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# THE IMPACT OF A VOLUMETRIC TAX ON WINE

**A submission to the October Taxation Summit  
In Reference to Environmental and Social Taxes; specifically Alcohol Taxation**



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This submission is prepared by CCW Co-operative Limited on behalf of its shareholders.

## **Background Information**

### **CCW Co-op Ltd**

CCW Co-op Limited (CCW) was formed in 1981 from the merger of two Riverland co-operatives – Berri Co-operative Winery & Distillery Ltd and Renmano Wines Co-operative Ltd – with the main aim to produce wine from shareholders’ fruit and offer a satisfactory return to CCW growers on fruit delivery.

In 1989 CCW was restructured, forming the publicly unlisted company Berri Renmano Limited, now Accolade Wines Australia Limited, (formerly Constellation Wines Australia) and shifted its equity holding into the International Wine Investment Fund (formerly the Wine Trust of Australia). CCW is now the preferred supplier of wine grapes to Accolade Wines Australia Limited.

CCW Co-operative is a shareholder group of over 600 wine grape growers in the Riverland area of South Australia. This represents approximately 50% of the contracted wine grape production of the Riverland region, and the organisation is the largest independent grape grower group in the country. Many of the wine grape shareholders are small to medium – sized primary producers.

### **The Riverland Region**

The Riverland is a region with a warm dry summer climate. The Riverland, along with the Murray Valley region (Near Mildura in Victoria) and the Riverina region are part of what is referred to in the industry as the “warm inland” regions. The warm climate dictates that the majority of fruit grown is used in various wine brands in the “Popular Premium” category of bottled product as well as cask wines. There are some boutique producers in the region producing limited amounts of wine that sells for approximately \$30 per bottle, but the vast majority of production is used in the own branded sub \$10 bottle product, cask wines, and some is transported outside the region. The retail prices that can be commanded for bottled wine have decreased in absolute terms over the past seven years, as the combined challenges of an unfavourable exchange rate, the global financial crisis and the imbalance between supply and demand have negatively impacted the industry. While most wine produced in the region is exported, it is vital that a viable domestic market can underpin export growth; hence the importance of sound domestic taxation policy.

The net result is that the region has suffered a reduction in farm gate income of wine grape sales from approximately \$292 M in 2002 to an estimated farm gate income of \$105 M in the recent 2011 vintage. The average price of wine grapes per tonne in 2002 was \$674 compared to \$274 estimated value per tonne in 2011, which is currently below the long term cost of production. The reduction in regional income has flow-on effects to allied industries in the region including transport companies, irrigation utilities, and agricultural supply companies but also companies that supply goods and services throughout the community.

The low returns have had a strong impact on growers, with many leaving the industry. The area under vineyard in the Riverland has decreased by 18% over the past 4 seasons, and CCW Co-op shareholder base has declined from 741 members in February 2004 to 612 members at 31<sup>st</sup> August 2011.

## **Executive Summary**

It is true that CCW Co-operative and, its business partner, Accolade Wines, are likely to suffer if a uniform rate of volumetric taxation is introduced as suggested by the recommendations under the Henry Review, 2008. Much of the fruit produced by CCW and the resulting wine sold by Accolade Wines is sold at low price points, which are the price points most likely to be heavily impacted by a volumetric tax.

This submission will outline the anticipated negative impacts that will be felt most severely in this region, and will then address the arguments commonly given in favour of a volumetric tax.

### **Anticipated Effect of a Volumetric Tax**

The magnitude of the effect of a volumetric tax will depend on the rate of excise imposed on the alcohol content of wine. Currently much of the comment centres on the beer rate of tax, or approximately \$41.68 tax per litre of alcohol as this rate was recommended under the Henry review. At this rate of tax, the following increases are expected<sup>1</sup>:

- 95% of wine would increase in price
- Overall sales of wine would fall by 34%
- Reduction in national vineyard area of 29,000 hectares
- 12,000 jobs lost across the industry including small wine producers forced out of business due to loss of the WET rebate
- Over 9,000 jobs lost from regional communities

The projected losses in associated businesses and industry utilities such as irrigation trusts would also be serious. One element that distinguishes the wine industry is its regional footprint. If the wine industry is put further in jeopardy with decreased wine sales due to additional taxation; the flow on effect to the Riverland region will be considerable. Depending on the rate of excise levied and the collection method that is used, the complexity and cost of a volumetric tax will also impose another burden on an industry already in difficulty. If the tax liability must be regularly reported and assessed by taxation auditors it will add another considerable level of administrative and audit costs. The taxation payment schedule may also impose another level of stress on wine companies whereby more capital may be required to meet the cash flow demands.

### ***Flawed Arguments in Favour of Volumetric Tax***

CCW believes that the ad-valorem Wine Equalization Tax (WET) that is currently used for wine is working. There are many emotive arguments in favour of changing

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<sup>1</sup> *Winemakers Federation Submission to the Henry Review, October 2008*

the current system to a Volumetric Tax (VT), with common arguments in favour including the following:

- ***The cost of antisocial behaviour is much greater than the current level of tax revenue; so alcohol is not “paying its way” to redress social cost.***
- ***A VT will be simpler to administer than the current WET;***
- ***The taxation of alcohol should be uniform;***
- ***The WET rebate is misused, and has now become excessively claimed beyond the intent and spirit originally intended;***
- ***The current system encourages production of cheap wine which is contributing to the current oversupply problems the industry faces;***
- ***Introduction of a volumetric tax will help to bring about the industry restructure needed***
- ***There is a need to reduce sales of cask wine, as it is the cheapest standard drink and therefore is the cause of alcohol abuse.***
- ***A volumetric tax should be brought in to combat antisocial consumption patterns and in particular binge and youth drinking.***

There is strong evidence that a volumetric tax will not be the “simple fix” proclaimed by some, and that it will not address the need to address antisocial drinking habits. CCW agree that measures must be taken to curb alcohol abuse in society; but these measures must be targeted rather than the blunt administration of a tax. In considering the common arguments above, consider the following evidence.

***The cost of antisocial behaviour is much greater than the current level of tax revenue; so alcohol is not “paying its way” to redress social cost.***

The core motivation for recommending a change to taxation of wine in the Henry Review was based around the assumption that the total social cost of alcohol consumption in Australia exceeds \$15b per annum.<sup>2</sup> The assumptions behind the findings in this paper have been refuted by another study<sup>3</sup> which assessed the realistic costs to society at closer to \$3.8b. The application of mainstream economic method resulted in a lower estimate of social cost of alcohol abuse. The total tax revenue from alcohol is greater than \$4b per annum, so the argument to increase the tax intake to offset the social impact is not supported by the most recent research.

***A VT will be simpler to administer than the current WET.***

Should a volumetric tax be imposed, the level of complexity and the cost will depend on the rate of taxation that is chosen. Far from being a good measure to address the perceived complexity of taxation between different alcoholic beverages, it is more likely that the administration, auditing and accounting of a volumetric tax will be more complex and time - consuming than is currently the case with the WET.

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<sup>2</sup> “The avoidable costs of alcohol abuse in Australia and the potential benefits of effective policies to reduce the social cost of alcohol”, 2008, Collins & Lapsley

<sup>3</sup> “The Cost of Costs Studies” 2011, Crampton & Burgess

Because the level of alcohol cannot be rigidly controlled in wine as it can with spirit and beer manufacture, the final alcohol content of wine is not “created”. It must be determined through testing. Wine grapes are harvested when the flavour dictates that the desirable wine style will be achieved. One variety, or even a single patch of wine grapes may be harvested at different maturity levels in successive years, resulting in wines with different alcohol content. Each wine will therefore need to be tested to determine the taxation liability. This will create an additional level of monitoring and cost for wine companies, and is highly likely to need government excise auditors to assess the tax liability of each winery site. If the rate of taxation is not rigidly audited, there may be large variation in the amount of taxation liable.

### ***The taxation of alcohol should be uniform***

There is a common argument in favour of a volumetric tax that suggests that wine is taxed “incorrectly”, and that the current system is “wrong”. Some recent reports have referred to the current wine taxation as “illogical” and “perverse”. This is despite the fact that the vast majority of goods sold are taxed according to value.

*The fact that the taxation regime is **different** does not mean that it is “**wrong**”.*

There is different logic in imposing taxes – one reason is to change consumptive behaviour, and another is to raise revenue. If the intent is to raise revenue, the method of taxation that imposes the least market distortion is an ad valorem tax. The more expensive a product is; the more tax is paid. If the intent is to change consumptive behaviour, such as suggested with a volumetric tax, then there must be clear evidence that the correct outcome will be achieved. The bulk of evidence suggests that this will not be the case with a volumetric tax on wine. In addition it will have the effect of creating the greatest market distortion by making the most expensive wine markedly cheaper, and by creating the greatest increase in floor price at the low price end of the market.

Much of the colourful language currently used to criticize the current tax system points out “preferential treatment” of lower price wine, and criticises the lack of price penalty based on price per standard drink. There is no less logic or credibility in criticising a volumetric tax for a bias toward regular consumers of expensive wine, who have the greatest capacity to pay tax.

Many arguments also criticise the disparity between the levels of taxation that is applied per standard drink across many types of beverages. The assumption that the taxation should be uniform is illogical – it infers that the only reason consumers choose a beverage is solely based on the percentage of alcohol it contains; and that consumers will make purchasing decisions based on the cost per standard drink rather than other parameters such as flavour, brand status, occasion, and matching the beverage with food.

It was the recognition that wine is unique as a sector, and that wine production is substantially different from spirits and beer that led to the formation of the WET in its ad-valorem form. The reasons for this sectoral difference still hold today.

***The WET rebate is misused, and has now become excessively claimed beyond the intent and spirit originally intended***

This may be the case, but if part of the taxation system is not working as originally intended, does it justify changing the entire system? CCW would suggest that if the WET rebate is not functioning as originally intended, and indeed if rebates are being excessively claimed, then the WET rebate should be reformed. This would add to the revenue retained by the Australian Government and preserve the integrity of the current taxation system for wine. In particular it is questionable why producers in New Zealand should benefit from a tax rebate originally designed to support the wine tourism industry in Australia.

***The current system encourages production of cheap wine which is contributing to the current oversupply problems the industry faces***

***And***

***Introduction of a volumetric tax will help to bring about the industry restructure needed.***

This is not true. The current problems with the imbalance between supply and demand have been caused by planting of a total vineyard area in excess of the need to meet the perceived export markets, combined with a contraction in international demand for wine on the back of the recent global financial crisis and the current currency pressure. It is stretching credibility to claim that the scale of expansion during the growth period was caused or indeed encouraged by a taxation system rather than commercial business decisions based on optimistic growth forecasts. The recent currency pressure may have caused the diversion of some wine that was destined for export back onto the domestic market, but the current production levels are not the direct result of domestic taxation policy.

It is in this light that CCW is concerned about the potential fallout of a volumetric tax. Much focus is given to the national situation in relation to the imbalance between supply and demand, but little focus is given to the *regional* supply and demand.

For many years the supply and demand statistics released by Wine Australia (formerly known as the Australian Wine and Brandy Corporation) has shown that that for reasons of cost of production (and the resulting price that can be sustainably paid for wine grapes) and flavour profile the fruit from warm inland regions should theoretically be balanced in regard to supply and demand. Riverland fruit has, however, been substituted with fruit from cool and coastal areas that has been sold by distressed sellers in these regions at unsustainable prices.

The Riverland region has recently lost 18% of the area, and the Murray Valley Wine Grape Growers Association area near Mildura in Victoria estimates that it has lost approximately 50% of its grape growers. These regions have already reduced the vineyard area in these regions by an amount close to the average 20% reduction that was suggested under the wine industry restructure agenda. If there is further stress in

warm inland regions due to the imposition of a volumetric tax it is likely that vineyard removal will be overdone in areas such as the Riverland. This will be to the detriment of the entire Australian wine industry in terms of the impact on the desired price and flavour profile of wine grapes.

Considering that the profitability of wine brands is challenged at present, it is difficult to see how significantly increasing the retail price through taxation will help. The oversupply of wine has resulted in wine brands losing value in absolute terms over the past six years. This has led to downward pressure on retail prices of wine, and subsequently the fruit that is used to make them. The greatest challenge facing the industry is the ability to regain this value, and return to profitability along the supply chain.

A volumetric tax would create the greatest distortion in the market; so both low cost bottled wine and cask wine products would suffer the greatest increase in retail price above current levels. All this increase in retail price would be due to tax; none of this price increase would be returned to processors or growers. After such price increases it will be more difficult for brand owners to command better prices in future so that contributors to the products can return to sustainable profit margins.

Considering the magnitude of impact on the Riverland region in light of the recent restructure that has already taken place, it is more likely that introduction of a volumetric tax would be severely detrimental to the process of restructure of the wine industry rather than aiding it.

***There is a need to reduce sales of cask wine, as it is the cheapest standard drink and therefore is the cause of alcohol abuse***

Just because cask wines are the cheapest form of alcohol it does not necessarily follow that the majority of consumers of this wine abuse alcohol. Furthermore, despite the effects of a potential volumetric tax, *some* form of alcohol will still be the cheapest in terms of cost per standard drink, and therefore the “theoretical” first choice for drinkers with an alcohol problem. When the tax was increased on RTD products, drinkers switched from RTD’s to full strength spirits. It is worth noting that these drinkers did not change their preferred drink of choice to cask wine or low priced bottled wine. Problem or habitual drinkers will switch to another form of alcohol rather than curb their drinking habits, so it is difficult to see the social benefit in this outcome.

The effect of a tax in curbing problem drinkers is highly debateable. Problem drinkers are the most insensitive to price. The consumers that are most likely to be deterred due to a price rise are the moderate drinkers.

The products that will be most severely impacted by a VT are wines at the cheaper price points, and in particular cask wine sales. There is evidence that cask wine plays a role in moderate consumption in the following table<sup>4</sup>. Note also that consumption patterns for small casks (ie two litre casks) are lower than that of bottled wine.

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<sup>4</sup> *Wine Intelligence, 2009*

<b>Consumption</b>	<b>bottle</b>	<b>small cask</b>	<b>large cask</b>
< 2 glasses / day	57%	73%	66%
> 2 glasses / day	43%	27%	34%

While it is unquestionable that some consumers abuse cask wine, there is little evidence that cask wine is responsible for widespread levels of alcohol abuse across the community, and that the current method of taxation is not encouraging undue, excessive or “favourable” consumption of cask wine.

Not only do cask wines play a role in moderate drinking patterns, they are also an environmentally friendly form of packaging in terms of transport cost and ease of recycling, due to the weight and packaging material used.

The concern does not only rest with sales of cask wine. A volumetric tax at the beer rate of \$41.68 per litre of alcohol would cause the price of 95% of wine sold in Australia to increase<sup>5</sup>. In fact all wine that currently sells for a retail price lower than \$27 per bottle will increase in price if the excise level of volumetric tax is set at this rate.<sup>6</sup> This means that anyone who enjoys wine that sells for less than \$27 per bottle will be negatively affected by a volumetric tax at this rate.

***A volumetric tax should be brought in to combat antisocial consumption patterns and in particular binge and youth drinking.***

Some products would decrease in price under such a volumetric tax (set at the same rate as full strength beer) such as bottled spirits, RTD’s and bottled wine that sells for more than \$27 per bottle. (Full strength beer is projected to increase slightly if the beer rate of excise is used.<sup>6</sup>) This is despite the fact that these products are associated with youth binge drinking, whereas cask wine is not. The following table shows youth drinking behaviour<sup>7</sup> and the products of choice:

<b>MALES</b>		
	<b>“Low Risk”</b>	<b>“Risky” or “High Risk”</b>
14-19	Pre-mixed spirits in a can (52.8%)	Regular strength beer (74.3%)
20-29	Regular strength beer (65.8%)	Regular strength beer (78.6%)
30-39	Regular strength beer (59.0%)	Regular strength beer (77.0%)
40+	Bottled wine (54.3%)	Regular strength beer (61.5%)

<b>FEMALES</b>		
	<b>“Low Risk”</b>	<b>“Risky” or “High Risk”</b>
14-19	Pre-mixed spirits in a can (64.2%)	Bottled spirits and liqueurs (84.9%)
20-29	Regular strength beer (58.8%)	Bottled spirits and liqueurs (67.6%)
30-39	Regular strength beer (68.9%)	Bottled wine (69.7%)
40+	Bottled wine (69.9%)	Bottled wine (72.2%)

<sup>5</sup> Winemakers Federation, submission to the Henry Tax Review

<sup>6</sup> Licensees’ liquor guide, 2010

<sup>7</sup> 2007 National Drug Strategy Household Survey



It is difficult to see how the imposition of a flat rate of volumetric tax will have a positive social benefit in light of this evidence. Cask wine does not figure as a primary product of choice in the above table.

## **Summary**

CCW believe that the imposition of a volumetric tax on the Australian wine industry would be severely detrimental to the industry irrespective of the current oversupply situation. It would be particularly painful at present, however. It might be possible to countenance the idea of limited economic pain if there were demonstrable social and environmental benefits to offset this pain; but this is clearly not the case.

If the WET rebate is being misused, then measures should be taken to address this problem. CCW believe that the WET rebate can be addressed without scrapping the current tax system.

Evidence suggests that imposing a volumetric tax on wine would create no clear benefits in regard to antisocial drinking behaviour, and that the potential pain far outweighs any possible gain. There seems to be little justification for a wholesale departure from the status quo, in particular given the potential damage that is likely to eventuate.

CCW is in favour of retaining the current ad-valorem taxation of wine, with a revision of the WET rebate to ensure that misuse or rorting of the rebates can no longer occur, and that the rebate regains its intended purpose.