TREASURY
WINE ESTATES

SUBMISSION TO

RE:THINK DISCUSSION PAPER

JUNE 2015

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WINE ESTATES

ABOUT TREASURY WINE ESTATES

Treasury Wine Estates (TWE) is one of the world's largest wine businesses, and a company that is extremely proud to have its global headquarters in Australia. We are active promoters of 'Brand Australia' internationally and are an example of an Australian business that is exporting to, and winning in, markets all over the globe.

TWE crafts some of our Australia's oldest and most iconic wine brands including Lindeman's (founded in 1843), Penfolds (1844) Wolf Blass, Pepperjack, Devil's Lair, Seppelt, and Wynns Coonawarra Estate. We also own or lease more than 9,000 hectares of prime winegrowing land in Australia; sell more than 30 million cases of wine each year globally, with more than 60% of our Australian produced wines exported. We directly employ over 3,000 people - winemakers, viticulturists, sales, distribution and support staff - over 2000 of which are based here in Australia. In addition, we support thousands of jobs through our supply chain, many of which are in regional areas.

TWE's domestic production spans five Australian states, with our wines exported to more than 70 countries globally; accordingly TWE has extensive experience of taxation regimes across the world.

As the largest player within the Australian wine industry, TWE has a strong interest in a simpler, fairer and lower tax regime.

The case for reform

Australia's taxation system should support the long term profitability and sustainability of the Australian wine industry, creating jobs, growth and opportunity for years to come.

Change is needed to ensure that domestic taxation arrangements do not continue to distort the market for our industry, prevent necessary restructuring, sustain the existing structural oversupply and impede our industry's global competitiveness.

This submission responds to the Re:Think Discussion Paper in two parts – the first focuses specifically reforms to the taxation of wine, and the second on questions the Discussion Paper raised that apply more broadly to Australian businesses.

This submission builds on TWE's Pre-Budget Submission to the Australian Treasury in February 2012, and our submission to the Tax Reform: Government Discussion Paper for October Tax Forum in 2011. TWE's submission on necessary wine taxation reform also broadly aligns with the submission provided by Pernod-Ricard Winemakers, the second largest producer of wines in Australia behind TWE.

TWE strongly believes that the recommendations provided in this submission positions the Australian wine industry for a sustainable and more profitable future; but we do not underestimate the challenges that meaningful reform provides for some sections of our industry.

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The status quo is not an option if Australia is to secure a vibrant, sustainable and profitable future for its wine industry. Current arrangements have sent the Australian wine industry backwards, and handicapped its potential to be a world-leading exporter of premium product.

The case for wine taxation reform is undeniable, and those opposing reform must clearly set out an alternate vision for the sector.

PART 1 – TAXATION OF WINE

Discussion Question 55: To what extent are the tax settings (i.e. the rates and bases and the administration) for each of these indirect taxes [including alcohol taxes] appropriate? What changes, if any, could be made to these indirect tax settings to make a better tax system to deliver taxes that are lower, simpler, fairer?

EXECUTIVE SUMMARY

For more than a decade, there has been widespread recognition that the Australian wine industry is in need of significant structural change. Yet there is overwhelming evidence that the current pace and extent of restructuring will not address the Australian wine industry's challenges.

The taxation of wine has a fundamental influence on both the structure, sustainability and profitability of the Australian wine industry, with the current ad valorem model for the Wine Equalisation Tax (WET) muting market signals that would otherwise drive restructuring more quickly and effectively.

In the context of the industry's current challenges, TWE believes that significant reforms are essential in order to overcome the industry's challenges and secure a profitable future of the industry and position Australian wine producers for future growth and international competitiveness. These reforms include:

1. amendment to the basis of wine taxation – major reform, or removal of the current WET Rebate, and a move to a category based volumetric model of taxation, with a single rate applied to the wine category within the WET regime (that is, not an excise arrangement);
2. increased resources allocated to supporting the marketing of Australian wines in key export markets, and addressing tariff and non-tariff barriers to trade; and
3. provision of a structural adjustment assistance to support uneconomic winemakers to move to more profitable production or other industries.

TWE submits that:

- Tax is one important policy lever that can be used to benefit the Australian wine industry, and whilst it is critically important, it is not the only policy instrument required to deliver long term success.
- After a decade of profitability challenges and oversupply, the Australian wine industry needs urgent reform in order to secure a viable future.
- Wine taxation should be transparent, easy to administer and equitable.
- Current wine tax arrangements actively distort the market, preventing necessary restructuring and sustaining structural oversupply.
- The current ad valorem model, coupled with the distorting effect of the WET Rebate, is undermining value creation and threatening the wine industry's sustainability in Australia whilst simultaneously eroding its premium positioning globally.

- Continuing with the current tax arrangements will mean more of the same, consigning the Australian wine industry to an unprofitable and oversupplied market.
- Wine taxation reform should create a tax system that supports a sustainable and profitable future for Australia's winemakers.
- Wine tax reform should contribute towards the premiumisation of the wine category as a whole; and such reform is best delivered through a category based volumetric tax system and significant reform to, or outright removal of, the WET Rebate.
- The package of reforms to the WET Rebate currently being advocated by the Winemakers Federation of Australia (WFA) are strongly supported by TWE; however TWE believes that reforms could go further including eventual outright abolition of the WET Rebate.
- Tax reform, and the move to a category based volumetric model for wine, should be delivered within the existing WET regime, without resorting to a complex excise-based approach with requirements such as bonded warehouses, inspections, weekly settlements and other highly bureaucratic and costly imports which are particularly burdensome for smaller winemakers and do not reflect the reality of how wine is produced. Despite representations by some, TWE has never advocated for an excise based approach with wine taxed at a comparable rate to beer; such an approach would be extremely damaging to the future of the industry.
- A category based approach to alcohol taxation is fundamentally sound and should be retained. A single volumetric tax for all forms of alcohol is not appropriate because of the unique structure of the wine industry.
- Reforms to the taxation of wine should be broadly revenue neutral.
- Changes to Australia's wine taxation system will affect all industry participants. It is essential that targeted transitional assistance is provided, to help some affected producers adjust their business model or exit the industry. TWE believes that savings delivered through major reforms to the WET Rebate could be delivered to help fund such transitional support. Additionally, consideration should be given by Government to incremental reductions in the WET Rebate in order to facilitate a smooth transition.
- Future Government support for Australia's wine industry should primarily be focused on international marketing activities, export promotion and addressing both tariff and non-tariff trade barriers. This support should be funded by additional savings made through reforms to the WET Rebate.

We do not underestimate the potential impact on sections of the wine industry and the need for significant adjustment, but it is clear that the status quo is not an option if Australia is to secure a vibrant, sustainable and profitable future for its wine industry. TWE supports meaningful transitional support, and the provision of restructuring assistance, to help the wine industry adapt and respond to these challenges. This is further detailed below.

Over several years, TWE has taken strategic decisions to premiumise its portfolio, whilst maintaining a strong Commercial wine business, and consolidate our production footprint – despite the tax disadvantages and short term cost penalties. This has not been an easy or pain-free process, but as a result, our business is now on a more sustainable footing. While TWE is likely to benefit from the wine tax reforms we are advocating for, wine tax reform is the only answer for the future of the Australian wine industry because it will position the industry for a sustainable and profitable future.

Those who advocate for maintenance of the status quo must demonstrate how a continuance of existing tax structures and industry rebates would address the profitability and oversupply issues currently facing Australian winemakers.

Given that the industry has not addressed these issues adequately over the last decade, if we fail to seize the opportunity for reform, the industry will decline further over the coming decade, with costs for Government growing disproportionately through increased adoption of the WET Rebate.

TWE notes that, due to the different business models of its members, the WFA has no stated preference on the structure of the WET regime. WFA's position on wine industry taxation is:

- No overall increase in the total tax revenue from the wine sector.
- Reform of the WET Rebate to remove unintended recipients and alleviate unintended consequences of the system that are distorting supply decisions.
- No use of tax or artificial minimum pricing measures as a lever for health reform, as non-price measures better target hazardous consumption.
- Maintenance of the differential tax rates for wine, beer and spirits (ie, no 'equivalency') to reflect the significant differences between wine and other forms of alcohol.

This submission remains consistent with WFA's tax position.

PART 1 – RECOMMENDATIONS

1. Amend the WET regime so that wine is taxed according to a category based volumetric model of taxation, with a single rate of tax applied to the table wine category.
2. Abolish the WET Rebate over the longer term; and as an immediate step, implement the package of reforms to the WET Rebate proposed by the WFA.
3. Maintain the existing level of Government revenue collected from the WET, resulting in a volumetric rate of approximately $1.40-$2.20 per litre of wine (dependent on the retention or not of the WET Rebate).
4. Provide the industry with transitional assistance to enable structural adjustment and address oversupply and uneconomic production.

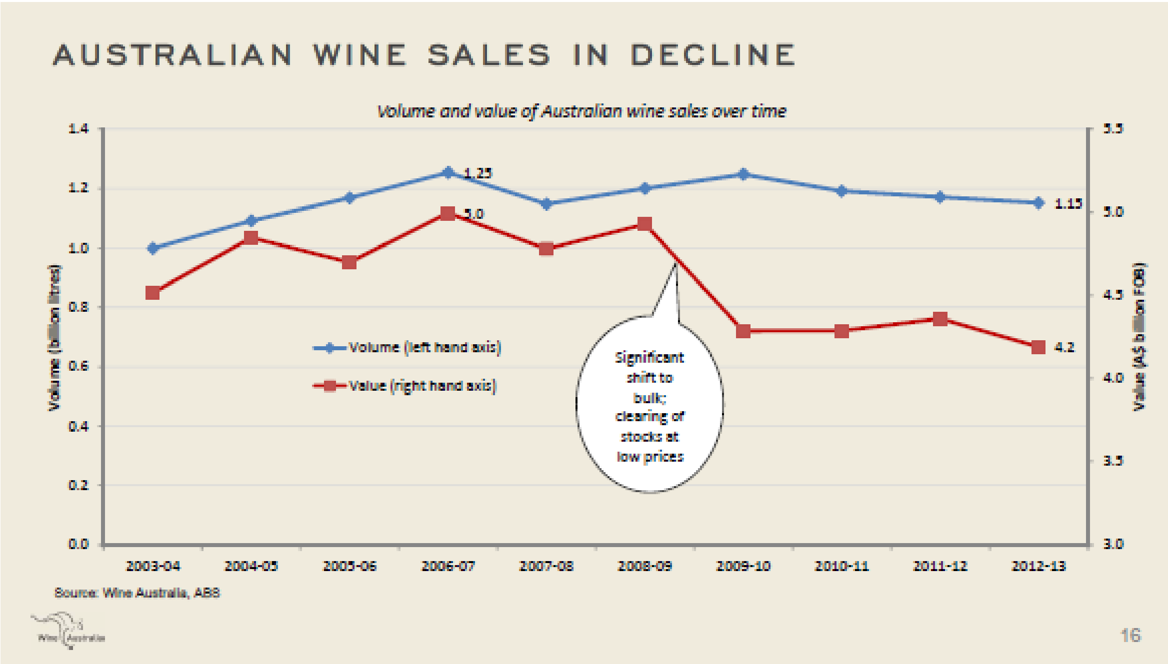
THE STATE OF AUSTRALIA'S WINE INDUSTRY – CONTEXT AND CHALLENGES

Wine is now Australia's sixth largest agricultural export, behind large commodity exports such as beef and wheat, and is the only alcoholic beverage industry that is a net exporter. We are also world class producers, exporting some of the best wines in the world – Penfolds is one of Australia's only luxury brands. Overall, Australia also produces a significant quantity of wine, being the world's 6th largest producer.

After decades of growth, by the mid-2000s, the wine industry found itself with a number of significant structural issues which remain to this day.

In the period between the 1990s and the mid-2000s, the industry grew significantly. After a peak in 2007, with $5bn in annual sales, export volumes plateaued, declining in volume by 14% since 2007. Export value also declined by 38% between 2007 and 2012, with a collapse of prices in key markets and sharp appreciation of the Australian Dollar in the aftermath of the Global Financial Crisis. Oversupply in Australia (particularly over 2004-06 period) appears to have contributed to 'dumping' of excess, cheap wine into the US and other markets. This practice continues to have ramifications for both the image of Australian wine in the US (where it is seen as 'cheap and forgettable') and pricing.

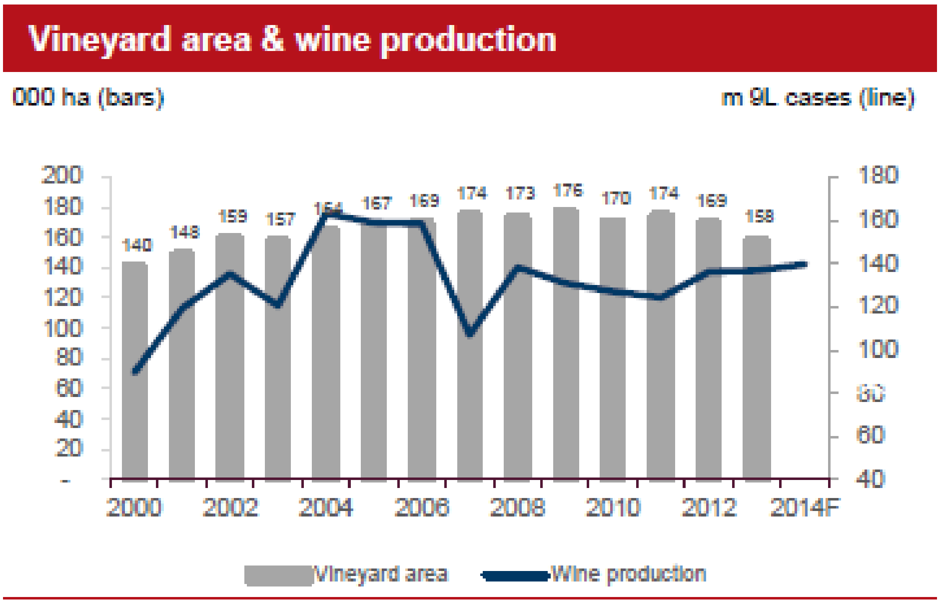
During this time, domestic demand growth also slowed, with larger volumes of foreign produced wine being imported into Australia. Overall, the past decade has seen Australian wine sales remain relatively stable, but the value of those sales have declined. Industry estimates that in Australia, 70% of wines sold at less than the $10 price point are sold through major chains. In addition, over the last decade, there has been a steady growth of private label brands sold and sourced through these retailers.

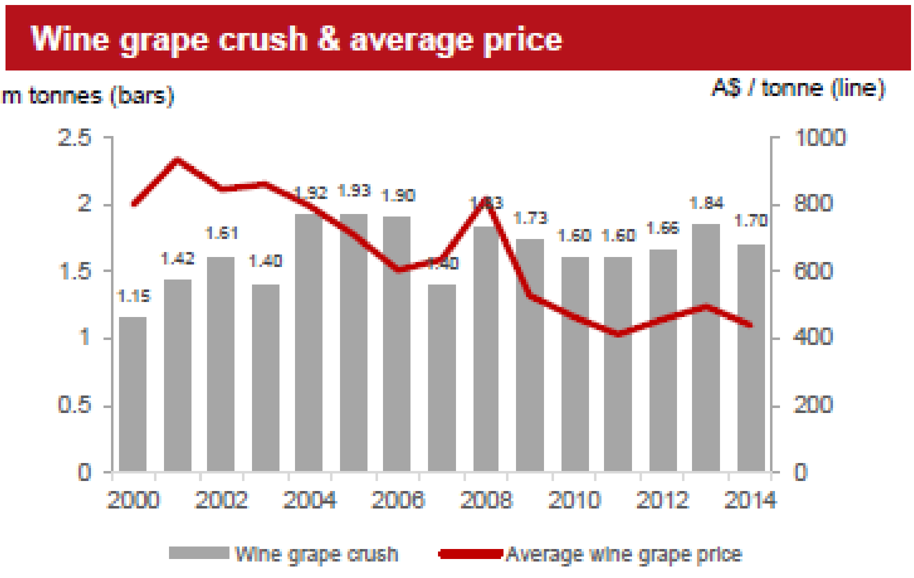


Graph 1: The Australian Grape and Wine Authority (formerly Wine Australia), November 2014

The fall in value and volume of Australian exports occurred simultaneously to the growth in bulk wine exports from New World wine producers such as Argentina, Chile and South Africa, which, according to Rabobank analysis, saw a cumulative increase in bulk wine exports of 100% in the decade from 2001-2010 (from 23% to 46% of total wine exports). At the end of that period, in 2011, Australia's production costs per tonne were higher than each of those countries listed. Overall, Australia's competitiveness in commercial wines has deteriorated over time.

The result has been significant and sustained oversupply. The weighted average price for Australian winegrapes declined by 50% between 1999 and 2014. In 2009, the industry bodies determined that, in order to deal with the glut, approximately 20% of supply needed to be removed (Wine Industry Statement - WFA, Wine Grape Growers Association (WGGA), the (then) Australian Wine and Brandy Corporation, and the (then) Grape and Wine Research and Development Corporation). That same statement suggested that on cost of production alone, at least 17% of vineyard capacity was uneconomic. Today the oversupply remains, with WFA estimating that 84% of Australian winegrape production produced at a loss in 2014.





Graph 2 and 3: OIV, Wine Australia, Winemakers' Federation of Australia, Ciatti, Australian Bureau of Statistics. Note: * Vineyard area: Pre-2009 data includes drying & table grapes and is not directly comparable to figures for 2009 onwards, * Wine production & grape crush: Break in the series from 2012 onwards due to change in ABS survey coverage.

Despite acknowledgement of these issues, very little meaningful change has occurred to address these challenges over the last 5-10 years.

Previous efforts by the industry to restructure have yielded few results. In its most recent Strategic Plan, AGWA states that while plantings have eased and the total vineyard area has fallen slightly, production has continued to exceed sales in the last two years, meaning stocks have begun building again, as they did in 2012 and 2013, and previously in the early-mid 2000s.

Dumping of domestic oversupply in export markets is also damaging the industry's reputation and ability to command premium price points in overseas markets.

While attempts to increase demand for Australian wine overseas are welcome, TWE considers that the pace of industry restructure is well short of what is required, and will remain so unless and until domestic taxation arrangements are significantly reformed.

Global tax comparisons

Tax reform should support the international competitiveness of the Australian wine industry. As the sixth largest producer of wine, and the fifth in terms of global export volume behind Italy, Spain, France, and Chile, we compete in a global market. However, Australia's current tax arrangements make this already significant competition markedly more difficult.

Indeed, there is a strong case for a potential decrease in the overall tax rate on wine, which appears to have been the effect contemplated when the WET Rebate was announced by the then Treasurer, Peter Costello. He considered that the Rebate would:

> *[R]educe compliance costs for all wine producers, with around 90percent of wine producers receiving a rebate that will entirely offset their WET liability (Media Release, 11 May 2004).*

TWE appreciates that a decrease in the revenue raised from wine may not be an option for Government given the current pressures upon the Federal Budget.

Globally, there remain significant differences in taxation of wine. For wines priced at around $12AUD per bottle, Australia's 29% WET is the highest tax rate among the significant wine exporting countries. The majority of wine exporting countries have zero taxes on wines. Italy, Spain and Argentina all enjoy zero taxes on wine, while France (0.7%), South Africa (4%), US (6%), and Canada (8%) are all significantly lower than Australia's 29% (Anderson, Nov/Dec 2014, Wine and Viticulture Journal).

At higher price points, among OECD countries, only Korea and Norway have a higher tax rate than Australia's. In fact, for these wines, Australians face an effective tax rate more than three times greater than the OECD average.

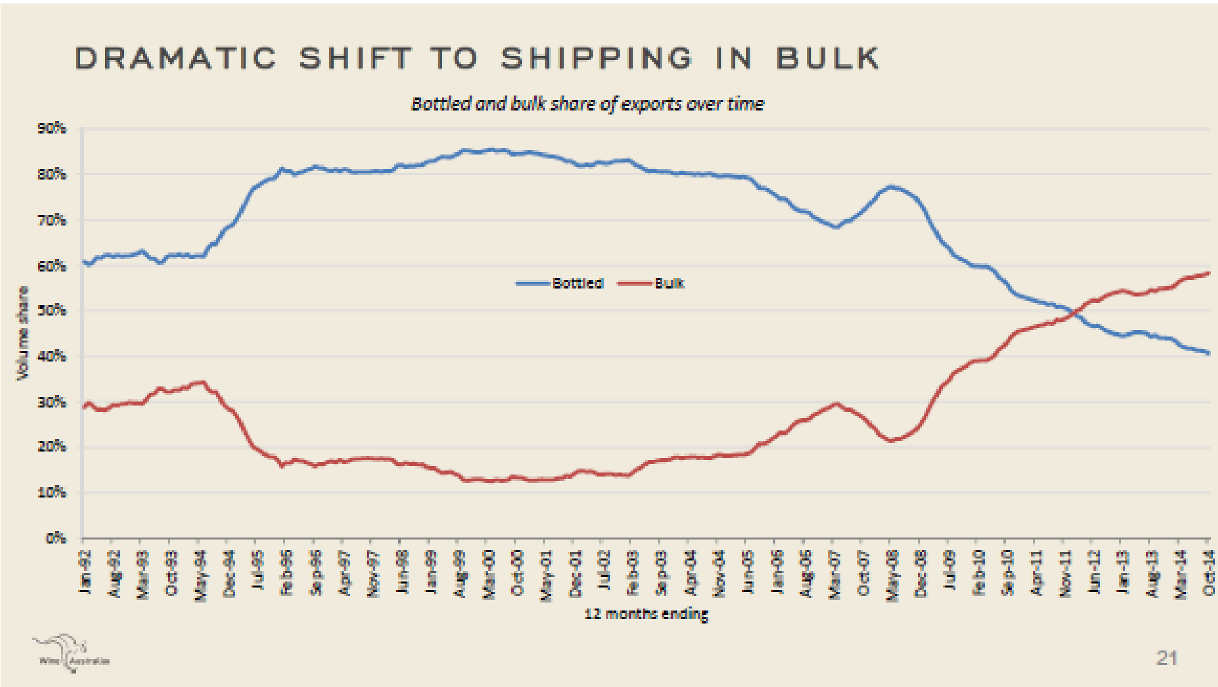
This competitive impact is not only felt when making direct international comparisons across wine, but Australia also taxes wine relative to other alcoholic beverages more than nearly every other wine-exporting country (Chile is the only exception to this, as they have a very low rate of tax on beer) (Anderson, 2014).

A sustainable future wine industry - Premiumisation of Australian wine exports

The current WET arrangements in Australia support lower-quality, low-value producers rather than driving the quality and profitability the sector needs. It incentivizes the cultivation of marginal land to produce low value wine, contributing to the industry's structural oversupply and undermining the vision of a sustainable industry with a global reputation for quality.

Coupled with these factors, Australia retains a high cost base for wine production with land values, labour costs and infrastructure charges all significantly above that of the wine industry's major competitors. Put simply, there is likely to be no long-term future in competing against low cost producers from Chile and Argentina given significantly higher domestic production costs.

The increased production of low value wine is illustrated by the figure below which shows the shift to shipping in bulk from the late 2000s.



Graph 4: The Australian Grape and Wine Authority (formerly Wine Australia), November 2014.

Today, approximately 90% of Australian exports are bulk quality (that is, wine at a cost of $4.99/L and below). It is this wine – that is, commercial quality wines for export, that are most susceptible to foreign exchange fluctuations, leaving the industry vulnerable to factors outside of its control.

TWE believes that sustainable business models, ones that are more resistant to unpredictable currency fluctuations, must be a strategic objective for the Australian wine industry.

Rabobank's 2012 analysis of the market concluded that:

> *Those who cannot sufficiently compete on a commodity product level, be it due to a high currency or a high-cost structure, must drive innovation and brand-building efforts to drive value growth through product differentiation.*

Australia cannot compete with other New World markets at a commercial product level and should pursue what the industry has agreed is its future – one that increases production of premium Australian wine.

Since 2005, the industry has recognised the need to premiumise the Australian wine category. The then Australian Wine and Brandy Corporation's (now AGWA) 'Directions 2025' paper, published in 2005, was a plan for the Australian wine sector to transform itself from a volume-driven industry, to one that 'delivers a more sustainable and profitable business environment for more growers and producers', and that this would be achieved by maintaining the existing space by extending the 'Wine Australia' brand into the new territory of premium wines. This strategy was endorsed by the then Government and the industry. However this plan is being impeded by the current WET Rebate, and the industry's inability to deliver meaningful structural change.

The industry has also recognised that the current industry structure is harming Brand Australia. In 2009, the wine and grape growing industry stated that oversupply was impacting our price structure '*distorting perceptions about our product and exacerbating competitive pressures…Just as damaging is the image being created that Australia is only a low-cost producer, making it difficult for our premium wines to gain recognition and market traction*' (Wine Industry Statement, 2009). The four industry bodies that authored the statement agreed that the Australian industry would not be able to continue to compete in the low value wine market over the long term.

In its first Strategic Plan, the newly established AGWA has repeated this view, stating that the industry needs to '*confidently articulate the unique quality proposition of our wines…*' A significant proportion of AGWA's three strategic priorities is to increase demand, though an investment in strategies that enhance our image and reputation – as one of quality, not quantity. A move to a category based volumetric model for the taxation of wine inherently supports this objective, while the current ad valorem approach actively works against it.

Furthermore, this message has been reinforced and is consistent with export growth strategies of the Australian Government and a number of state governments, including the South Australian, Victorian and Tasmanian governments.

Government and industry plans for premium food and wine exports is supported by current market intelligence on global growth. The most profitable growth for the wine sector is in higher value wines. There is significant opportunity in markets such as the US, China, Hong Kong and Singapore. The average value of wine exports to Asia is A$18.77 a litre, compared with the global average of Australian wine exports of A$3.37 a litre. The significant challenge facing the Australian industry in many markets is how to leverage these opportunities, and opportunities presented by new Free

Trade Agreements agreed with Korea, China and Japan. The US, the largest wine market in the world, is seeing growth in wine demand most strongly at premium price points.

Similarly, trends toward premiumisation are also being witnessed in the otherwise relatively stagnant domestic market, with the largest growth in the sector until the first quarter of calendar year 2015 being in the over $20 per bottle market.

Yet, an ad valorem approach actively works against the development of premium offerings and continues to exacerbate the ‘commoditisation trap’ in which the Australian wine industry currently finds itself in many export markets.

A category based volumetric model of taxation for wine will instead actively support increased Australian premium wine production, creating a tax system that supports a sustainable and globally competitive Australian wine industry, including greater price competitiveness, and removing de facto penalties currently imposed on those who seek to create high quality wines.

In line with recommendations made by the WFA, savings made by reforms to the WET Rebate should be allocated, at least in part, to support export market development and promotion, further supporting the industry to realise its export growth opportunities in the premium market.

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PROPOSED MODEL: A CATEGORY BASED VOLUMETRIC WET, WITH NO REBATE

WET Rebate Reform

TWE is a member of the WFA and supports its campaign to reform the WET Rebate to remove unintended recipients and alleviate unintended consequences of the system that are distorting supply decisions, specifically to remove eligibility for the Rebate from foreign entities and from bulk and unbranded wine that is not fit for retail sales.

TWE is pleased that WGGA (representing Murray Valley, Riverland and Riverina grape growers among others), Riverland Wine, Wines of Western Australia, Wine Victoria, the South Australian Wine Industry Association, the NSW Wine Industry Association and Wine Tasmania also supported these reforms.

As shown by the limited ATO data available, the current Rebate appears to be open to rorting, with $61m being claimed by applicants that are not designated as either grape growers or wine manufacturers. The Australian National Audit Office (ANAO), in a 2010 report on the administration of the WET, similarly recognised that: '*A number of schemes have arisen in recent years where grape growers are attempting to improperly access the producer rebate, while some wholesalers and retailers have also been inventive in minimising the amount of wine tax paid. Some of these schemes are within the provision of current legislation but have the potential to erode revenue, contrary to the original intent of the tax. Other schemes and compliance issues can contravene wine tax legislation*.'

While TWE fully supports WFA's ongoing advocacy on WET Rebate reform, it would urge the Government to go even further. The WET Rebate is a damaging subsidy that has negatively impacted the profitability and productivity of the industry. It is preventing consolidation and sustaining uneconomic production, at a time when the industry urgently needs to retire excess supply and rebuild value in the Australian wine category.

This view is supported by the Productivity Commission's 2014 submission to the Agricultural Competitiveness Taskforce, which stated:

> *[The Government should] avoid measures that perpetuate the fragmentation of farms by discouraging those which are unviable from exiting the sector. Sectoral assistance, for example, distorts market signals and provides an incentive for uncompetitive farms to remain in operation. It will also impede more efficient farm businesses from expanding their operations by acquiring land to capture economies of scale.*

The cost of the Rebate, is significant and growing. Since its introduction, the WET Rebate has grown substantially, from $220 million in 2008/09 to $280 million in 2012/13. The WET Rebate is now forecast to cost the Australian taxpayer $310 million in 2015/16. These funds could be better directed into activities that support and promote the whole industry, increasing demand for our product and supporting truly regional cellar door and employment opportunities.

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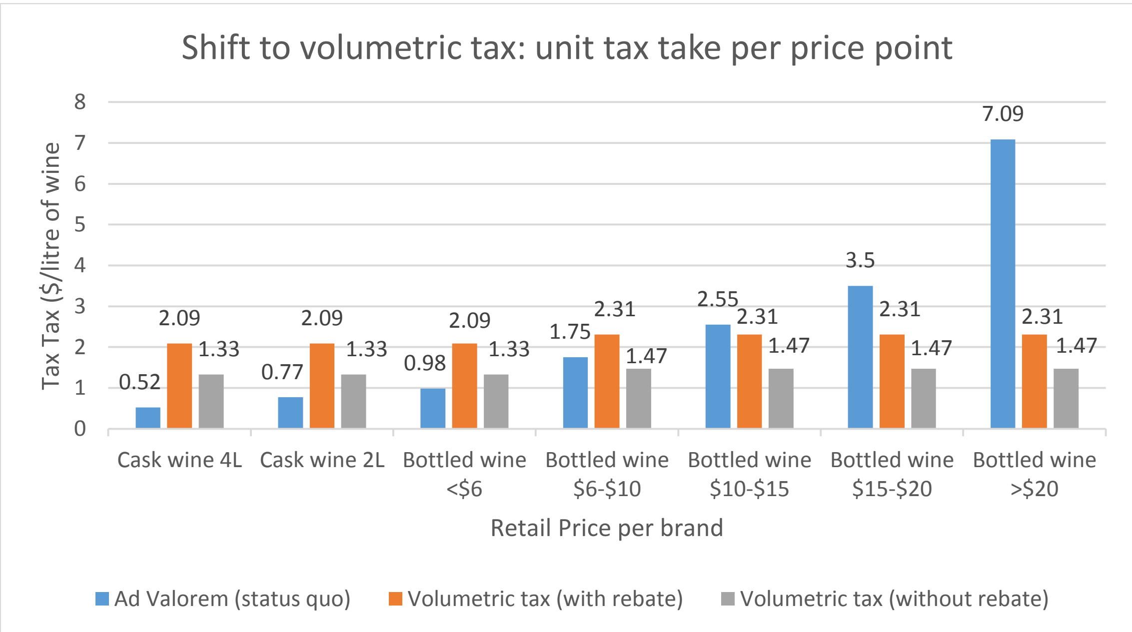
TWE recommends that the WET Rebate should be fundamentally reformed to become a cellar door style rebate available only to the retail sales of genuine wine producers, or abolished. Amending the WET Rebate to tighten or amend eligibility, whilst welcome, risks creating new loopholes which may be open for abuse and could generate further complexity in wine taxation arrangements. Abolishing the WET Rebate in its entirety and separately providing for a regional employment program to support regional cellar doors would address some of the objectives of this tax review – namely simplicity and fairness – while continuing to provide support for small wineries and those who are truly involved in contributing to the industry.

The size of the saving to Government from removing the Rebate would be significant. This saving could also be allocated to marketing and export promotion, and an industry structural adjustment package, the principles for which are outlined below.

A category based volumetric WET

The current taxation of wine, which is based on wholesale sale value, results in significantly different taxes on the one product – wine – that is similar, if not equal, in alcohol strength.

Analysis undertaken by Boston Consulting Group (BCG) on behalf of TWE and Pernod Ricard Winemakers illustrates this point. Low cost (particularly cask) wine is virtually tax-free, which can translate to unjustifiably low cost per litre of alcohol at a retail level. For a four Litre cask, the average WET per Litre is around 50 cents. While wine that may be exactly the same in terms of alcoholic content, but instead sells at $15-20 a bottle, pays around $3.50 in WET. It is clear from this example how the existing tax structure incentivises consumption and production of low-priced, low--quality wine.



The effect is that mid-range and higher quality wines attract a de facto 'luxury tax' through the current system. Yet, as outlined, the future of the industry is seen by most industry participants, governments and market analysts as capturing growth at more premium price points. Only a category based volumetric system for the taxation of wine can support this model.

BCG's analysis considered what level of volumetric taxation would result in revenue neutrality for government, in relation to the total tax take on wine. This analysis was underpinned by assumptions about price and demand elasticity at different price points for wine and about other alcohol beverages; and the effect of tax on wine exports and imports, based on observed past data, among others. The BCG model determined that if the WET Rebate was abolished, the appropriate tax rate would be around $1.40 per litre of wine, or just over a dollar a bottle. If the WET Rebate was retained, the tax rate would be around $2.20 per litre of wine, or just over $1.60 per bottle.

Consequently, if the WET Rebate was removed, wines priced in the price point of $6-10 and above would not rise in price and in fact may see price reductions. While this analysis gives some indication of the expected impact on wine prices at a revenue neutral rate, BCG's analysis cannot predict the price impact to the consumer. The size of wholesale price reductions passed on to consumers will be determined in part by other participants in the supply chain who operate between producers and consumers.

Given the state of the industry and current oversupply, it is likely that producers of lower priced wine (that is, lower than $6 a bottle) would be more adversely affected. The nature of grape growing and wine making means that these producers may not simply be able to adjust to producing higher value wines. Likely affected participants are not smaller producers. As smaller wineries typically produce at higher price points, a shift to category based volumetric taxation would benefit the average small producer. BCG analysis showed that 44% of sales for a winery with between $1-5million annual revenue are at wines prices above $20. Across the industry, the larger the winery revenue, the lower their average cost per bottle, with wineries generating above $20m in revenue producing bottles at an average below $6 per bottle.

While production volumes would likely fall as a consequence of a move to a category based volumetric model, the impact would be felt in the least productive sections of the industry. In order to assist the least profitable and productive participants to transition away from the industry, TWE strongly recommends that government consider how industry can successfully transition to the category based volumetric model proposed, while providing a structural adjustment program, with overall budget neutrality over the forward estimates.

In 2011, Allen Consulting applied the Productivity Commission's policies on structural adjustment programs, including looking at the long term nature of the wine industry's wine glut, the need for structural change being substantial and the need for transition, and concluded that a structural adjustment program would be justified.

Any structural adjustment program would need to be targeted at supporting the necessary and beneficial restructure of the industry out of its current structural oversupply. This could be provided through replicating successful structural adjustment packages such as exit grants, concessional loans for producers to transition to other agricultural industries and access to professional advice and rural financial counsellors. The potential need for exit packages has similarly been long recognised by industry bodies.

The Australian Department of Agriculture has designed and implemented such packages for a range of agricultural industries in need of structural adjustment. These experiences could be utilised to design a transitionary program. For example, the 2011 Contractors Voluntary Exit Grants Program, was implemented for the Tasmanian forestry industry for similar reasons – to 'support the restructuring to a smaller operating environment'. The grants were only provided on a voluntary and competitive basis. Similarly, in 2010, the Department of Agriculture designed and delivered an Exceptional Circumstances Exit Grant Program for farmers in areas that had been affected by drought. These grants were complemented by funding for advice and training, which could be utilised by producers who needed financial advice about restructuring or alternative industries.

While the specific design, delivery and timeframes would need to be informed by recent government programs, TWE supports a structural adjustment package that is:

- not permanent
- available to those producers and winemakers who are unprofitable and who independent financial professionals consider will be unlikely to become profitable in the near future
- voluntary
- assist producers and winemakers to identify and transition to other industries, and
- results in the industry adjusting to equilibrium where supply no longer exceeds demand.

Impact on consumption and social costs

Previous tax reviews have considered that tax should be used to reduce social costs associated with certain behaviours. The Re:Think Discussion Paper similarly states that tax should be used to reduce social costs of excessive consumption and that consumers change the amount of different types of alcohol they consume based on relative price of difference alcohols. While TWE acknowledges these views, it considers that there are other ways to achieve social outcomes that are more efficient and effective.

TWE supports focused initiatives designed to target at-risk drinkers and reduce harms caused by the small minority of individuals who consume alcohol irresponsibly. However, 'heavy drinkers' do not appear to be price sensitive and consequently while a move to a category based volumetric model of taxation for wine would likely result in a reduced sales at the lowest per standard drink price point (typically cask wine), it is not likely that an overall increase in wine taxes or the revenue raised from the wine category will significantly impact at-risk drinkers, and instead affect consumption patterns of responsible drinkers. Further information on wine taxation and alcohol misuse can be found in the WFA submission to Re:Think.

Most Australians consume alcohol responsibly, and ABS data from May 2015 shows that Australians are drinking less alcohol than at any time in the previous 50 years. This finding comes after the Australian Institute of Health and Welfare's (AIHW) findings in 2014 that:

- Daily drinking declined significantly between 2010 and 2013 (from 7.2% to 6.5%) and was at the lowest level seen since 1991. Rates fell for both men and women.
- Between 2010 and 2013, there was a significant increase in the proportion of people who had never consumed a full serve of alcohol (from 12.1% to 13.8%).
- Fewer people aged 12 – 17 are drinking alcohol and the proportion abstaining from alcohol increased significantly between 2010 and 2013 (from 64% to 72%).
- Younger people are continuing to delay starting drinking —the age at which 14-24-year olds first tried alcohol has increased since 1998 from 14.4 to 15.7 years in 2013.

TWE participates in a number of responsible consumption initiatives globally, and would be pleased to work with Government, through the Inter-Governmental Committee on Drugs, to help determine industry's and Governments' priorities for responsible consumption initiatives that target at-risk drinkers and harm caused by irresponsible consumption by the small proportion of Australians who drink to excess.

The distinction between wine and other forms of alcohol

A category based volumetric tax is the most appropriate tax regime for wine. However, the sector is starkly different to the beer and spirits categories and TWE considers that a 'one size fits all' alcohol excise regime is not appropriate, and would not position the Australian wine industry for a viable future. TWE does not agree that all alcohol taxes should be taxed at a single rate.

In summary, the nature and costs of production, the significant benefits the industry brings to regional Australian communities, and export nature of the industry all distinguish it from other alcohol categories.

Typical wine production costs are far higher than beer and spirits due to the capital intensive nature of wine making and the complex nature of the process, including the annual vintages which then require intense production followed by long fermentation, maturing and storing periods. Consequently, the returns on capital are significantly less than other alcohol industries, yet retailer margins are greatest on wine sales.

As an agricultural industry, the wine industry is also subject to a research and development levy and a marketing levy, unlike any other alcohol industry. These federal levies are in addition to state-based levies and emergency pest and disease management levies.

In addition, as outlined earlier, the wine industry generates significant economic and social benefits across Australia. It contributes to innovation, employment and tourism. It is the least consolidated sector of the alcohol beverages industries and is a significant employer, particularly in regional Australia. Employment on wine bottling production lines have recently provided alternative employment some members of the car manufacturing and other manufacturing industries. The industry is the only net-exporter of the alcohol industries and through its world-class premium wines it is a significant contributor to our export income, contributing to 'Brand Australia', our global positioning, and attracting significant tourism to our cities and our regions.

TWE believes that a category based volumetric approach to the taxation of wine would be broadly welcomed by other industries and sectors.

Consequently, category based taxation models for beer and spirits should be maintained, in order to reflect the significantly different cost and benefit profiles attributed to alcohol products and categories. A flat volumetric tax across all alcohol categories would decimate the wine industry, and, as outlined above, would be unprecedented internationally.

In this vein, TWE recommends that changes to the tax regime are achieved by amending the WET legislation, rather than applying an excise regime. The wine industry has never been an excised industry and does not have the mechanisms established to administer it as one. The reasons for this are the nature of the industry and the product. This year's Department of Agriculture Portfolio Budget Statement (2015-16) estimated that there are 6,300 grapegrowers and 2,995 wineries across 71 regional communities in Australia. Wine itself can be moved and blended in different regions and in different quantities depending on the vintage in order to make a final product. These characteristics would mean establishing an excise regime for the industry would be extraordinarily complex, expensive to administer and impractical.

Further information on the basis for a differential tax rate to other alcohol industries can be found in the WFA submission to Re:Think.

Re:Think – WET reform and the opportunity for lower, simpler, fairer taxes

WET reform and WET Rebate abolition both provide opportunities to fulfil the Government's ambitions for a lower, simpler and fairer tax system.

The complex nature of the existing WET regime is well documented. In 2010, the Australian National Audit Office (ANAO) reviewed the WET noting its significant complexity relating to calculating the value of the wine and consequent tax payable, based on definitions such as 'assessable dealing', 'taxable value' and the time of dealing (among others) and interactions between them.

A move to a category based volumetric taxation model provides an opportunities to simplify the tax system significantly, applying one taxation rate across the category. TWE would recommend that the whole table wine category receive one tax rate treatment. The nature of the industry is such that varietals and vintages and other external influences can impact on alcohol content, and attempting to reflect as much in the tax paid would continue a significant level of complexity. The simplest option would be to have one tax rate applied to the whole category of table wine.

Finally, this submission is aligned with other Government policies, some of which have been referred to throughout this submission. This includes the Government's desired premium positioning of

Australian product in global markets based on its quality and provenance attributes. It assists the Government to realise the benefits of recently agreed Free Trade Agreements. It is in line with various portfolio specific priorities, including agriculture, regional development, international trade and industry. Finally, this is a financially responsible approach which will not affect government revenue or increase the overall tax take.

<u>PART 2 – TAXATION OF CORPORATE STRUCTURES</u>

TWE would like to provide the following brief comments on other sections of the Discussion Paper. These comments are in addition to, and supplementary to the Corporate Tax Association (CTA) and G100's submissions to the Re:Think Discussion Paper.

PART 2 – RECOMMENDATIONS

1. That the Government commission a comprehensive independent review of the entire FBT framework, including its exemptions and concessions, to simplify and modernise the FBT regime to ensure that the compliance burden is commensurate to the revenue raised by the tax.
2. That Australia lower its corporate tax rate such that it is competitive with relevant countries including the higher-growth OECD countries and the more developed Asian economies.
3. Retain the dividend imputation system in its current form.
4. Retain the existing R&D tax incentive.
5. That the Government work with the State and Territory Governments to design and implement a single uniform stamp duty law, administered by a single agency.
6. That the Government work with the State and Territory Governments to design and implement a single uniform payroll tax law, administered by a single agency.

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Fringe Benefits Tax (FBT)

Discussion Question 7: What should our fringe benefits tax system look like and why? **Discussion Question 17:** To what extent are the concessions and exemptions in the fringe benefits tax system appropriate?

TWE recommends that the Government review the entire FBT framework, including its exemptions and concessions, with a view to the tax being significantly simplified and modernised such that the compliance burden is commensurate to the revenue raised by the tax.

The administration of FBT is overly complex for employers, resulting in substantial compliance costs which produce modest tax collections for the Government (1.2% of total Government revenue was raised by FBT in 2014). In simple terms, TWE considers that the complexity and compliance costs of FBT are not justified by the revenue it raises. For example, TWE have made a number of modifications to its existing IT systems to be able to capture the data required to prepare its annual FBT return but will still have one dedicated full time equivalent role spend six weeks completing the FBT return, for a FBT liability of just under $2m.

The FBT rules are complex and inefficient in compliance terms. In some instances, FBT requires more compliance processes, form filling and documentation than does income tax. FBT illustrates a policy mindset of "plug every gap and collect every dollar, irrespective of compliance costs and complexity." For example, car parking fringe benefits can require physical distance measurements of which car parks are nearby, then calculating and tracking those car parks' fees continuously.

FBT exemptions and concessions should also be reviewed. The need and appropriateness for each exemption and concession should be reviewed to determine whether it is still appropriate in today's society and whether onerous compliance costs can be reduced through greater simplification. For example:

- The minor benefits exemption limit of $300 is too low from a compliance perspective and should be significantly increased. Limits should be indexed to reflect increases in salaries, or alternatively reviewed on a regular basis; and
- The current rules around the in-house benefits exemption are complex and punitive. The rules actively work against a company being able to promote their products with their employees. The minor benefits exemption should be extended to include in-house benefits.

Finally, TWE recommends that the Government consider a streamlined FBT which only includes a tax on cars, loans, residential housing, expense reimbursements and any other benefits that could reasonably be argued as being part of an employee's remuneration package.

Lowering the Corporate tax rate

Discussion Question 24: How important is Australia's corporate tax rate in attracting foreign investment? How should Australia respond to the global trend of reduced corporate tax rates?

Australia's corporate tax rate has not kept pace with international trends and is now relatively high in both effective tax rate and nominal tax rate terms. Many countries, including the UK and Canada have significantly reduced their corporate tax rate in recent years while Australia's corporate tax rate has remained constant at 30%. As a result, Australia's tax rate is now significantly above the average rate for the OECD (25% in 2014) and other significant trading and investment partners such as China (25%) and Singapore (17%). This impairs Australia's competitiveness in attracting and retaining businesses.

In the current Base Erosion and Profit Shifting (BEPS) environment, lowering the corporate tax rate in Australia may discourage companies from engaging in profit shifting and tax avoidance activities. In addition, given the responsiveness of foreign direct investment to tax, a reduction in both the nominal and effective corporate income tax burden is likely to improve economic growth by further encouraging foreign investment.

TWE recommends that Australia lower its corporate tax rate such that it is competitive with relevant countries including the higher-growth OECD countries and the more developed Asian economies. Ideally the corporate tax rate should be reduced to align with the OECD average of 25%. TWE acknowledges that there may be a need to consequently increase the tax base in order to retain or increase revenue collection.

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Dividend Imputation

Discussion Question 25:
Is the dividend imputation system continuing to serve Australia well as our economy becomes increasingly open? Could the taxation of dividends be improved?

Dividend imputation is an important feature of the tax system and equity markets for domestic investors, and continues to serve Australia well. The benefits of dividend imputation include the elimination of double taxation of company profits, reducing the bias for debt over equity, and reducing the incentives for Australian companies to reduce their tax. The imputation scheme also results in higher rates of return for Australian investors.

One of the major benefits of the imputation system is that it encourages companies to effectively distribute dividend profits that have already been taxed, it results in Australian domestic shareholders being supportive of companies paying tax that translates into franking credits that are available to attach to dividends. This has the associated benefit of encouraging higher payout ratios, for example, compared with other countries such as the USA, and has meant that the parking of profits in lowly taxed jurisdictions is not a major effect of the Australian tax system.

In the case of dividends paid to offshore shareholders, franking credits are in effect retained by the ATO which is revenue positive. The removal of dividend imputation would result in a reintroduction of double taxation on domestic corporate profit distributions and would have a negative effect on Australian domestic investors and equity markets. Consequently TWE recommends retaining the dividend imputation system in its current form.

R&D tax incentive

Discussion Question 39:
Does the R&D tax incentive encourage companies to conduct R&D activities that would otherwise not be conducted in the absence of government support? Would alternative approaches better achieve this objective and, if so, how?

R&D is often a critical step in innovation and the economic benefits of innovation, including productivity enhancements and job creation, are well recognised.

TWE has its own R&D program, and does not consider that the R&D tax incentive is the primary driver of its R&D decisions – R&D is a business cost like any other cost – however, it does effect investment in R&D at the margin. TWE also considers that the R&D tax incentive operates effectively to encourage large companies to undertake their R&D activities in Australia, having flow on benefits for Australian based industries and the Australian economy.

The following factors are also important in this debate:

- The R&D tax regime does encourage companies to invest in risky R&D projects in order to generate innovation and competitiveness for Australian companies;
- Over the last decade, foreign tax jurisdictions have continually increased their R&D incentives in the form of tax concessions/offsets/deductions to attract investment and innovative talent to their country. Countries like Singapore and India provide very generous R&D tax incentives – up to 400% deductions.
- With an increasingly mobile global workforce, it is not difficult to relocate and/or undertake R&D work in a country which provides more generous tax incentives to do so. We should encourage innovation to be carried out in Australia.

Consequently, TWE considers that any increase in the after-tax cost of R&D (by removing or reducing) the incentive, will discourage investment at the margin for many companies, and will result in Australia becoming a relatively more expensive place in which to invest.

TWE recommends retaining the existing R&D tax incentive.

State and local taxes

Discussion Question 52:
What are the relative priorities for state and local tax reform and why? In considering reform opportunities for particular state taxes, what are the broader considerations that need to be taken into account to balance equity, efficiency and transitional costs?

State taxes, by their nature and their administration, are inherently inefficient and undesirable in a modern country with no trade barriers and an integrated economy. Australia has too many business taxes imposed by various levels of Government. Some of those taxes raise very little revenue but they all involve significant compliance and administration costs.

Stamp Duty

Whenever an Australian business considers a business reorganisation within Australia to improve efficiency, significant stamp duty issues arise and need to be considered. If a business operates in every state and territory it will need to deal with eight different stamp duty Acts which is extremely inefficient and costly. It is common for a business to restructure itself in order to attract capital or investment with perhaps a merger of entities, or a demerger, or restructure of activities while maintaining the same ownership. In addition there is inconsistency in the administration of the business reorganisation concessions across jurisdictions with some states administering the business reorganisation concessions reasonably while others take a very restrictive or unsympathetic approach in applications for relief under their statutes.

TWE recommends that a single uniform statute be implemented which would apply across all of the states and territories and be administered by a single agency. TWE acknowledges that this may be difficult to achieve given the different levels of Government but at a minimum TWE would recommend that a consistent approach to the grant of relief from stamp duty for business reorganisations be applied.

Payroll Tax

Australia is one of the few countries that levy payroll taxes, and the high rates of these taxes impacts on Australian companies' international competitiveness. Payroll taxes also cause significant compliance costs and burdens, with eight different Acts across the country. TWE recommends the implementation of a single uniform statute to apply across all States and Territories. Consolidating a company's payroll tax reporting requirements to a single national body would deliver simplicity and efficiency for any businesses that operate in several states.

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