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Tax Forum
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SUBMISSION TO THE OCTOBER TAX SUMMIT
IN REFERENCE TO SOCIAL AND ENVIRONMENTAL TAXES

THE SUGGESTED VOLUMETRIC TAXATION OF WINE

This is a submission by Riverland Wine Industry Development Council and the Riverland Winegrape Growers' Association on behalf of wine industry participants in the Riverland region in South Australia. For the sake of brevity, the term Riverland Wine (RW) will be used as the singular reference to these two bodies.

EXECUTIVE SUMMARY

RW represents more than 1,100 wine growers and more than 30 wine makers who grow grapes and produce wine in the Riverland region of South Australia. The region grows approximately 20,000 hectares of winegrapes to be the single largest wine production region in Australia with annual harvests in the range of 350,000 tonnes to 400,000 tonnes for an average farmgate income level well in excess of $150m and wine production estimated to be worth more than $3b per annum. The grape and wine industries are the cornerstones of this region's economy.

All the major Australian wine processors are represented in this region together with a significant number of smaller boutique producers. The region is noted for its very high levels of productivity and efficiency both in vineyards and in wine production. Almost sixty percent of the region's irrigated horticulture is winegrape production and the region is widely recognised for its very high levels of efficiency in terms of irrigation technology and management practices.

RW is concerned at recent suggestions that a volumetric tax on alcohol should be considered as part of the recent calls for taxation reform. The core reasons for opposing such a tax are that it will not address problem drinking and anti-social behaviour in society; that it will be more complex and costly to impose and administer than the current system; and further it will disproportionately damage the RW industry. RW supports addressing the rebate on the Wine Equalisation Tax to ensure that the spirit and intention of the rebate is maintained, and that the current tax regime retains its credibility.

There is no argument that the abuse of alcohol in society should not be tolerated. Measures to curb such abuse must be targeted, efficient and effective. Claims that simply raising the price of some alcoholic beverages will be effective in addressing youth and problem drinking are not supported by evidence.

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Contrary to some recent statements a volumetric tax will be more complex and more costly to administer, not simpler as claimed. This will be problematic for both large and small producers.

Some areas of the current Wine Equalisation Tax (WET), in particular the WET rebate may benefit from attention. There are claims that the current system is open to some rorting. RW supports tightening of the current system to avoid unjustified rebates as a matter of principle.

As the regional industry body we are concerned that the RW industry will be disproportionately affected by a volumetric tax. While we agree that society must take measures to address problem alcohol consumption, the evidence shows that a volumetric tax will cause significant industry harm while providing minimal if any benefits in the form of improved patterns of alcohol consumption.

For this reason RW strongly suggest that the current ad-valorem system of taxation of wine remains in place, and that necessary change to the WET rebate is made to address the shortfall in the current system.

THE CASE FOR CHANGE TO THE CURRENT TAXATION OF WINE

There are many current arguments being put to change the way that wine is taxed from the current ad-valorem method to a volumetric tax. RW believe that these do not stand up to scrutiny.

The core reasons mooted for change in the current ad-valorem system of taxation include:

- The apparent need for alcohol to meet the social cost of alcohol abuse in society;
- The need to correct adverse drinking habits
- The need to address the complexity of the current system
- The claim that changing to a volumetric tax will somehow aid industry restructure;
- The current WET rebate is being misused and rorted

Is there a case for taxation change?

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.[1] The assumptions behind the findings in this paper have been refuted by another study[2] 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 weak.

"Wine is taxed 'preferentially' or 'incorrectly' "

Some recent reports have referred to the current wine taxation as "illogical" and "perverse". Wine is taxed differently from spirits and beer in that the tax is ad valorem. *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;

[1] "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

[2] "The Cost of Costs Studies" 2011, Crampton & Burgess

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the more tax is paid. This is the same way that tax scales work with personal income tax. 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 retail 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 at the expense of those who do not.

Tax as a tool to modify drinking behaviour

Heavy Drinkers are not price sensitive. Those who regularly consume alcohol at problem levels will be the last to modify their behaviour due to a tax. Moderate drinkers have the highest elasticity of demand, whereas heavy drinkers have an inelastic demand for alcohol. Attempting to address drinking behaviour by imposition of a tax is likely to cause a drop in sales, but not from the target cohort of problem drinkers.

In the case of cask wine, it is most likely the older, low income moderate consumers who will be responsible for the projected drop in wine sales. The heavy drinkers will either simply pay the increased price at the expense of other household spending, or they will simply purchase other products such as spirits or beer. This is a sound assumption given that these products will either remain static in price, or will be cheaper under a volumetric tax regime.

The central assumptions behind this tax are based on flawed logic. It infers that the only reason people drink all alcoholic beverages are for the alcohol. This would be a grave disappointment for the world's wine makers, brewers and distillers whom all spend so much time and effort in producing a product that tastes attractive to a consumer. It also assumes that taxation will modify consumers' behaviour in a desirable, predictable and orderly manner. As seen from previous evidence, this is unlikely to be the case in regard to wine.

Moreover it raises the question: Why shouldn't someone enjoy a low priced glass of wine if they so choose, without the assumption that they are only trying to become intoxicated, and that they are not in control of their behaviour? How is it logical to assume that consumers of expensive wine are all responsible moderate consumers, and that drinkers of cask wine are all excessive drinkers in need of rehabilitation?

Why should it be seen as acceptable that increasing the price of a product to decrease its consumption is an acceptable measure, rather than targeted measures in particular in areas where excessive drinking is problematic?

Consider the following comparison.

Road accidents kill many people every year. The vast majority of people drive low priced cars: Fords, Holdens, Japanese and Korean imports. Far fewer drivers have accidents in expensive imported and luxury cars. These higher – priced cars are currently subject to a higher rate of tax – the luxury car tax.

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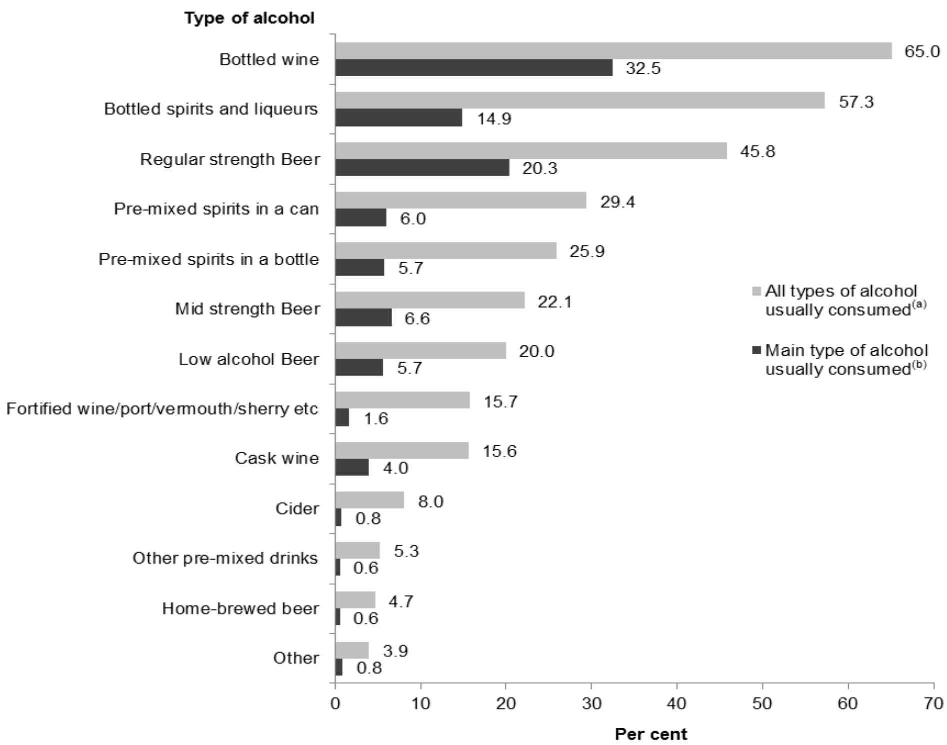
Is it logical to therefore assert that the cheaper cars are "unfairly advantaged" by a "perverse" taxation regime that gives them a price advantage over the other cars?
Is it sensible to state that "all cars should be taxed the same", and that "the current system of taxing motor vehicles is Australia is a dog's breakfast"?
Does it make sense that in the interests of road safety, that the taxation of all cars should be changed so that:

- The lower priced cars that figure heavily in road traffic accidents are made more expensive?
- The higher priced cars that feature less in accident statistics are reduced in price?

Would such a taxation regime be accepted by the public, in the interests of health and safety?

THE CASE TO CORRECT CURRENT ADVERSE DRINKING HABITS

"The need to reduce consumption of "truly awful" cask wine"
There is no question that alcohol abuse occurs with all types of products, but the claims to the effect that cask wine is the root cause of all evils is not supported by evidence. Proponents of a volumetric tax on alcohol claim the need to reduce sales of cask wines as it is currently attracts the lowest rate of tax per standard drink. Note the following chart from the 2010 National Drug Strategy Household Survey Report



(a) Respondents could select multiple responses.
(b) Respondents could select only one response.
(c) Drank alcohol in previous 12 months.
Main and all types of alcohol usually consumed, recent(c) drinkers aged 14 years or older, 2010

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Cask wine is the "Main type of alcohol consumed" for only 4% of those surveyed above[3]. Wine cask sales have been steadily declining[4], and notably since the widespread introduction of screw cap closures on bottles. This supports the statement that many consumers choose cask wines due to convenience and the ability to re-seal the package without spoilage.

The phrase "truly awful cask wine" erroneously infers that the only reason for drinking cask wine is as a source of alcohol. The following data shows the predominant beverage of choice for consumers classed as high risk due to excessive drinking behaviour[5]:

MALES		
	"Low Risk"	**"Risky" or "High Risk"**
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%)

FEMALES		
	"Low Risk"	**"Risky" or "High Risk"**
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%)

- Wine does not rate as a major beverage of choice among young drinkers (the red band)
- Cask wine is not rated as the drink of choice in any cohort, and in particular is not the drink of choice of high risk drinkers
- The current drinks of choice among the high risk young drinkers are currently taxed at the highest levels with a volumetric tax, and are currently some of the most expensive in terms of cost per standard drink. This suggests the claimed changes to behaviour as a result of a volumetric tax on wine are not supported by evidence.

Why consumers drink cask wine

The main reasons people chose cask wine are to do with income and age. According to *Wine Intelligence;*

Age:

48% of frequent large cask users are aged 55+; only 12% are younger than 34 years
38% of frequent small cask users are aged 55+; only 24% are younger than 34 years

Income:

41% of frequent large cask users earn < $50,000
36% of frequent small cask users earn < $50,000

3 Note that respondents could select only one response to this question, and that this reflects 4% of total consumers
4 Source: ABS Catalogue No 8504.0 via AWBC Winefacts Statistics
5 2007 National Drug Strategy Household Survey

The term "frequent" refers to drinking more than once per week.

There is evidence that cask wine plays a role in moderate consumption[6]. Note also that consumption patterns for small casks (ie two litre casks) are lower than that of bottled wine.

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

There is little evidence that cask wine is excessively represented with widespread levels of alcohol abuse in the community, and that the current method of taxation is not encouraging undue, excessive or favourable consumption of cask wine.

It's not only about 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. In fact all wine that currently sells for a retail price lower than $27 per bottle will increase in price if the level of volumetric tax is set at this rate.[7] 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.

It is worth noting the products that are projected to *decrease* in price under a volumetric tax (set at the same rate as full strength beer) include 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.[6]) It is notable that light beer is projected to rise. This is due to the likely removal of the current tax free threshold on the first 1.5% of alcohol in beer. This exemption was brought in for health reasons, to make light beer comparatively cheaper than full strength beer.

Given that spirits, RTD's and full strength beer are projected to either hold price or decrease in price under a volumetric tax, there appears to be a contradiction in respect to the intended social benefits and health outcomes that are pursued under such a regime. Referring back to the chart on page 2 that shows the type of alcohol consumed, it is interesting to note that full strength beer, ready mixed spirits, and bottled spirits are all more heavily consumed than cask wine. Yet cask wine will suffer the greatest impact of a volumetric tax. Similarly, the table on page 3 shows that young drinkers predominantly choose bottled spirits, pre-mixed drinks in a can, or full strength beer. All of these beverages are projected to either hold or decease in price.

Note that cask wine did not rate as a preference for high risk drinkers. Again, the predominant choices of beverage for risky drinkers will decrease under a volumetric tax regime. The exception is female risky drinkers over the age of thirty who tend to choose bottled wine. This is projected to increase slightly in price.

Moreover, the increase in taxation on RTD's did not result in increased consumption of cask wine. Instead, these consumers changed to purchasing full strength bottled spirits. This illustrates two major flaws in the argument in favour of the claimed benefits of a taxation to modify drinking behaviour:

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[6] *Wine Intelligence*, 2009
[7] Licensees' liquor guide, 2010

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- Clearly these consumers were not motivated to choose wine in terms of the low cost per standard drink;
- Young and heavy drinkers will simply change their preferred source of alcohol rather than reduce their consumption.

If a volumetric tax will modify drinking behaviour as claimed – young drinkers, and high risk drinkers are more likely to have their consumption habits **encouraged** by a volumetric tax. The evidence strongly suggests that sales of low price bottled wine and cask wine will be heavily impacted, yet the evidence does not show that consumers of these products are widely represented in the high risk category.

It is difficult to see a positive social benefit from a volumetric tax if it would make the products that are identified with excessive drinking; particularly youth binge drinking, cheaper.

THE NEED TO ADDRESS THE COMPLEXITY OF THE CURRENT SYSTEM

"The current tax system is too complex. There should be a single tax system for all alcohol."

The current system of taxation is not so complex that it is difficult to administer. As can be seen from the example above – it is likely that a volumetric tax system will be *more* complex and costly to administer than the current taxation system. This would be even more so in the event that a multi – tiered rate of volumetric tax were introduced. Introduction of a system that requires accurate knowledge of the alcohol content of every separate batch of wine, and the calculation of the tax liability for which the producer is liable will create an added layer of bureaucracy and cost for both the producer and possibly the government that assesses the tax. This is the case with the volumetric taxation of brandy at present. It is also likely to have severe effects on the taxation payment cycle and cash flow of wine companies.

"Wine is no different – alcohol is alcohol is alcohol".

Wine is different. It is consumed differently, and it is produced differently.

Overwhelmingly wine is enjoyed with food, and in moderation. 92% of wine drinkers consume wine with food[8], notably 88% of small cask drinkers and 85% of large cask drinkers enjoy wine with food. While much is made of the social cost of alcohol abuse and anti-social behaviour it is unlikely that the vast majority of wine drinkers who enjoy their wine with food will be heavily represented in the cohort that causes problems considering the age profiles shown on page 3.

Wine also has a strong regional footprint. It employs many people in regional communities, and supports allied industries across the country.

There is an important difference between wine and other alcoholic beverages such as beer, spirits, and spirits – based drinks. Wine accumulates alcohol from the fermentation of grape juice. The level of alcohol cannot easily be manipulated down or up, as the level of alcohol is determined by the level of sugar in the grapes used. The winemaker has limited control over

[8] *Wine Intelligence*, 2009

the final alcohol level in the wine. Harvesting fruit early is one option, but in order to make fruit – driven styles of wine that are popular in the markets, ripe wine grapes are required.

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 will not be "created". It must be "found" through testing. This means that wine that will be subject to an excise tax must be tested to determine the rate of tax. 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.

Consider the following scenario of two different wine styles, held in a 100,000L wine tank in a winery. Both are destined for the domestic market and therefore both subject to a proposed wine excise at a beer rate of $41.68 per LAL (see over):

Different Wine styles		
Tank capacity (L)	100,000	
Vol Tax Rate ($/LAL)	$41.68	
	Wine 1	***Wine 2***
	Dry White Wine	Red Table Wine
Baume at harvest	9.00	14.50
Average alcohol content	9.00%	14.50%
Tax Liability	$375,120.00	$604,360.00
Difference in tax liability due to wine style (For this tank)	**$229,240.00**	

Compliance with tax requirements will therefore require careful monitoring, and as such another layer of monitoring and expense will be unavoidable.

It is these differences with the wine industry that led to the introduction of the WET, rather than simply imposing a volumetric tax on wine. The added level of complexity in the industry, the differences in the production methods, the difference in consumption patterns all strongly reinforce the case for retention of the status quo.

THE CLAIM THAT A VOLUMETRIC TAX WILL AID INDUSTRY RESTRUCTURE

"A Volumetric tax will bring about the industry restructure needed"
This is patently false, and focuses only on the national situation in regard to supply and demand without taking account of the regional situation. When the wine industry peak bodies drafted the Wine Restructuring Action Agenda (WRAA) it stated that the desired removal of vines across the nation would be an average of 20% of the total area. The WRAA document also recognised the long known fact that the main cause of the oversupply problem was not the inland regions, but cool and coastal temperate regions. The Riverland region has recently lost 18% of the area, and the Murray Valley area near Mildura in Victoria

estimates that it has lost approximately 50% of its grape growers. The industry is well into the restructure, and there is strong evidence that the removal of growers from inland regions maybe approaching or greater than the number desired under the WRAA.

Currently the wine industry has reduced profitability through the need to heavily discount in order to sell product. Wine labels are selling for lower retails prices in absolute terms than they did several years ago, which has devalued the brands. In order for the industry to regain profitability, there is a need for these products to be able to increase prices back to a sustainable level, so that all stakeholders are once again making money and remaining viable, and reinvesting in their industry.

If a volumetric tax is introduced, many of the popular premium brands will suffer an increase in price that will severely distort the market through the impost of tax alone. None of this increase in shelf price will be returned to the grower of the fruit, nor the winemaker responsible for making the wine. The resulting sticker shock at the point of sale will make it more challenging for makers of these wines to be able to return pricing to sustainable levels. For this reason the proposed tax works against a possible industry restructure, rather than helping it.

The volumetric tax will not help the industry by forcing further restructure. The restructure is already well under way. The imposition of a volumetric tax in addition to the projected negative impacts mentioned previously may well be disastrous for the Riverland region as most of the wine produced will suffer severe price increases under a volumetric tax.

"The current tax is prolonging the current wine glut"

There have recently been some statements to the effect that the current tax system is *contributing* to the wine glut, due to supposed taxation "favouritism" of large volume cheaper wine products. This is not true. The central reasons for the glut in domestic sales are primarily the unfavourable exchange rate compounded with adverse economic conditions in traditional Australian markets in the USA, UK and Europe. This in turn has led to diversion of some of the wine originally intended for export onto the domestic market.

THE CASE FOR CHANGE TO ADDRESS MISUSE OF THE WET REBATE

"The WET rebate is being rorted"

Then fix the WET rebate. The definitions of "a producer" may be tightened along with other definitions as needed, and the original intent of the WET rebate can be returned. RW strongly supports revisiting the WET rebate and taking whatever measures are required to remove rorting of the tax. It is essential that the current taxations system work well, and that it works as intended.

THE NEGATIVE IMPACT OF VOLUMETRIC TAX ON INDUSTRY

The proposed volumetric tax would disproportionately damage inland regions, by imposing the greatest impact on the lower – priced wine that is produced in these regions. The following impacts are modelled if a volumetric tax at the rate of full strength beer is introduced:

- 95% of wine would increase in price

- Sales fall by 34%
- Reduction in vineyard area of 29,000 ha
- Loss of 12,000 jobs nationally, including small producers forced out of business by removal of the WET rebate;
- Significant cash flow implications and increased administration and compliance costs;
- Negative impacts on tourism, trade employment, and jobs in allied industries

SUMMARY

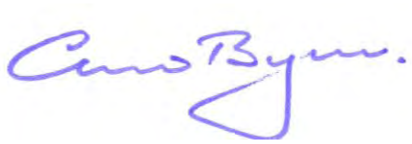
The Federal Treasurer stated that imposition of a volumetric tax was not desirable at a time when the industry was in a state of restructure.

There is strong evidence, however, that a volumetric tax will not address the social problem from excessive drinking in this country. In fact it is likely that it will reduce the price of products that contribute most to binge and problem drinking. The greatest impact will be felt by cask wine, which the evidence shows is not highly represented as a product of choice by abusers of alcohol. There will be disproportionate suffering in the Riverland region in the wine industry and allied industries.

The very motivation from the Henry review to consider this tax was because it was to address the perceived inability of the current taxation regime to pay for the social cost of alcohol abuse. This primary assumption has been discredited by the “Cost of Costs” paper by Crampton and Burgess, 2011, and so the primary reason for considering a volumetric tax was based on flawed assumptions.

The above evidence shows that there is <u>no good time</u> for this proposed tax.

RW is in favour of retaining the current tax system, with tightening of definitions of the WET rebate to prevent rorting of the system.



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