Australian Government
The Treasury

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Discussion paper
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1: Executive Summary

On 5 May 2015 the Assistant Treasurer announced the release of a discussion paper on the wine equalisation tax rebate (WET rebate). This discussion paper forms part of the Tax White Paper process. The next step in this process is the release of a Green Paper in the second half of 2015. Further community consultation on possible reforms to improve the tax system will follow, with a White Paper expected in 2016.

The wine industry has been an Australian success story, enjoying a sustained period of rapid growth in the 1990s and early 2000s. However the industry has faced significant challenges since that time. In particular, low wine grape prices and weaker export performance have put pressure on Australian winemakers and grape growers, many of whom are believed to be operating below cost of production in recent years. There is a growing consensus that the Australian wine industry is currently experiencing a period of sustained oversupply of wine and wine grapes and that the industry will need to adjust in order to grow and prosper.

Growers, producers and other stakeholders have raised concerns about whether the WET rebate is contributing to some of the challenges currently facing the wine industry. This paper is intended to stimulate public discussion on how the WET rebate scheme may be contributing to distortions in the production of wine and seek feedback on what opportunities there might be to better target the support that the rebate offers.

The Government's objective is to achieve a better tax system that delivers taxes that are lower, simpler and fairer. This discussion paper seeks to better inform discussion and analysis of the WET rebate as part of the Tax White Paper process and ongoing Government policy development.

2: Taxation of wine in Australia

Context

Arrangements for the taxation of alcohol in Australia are complex. Beer and spirits are taxed based on their alcohol content (known as *volumetric* taxation) with different excise rates applied depending on the type of alcohol (beer, brandy, other spirits and other excisable beverages), the alcohol content and whether it is draught or packaged (for beer). In contrast, wine is taxed on the basis of its value, by the WET.

Before the development of the Goods and Services Tax (GST) there was no clear policy approach for the taxation of wine. For periods of time, wine attracted no tax or was subject to various rates of tax which changed frequently. From 1974 a Wholesale Sales Tax (WST) was applied to wine which was, by the time of the introduction of the GST, imposed at a rate of 41 per cent. The WET replaced the WST and was introduced as part of the 2000 tax reforms, coming into effect on 1 July 2000.[1]

The rate of WET of 29 per cent was designed so that it would, with the addition of 10 per cent GST, be equivalent to the WST rate of 41 per cent. This ensured that both the retail price of wine and the revenue from wine tax remained relatively stable.[2]

The nature of wine production means that the industry is subject to external factors such as climate and disease which may explain, at least in part, the different approaches successive governments have taken to the taxation of wine in comparison to other forms of alcohol. Smaller winemakers, whose profitability may be dependent on the quality of a particular year's vintage can be more susceptible to these externalities than larger winemakers, who are able to utilise a diverse range of locations and more sophisticated winemaking techniques.

Grape and wine production also has less flexibility than most other industries due to the following factors:

- vineyard plantings have a lifespan of 15 years or more, and three to five year lead times for income generation;
- wine has a long period of fermentation, maturation and storage, particularly compared with beer;
- there is only one harvest and therefore one seasonal vintage per year; and

1 The WET was introduced by the A New Tax System (Wine Equalisation Tax) Act 1999.
2 A New Tax System (Wine Equalisation Tax) Act 1999: Second reading speech of the then Treasurer the Hon Peter Costello MP.

- it can be difficult for some growers and producers in different regions to vary alcohol levels in wine or change grape colour and types to match changes in consumer tastes. This can be less of a concern for larger producers.

Wine production is also more capital intensive than other alcohol industries and uses long-life assets, which can contribute to lower returns on capital compared to other industries.

Profitability is generally more stable for producers of other types of alcohol such as beer and spirits, as these products are less dependent on the climate and other external factors. In particular, beer and spirits are produced from crops (such as hops, barley, other grains and potatoes) that are readily available all year round and are not subject to the challenges of seasonal vintages. Beer and spirits also tend to have higher returns to capital and lower cost structures than wine, particularly because they often have significantly larger economies of scale.

How is wine taxed?

All sales of wine in Australia attract the WET, which is applied at the rate of 29 per cent of the final wholesale price on domestic sales of both Australian and imported wine. In addition to this, sales and importations of wine also attract the GST. The WET does not apply to the sale of exported wine.

There is considerable complexity in calculating the WET, with the law requiring claimants to take into consideration a number of factors such as the type of the wine product, the point of sale, whether an exemption applies and the taxable value.

As wine may be bought and sold many times through the production process, the WET is usually applied on the last wholesale sale of wine – that is, where a wholesaler sells wine to a retailer, such as a bottle shop, hotel or restaurant. The legislative deferral of the WET liability to the last wholesale sale is called ‘quoting’.

In general, quoting occurs when a GST-registered purchaser of wine provides (‘quotes’) their Australian Business Number (ABN) to a supplier of wine, which allows a particular supply or sale of wine to be exempt from WET. Quoting is used to exempt WET in other circumstances, such as where the purchaser will export the wine. Quoting is not mandatory and a supplier is not obliged to accept a quote.

The WET only applies to beverages that contain more than 1.15 per cent by volume of ethyl alcohol. A variety of different alcoholic products are considered wine for the purposes of the WET, including grape wine, grape wine products, fruit or vegetable wine, cider or perry, mead and sake. Other alcoholic beverages such as beer and spirits that are not subject to the WET are subject to the excise regime.

Box 1: Operation of the WET

Grape Winery is a wine producer who sells some of its wine to Wine Distributions, a wine wholesaler who supplies wine to restaurants and bottle shops. When Wine Distributions purchases the wine, it is entitled to quote its ABN to Grape Winery because it is intending to make a wholesale sale of that wine.

Grape Winery sells $15,000 worth of wine to Wine Distributions. It charges $1,500 in GST on the sale but no WET because Wine Distributions provided Grape Winery with a quote.

Wine Distributions adds on its mark up and sells the wine to two retail outlets for $9,000 and $11,000. As the sales are the last wholesale sales, Wine Distributions must include WET and GST on the invoices, which total $12,771 ($9,000 + WET $2,610 + GST $1,161) and $15,609 ($11,000 + WET $3,190 + GST $1,419) respectively. When the retail outlets sell the wine, the WET is passed on to consumers in the cost of the wine.

Wine Distributions remits WET of $5,800 and GST of $2,580 on its next activity statement.

Tax on imported wine

The volume of wine imported into Australia has increased in recent years. In 2013 imports accounted for 15 per cent of wine consumption, compared to 4.5 per cent in 2000 and 11 per cent in 2010.[3] Much of this growth has been from New Zealand, which provided 64 per cent of wine imports to Australia in 2014.[4]

WET is payable on imported wine at the time it is imported, unless an exemption exists or the importer is entitled to defer the WET to a later stage in the distribution process by quoting its ABN.

Wine imported into Australia also generally attracts a tariff of 5 per cent, however under free trade agreements no tariff applies to wine imports from a number of countries.[5]

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3 Anderson K 2015, *Growth and Cycles in Australia's Wine Industry – A statistical compendium, 1843-2013*, University of Adelaide Press, page 196. E-Book available at: http://www.adelaide.edu.au/press/titles/austwine/austwine-ebook.pdf.

4 Australian Bureau of Statistics (ABS) 2014, *Shipments of Wine and Brandy in Australia by Australian Winemakers and Importers*, June 2014, cat. No. 8504.0, ABS, Canberra and Winetitles 2015, *Australian and New Zealand Wine Industry Directory.*

5 Under free trade agreements, no tariff applies to wine produced in the United States, New Zealand, Singapore, Chile, Thailand, Papua New Guinea, Malaysia, Japan, the Association of Southeast Asian Nations (ASEAN) countries, Pacific Island Forum countries, developing countries and least developed countries.

Government support for the wine industry

Cellar door schemes

Prior to 2004, wine producers had access to a maximum rebate of $42,000 for cellar door and mail order sales under the Australian Government Cellar Door Rebate scheme. This scheme was introduced in 2000 as part of the A New Tax System reforms with the states and the Commonwealth contributing to the cost of the scheme (the states paid 15 per cent and the Commonwealth the remaining 14 per cent). Prior to 2004, the Commonwealth also provided accelerated depreciation for grapevine plantings.[6]

Claiming through two government agencies proved to be administratively burdensome for the industry, so as part of the 2004 WET rebate reforms it was agreed that the Commonwealth would fund the new WET rebate in its entirety at 29 per cent. The intention of the Commonwealth was that the states would discontinue their cellar door rebate schemes; however some states continued to pay separate subsidies. The Victorian and South Australian State Governments continue to offer subsidy programs for cellar door and mail order sales of wine.

Introduction of the WET rebate

The WET rebate was introduced in 2004 with an initial maximum rebate amount of $290,000.[7] This was increased to a maximum of $500,000 in 2006.[8]

At the time of its introduction, the WET rebate effectively exempted an amount of $1 million of each producer's domestic wholesale wine sales from the WET on an annual basis.[9] Since 2006, the rebate effectively exempts approximately $1.7 million of each producer's domestic wholesale wine sales.

The stated intent of the WET rebate is to benefit small wine producers in rural and regional Australia. The explanatory material to the Bill to establish the WET rebate stated that a majority of wine producers would be able to fully offset their WET liability by accessing the WET rebate. In particular, small wine producers in rural and regional Australia would benefit by having their WET liability reduced or offset entirely.[10]

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6 This was discontinued as part of the WET rebate reforms: Tax Laws Amendment (Wine Producer Rebate and other Measures) Act 2004.

7 The WET rebate was introduced by Tax Laws Amendment (Wine Producer Rebate and Other Measures) Act 2004; see also the press release of the then Treasurer the Hon Peter Costello MP: http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2004/030.htm&pageID=003&min=phc&Year=2004&DocType=0.

8 Tax Laws Amendment (2006 Measures No. 3) Act 2006.

9 Australian Government 2004, *Budget 2004-05, Budget Paper No.2, 'Wine industry assistance — providing a wine equalisation tax producer rebate'*, Australian Government, Canberra, page 39: http://budget.gov.au/2004-05/.

10 Tax Laws Amendment (Wine Producer Rebate and Other Measures) Bill 2004: Explanatory Memorandum, paragraph 1.7. See also the press release of the then Treasurer the Hon Peter Costello MP: http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2004/030.htm&pageID=003&min=phc&Year=2004&DocType=0.

The WET rebate entitles individual wine producers to a rebate of 29 per cent of the wholesale value of eligible domestic sales up to a maximum rebate of $500,000 each financial year. The maximum rebate amount of $500,000 also applies to a group of associated producers.

To be eligible for the WET rebate, an entity must be a producer of wine. The term producer is defined quite broadly under the current provisions to include entities that are registered or required to be registered for the GST, and:

- have manufactured wine; or
- provided their produce to a contract winemaker to make wine on their behalf; or
- have subjected purchased wine to a process of manufacture. This includes blending a distinct finished wine from two or more different wines and further manufacturing raw or unfinished wine (including stabilising, fining and filtering, secondary fermentation, maturation and racking to clarify the wine by removing unwanted solids).[11]

In order to be eligible for the rebate, an entity must also be liable to pay WET on the wine or would have been liable to pay WET on the wine had the purchaser of the wine not quoted for the sale of the wine.[12]

Box 2: Operation of the WET rebate

Grape Winery has wine that has been made for it using both grapes from its own vineyard and grapes it has purchased. As it has no production facilities, it sends the grapes to Big Vine Winery and Big Vine Winery manufactures the wine under contract for a fee.

Grape Winery sells $15,000 worth of wine to Wine Distributions. It charges $1,500 in GST on the sale but no WET because Wine Distributions provided it with a quote.

Grape Winery remits the GST and claims a WET rebate of $4,350 on its next activity statement.

New Zealand rebate scheme

The New Zealand rebate scheme entitles New Zealand wine producers to a rebate of 29 per cent of the approved selling price of the wine in Australia. The approved selling price is the price for which the wine is sold net of any expenses unrelated to the production of the wine in New Zealand. The New Zealand scheme came into effect from 1 July 2005, and is in accordance with Australia's obligations under the *Australia-New Zealand Closer Economic Relations Trade Agreement 1983*.[13]

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11 Australian Taxation Office (ATO) 2009, *Wine Equalisation Tax Ruling, WETR 2009/2, Wine equalisation tax: operation of the producer rebate for other than New Zealand participants,* ATO, Canberra.

12 ATO 2009, *Wine Equalisation Tax Ruling, WETR 2009/2, Wine equalisation tax: operation of the producer rebate for other than New Zealand participants*, ATO, Canberra, page 6.

13 Article 7(2).

To be eligible for the rebate, a New Zealand winemaker must:[14]

- produce wine in New Zealand that is exported to Australia; and
- substantiate that WET was paid in Australia on the sale of the wine.

The New Zealand rebate only applies where the wine is ultimately sold in Australia. To fulfil this requirement, a New Zealand producer does not actually have to sell the wine in Australia. In fact, it is usually an Australian entity such as a wholesaler or distributor that makes the sale in Australia.

Box 3: Operation of the New Zealand rebate

Kiwi Wines (KW) is a wine producer that makes sauvignon blanc on the North Island of New Zealand. KW is not registered for GST in Australia. It sells A$20,000 worth of wine to Aussie Beverages, an Australian importer and wholesaler. Aussie Beverages imports the wine into Australia and quotes to Customs on importation as it intends to sell the wine wholesale in Australia.

Just before the end of the financial year, Aussie Beverages sells half of the shipment it bought from KW to a retail chain for A$17,028 (WET and GST inclusive).

Aussie Beverages provides a statement back to KW notifying it that Aussie Beverages has sold half the shipment and that WET was paid on that sale. Aussie Beverages remits the WET and GST on its next activity statement.

After the end of the financial year, KW lodges a claim for a rebate with New Zealand Inland Revenue (NZIR). In that claim it provides the following:

- New Zealand customs export entries;
- Australian customs import entry numbers;
- Aussie Beverages purchase invoice;
- the statement from Aussie Beverages that WET has been paid on the wine in Australia; and
- a worksheet showing how the rebate claim was calculated.

As a New Zealand producer, KW claims a rebate on the approved selling price. Therefore, the amount that KW is entitled to claim is A$2,900 (half of $20,000 x 29 per cent).

NZIR verify all the claim details and send the claim, with its supporting documentation, to the Australian Taxation Office (ATO) for payment.

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14 ATO website: https://www.ato.gov.au/Business/Wine-equalisation-tax/In-detail/WET-and-New-Zealand-wine-producers/Wine-equalisation-tax---producer-rebate-for-New-Zealand-wine-producers/.

The cost of the New Zealand rebate

The cost of the New Zealand rebate has risen each year since its inception, from under $6 million in 2006-07 to $25 million in 2013-14.[15] The rise is largely due to the increased value of New Zealand wine exported to Australia. In its 2011 report, the Australian National Audit Office (ANAO) found that another cause of this rise was an increased incidence of New Zealand grape growers accessing the New Zealand rebate by using contract winemakers' facilities to enable them to register as wine producers.[16]

WET as a source of revenue

In 2013-14 WET accounted for $826 million in Commonwealth revenue. In comparison, the 2013-14 revenue from excise and excise-equivalent customs duty on beer was $2,307 million; on spirits it was $1,902 million; and on other alcoholic beverages it was $908 million.[17]

Approximately 3,880 Australian entities pay WET. Of these, 20 taxpayers accounted for 89 per cent of the WET revenue in 2013-14. While the amount of the net tax paid by the remaining taxpayers is relatively low, these entities receive the bulk of the WET rebate and other credits ($270 million WET refundable in 2013-14).[18]

Due to the way in which entities report claims for the WET rebate on the Business Activity Statement (BAS) together with other WET credits, it is not possible to obtain the exact quantum of WET rebates claimed.[19]

However BAS data suggests that WET credit claims have increased every year since the introduction of the rebate in 2005, with $199 million of WET refunded in 2006-07 and $311 million in 2013-14.[20] The number of entities claiming WET credits has increased since 2007 (Chart 1).

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15 ATO 2015, Taxation statistics 2012–13, *Goods and services tax: Selected GST, WET and LCT items, 2001-02 to 2013-14 financial years*, ATO, Canberra.

16 ANAO 2010, *Administration of the Wine Equalisation Tax*, the Auditor-General, Audit Report No.20 2010-11, page 17, paragraph 30.

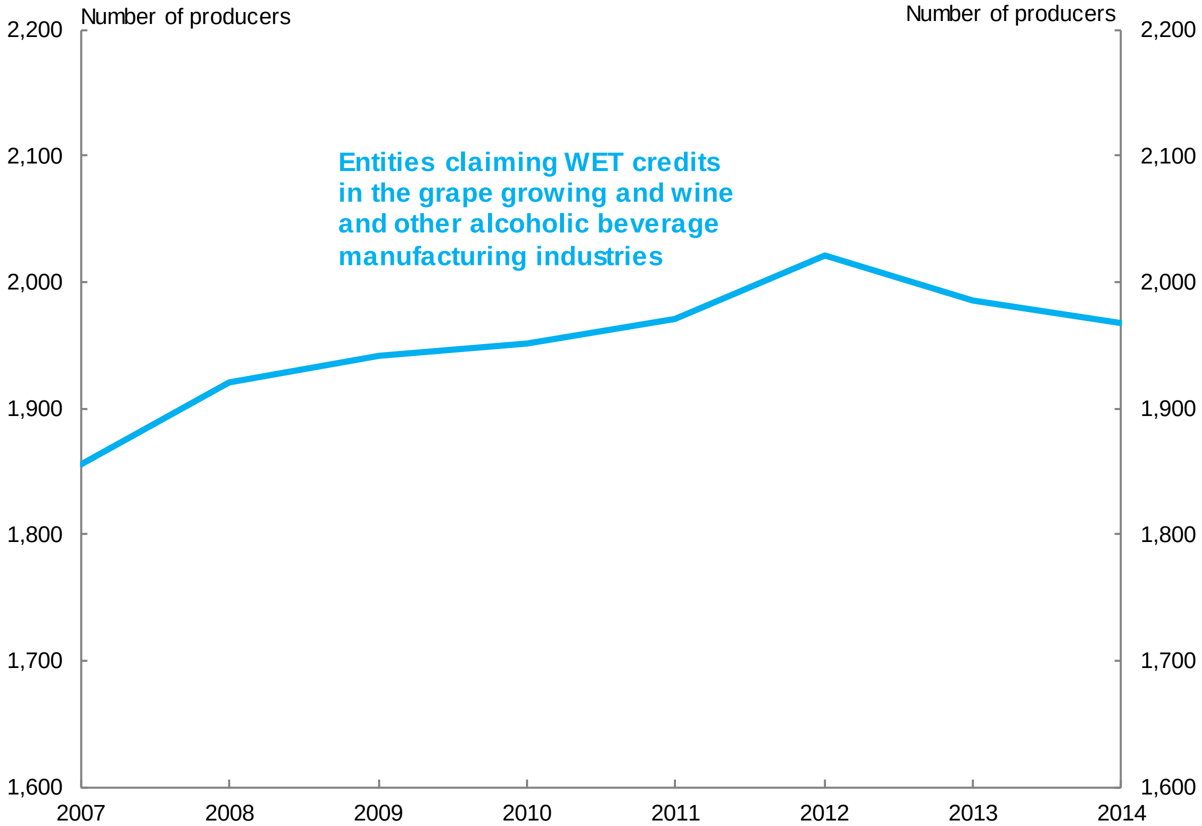
17 Commonwealth of Australia 2014, *Final Budget Outcome 2013-14*, *Table 4: Australian Government general government sector (accrual) revenue,* Australian Government, Canberra. Other alcoholic beverages are those not exceeding 10 per cent by volume of alcohol (excluding beer, brandy and wine). This includes so-called 'alcopops' or 'ready-to-drink' beverages.

18 ATO data.

19 WET credits include WET rebates, but also include: credits for overpaid wine tax; credits to avoid wine being taxed twice; export-related credits; import-related credits; and credits for bad debts.

20 ATO 2015, Taxation statistics 2012–13, *Goods and services tax: Selected GST, WET and LCT items, 2001-02 to 2013-14 financial years*, ATO, Canberra.

Chart 1: Number of entities claiming WET credits



Source: ATO data.

The majority of WET credit claimants claim amounts far less than the $500,000 WET rebate maximum. In 2013-14, of the 1,967 entities that claimed WET credits in the grape growing, wine and other alcoholic beverage manufacturing industries, 1,464 claimed WET credits of less than or equal to $100,000.[21]

21 The wine and other alcoholic beverage manufacturing industries include those entities who produce the variety of different alcoholic products that are considered wine for the purposes of the WET, including grape wine, grape wine products, fruit or vegetable wine, cider or perry, mead and sake.

3: Challenges presented by a changing industry

Background on the wine industry

Some facts and figures on the wine industry

- Wine production is a major agricultural industry in Australia, employing around 30,000 people directly, and many more indirectly.[22]
- Over 2,400 wineries and approximately 5,900 independent wine grape businesses operate in Australia, comprising mostly small operations located in all states and the Australian Capital Territory, but predominantly in South Australia, New South Wales and Victoria. Of these wineries, approximately 70 per cent crush less than 100 tonnes of grapes.[23]
- The number of wineries in Australia went from 2,299 in 2008 to 2,532 in 2012 and 2,481 in 2015.[24] Over the same timeframe, the number of grape growers decreased, from 7,915 in 2008 to 6,251 in 2012.[25]
- Australia is the seventh largest wine producing country, with around two-thirds of this wine exported and the other third consumed domestically. Export sales were valued at $1.89 billion in 2014-15,[26] and domestic sales of wine reached $2.37 billion in 2012-13.[27]

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22 Winemakers' Federation of Australia: http://www.wfa.org.au/information/noticeboard/wine-tax-unchanged-in-tough-budget/.

23 Winetitles 2015, *Australian and New Zealand Wine Industry* and Department of Agriculture.

24 Winetitles 2015, *Australian and New Zealand Wine Industry*.

25 Anderson K 2015, *Growth and Cycles in Australia's Wine Industry – A statistical compendium, 1843-2013*, University of Adelaide Press.

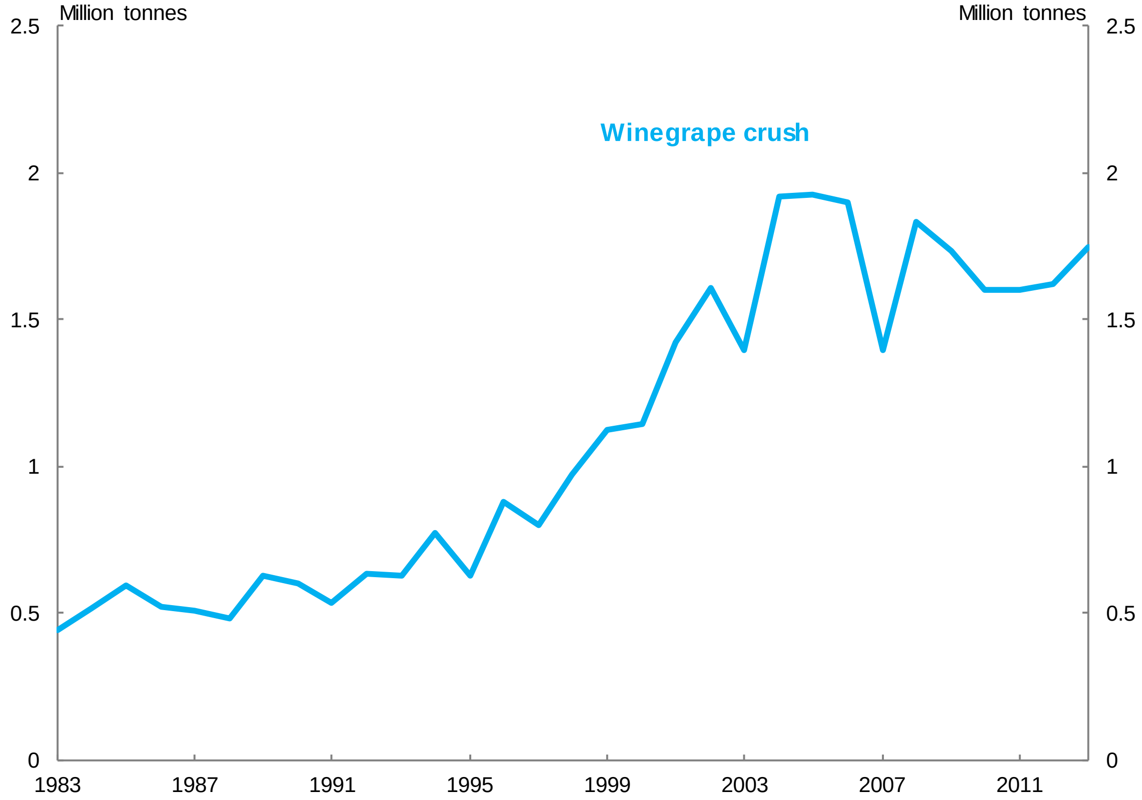
26 In the 12 months to 30 June 2015. Wine Australia June 2015, *Wine Export Approval Report*.

27 ABS 2013, *Australian Wine and Grape Industry*, 2012-13, cat. No. 1329.0, ABS, Canberra.

Wine grape crush and wine production

- Wine grape crush increased over time from 0.44 million tonnes in 1983 to a peak of 1.93 million tonnes in 2005. Since 2005, wine grape crush has remained relatively steady, with 1.7 million tonnes of grapes being crushed in 2014 (Chart 2).[28]
- Similarly, wine production increased until peaking in 2004 at 1,443 million litres and has been relatively steady since 2008.[29]

Chart 2: Wine grape crush



Source: Winetitles 2015, *Australian and New Zealand Wine Industry* and ABS 2013, *Australian Wine and Grape Industry*, 2012-13, cat. No. 1329.0, ABS, Canberra.

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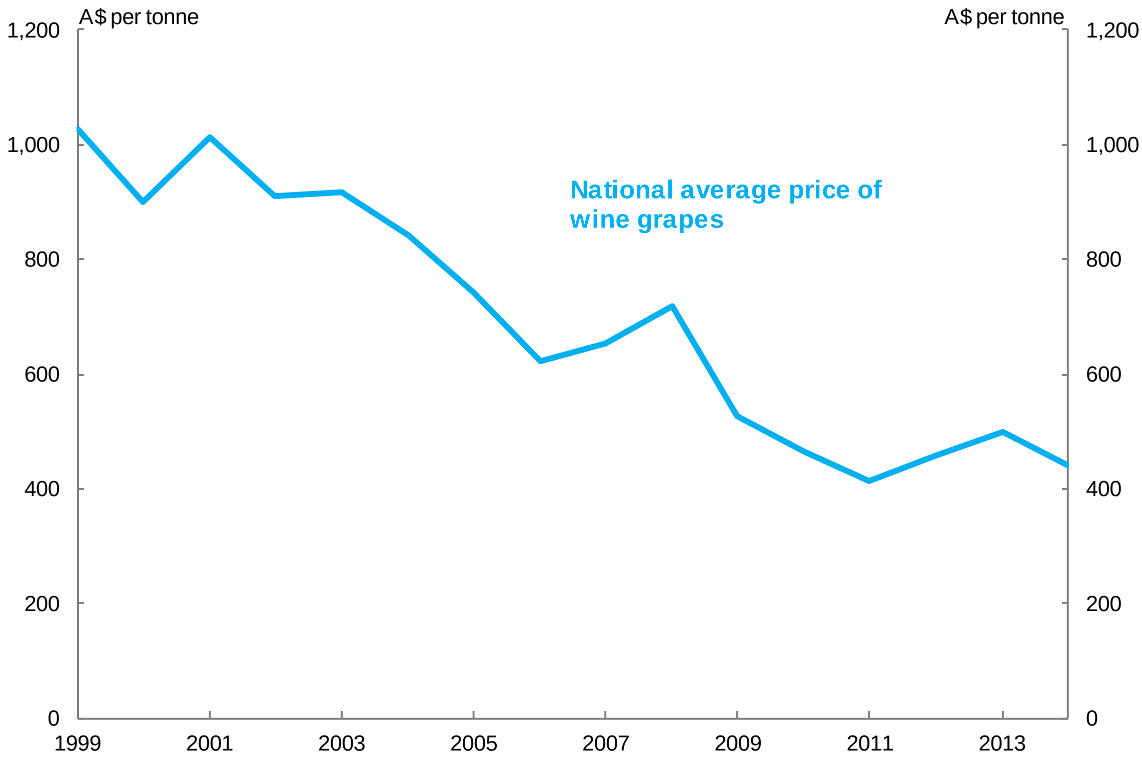
28 Winetitles 2015, *Australian and New Zealand Wine Industry* and ABS 2013, *Australian Wine and Grape Industry*, 2012-13, cat. No. 1329.0, ABS, Canberra. Note: Regarding ABS data, prior to the 2011-12 collection, estimates of grape crush, wine production and inventories and the value of domestic wine sales was produced from a partial coverage census of winemaking businesses that crushed 50 or more tonnes of grapes. The change in the survey design has resulted in a break in the data series between 2010-11 and 2011-12. Comparisons between data from 2010-11 and 2011-12 should be interpreted with caution. The impact of this change in coverage is an approximate increase of 6.0 per cent to 6.5 per cent in grape crush, wine production and wine inventories at a national level.

29 Beverage Wine Production. Winetitles 2015, Australian and New Zealand Wine Industry. This uses ABS 2013, Australian Wine and Grape Industry, 2012-13, cat. No. 1329.0, ABS, Canberra until 2012-13 and Winemakers Federation of Australia *Vintage Survey* data after 2012-13.

Wine grape prices

- Wine grape prices have fallen since 1999, when the average price for wine grapes was $1,026 per tonne, until 2014, when the average price for wine grapes was $441 per tonne (Chart 3).[30]
- Despite wine grape volumes increasing, total returns to wine grape producers have fallen over the same period (Chart 4).[31]
- Media attention on low grape prices in recent years has focused on prices offered to growers from warm inland regions, much of which has claimed that prices offered in 2014 were below the cost of production. The Winemakers' Federation of Australia 2015 Vintage Report found that 92 per cent of grapes produced in warm inland areas were unprofitable in 2015.[32]
- International bulk wine prices, which vary according to world grape production, also influence Australia's domestic wine grape prices.

Chart 3: Average wine grape price



Source: Australian Grape and Wine Authority, *Annual Price Dispersion Reports* and Anderson K 2015, *Growth and Cycles in Australia's Wine Industry – A statistical compendium*, 1843-2013, University of Adelaide Press.

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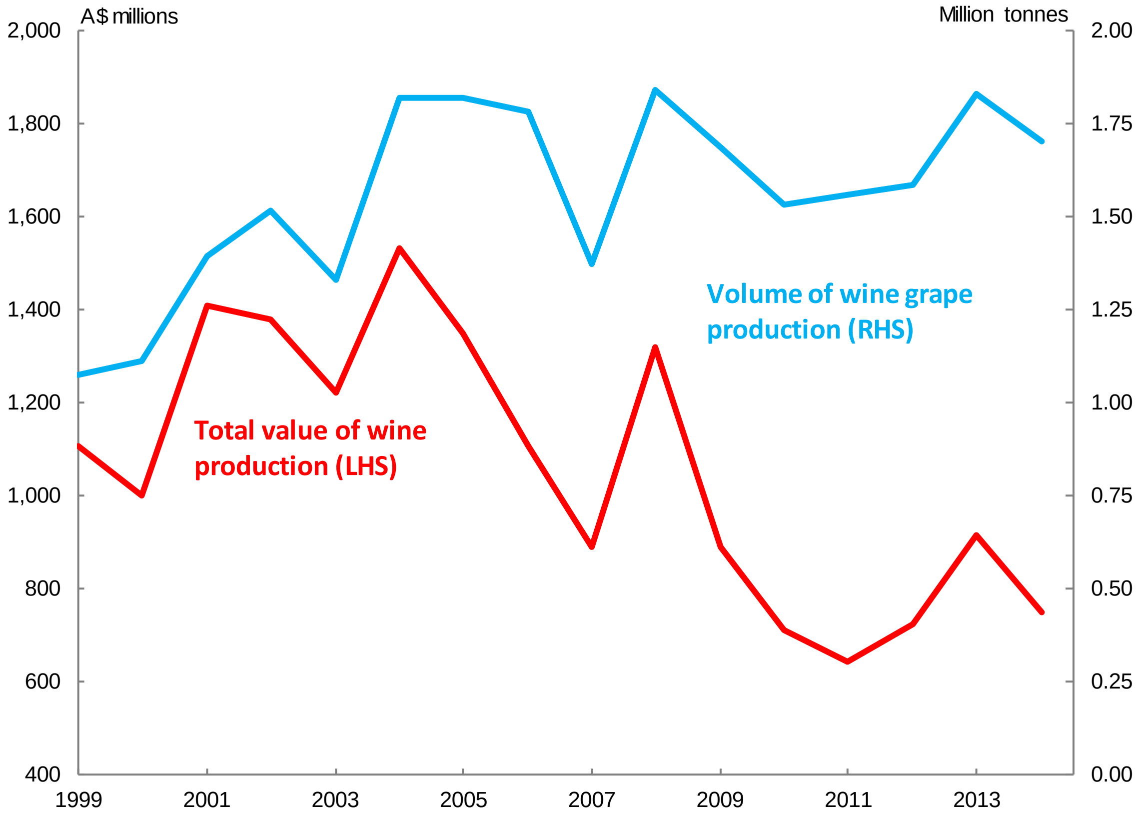
30 Australian Grape and Wine Authority, *Annual Price Dispersion Reports* and Anderson K 2015, *Growth and Cycles in Australia's Wine Industry – A statistical compendium, 1843-2013*, University of Adelaide Press.

31 Anderson K 2015, *Growth and Cycles in Australia's Wine Industry – A statistical compendium, 1843-2013*, University of Adelaide Press.

32 Winemakers' Federation of Australia 2015, *Vintage Report 2015*.

Chart 4: Wine grape: volume and value



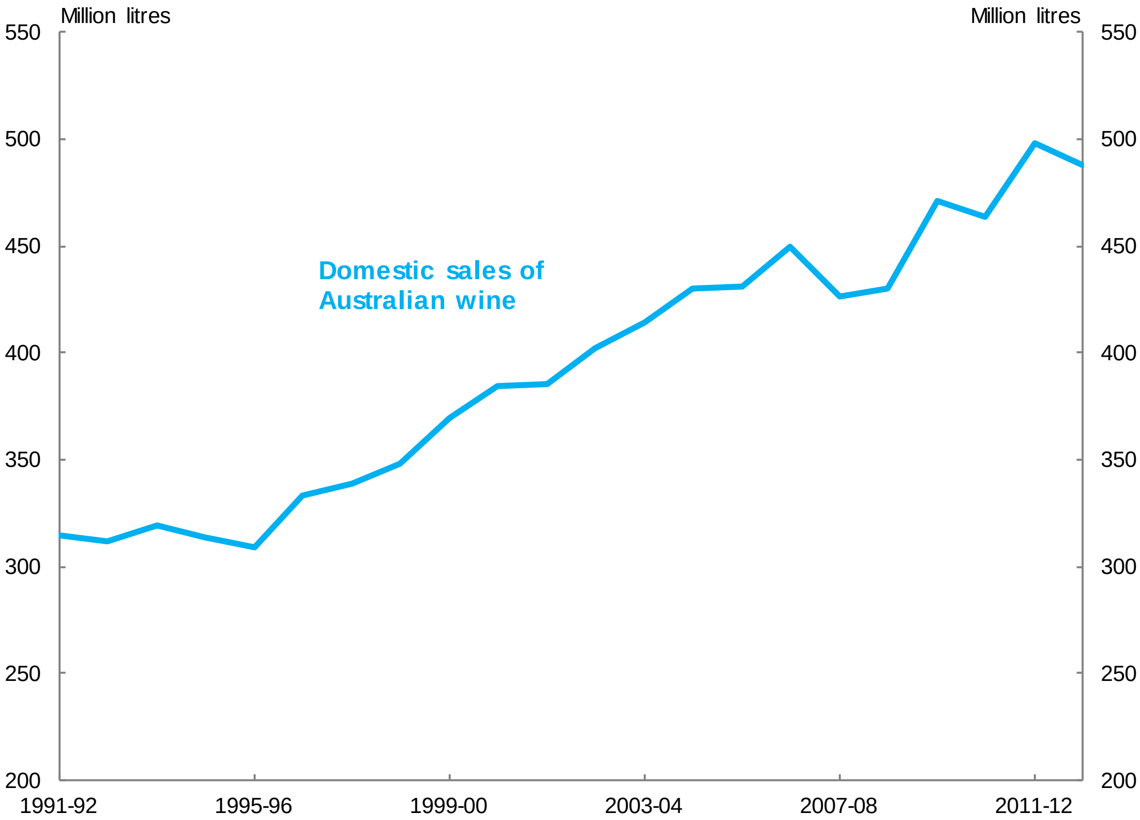
Source: Anderson K 2015, *Growth and Cycles in Australia's Wine Industry – A statistical compendium, 1843-2013*, University of Adelaide Press.

Domestic and export markets

- The volume of domestic sales of Australian wine has consistently increased since the early 1990s (Chart 5).[33]
- The value of domestic sales of Australian wine has remained relatively steady over time: in 1999-00 domestic wine sold for an average of A$4.69 per litre, in 2002-03 it was A$5.21 and in 2012-13 it was A$4.86.[34]

33 ABS 2013, *Australian Wine and Grape Industry*, 2012-13, cat. No. 1329.0, ABS, Canberra.
34 ABS 2013, *Australian Wine and Grape Industry*, 2012-13, cat. No. 1329.0, ABS, Canberra.

Chart 5: Domestic sales of Australian wine



Source: ABS 2013, *Australian Wine and Grape Industry*, 2012-13, cat. No. 1329.0, ABS, Canberra.

- The volume and total value of Australian wine exports increased in the 1990s and early 2000s, and peaked in 2007 when 786 million litres of wine, valued at approximately $3 billion were exported. Since then the volume and total value of exports have decreased such that in 2014-15 exports were 724 million litres, valued at approximately $1.89 billion (Chart 6).[35]

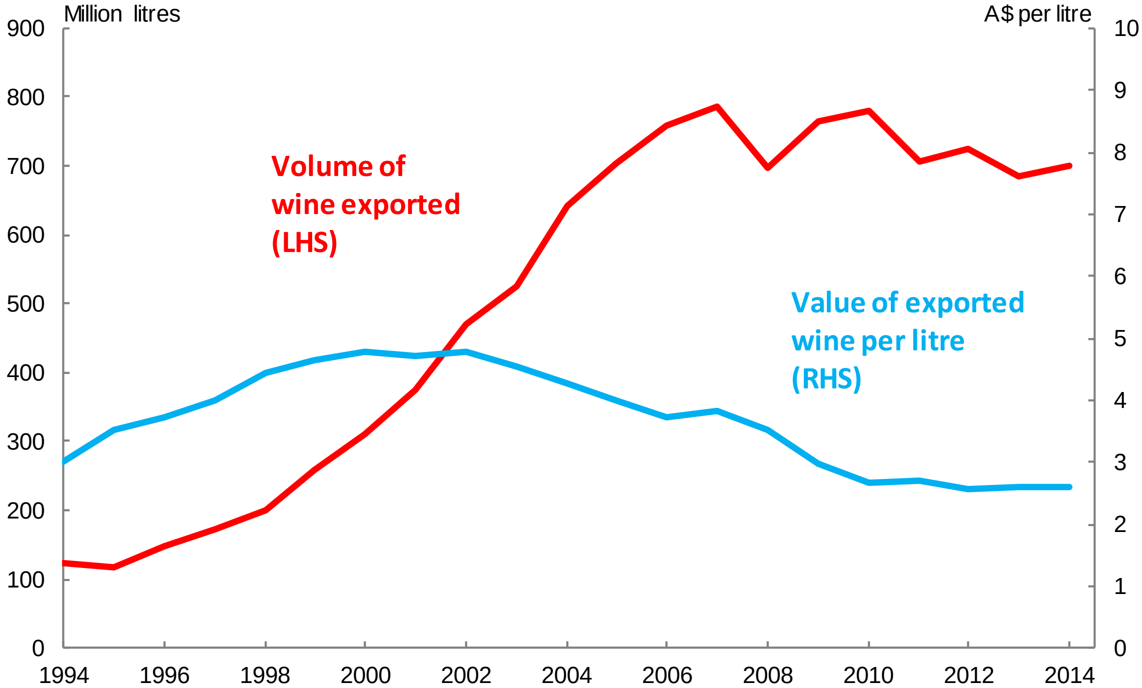
- Over time the average value of Australian export wine has decreased from a peak of A$4.79 per litre in 2002 to A$2.60 per litre in 2014.[36] Despite this, export volumes have not adjusted down significantly, instead increasing until 2007 before showing a relatively small decrease since then (Chart 6).

- Various factors may have influenced this behaviour. Some stakeholders take the view that the oversupply of Australian wine has been dumped at low prices in overseas markets and this has harmed the international brand image of Australian wine. The strong Australian dollar in recent years has also meant that exporters are paid less in Australia dollars for their wine.

35 In the 12 months to 30 June 2015. Wine Australia June 2015, *Wine Export Approval Report*.

36 Wine Australia December 2014, *Wine Export Approval Report*. Accessed through Winetitles 2015, *Australian and New Zealand Wine Industry*.

Chart 6: Wine exports: volume and value per litre



Source: Wine Australia (December 2014) *Wine Export Approval Report*. Accessed through Winetitles (2015) *Australian and New Zealand Wine Industry*.

- Despite the challenges for Australian wine exports since 2007, export performance strengthened slightly last year. In the 12 months to the end of March 2015, Australian wine exports increased by 3.6 per cent by volume and 3.9 per cent by value over the previous corresponding twelve months, the highest growth since 2007. Exports were assisted by the decline in the value of the Australian dollar against the United States (US) dollar.[37]

37 Wine Australia June 2015, *Wine Export Approval Report*.

Impact of the WET rebate

The decrease in export performance since around 2007 and other factors, including the value of the Australian dollar against the US dollar and increased competition from New Zealand producers in the domestic market, have contributed to the significant challenges facing the Australian wine industry. Large surpluses of grapes and wine have highlighted issues in parts of the wine industry, notably inefficient vineyard and wine operations.

In part due to the changing nature of the wine industry, the types of production for which the WET rebate is claimed have increased and the rebate is now supporting the wine industry in a way that was not envisaged when it was introduced.

Eligibility for the rebate is open to a relatively broad group of entities, including:

- grape growers who undertake manufacture themselves (that is, crush grapes and ferment the juice);
- grape growers who have the grapes processed into wine on their behalf;
- winemakers who purchase grapes and manufacture the wine;
- blenders and entities undertaking other further manufacturing processes;
- contract winemakers (in some cases);
- ‘virtual winemakers’ who have no involvement in the winemaking process (they do not own or lease vineyards, have no plant or equipment or a cellar door). These virtual producers acquire grapes and/or wine and contract out the manufacturing or blending process in order to claim the WET rebate;
- producers of branded wine where the producer owns the brand;
- producers of branded wine where the wholesaler or retailer owns the brand;
- producers of bulk and unbranded wine; and
- non-resident producers - producers that are based overseas but undertake winemaking in Australia.

As the ANAO noted in its 2011 report, the operating conditions in the industry have created a difficult environment for the administration of the WET rebate by the ATO.[38] A number of schemes have arisen in recent years for the purpose of improperly accessing the rebate. Wholesalers and retailers are also incentivised to minimise the amount of WET paid and maximise WET rebate claims. Some of these arrangements are within the law but have the potential to erode revenue, contrary to the original intent of the law.

Bulk wine purchases

There seems to be a growing trend in the wine industry for some wineries to purchase bulk wine from grape growers instead of purchasing grapes to make wine. This effectively enables wine grape growers to become wine producers and entitles them to claim the WET rebate on the wine sold to the winery. The WET rebate is then factored into the processing fee charged by wineries to produce the wine or into a lower price charged to the winery for the finished wine. This can provide a means for wineries to gain access to wine that is financially subsidised by multiple rebates.

Box 4: Bulk wine arrangements

ABC Winery (ABC) is a large producer who manufactures wine from its own grapes and grapes it obtains from other growers. In previous years, ABC would make wine for a cost of $1.36 per litre.

As it has sales in excess of $10 million per year, ABC is able to claim the maximum rebate of $500,000 early into the financial year. This means that on the majority of its sales there is no further rebate entitlement.

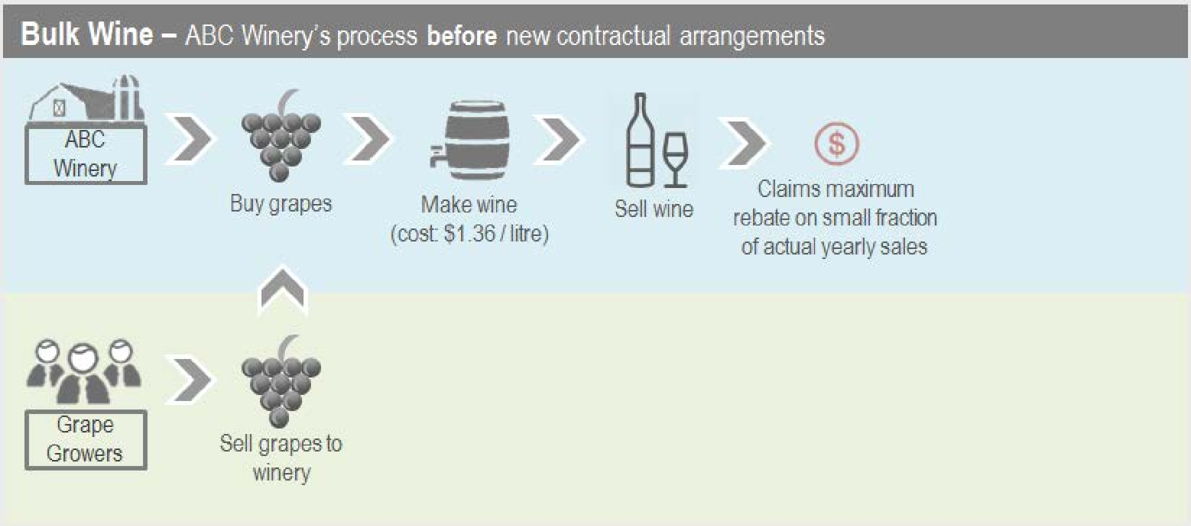
ABC changes its contracts with its growers so that the grower retains ownership of the grapes through the manufacturing process. ABC buys the resulting wine for $1.36 per litre (that is, at cost) and charges an inflated processing fee. Despite the cost of the wine being the same as it was under the previous arrangement, ABC has now derived a profit through the processing fee.

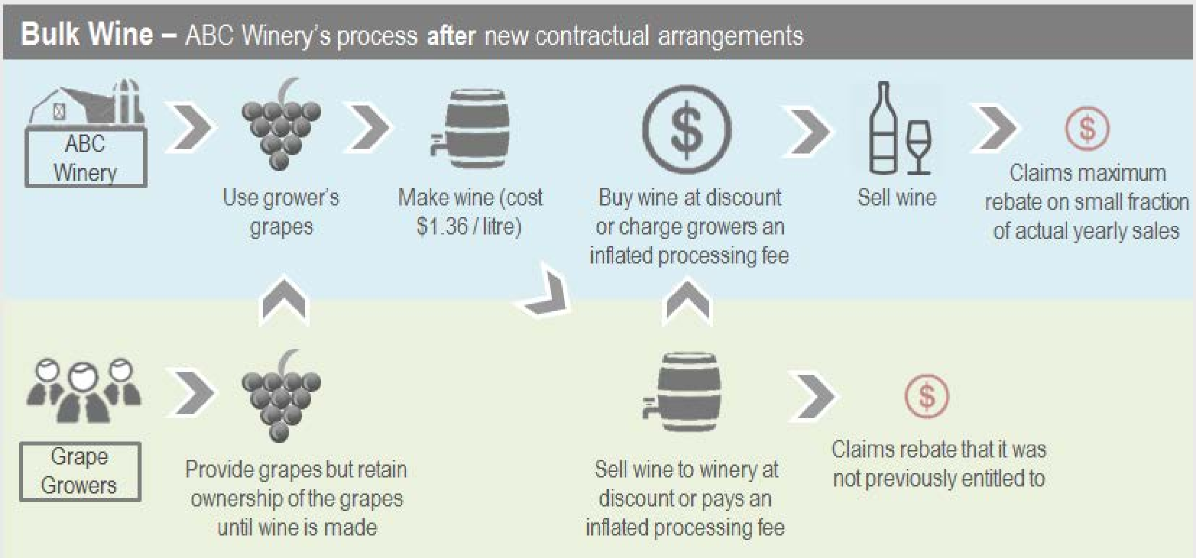
The rebate, which never previously existed as an entitlement to either ABC Winery or the growers, is now payable to the growers and enables them to use part of it to pay the higher production fees charged by ABC or, alternatively, to sell the wine to ABC at a reduced price.

Therefore, both the growers (by receiving a rebate) and ABC (by being paid for winemaking services and/or paying a reduced price for the resultant wine) financially benefit as a result of the changes to the contracts.

38 ANAO 2010, *Administration of the Wine Equalisation Tax*, the Auditor-General, Audit Report No.20 2010-11, page 17, paragraph 30.

Box 4: Bulk wine arrangements (continued)





Blending and further manufacture

There are concerns that producers are potentially able to claim more than one rebate for a given parcel of wine through blending and further manufacture. To do so producers undertake blending or further manufacture of wine, often by creating business arrangements involving additional interposed entities, solely so that the WET rebate can be claimed multiple times on the same wine.

These arrangements can be structured to circumvent changes in the law in 2012 that were intended to prevent multiple rebate claims on the same wine.[39]

39 Changes were made by the Tax Laws Amendment (2012 Measures No. 5) Act 2012.

Box 5: Blending arrangements

Adelaide Wines contracts Melbourne Winery to manufacture wine on its behalf. Adelaide Wines then sells the wine to Melbourne Winery and claims a WET rebate on that sale.

Melbourne Winery blends the wine with another variety and sells the resulting wine to Sydney Winemaker. Melbourne Winery is not entitled to claim a rebate on that sale as it has already exceeded the maximum rebate of $500,000 for that financial year. Melbourne Winery provides Sydney Winemaker with a notification that they are not entitled to a rebate.

Sydney Winemaker blends the wine with another parcel of wine it has purchased from Melbourne Winery and for which it also has a notification. As Sydney Winemaker has been notified that Melbourne Winery has not claimed an earlier rebate amount, Sydney Winemaker claims a rebate on the entirety of the wine when it sells it.

Changes in contractual arrangements

There are various ways that entities are able to restructure their contractual arrangements to inflate their rebate claims.

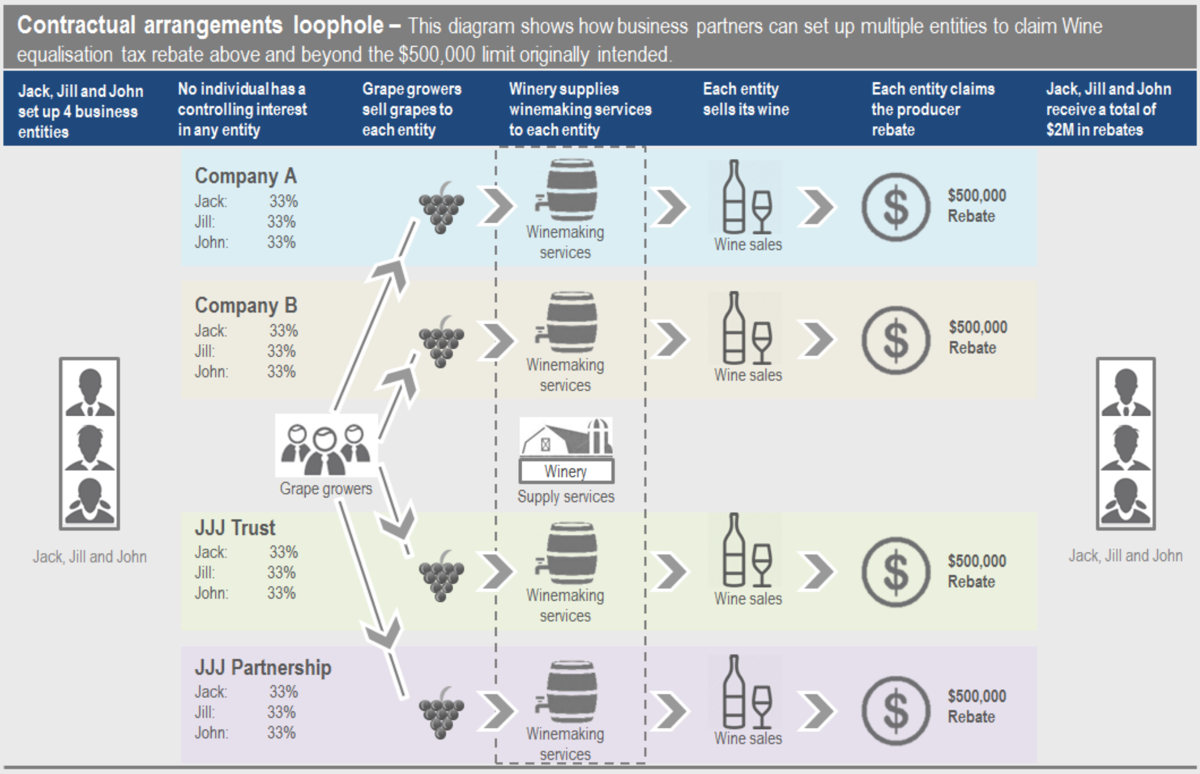
For example, medium to large producers may structure their businesses to circumvent the $500,000 WET rebate cap and obtain access to multiple rebates (see Box 6).

Box 6: Structures to access multiple rebates

Jack, Jill and John are friends. They each have a 33.3 per cent interest in four entities: Company A, Company B, the JJJ Unit Trust, and the JJJ partnership.

Each entity acquires grapes, has the grapes processed under contract at the same winery and sells the resultant wine. Because neither Jack, Jill nor John control any of the entities in their own right, and because none of the entities control any of the other entities, the four entities are not associated producers. Each entity is therefore able to claim up to $500,000 in rebates. So the same three investors, by producing wine via four entities, are able to claim $2,000,000 in total rebates.

Box 6: Structures to access multiple rebates (continued)



Another example is where winemakers who have exceeded the $500,000 WET rebate cap enter into arrangements with grape growers. In this type of arrangement, the winemaker makes grapes into wine while still under the ownership of the grape grower (see Box 4). The grape grower then sells the wine to the winemaker under a pre-arranged sale. This enables the grape grower to access the rebate and the winemaker to obtain the wine at a price subsidised by the rebate.

Winemakers selling their wine to wholesalers and distributors can inflate the sale price of the wine by including ‘promotional’, ‘marketing’ or other costs. The distributor then invoices the producer for these amounts to avoid paying the inflated price, however the producer claims the rebate on the inflated sale price (see Box 7).

Box 7: Inflating the sale price of wine

Grape Winery enters into a new distribution contract with Wine Distributions.
Grape Winery is a small winery that has only claimed around $200,000 in WET rebate in the previous years.

Grape Winery previously sold their merlot to Wine Distributions at $60 per case. The new contract specifies that the wholesale sale price for the merlot is $110 per case. It also specifies that Wine Distributions will charge Grape Winery a $50 per case fee for distribution networks, storage and marketing activities. No specific activities are listed in

Box 7: Inflating the sale price of wine (continued)

the contract except that Wine Distributions will list the merlot on its website.

All sales are under quote so there is no WET liability on the sales.

The price stated on Grape Winery's sales invoice is $110 per case. However, Wine Distributions only ever pays $60 per case to Grape Winery for the merlot.

Grape Winery calculates its rebate claim on the $110 price as per the invoice, inflating its rebate claim.

Wine Distributions sells the wine to retail outlets at $120 per case.

Virtual wine producers

Virtual wine producers are entities that claim the WET rebate despite having no involvement in the winemaking process (they do not own or lease vineyards and do not have plant or equipment or a cellar door). To claim the rebate, virtual producers acquire grapes and/or wine and contract out the manufacturing or blending process.

Some of these entities may exist for the sole purpose of claiming the WET rebate. Generally these entities are not legally related to the entity that benefits from the additional WET rebate claims, making these arrangements difficult to detect.

Box 8: Virtual wine producers

Frank has contacts in the wine trade. He learns that a parcel of excess grapes is available from a local vineyard and one of his contacts, who owns a nearby winery, has capacity to process the grapes and knows a buyer for the wine. Frank registers for GST, buys the grapes and has them processed at his contact's winery for a fee. Frank sells the resultant bulk wine, thus enabling him to claim a WET rebate.

4: The Future of the Rebate

Determining the purpose of the WET rebate

The previous chapter outlined some of the challenges faced by the wine industry and discussed whether the WET rebate is driving behaviour that is in effect exacerbating these challenges, in particular by encouraging the production of bulk wine which in turn encourages businesses structuring to obtain the rebate.

The WET rebate may be contributing to distorted production patterns of wine in a variety of ways, including:

- leading to oversupply of wine and wine grapes;
- preventing necessary industry adjustment – supporting otherwise unviable wine producers;
- preventing market consolidation – encouraging wine producers to remain fragmented in order to claim the WET rebate; and
- trapping businesses in the industry. Some businesses which would not be viable in the absence of the rebate may want to exit the industry, but are reliant on the cash flow that the WET rebate provides. In the absence of the rebate such businesses may transition out of the industry.

Some stakeholders are of the view that a sustainable wine industry is one where the production of high quality wine results in successful and recognisable brands in the export market. These stakeholders believe that, if Australian wine producers continue to focus on lower value wine, the wine industry will not be competitive and will not experience strong future growth, because Australian producers have higher costs of production than major competitors in the low price wine market.

As discussed in Chapter 2, the stated policy intent of the WET rebate is to support small winemakers particularly in rural Australia. However, the way that the law is currently drafted means that there are actually a number of potential recipients of the rebate along the production and distribution chain including: grape growers; manufacturers of wine; others who transform wine into a saleable product, including blenders of wine; and cellar door sellers of wine. In some instances, other entities such as wholesalers, despite not being direct recipients of the rebate, indirectly benefit from the rebate as it can enable them to drive down purchase prices and increase their profit.

The issue therefore arises as to whether the benefits of the rebate should be strictly directed to supporting small wineries or if there are other policy goals such as: supporting the export of Australian wine; promoting economically sustainable production; supporting small regional Australian wineries; and providing assistance for producers or others in certain circumstances (such as drought).

There are a number of ways in which the WET rebate could be changed to better align the benefit it provides with the future sustainability of Australia's wine industry. These might involve using the rebate to facilitate a restructuring of the wine industry, making changes to eligibility for the rebate, or restructuring the rebate to provide a fairer and more fiscally sustainable approach to the level of assistance it provides.

Discussion questions:

1. Is the WET rebate delivering benefits to the wine industry and/or contributing to distortions in the wine industry? How?
2. Is the future sustainability of the Australian wine industry linked to the production of high quality wine? How?
3. Is there a policy case to be made for the WET rebate continuing to operate in its current form?
4. How could the WET rebate be redesigned to better support the wine industry?
5. Should the purpose of the WET rebate be to support rural and regional winemakers only? How could this be achieved?
6. What other policy goals should the WET rebate pursue? Why?

Future directions for the WET rebate

Abolishing the rebate

Abolishing the WET rebate would remove distortions within the wine market caused by the rebate. The effective reduction in income would have the effect of causing the industry to restructure in a way that reflects current market conditions.

However, abolishing the WET rebate would have significant impacts on the wine industry. Many small and medium wine producers and some grape growers currently rely on the rebate to support and supplement their businesses. These entities may find it difficult to adjust and as a result these marginal growers and producers may exit the wine industry. While this could help to address the current oversupply of wine and wine grapes, individual businesses would bear the burden of the readjustment. Some geographical regions could be particularly affected, especially where grape growing is less efficient and reliance on the rebate is more pronounced.

Discussion questions:

7. Should the WET rebate be abolished? Why?
8. If the WET rebate was removed, what would be the likely effects for the wine industry?

Replacing the WET rebate with a grant scheme

In order to address the impacts of removing the WET rebate, transitional arrangements could be adopted to minimise harm to the wine industry and individual wine producers and growers. One example would be to phase out the rebate to give wine producers time to adjust. The WET rebate could be replaced with a grant to existing recipients.

The move from a rebate provided through the tax system to a grant arrangement would better reflect the change in the status of the payment as one of assistance to the wine industry which would be independent from the payment of the WET. The grant would be phased out over a period of time, providing support to industry while achieving structural adjustment.

Discussion questions:

9. Should the WET rebate be replaced with a grant scheme that would phase out over a defined period of time? Why/not?
10. Over what period of time should the grant phase out? What transitional arrangements should apply?
11. Are there other ways that the wine industry could be supported to restructure? What are they?

Changing the WET rebate

Excluding bulk, unpackaged and unbranded wine

The Winemakers' Federation of Australia (WFA) has put forward an option to restrict eligibility for the WET rebate by excluding bulk, unpackaged and unbranded wine. Under the WFA's model, eligibility for these products would be phased out by 25 per cent each year over four years and would have the effect of directing the WET rebate to wine businesses with an investment in regional Australia and that produce branded wine products.

The WFA's proposal would mean that entities that sell bulk wine as part of their current commercial practice would no longer be eligible for the rebate. Many of these producers tend to be in the lower value and more depressed sectors of the industry. Entities that currently make use of bulk wine could respond by circumventing the changes by revising their contracts to sales of packaged wine. This would enable the producers to still claim the WET rebate.

Limiting the WET rebate

Tightening the definition of ‘producer of wine’ to an entity that: manufactures the wine by undertaking the primary fermentation of the grapes, other fruit, vegetables or honey in Australia; [40] and owns the grapes, other fruit, vegetables or honey from which the wine is manufactured could reduce eligibility for the WET rebate. By allowing an entity to only claim the rebate on the proportion of the wine (by volume) that the entity fermented would still allow entities that blend purchased wine with their own wine to access the rebate.

This approach would reduce the claims for the rebate and eliminate structural arrangements that involve blending and other further manufacturing processes. It may also have an impact on virtual winemaking processes (where the virtual producer has no involvement in the winemaking process), particularly where the virtual producer does not undertake any primary fermentation of the wine. Where a producer acquires grapes and contracts out the winemaking process, it undertakes a primary fermentation process and would still likely be eligible for the rebate under this proposal.

This approach would not eliminate the structuring around producers who have exceeded the $500,000 WET rebate cap. Entities may still be able to enter into arrangements to supply larger producers with the wine that has had the financial benefit of the rebate (see for example Boxes 4 and 5 in Chapter Three).

Discussion questions:

12. Should eligibility to the WET rebate be restricted by excluding bulk, unpackaged and unbranded wine?
13. Should the definition of ‘producer of wine’ be amended to restrict claims for the rebate?

Demonstrating that WET has been paid on wine

Producers can claim the WET rebate for WET paid or for WET that they would have paid if the purchaser of their wine had not quoted their ABN. This means that producers can, and often do, claim the WET rebate without actually paying WET (as the WET is paid by somebody further down the production chain).

This also means that a WET rebate can be claimed before the WET is actually paid and that the amount paid in WET rebate has no correlation to the WET ultimately collected on later wholesale sales.

In contrast, under the New Zealand rebate scheme, the producer can only claim the rebate if it shows that WET was paid on the sale of the wine (that is, show that WET has subsequently been paid, further along the supply chain).

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40 The producer may not need to physically manufacture the wine themselves. The producer could also have it manufactured by another entity on its behalf (contract manufacture).

This approach could increase compliance costs on claimants, as wine producers would have to track the sale of their wine through the supply chain to claim the rebate.

Discussion question:

14. Should the WET rebate only be allowed for wine on which WET has been paid? Why?

Reducing the WET rebate cap

Reducing the maximum amount of the WET rebate (currently capped at $500,000 per financial year), would reduce the maximum WET rebate claimable for producers and reduce the overall WET rebates paid.

The majority of wine producers claim significantly less than $500,000. This means that reducing the cap may impact a relatively small number of larger wine producers. This could better target the rebate to smaller wine producers.

Reducing the WET rebate cap could result in behavioural changes, for example, an increase in structuring arrangements designed to access multiple rebate entitlements. It would not address the incentive that currently exists for large producers to structure their winemaking businesses into multiple entities. For example, for a producer who is currently claiming $300,000 per year, there would be an incentive to split its business across two entities to maintain its $300,000 yearly entitlement.

Rebate less than the full amount of WET payable

Providing the rebate at a percentage that is less than 100 per cent of the current WET rebate amount would also reduce the overall WET rebates paid. For example, the WET rebate could provide a rebate of 60 per cent of WET payable up to a maximum of $500,000.

Without changing the cap of $500,000, this would not reduce the maximum WET rebate payable to each producer. However it would mean that a producer of a certain size would receive a smaller rebate.

The impact would primarily be borne by smaller producers. The majority of producers claim well under the $500,000 maximum rebate and so their total entitlement would reduce by 40 per cent. For larger producers that have already exceeded the maximum WET rebate cap there would be little or no impact.

Discussion questions:

15. If the cap was reduced, what should the maximum WET rebate be?
16. If the rebate was only available for a proportion of the WET, what should that proportion be?

A smaller rebate for all alcohol producers

Replacing the WET rebate and the Brewery Refund Scheme (which has a maximum annual entitlement of up to $30,000) with a rebate scheme for all independent alcohol producers on the tax they paid (either WET or excise) would create a more level playing field for small producers of beer, wine and spirits. The rebate could be targeted at entities that:

- are legally and economically independent of any other entity that manufactures the product;
- sell the product directly from the production facility (a brewery, distillery or cellar door) either wholesale or retail; and
- pay excise or WET as applicable.

The consequences of this approach would be that:

- all legally and economically independent entities in the alcohol industry would be able to access a rebate;
- arrangements and schemes around the WET rebate that currently exist in the wine industry would be significantly reduced;
- non-resident entities that do not have production facilities in Australia would not be entitled to claim the rebate; and
- entities currently claiming in excess of the new maximum rebate amount may experience financial hardship, if they rely on the current rebate to ensure that their business is viable.

Removing the New Zealand rebate

Some stakeholders have expressed concerns that access to the rebate gives New Zealand winemakers a commercial advantage in that New Zealand producers can receive the rebate but do not pay the WET. However, eligibility for the New Zealand rebate is contingent on WET being paid on the wine and therefore there is no commercial advantage.

Adjusting the New Zealand producer rebate could have implications for Australia's international trade obligations, including under the *Australia and New Zealand Closer Economic Relations Trade Agreement 1983*. Australia's international trade law obligations provide that like imported products should be treated in the same way as domestic products under Australian taxation law.

Discussion questions:

17. Should New Zealand producers' access to the rebate be changed? If so, how?
18. Should the WET rebate be replaced by a small rebate for independent Australian alcohol producers such as wineries, distilleries and breweries?
19. Would any significant changes to the rebate require transitional arrangements to help the wine industry restructure? How should transitional arrangements be designed?

5: Summary of Discussion Questions

1. Is the WET rebate delivering benefits to the wine industry and/or contributing to distortions in the wine industry? How?
2. Is the future sustainability of the Australian wine industry linked to the production of high quality wine? How?
3. Is there a policy case to be made for the WET rebate continuing to operate in its current form?
4. How could the WET rebate be redesigned to better support the wine industry?
5. Should the purpose of the WET rebate be to support rural and regional winemakers only? How could this be achieved?
6. What other policy goals should the WET rebate pursue? Why?
7. Should the WET rebate be abolished? Why?
8. If the WET rebate was removed, what would be the likely effects for the wine industry?
9. Should the WET rebate be replaced with a grant scheme that would phase out over a defined period of time? Why/not?
10. Over what period of time should the grant phase out? What transitional arrangements should apply?
11. Are there other ways that the wine industry could be supported to restructure? What are they?
12. Should eligibility to the WET rebate be restricted by excluding bulk, unpackaged and unbranded wine?
13. Should the definition of ‘producer of wine’ be amended to restrict claims for the rebate?
14. Should the WET rebate only be allowed for wine on which WET has been paid? Why?
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