Submission to Australian Government - Wine Equalisation Tax Rebate - Tightened Eligibility Criteria

Our association represents 95 of approximately 130 wine producers located in the Hunter Valley region of NSW. We participated in the NSW consultation meeting held on 22 September 2016, and have been actively involved in the development of the positions put by the WFA and NSW Wine Industry Association to Government in recent meetings.

The purpose of this submission is to summarise the HVWTA position on the discussion questions you have put to industry concerning Government's proposed approach to implementing the tightened eligibility criteria. In order to put our comments in perspective, we have first provided relevant background to the WET Rebate considerations that are directly related to the wine-tourism centricity of our region.

1. Background to The Hunter Valley Wine Region

1. The Pokolbin and Broke/Fordwich wine sub-regions in the Hunter Valley region cater for the largest number of wine tourists of any wine region in Australia. The Hunter Valley is the second most visited tourism destination in NSW. It is also the oldest wine region in Australia. There are around 136 wine producers located in the Hunter Valley, of which only four are related to national brand wine producers. These producers host cellar doors, and many have bistro, restaurant and event facilities, attracting tourists and generating growth in related regional tourism businesses.

2. Our region is characterised by a small number of medium scale producers and a large number of small producers. Based on annual membership returns to our association, the top 22 wine producers each crush between 100-2500T of grapes each year. 77% by number of our total wine producers each crush less than 100T every vintage, with many in the 10 - 30T range.

3. In June 2016 the WFA conducted a survey on the impact that the proposed budget changes would have on each wine business that responded. The table in Attachment 1 summarises the responses and further breaks down the tonnes crushed for the Hunter Valley region.

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4. To demonstrate the contribution of wine sold Direct to Consumer (DTC) to wine producers in our region we sampled 15 of the top 30 wineries in the Hunter region.[1] The pie chart below shows that almost 50% of wine from the larger wineries is sold DTC, through cellar doors and wine clubs. Bulk and Unbranded wine sales are negligible for this region.

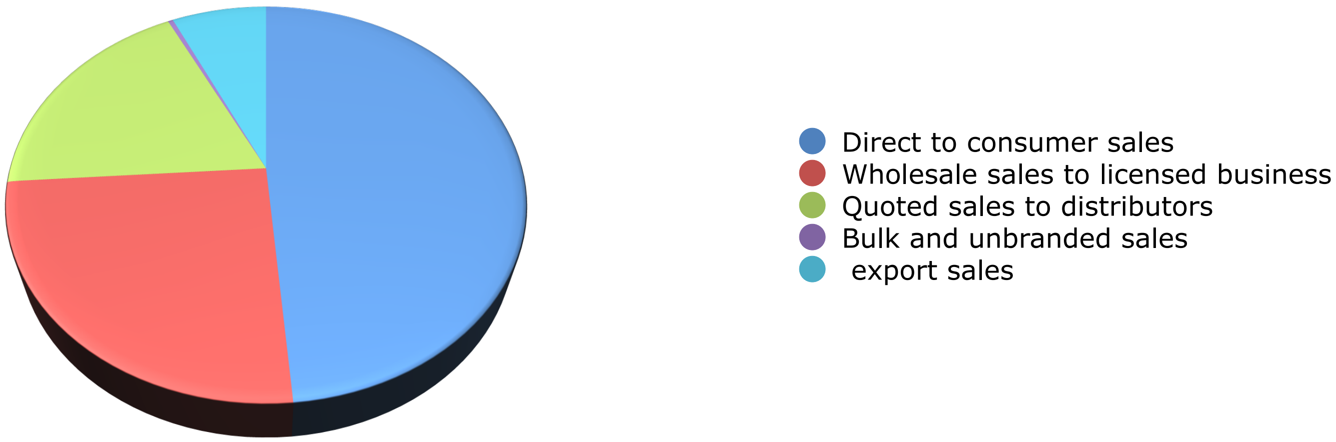

Chart 1. Wine sales by market segment/value sold by a sample of the large/medium Hunter Region Wine Producers in FY2016. (Total sales: $75.381m)

5. The Hunter Valley region survey responses to the June 2016 WFA industry survey confirmed that the most of these wine producers sell the majority of their wine produced DTC. Of a population of 62 respondents, the table below shows the percentage of sales for FY2015 for domestic rebatable wine.

Table 1. Profile of Hunter Valley Regional DTC Wine Sales from WFA Survey

Survey Respondents	Did not provide response	0-80% Domestic Sales of Rebatable Wine	81-90% Domestic Sales of Rebatable Wine	91-99% Domestic Sales of Rebatable Wine	100% Domestic Sales of Rebatable Wine
Number of Wine Producers	2	7	3	12	38
% of Sample	na	11	5	19	61

[1] The survey used actual BAS data for the year ending 30/6/2016, supplied under confidentiality agreement to Saywell Accountants. They complied a spreadsheet that contained the contributed dat for 15 of the largest wine producers, preserving the confidentiality of each wine producer but insuring the integrity of the data.

6. DTC markets (either via cellar door or through membership wine clubs and internet direct sales) are vital for all our wine producers, and their cellar doors and other facilities, concerts and wine events attract visitors to the surrounding regional tourism industry participants such as resorts, restaurants, gardens, golf courses and other tourism experiences. Additional investment has been made in building cellar door assets, and operating cellar doors on weekends and public holidays incurs additional costs when contrasted to producers in other regions that wholesale the majority of their production.

7. While we support the need for both tightened eligibility criteria to improve integrity of the rebate, and the earlier introduction of these tests to preserve budget neutrality, we suggest that Government recognises the importance of continuing to support the original intent of the WET rebate. That is, to support the development of regional wine businesses and cellar door/wine tourism through focused support for the regions wine producers in relation to the cap reduction proposals. Growing the DTC component of the wine sales is a critical measure of the success of this program.

8. The WET liable on these sales is a little more skewed towards the wholesale/distributor segments due to the higher WET % applied to wine sold to these segments. Note that approximately 6% of WET paid by these producers relate to cellar door tastings and free samples given.

9. Of the 15 wine companies sampled 8 or 53% exceed the WET rebate cap of $500,000. Any reduction of the WET cap would therefore require them to generate sales to cover this lost revenue, or reduce costs to sustain current profitability. If the cap reduces to $290,000 then these companies would need to generate and additional $2.1m of sales[2] or reduce costs by that amount. (Note that if this wasn't achievable, the company tax paid by the entity would reduce accordingly as the profit would be less, so Treasury tax receipts may suffer further). The survey documented the importance of retaining the rebate at the $500,000 level given investment plans, employment commitments, and particularly to contributing to the economic viability of operating cellar doors given the high labour costs generally entailed with weekend trading.

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2 Assuming a net margin of 10%, although many wine producers earn less than this so this would be the best possible position.

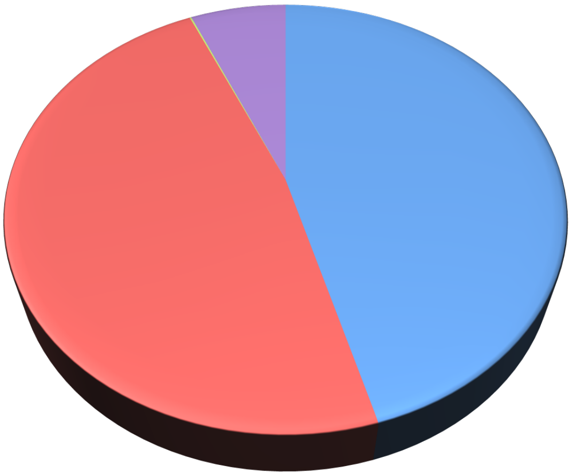

Chart 2. WET payable on wine sales to each market segment for a sample of 15 large Hunter Region wine producers. (Total WET paid by this group in FY2016 was $12.075m.

10. The industry lacks official wine sales and WET rebate claimed data. Attachment 2 shows the number of wineries in the June 2016 WFA sample (Population = 65, or approximately half of the Hunter Valley wine producers that responded) that claimed WET based on their 2015 BAS returns. If the rebate cap was reduced to $350,000 then 14 wine producers would loose a total of $1.89m of WET rebate, or an average of $132,000 per producer. If the rebate cap was reduced to $290,000 then these numbers would be $2.9m or $181,000 per producer on average, but clearly more than 8 Hunter Valley wine producers would loose the full amount of the rebate difference.

11. Another point of difference in our wine region is that from a population of 130 wine producers, 57 of the smallest wine producers own vineyards and cellar doors but did not have a winery. This was confirmed by the June WFA survey, which showed that of the 65 wineries responding, 32 did not have a winery - they use the valley's specialist larger wineries to contract make their wines. Unless the proposed eligibility criteria change to embrace these producers without winery assets, many will be forced out of the wine business, and the wine tourism product mix in our region will be poorer. we have been advised that if this change occurs, some of the major contract winemakers will face significant business challenges as their contract winemaking services will be less needed.

2. HVWTA Position on WET Rebate: Tightened Eligibility Criteria

During the past month we have attended the consultation meeting for NSW, and hosted a visit by Senator Ruston. We have participated in the development of the WFA and NSWWIA positions. As a region we also find much to support in the WoWA proposals that have been presented to Government.

We are aware that the views expressed immediately post the May budget have progressed and become more focused as both Government and Industry consult on improving the integrity of the WET rebate, and on coming together to agree on the critical aspects of what makes for an eligible product and eligible producer.

Your Implementation Paper requested input on the matters discussed. The Hunter Valley region concurs with the position that has emerged from both industry dialogue and industry/government consultation. To be both clear and brief, our position on the questions posed is summarised below.

<u>1. Eligible Product.</u>

Eligible product is packaged and branded wine that is:

1. Packaged in a container not exceeding 5L in a form fit for retail sale.
2. Branded - the producer has to be the beneficial owner of the brand, attested by the wine producer's registered trademark. Packaged wines with licensed trademarks are not eligible.
3. Packaged wines with a common law trademark to be addressed by exception.
4. Wine on which the eligible producer has paid WET. (Note: There would need to be further consideration of how to address 'Quoted' sales as this would disqualify sales to distributors. In the case of sales to distributors it is the distributor that pays the WET and the producer makes a claim for 'notional WET' based on the price charged to the distributor.)

<u>2. Eligible producer.</u>

Producer eligibility revolves around the eligible producer having ownership of the grapes at the crusher through to the final branded packaged product.

1. 85% of the rebatable wine must be owned as grapes at the crusher. The producer must be able to demonstrate proof of ownership at the crusher through weigh-bridge receipts or the like.

2. A further 15% of other wine can be blended in to the eligible product.
3. To allow flexibility for unkind vintage conditions resulting in a loss of own grape product, this 15% can be averaged over a rolling 4 year period.
4. There would be no additional reporting requirements - but proof would be subject to weigh bridge documents, wine grape levy returns, and label integrity records audits.
5. This means that there does not need to be a winery definition, an assets test or a test requiring the definition of carrying on a wine business required. This would make it easier and less costly to administer.
6. We are aware that Government is concerned with the integrity of access to the rebate. We suggest that Government explores the following to improve integrity subject to the revised product and producer definitions:
    1. Link eligible producer to registration for submitting a return for the wine grape levy, and ensure that all registered producers must supply their ABN.
    2. Make small modifications to the Eligible Producer BAS reporting to show additional breakdown of sales (and WET rebate claims) by category - Sales: DTC, Wholesale, Distributor, bulk and unbranded, and export sales; and the corresponding claims for WET rebate for the relevant categories and for Tasting and Sample Stock used.
    3. Government to consider data matching opportunities between the wine Grapes Levy Returns and BAS matching on ABN to tighten integrity.

<u>3. Cap changes related to eligible wine and eligible producer.</u>

1. While the discussion paper didn't request comment on this, the Hunter Region requests Government to consider introducing a two-level cap that recognises the policy intents of supporting regional wine producers that are engaged in cellar door and wine tourism. Wine producers that have made considerable investments in cellar doors and other wine tourism assets make a significant contribution to the region's economy, and Government should show continuing support for these investments.
2. We support the proposition that has been discussed at the consultation meetings that a two-tier cap is introduced, with the first portion of rebate cap applied to Wholesale, Distributor and DTC sales, and the second portion preserved for additional DTC sales.

3. The creation of a two-tier cap, along with bringing forward eligibility tests, should allow the Government to implement a reduced cap that does not incentivise creation of business structures simply to access the WET rebate, while retaining the existing cap for those wine-tourism producers investing in DTC sales in a wine region through investing in cellar doors.

4. It is contended that these producers, and their DTC sales component, are not the cause of the integrity issues that Government is responding to, and that the other proposed changes above should address these concerns.

5. The retention of wine producer access to the existing $500,000 cap would be preserved for those producers engaged in and supporting wine tourism in their region.

6. The presence of a physical cellar door would evidence the ability of a wine producer to claim the additional DTC 'top up' rebate.

<u>4. Timing.</u>

1. Bring forward eligibility changes to product and producer to 1 July 2017.

2. Packaging and branding requirements will apply from 1 July 2017.

3. Eligible producer requirement (own 85% grapes) will also apply, but all wine prior to intro date will be deemed to be eligible until 1 July 2018.

4. Push out cap reduction to 2018 (potentially 2019 – seek review of impact of eligibility changes).

   The HVWTA proposes that Government allocate some of the AGWA additional funding proposed in the budget to fund regional input output terroir based economic models and study of wine tourism impacts, followed by a period where their effect can be validated before proceeding with cap reduction. The Hunter Region volunteers to collaborate with Government in undertaking such a study, and have advanced discussions with economic academics capable of assisting with such a modelling exercise. We propose to approach the Minister to seek guidance and support in the near future.

3. Attachments.

1. Size of Producers by Tonnes Crushed in 2015 Vintage (Respondents=65).

Tonnes	<10	51-100	101-150	151-300	301-500	501-1000	1001-2000	2001-3000	>3001
Hunter Valley Wine Producers	10	9	13	7	16	3	3	1	2

2. WET Rebate Claimed by Sample of Hunter Valley Wine Producers FY2015.

Amount of WET Rebate Claimed FY2015	<$290,000	$290,000-500,000	>$500,000
Number of Hunter Valley Wine Producers claiming this level:	46	4	12

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7/10/2016