under intolerable pressure, coping with drought, water restrictions, spiralling costs, global grape over-supply and cascading prices. Farm-gate profitability has been eroded to zero for many growers, leading to a landscape of abandoned properties in the area of the Murray Darling catchment in North West Victoria and South West NSW.

This is the operating environment under which growers are labouring. And now they confront renewed speculation that a volumetric tax may be in the government's thinking; that it could finally bend to the will of the beer and spirits lobby and replace the current ad valorem system with a volumetric model.

Adding to the concern swirling around alcohol taxes is the continuing debate on whether the GST rate should be increased from 10 per cent to 15 per cent, and whether it should be applied to fresh food. Such a move would increase the average family food bill, and reduce people's discretionary spend on such items as wine. Increasing the GST and broadening its coverage cannot be labelled tax reform; it's simply a means of increasing taxation income.

Submission focus

A better tax system to deliver taxes that are lower, simpler, fairer…

This is the government's objective. Accordingly, Murray Valley Winegrowers' (MVW) is focusing mainly on the areas of taxation that will help achieve this goal: opposing the introduction of a volumetric tax (because it would not be simpler or fairer), and advocating changes to the Wine Equalisation Tax (WET) rebate system (because it would be fairer).

It has long been the obsession of the beer and spirits industries to get the government to tax wine according to its alcohol content for no other reason than to make most wine more expensive. This, they believe, would result in consumers drinking more of their product. But at what cost?

Unlike the largely metropolitan-based major beer and spirit conglomerates, growing grapes and making wine is the industry of rural and regional Australia: more than 6000 winegrape growers and 2500 winemaking businesses scattered around Australia.

If the interests promoting replacing the current ad valorem system of taxing wine with a volumetric formula succeed in their campaign, 80 per cent of all wine sold in Australia will increase in price. Bottled wine in the sub $12 category and cask wine, which together account for around 80 per cent of sales, would skyrocket in price. Cask wine, which is favoured predominately by the older members of our community, would more than double in price. A price hike of this magnitude would steer people away from wine consumption.

Much of the more affordable wine produced in Australia comes from the three major inland wine regions of Murray-Darling/Swan Hill NSW/VIC, Riverland SA and Riverina NSW. They would feel the impact the most, at a time when the Winemakers Federation of Australia (WFA), in its 2014 Vintage Report, indicated that more than 90 per cent of inland-region vineyards were unprofitable while across Australia around 84 per cent of vineyards were unprofitable.

One major wine business in the Murray-Darling region believes that the fallout from a volumetric tax would include the closure of its regional processing facility. This would leave at least 60 growers having to find buyers for around 50,000 tonnes of wine grapes.

The grape and wine industry is not immune to the need for some changes to the way it's taxed. The majority of industry participants has sought reform by way of amendments to the Wine Equalisation Tax (WET) rebate system. Rarely has the industry responded in such a united fashion as when, pre-budget, the two national industry bodies - Wine Grape Growers Australia (WGGA) and Winemakers Federation of Australia (WFA) - state wine industry associations, and the three major inland regions presented the case for change.

Concerns about the WET rebate have been driven by the fact that although the amount of wine produced has remained relatively static, the number of claimants has increased substantially. The WET was introduced to assist mainly small to medium-size winemakers and local economies as most (winemaking businesses) were embedded in regional communities. The limit of the rebate has increased from $290,000 pa per entity to $500,000 pa. Rebates now total more than $300 million pa, paid to almost 2000 claimants. In the period 2007-08 to 2012-13 the number of rebate claimants increased by 21 per cent (338), jumping from $220 million to $308 million.

In recent years controversy over the WET rebate has intensified, with many in the industry blaming it for distorting the marketplace and suppressing grape prices. It has been argued that a significant volume of bulk and unbranded wine is purchased cheaply, as the seller is able to add to the sale price by claiming the 29 per cent rebate. Much of this wine ends up in “private label” bottles on supermarket shelves. In effect, the rebate has been treated as a subsidy; some recipients haven’t paid the tax in the first place yet have had claims for the rebate accepted. Abuses have been alleged: rebate claims on bulk wine that’s been declared as domestic product but which is then exported, and multiple claims on the same bulk wine consignment.

Additionally, NZ wine producers have been able to claim the rebate, receiving $25 million in 2014, rising from $6 million in 2007. Unlike wine imports from other countries, NZ producers are not required to be registered for Australian GST, and do not need to lodge an Australian tax return. It’s argued that NZ producers should be subject to the same tax compliance measures and associated costs as Australian and other foreign producers.

From savings delivered by reform of the WET rebate scheme, industry has suggested to government that another $25 million be diverted to the Australian Grape and Wine Authority (AGWA) for marketing purposes to grow the demand for Australian wine. The policy agreed by the major elements of the wine industry urges the Federal Government to:

- Phase out over four years rebate eligibility applicable to bulk, unbranded and private label wine;
- Abolish the separate NZ producers’ WET rebate scheme, and create a level playing field for all WET rebate claimants;
- Restrict the rebate to businesses that maintain business premises in Australia and hold an Australian liquor license;
- Maintain the current ad valorem method of taxing wine and hold the rate of taxation;
- Remove uncommercial practices that have the sole purpose of accessing the rebate

Wine *is* different

The spirits and beer industries have long argued that wine should not be treated separately; that wine taxes should be levied at the same rate as that imposed on them. However, the process involved in making and selling wine differs markedly, and wine taxes in Australia are among the highest in the world. **A volumetric tax would make our wine more expensive and the job of selling it around the world even more difficult.**

Wine is produced largely in regional areas from grapes processed over a three-month period, using equipment and facilities that mostly lie dormant the rest of the year. The majority of Australian wine is exported, last year earning $1.8 billion, which far exceeds the export earnings of Australian produced beer and spirits.

According to a recent report prepared by the WFA, wine contributes:

- AUD$1.77 billion to the national economy, most of which is reinvested into regional Australia (which is 14 times more than the spirits industry and 1.5 times more than beer);
- Provides 60,000 jobs of which 16,122 are direct jobs, across more than 60 designated wine regions in regional Australia (which is 20 times more than spirits and four times more than beer), and
- AUD$8.2 billion through wine tourism.

The winemaking sector believes that a fall in wine consumption domestically, as a result of significant price rises through the imposition of a volumetric tax, would damage the international competitiveness of Australia's wine producers. This would occur due to a reduction in the economies of scale; less wine produced for the domestic market would increase the fixed costs carried by each unit of wine, including those produced for export markets, thereby reducing Australia's competitiveness in an already difficult environment. (Australian wine exporters already pay higher taxes than competitor countries).

Wine is quite different to beer and spirits in a variety of ways that make it vulnerable to any change in taxation. The WFA includes these as:

- Wine is the least profitable of the alcohol manufacturing sectors in Australia;
- Wine is the only net exporter, exporting AUD$2 billion per annum (12 times more than spirits and 39 times more than beer);
- Wine is the least consolidated sector;
- Retailer margins are greater on wine than beer and spirits (reducing the profit for grape growers and winemakers);
- Wine is more capital intensive than beer;
- Invested capital required to generate AUD$1 of profit is higher in the wine industry;
- The wine industry needs a higher level of working capital than beer and other beverages, and
- Average return on invested capital for wine is less than 1 per cent; in contrast beer is 20.3 per cent.

The WFA asserts that retailers generate more margin on wine sales than from beer and spirits. The retail power within the Australian wine industry is such that the WFA anticipates that increases in wine prices resulting from a volumetric tax would be passed on to wine producers. In turn, wine producers would endeavour to recoup this by paying less for grapes.

It is not alarmist to suggest that wine sales would plummet under a volumetric tax regime. In the firing line will be the 2000 winegrape growers in the "big three" inland regions of Australia, which grow the grapes for the "affordable" wines consumed by the majority of Australians.

Members of the health lobby may argue that the harm caused to industry through reduced grape and wine sales would be worth it; that it would be a small price to pay if alcohol consumption dropped. But would reduced wine consumption equate to reduced alcohol-induced harm?

It has been clearly established that the majority of wine bought in Australia is priced at around $15 or less (bottle and cask), and that a volumetric tax would result in price hikes for all wine worth $12 and less. Indeed, the price of cask wine would more than double. But people who drink cask wine are not regarded as those most at risk from alcohol abuse, as found by University of Adelaide researchers Wendy Umberger and Simone Mueller in a 2009 study. They concluded that consumers of cask wine typically were:

- Mostly aged 55+; only 12% are 34 or younger;
- Earn less than AUD$50,000 per annum;
- On average drink fewer glasses per drinking occasion (one or 2 per night); and
- Usually eat food while drinking wine.

Nielsen Sales Data records a steady decline in sales of cask wine even though it's one of the cheapest forms of alcohol per standard drink. It is not the product of choice for abusers of alcohol; it's for older consumers and the budget conscious.

Complex and unfair

The Federal Government wants a simpler tax system. In that case, it will not want a volumetric tax for the wine industry. Its discussion paper highlights Australia's tax system as, "too complex, with significant resources spent on tax compliance and tax management issues". Moving to an excise-based system for wine would add to complexity and compliance costs.

As explained, wine *is* different. The industry is largely regionally based with over 2500 individual producers, making and selling a product with an alcohol content that varies from year to year, from batch to batch and between varietals. The cost of compliance with an excise-based system would be burdening a struggling industry with additional costs and red tape. While the WET rebate system needs attention, WET is a much simpler system to administer than the excise system for beer and spirits, the reasons being:

- WET is based on the wholesale price of the wine, not its alcohol and volume. This is a more practical approach for a product that's not manufactured according to a recipe and has an alcohol volume that fluctuates season to season due to the fact that wine is an agricultural product, with variations in climate affecting natural sugar levels;
- WET is not indexed in line with the CPI – and is therefore a consistent rate allowing for simpler compliance systems;
- Wine can be moved freely as the tax is based on its value not its volume (there is no costly expense of running bonded premises or monitoring movement of the product to bonded premises only). The excise system for alcohol in Australia has been the subject of abuse, with fraud and leakage of product;
- WET suits a regionally based product. An excise system would pose issues for a regionally based product such as wine, as audits would be costly and difficult;
- Wine can be stored for lengthy periods, in contrast to beer and the majority of spirits. A bonded warehouse system would be a significant burden on wine businesses, and

- WET is reported and paid on the business activity statement, the same way as other taxes are paid. There is no weekly payment requirement, therefore reducing paperwork and compliance costs.

An excise-based system would require auditing of hundreds of bonded warehouses required for the storage of wine, which would create a major auditing challenge for the Australian Taxation Office. The cost of compliance would be significant for the over 2500 individual wine producers in Australia, most of them small businesses.

Australian wine is already one of the most heavily taxed in the world. A recent study by Professor Kym Anderson of the University of Adelaide shows that Australia is taxing wine, relative to other alcohol beverages, more than other wine exporting countries. A change to a volumetric tax would further increase the differential between Australian wine producers and their international competitors, by adding to higher operating costs and increasing taxes. This could not come at a worse time for a struggling industry that exports more than 60 per cent of its product.

Taxing times

The Australian grape and wine industry continues to face economic uncertainty and its toughest trading conditions in 20 years. Structural adjustment is still occurring, and a change to the tax system would threaten the viability of a sector that's under great stress.

In 2011, the then Federal Government (with the support of the Opposition) rejected the Henry Review recommendation to move to a volumetric system for all alcohol sold in Australia. It rightly acknowledged the negative impact that a change to a volume-based tax would have to the viability of the Australian wine industry while it was undergoing a major restructure.

Economically, the Murray-Darling/Swan Hill winegrape industry is on a knife-edge – prices for major grape varieties are the lowest they've been in 10 years and prospects for a turnaround in fortunes in the immediate future are bleak. **The imposition of an unfair, unwieldly and unnecessary tax when the grape and wine industry is at its lowest would be catastrophic.**

The following table illustrates the degree to which the regional industry landscape has changed in the 10 years 2004 to 2014 (key statistics for the 2015 harvest are not yet available). Of particular concern is the collapse in growers' income.

Decade of change, Murray-Darling/Swan Hill wine regions, 2004 - 2014

	2004	**2014**
Murray Darling / Swan Hill wine grape production - tonnes	396,000	413,627
Grower tonnes Winery-grown tonnes	357,000 39,000	330,387 83,240
Value total crush	**$225 million**	**$129 million**
Value grower fruit	**$200 million**	**$97 million**
Chardonnay price $/tonne	$881	$216
Shiraz price $/tonne	$620	$314
Cabernet Sauvignon $/tonne	$487	$328
Growers on database	**Approx. 1300**	**499**
National crush	1.91 million tonnes	1.7 million tonnes

There is no logical reason why the Federal Government would plunge an already fragile industry into greater peril under the guise of tax reform.

The recent referral to Treasury of a range of tax issues canvassed pre-budget by the WFA must examine in detail the consequences of switching from an ad valorem tax system to volumetric, and the recommended measures for reform of the WET rebate scheme. Without this, *Re:think* in relation to the grape and wine sector will need to be re-thought.

Enquiries

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