Submission to consultation on WET rebate tightened eligibility criteria





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About the Foundation for Alcohol Research and Education

The Foundation for Alcohol Research and Education (FARE) is an independent, not-for-profit organisation working to reduce the harm caused by alcohol.

Alcohol harm in Australia is significant. More than 5,500 lives are lost every year and more than 157,000 people are hospitalised making alcohol one of our nation's greatest preventive health challenges.

For over a decade, FARE has been working with communities, governments, health professionals and police across the country to stop alcohol harms by supporting world-leading research, raising public awareness and advocating for changes to alcohol policy.

In that time FARE has helped more than 750 communities and organisations, and backed over 1,400 projects around Australia.

FARE is guided by the World Health Organization's *Global strategy to reduce the harmful use of alcohol*[*] for stopping alcohol harms through population-based strategies, problem directed policies, and direct interventions.

If you would like to contribute to FARE's important work, call us on (02) 6122 8600 or email info@fare.org.au.

[*] World Health Organization (2010). *Global strategy to reduce the harmful use of alcohol.* Geneva: World Health Organization.

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Summary

The alcohol taxation system is a complex arrangement that does not adequately recognise the extent of harms that result from the consumption of alcohol in Australia. It has been described as illogical and incoherent, and there have been multiple calls from government reviews for taxation reform. The most illogical part of the alcohol taxation system is the Wine Equalisation Tax (WET). Wine is taxed on an ad valorem basis under the WET, based on the wholesale price of the product. This is in contrast to all other alcohol products sold in Australia, which are taxed on the basis of the volume of pure alcohol within the product.

The WET provides an incentive to produce large volumes of low quality wine. This is concerning because low prices increase the level of consumption and lead to higher levels of alcohol harm. The WET favours large producers, who benefit from greater economies of scale and are therefore able to produce cheaper bulk wine. To counter this distortion, the WET rebate was introduced to support small rural and regional wineries in Australia who were disadvantaged under the WET.[1] This is an inefficient and wasteful arrangement that has led to a system that is not achieving its objectives, with some producers receiving the rebate even though they have remitted no WET.

Rorting of the system has also occurred, with some businesses creating complex company structures to claim the rebate at several phases of production or with different companies at the same level in the supply chain. In addition, New Zealand producers have benefited from access to this rebate, which was designed to support small regional Australian producers. The WET rebate has also created structural problems within the industry and encouraged an oversupply of wine.

The WET and WET rebate represent corporate welfare by providing a significant subsidy to the wine industry. The Australia Institute estimates that the level of subsidy provided to the wine industry is in excess of $1 billion per year.[2]

The proposed changes to the WET rebate eligibility in the 2016-17 Commonwealth Budget go some way to addressing the rorting of the system that is occurring. However, it is disappointing that the proposed changes fundamentally fail to consider the broader context of the WET and alcohol taxation more broadly. Taxation of alcohol aims to generate revenue and address the negative externalities associated with its consumption. Despite this, the WET and WET rebate run counter to these objectives. They contribute to significant harm within the community and to problems within the industry by incentivising the production of cheap wine, supporting unprofitable enterprises, and creating wasteful economic distortions.

This submission

While the WET rebate has been identified as a priority area for reform, there are a variety of issues affecting alcohol tax in Australia. These issues have resulted in adverse health outcomes and wasteful economic distortions. Accordingly, this submission addresses both elements of the *WET rebate tightened eligibility criteria implementation paper*, and issues associated with alcohol taxation more generally.

Recommendations

1. That Treasury restrict the eligibility for WET rebate to businesses with a turnover of less than $2 million.
2. That Treasury recommend reforming the alcohol taxation system by replacing the Wine Equalisation Tax (WET) with a volumetric tax rate and abolishing the WET rebate through a phased approach. This should include:
    - transitioning to a differentiated rate that is based on the alcohol content of wine.
    - an increase to the excise rates on all alcohol products by a minimum of ten per cent.
    - indexation of alcohol excise rates to average weekly ordinary time earnings, rather than the Consumer Price Index, to ensure that the cost of alcohol does not reduce relative to personal income.

Harms resulting from the current taxation system

The harms associated with taxing wine on an ad valorem basis, while other products are taxed based on volume of pure alcohol, are both economic and health-related. Research from the Parliamentary Budget Office identified that the effective rate of taxation on $15 cask wine (4L) in 2014-15 was $2.99/LAL, compared with an average across all alcohol classes of $36.05/LAL.[3] That is, tax on cheap cask wine in 2014-15 was 8.3 per cent (or less than 1/12) of the average rate across all classes of alcohol. Other categories of wine also had excise rates markedly lower than the average, including $7 bottles and $15 bottles (with rates of $7.97/LAL and $17.07/LAL respectively).[4] More expensive wines, however, are taxed higher than the average rate. For example, a $40 bottle pays an effective rate of $45.54/LAL.[5]

By applying lower tax to cheap wine and higher tax to expensive wine (relative to the rates applied to other alcohol products), the WET creates perverse incentives for the production of cheap bulk wine. It also presents a disadvantage to premium wine producers, who pay higher rates of excise relative to premium products in other alcohol classes (such as beer). In fact, to account for the disadvantage presented to smaller producers under the WET system, the WET rebate was purportedly introduced to support small wine producers in rural and regional Australia. Despite this, no limit is applied with respect to the size or location of businesses accessing the rebate. As such, a market distortion is created by applying tax to wine (and cider) in a manner that is not consistent with other alcohol products. This distortion has been addressed through a rebate to assist sections of the industry that are disadvantaged by the system, but is not restricted to businesses that experience the disadvantage.

The production of cheap wine affects not only the wine produced for domestic markets but also those destined for export.[6] This is a risky strategy since this market segment is price sensitive, fiercely competitive on a global scale, and operates on low profit margins.[7] Australia's largest producers have publicly criticised the WET for incentivising production of bulk cheap wine that has the potential to damage the reputation of Australian produce internationally.[8]

Through incentivising the production of cheap wine, the WET is also detrimental to public health. Research has demonstrated that the heaviest drinkers favour cheap alcohol.[9] That is, individuals that are dependent on alcohol and are most at risk of lifetime harm favour cheaper products. The basic economic principle of elasticity suggests that increased financial availability results in greater demand for a product. Put simply, cheap bulk wine results in higher consumption (particularly among the heaviest drinkers) and subsequent alcohol-related harm.

The case for change

Reducing harm through a volumetric tax

Taxation is the most cost-effective approach to reducing alcohol harm, and is strongly supported by research both within Australia and internationally.[10] Of the available intervention approaches, setting a reasonable minimum price for alcohol through the imposition of volumetric taxes on alcohol is considered the most effective means for reducing alcohol harm.[11] It would be effective in providing additional public revenue and in reducing harmful consumption,[12] particularly among heavy drinkers.[13] Indeed, international research shows that this is the most effective means of targeting harmful drinkers.[14] In Australia, research has demonstrated that the heaviest drinkers are most responsive to price.[15] An increase in price through the equitable taxation of wine would therefore result in the largest reduction in consumption among drinkers most at harm of long-term risk. Moving the WET to a volumetric tax would deliver large and sustained health benefits.[16]

Transitioning to a volumetric tax is likely to reduce the harmful results of alcohol consumption among young people in particular. Policies that increase the price of alcohol lead to a reduction in the proportion of young people who are heavy drinkers, a reduction in underage drinking, and a reduction in per occasion 'binge drinking'.[17] Recent research found that a one per cent increase in price due to taxation, resulted in a 1.4 per cent reduction in binge drinking by adults (defined as drinking at or above levels associated with intoxication).[18] This research extends evidence that increasing the price of alcohol through taxes is effective in reducing not just overall consumption, but high-risk consumption.[19,20]

Support for reforming the WET system

There is broad support for overhaul of the alcohol tax system. In addition to a variety of government reports recommending such reform (with many specifically recommending a transition to volumetric tax), alcohol industry businesses and representing bodies have also advocated for change. To date, at least ten government reviews have concluded that the alcohol tax system should be overhauled.[a]

Foremost among these was the 2009 Henry Review, which determined that reforming the WET was a matter of urgency for the Australian Government.[21] In 2011-12, the Australian National Preventive Health Agency (ANPHA) concluded that the WET required reappraisal.[22] In its final report, ANPHA

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[a] Reviews that have recommended a volumetric tax be applied to wine include:

- the 1995 Committee of inquiry into the wine grape and wine industry
- the 2003 House of Representatives Standing Committee on Family and Community Affairs inquiry into substance abuse
- the 2006 Victorian inquiry into strategies to reduce harmful alcohol consumption
- the 2009 Australia's future tax system (Henry Review)
- the 2009 National Preventative Health Taskforce report on *Preventing alcohol related harms*
- the 2010 Victorian inquiry into strategies to reduce assaults in public places
- the 2011 WA Education and Health Standing Committee inquiry into alcohol
- the 2012 Australian National Preventive Health Agency *Exploring the public interest case for a minimum (floor) price for alcohol, draft report*
- the 2012 Australian National Preventive Health Agency *Exploring the public interest case for a minimum (floor) price for alcohol, final report*
- the 2014 House of Representatives report on the *Inquiry into the harmful use of alcohol in Aboriginal and Torres Strait Islander communities*.

stated that, “There was strong endorsement from a wide range of stakeholders for a volumetric tax on all alcohol products and many noted, referring to the Henry Tax Review, that reform of the WET could have similar effects in reducing alcohol harm as those of a minimum price”.[23]

The Henry Review stated that the “current alcohol taxes reflect contradictory policies… As a consequence, consumers tend to be worse off to the extent that these types of decisions to purchase and consume, which may have no spillover cost implications, are partly determined by tax”.[24] The Henry Review recommended that alcohol taxes should be set to address the spillover costs imposed on the community of alcohol abuse.

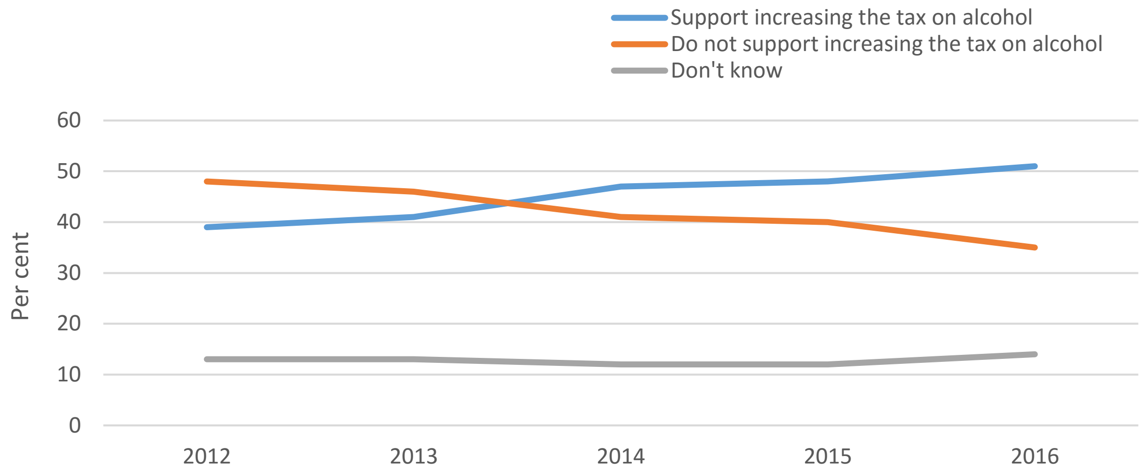
Within the alcohol industry, the Distilled Spirits Industry Council of Australia[25] and Brewers Association,[26] as well as two of the largest wine producers and a variety of boutique producers, are supportive of reforming the WET. There is a common misconception that the wine industry is not supportive of alcohol taxation reform. To the contrary, there is now evidence of support from large, medium, and small producers within the industry.

Treasury Wine Estates and Pernod Ricard Winemakers are the two largest wine producers in Australia, making up 20.1 per cent of Australian wine production.[27] Treasury Wine Estates has stated that, “The phenomenon of very cheap wines seen in Australia in recent years is a further unintended consequence of the WET rebate, and adds weight to calls to remove or fundamentally reform the scheme”.[28] Former Chief Executive David Dearie used stronger language in another forum, calling for the scrapping of the WET and WET rebate and saying that it is “widely rorted, underpins the excess supply that has blighted Australian wine”.[29] Pernod Ricard Winemakers (previously Premium Wine Brands) have also publicly criticised the WET, advocating instead for a volumetric system.[30]

Commentary from within the wine industry suggests that there are several other small and medium sized producers who acknowledge that the industry would benefit from reforming the WET. Jeremy Oliver, an Australian wine writer and presenter has written, “Is there any sense in any aspect of the current taxation environment? If so, I can’t see it. Surely it’s time to fix this thing before the collateral damage it directly causes gets even worse”.[31] Westend Estate Wines (now Calabria Family Wines) says that, “The Wine Equalisation Tax is having a negative impact throughout the domestic market, and virtual wineries with no long-term vision are abusing the system which was put in place to benefit the smaller wineries”.[32]

There is also increasing support for higher taxes on alcohol among the public. Independent polling conducted by Galaxy Research revealed that the majority (51 per cent) of Australian adults support increasing alcohol tax, while the proportion that do not support increasing the tax has reduced to 35 per cent (see Figure 1).[33]

Figure 1. Support for increasing tax on alcohol, 2012 to 2016



Source: Foundation for Alcohol Research and Education (FARE), *Annual alcohol poll*, 2012 to 2016.

The future of the WET rebate and alcohol taxation

WET rebate eligibility

Proposed amendments to the WET rebate, albeit go some way, but fall well short of reducing the economic distortions and rorting that have resulted from the current policy settings. Reducing the scale, and tightening eligibility by introducing definitions for eligible products and producers, will help to reduce the deliberate rorting that has occurred.

However, the recommended reforms fail to ensure the eligibility for the WET rebate reflect its intentions in supporting small producers in regional and rural areas. In particular, there appears to be no limit applied to the size of businesses accessing the rebate. It is therefore recommended that eligibility is restricted to small businesses. This should be defined as those with a turnover of less than $2 million, consistent with the definition applied by the Australian Taxation Office.[34]

Recommendation

1. That Treasury restrict the eligibility for WET rebate to businesses with a turnover of less than $2 million.

Alcohol taxation

Review of Australia’s alcohol taxation needs to prioritise reforming the WET, the most inequitable part of the taxation system. A staged approach for alcohol taxation reform may be introduced, including three transitionary phases identified below.

Phase 1 – Transitioning to a volumetric system and discontinuing the WET rebate

The WET must move to a volumetric tax as a matter of urgency. In order to allow time for businesses and consumers to adjust to the changes, a transitionary arrangement could first set a rate that is revenue-neutral relative to the amount currently received under the WET. Independent modelling[35] suggests that this arrangement would result in:

- an increase in the price of non-premium cask wine of 28.54 per cent, and a corresponding 8.5 per cent reduction in consumption.
- a small decrease (of less than one per cent) in the consumption of beer
- a decrease in total alcohol consumption of just under one per cent
- an increase in revenue of $73 million per annum (through taxes other than alcohol tax as a result of economic stimulus).

Under a volumetric system, it is no longer necessary to subsidise businesses disadvantaged by the current system. The WET rebate may therefore be discontinued, saving an additional $333 million per annum.[36]

A volumetric tax system would support the viability of smaller producers by taxing wine based on alcohol content rather than price. This would support premium wine brands and maintain the reputation of Australian wines internationally. As such, the $50 million in corporate welfare earmarked for the wine industry will not be necessary. Instead, boutique wines would be supported by an equitable alcohol tax system that rewards quality rather than bulk production. It is recommended, therefore, that corporate welfare to the wine industry is discontinued, with support to tourism and boutique wine exports provided by an equitable and economically-sound volumetric approach.

Phase 2 – Introducing a differentiated rate for wine, consistent with other alcohol products

Wine should then be transitioned to a rate that appropriately reflects its alcohol content. Other alcohol products, including beer and spirits, are currently charged a differentiated volumetric rate based on their alcohol content. Stronger products, such as spirits, are charged a higher rate, reflecting their susceptibility to abuse and subsequent alcohol harm. To apply a rate of tax commensurate to its strength, wine should be taxed at a rate halfway between full-strength beer and spirits.

Modelling undertaken by ACIL Allen Consulting[37] suggests that, relative to current levels, this rate ($56.46/LAL at time of research) would result in:

- an increase in tax revenue of $2.3 billion per annum
- a 30 per cent reduction in the consumption of cask wine
- a decrease in total alcohol consumption of 7.1 per cent.

Phase 3 – Increasing excise on all alcohol products by ten per cent

Finally, while excise rates have been indexed to the Consumer Price Index, they have reduced relative to income. To ensure that the cost of alcohol does not reduce relative to personal income in the future, excise rates should be indexed to average weekly ordinary time earnings. This approach would be consistent with excise rates applied to tobacco products, and recognise that alcohol consumption should not increase with prosperity. To reinstate an appropriate level of excise, a ten per cent increase should be applied to excise on all alcohol products.

ACIL Allen Consulting modelling[38] suggests that moving wine and cider to a volumetric tax at a rate half-way between full-strength beer and spirits, and applying a ten per cent increase to excise charged on all alcohol products, would result in:

- a reduction of alcohol consumption by 9.4 per cent
- an increase revenue by $2.8 billion per annum.

Recommendation

2. That Treasury recommend reforming the alcohol taxation system by replacing the Wine Equalisation Tax (WET) with a volumetric tax rate and abolishing the WET rebate through a phased approach. This should include:
    - transitioning to a differentiated rate that is based on the alcohol content of wine
    - an increase to the excise rates on all alcohol products by a minimum of ten per cent
    - indexation of alcohol excise rates to average weekly ordinary time earnings, rather than the Consumer Price Index, to ensure that the cost of alcohol does not reduce relative to personal income.

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