

Wine Equalisation Tax Rebate Consultative Group report

October 2015

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EXECUTIVE SUMMARY

This report sets out the Wine Equalisation Tax (WET) Rebate Consultative Group's (the Consultative Group) recommendation to Government, for reform of the WET rebate, drawing on the WET Rebate Discussion Paper (the Discussion Paper) and stakeholder submissions.

On 21 August 2015, the then Assistant Treasurer released the Discussion Paper for public consultation. Consultation on the paper closed on 11 September 2015.

The stated policy intent of the WET rebate was to assist small producers in rural and regional Australia by allowing them to reduce or fully offset their WET liability. Since its introduction, the rebate has become an important source of financial support for winemakers and has been factored into the production and distribution chain.

There was agreement from the Consultative Group that the rebate delivers important support to the sector, and should be retained. While the rebate has provided important support, the current use of the rebate has led to some unsustainable outcomes in the industry. These impacts should be directly addressed through reform, rather than out-right abolition of the rebate.

A number of submissions provided anecdotal evidence that some industry participants are entering into structuring arrangements in order to maximise rebate claims, notwithstanding this, there are however many legitimate business motivations for certain forms of structuring production processes.

The Consultative Group considers that reform is warranted, and should focus on providing targeted industry support, moving the WET rebate closer in line with the original policy intent. Ongoing industry support will provide certainty for the industry, underpinning investment in regional areas in winemaking infrastructure, as well as vineyards and cellar door businesses. This will, in turn, support tourism and regional employment.

The Consultative Group makes the following majority recommendation consisting of five elements to Government for immediate action:

1. amend the definition of a 'producer' of wine to better target the WET rebate;
2. amend the definition of 'rebateable wine' to limit entitlement of the WET rebate to packaged product and to branded product;
3. introduce specific anti-avoidance provisions in the *A New Tax System (Wine Equalisation Tax) Act 1999* (WET Act) to strengthen the Australian Tax Office's (ATO) capacity to address schemes that inappropriately take advantage of the WET rebate;
4. phase-in recommendations one and two to better manage industry transition, along with industry assistance; and
5. provide funding to the Australian Grape and Wine Authority (AGWA) and provide additional support through the Export Market Development Grants (EMDG) scheme to promote Australian wine overseas, as part of the 2015-16 Mid-Year Economic Fiscal Outlook (MYEFO).

While this proposed recommendation is an important first step to move the WET rebate closer to its original intent, the Consultative Group recognises that it will not completely address the distortions in the industry caused by the WET rebate, nor the full range of schemes that are currently exploiting it.

Given this, a minority of Consultative Group members supported a second recommendation, for the Government to continue work exploring future improvements and reform. This further work on the subsidiary recommendation could be carried out as part of, or separate to the broader Government's Tax White Paper process. This group could assist in that regard if the Government thought fit.

REPORT — SCOPE AND TIMING

The Consultative Group was announced by the Government at the time of release of the Discussion Paper on 21 August 2015, with submissions due by 11 September 2015.

The Consultative Group was asked to consider submissions and provide specialist industry advice to the Government on reform options. The Consultative Group was chaired by Mr Russ Campbell of the Commonwealth Treasury and was comprised of a range of expert industry representatives, including:

- Mr Tony D'Aloisio AM, Winemakers' Federation of Australia;
- Mr Darren De Bortoli, De Bortoli Wines;
- Ms Rebecca Duffy, Holm Oak Vineyards;
- Mr Nigel Gallop, Fraser Gallop Estate;
- Mr Tom Harvey, McLaren Vale Group Wine and Tourism Association;
- Mr Robert Hill-Smith, Yalumba;
- Mr Larry Jorgensen, Wines of Western Australia;
- Mr Anthony Murphy, Trentham Estate Wines;
- Mr Roger Sharp, Treasury Wine Estates; and
- Mr Lawrie Stanford, Wine Grape Growers Australia.

The Consultative Group met twice. The first meeting was held on 18 September 2015 and the second meeting was held on 6 October 2015. The Consultative Group considered the range of views outlined in the approximately 60 submissions received in response to the Discussion Paper, with the aim of providing the Government with its report as requested in October 2015.

This report sets out the Consultative Group's recommendation to Government for reform. It also notes three, non-exhaustive areas of interest that could form the basis of future work by Government to further improve and reform the WET rebate and taxation of the sector.

BRIEF HISTORY OF THE WET REBATE

In 2000, as part of the tax reform process, the Government undertook to ensure that small winemakers with cellar door and mail order sales up to \$300,000 (wholesale) per annum were, in most cases, effectively free from WET.

In 2004, the then Treasurer announced the introduction of the WET rebate. The rebate was to replace the Cellar Door Rebate Scheme and the accelerated depreciation provisions for grapevine plantings and provided every wine producer relief from the WET of up to \$290,000 each year. Some states retained the Cellar Door Rebate Scheme.

Further changes were made in the 2006-07 Budget when it was announced that from 1 July 2006, each wine producer or group of producers would be able to claim up to an increased maximum WET rebate of \$500,000 each financial year.

The most recent changes to the WET rebate were made in 2012 to restrict the amounts to which producers were entitled known as the 'blending rules'

NEW ZEALAND WET REBATE

The New Zealand rebate scheme entitles New Zealand wine producers to a rebate of 29 per cent of the approved selling price of wine sold 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*.¹

POLICY OBJECTIVE

The original policy intent of the WET rebate (as evidenced by the change in 2006) was to assist small producers in rural and regional Australia by allowing them to reduce or fully offset their WET liability. Since its introduction, the rebate has become an important source of financial support for winemakers—particularly those in regional Australia. It has also been factored into the supply chain.

The Consultative Group agreed that a number of arrangements currently used to maximise rebate claims encourage some industry participants to enter into structuring arrangements. While there are many forms of structuring that represent sound business models for production, it is also clear that many arrangements have not been pursued with this dominant purpose, and indeed have been utilised primarily to maximise rebate claims, well beyond the original policy intent of the rebate. The Consultative Group supports pursuing reform options that strengthen the integrity of the rebate and help refocus access to the rebate closer to the original policy intent.

The Consultative Group recognises the importance of industry support going to businesses and individuals with 'skin in the game' through direct investments in the industry in the form of vineyards, cellar doors, wineries and branded labels. A number of Consultative Group members, as well as numerous submissions, highlighted the role of the rebate in providing direct financial support to winemakers, which has in some cases funded the further development of the wine industry. It has

1 Article 7(2).

also been suggested that a flow on effect of the WET rebate has been to provide support to regional communities. For example, it has enabled new and young winemakers to pursue innovative styles.

Since its introduction, the WET rebate has underpinned investment in the regional areas in winemaking infrastructure, vineyards and cellar doors. This has enabled the number of smaller winemakers to increase. The increase in producers has created diversity in the wine industry, which has in turn supported tourism and regional employment.

Consultative Group members have framed their recommendation with a view to ensuring the right balance between a diversity of providers and a sustainable industry. Given the reliance on the rebate of many industry participants, all members were supportive of reforms that ensure that the original policy intent of the rebate is given effect.

In keeping with this view, there was also unanimity among industry experts on the Consultative Group that the rebate is for Australian producers, and that it should not be available to those from other jurisdictions (including New Zealand), but if support is to be available, there needs to be a level playing field for all winemakers in the Australian marketplace.

THE CONSULTATIVE GROUP'S RECOMMENDATION

The Consultative Group recommends retention of the WET rebate by the Government with the following majority recommendation consisting of five elements for immediate action, designed essentially to return the rebate closer to its original intent:

Recommendation for immediate action

The Consultative Group makes the following majority recommendation consisting of five elements for immediate action:

1. amend the definition of a 'producer' of wine to better target the WET rebate;
2. amend the definition of 'rebateable wine' to limit entitlement of the WET rebate to packaged product and branded product;
3. introduce specific anti-avoidance provisions in the WET Act to strengthen the ATO's capacity to address schemes that inappropriately take advantage of the WET rebate;
4. phase-in elements one and two to better manage industry transition, along with industry assistance; and
5. provide funding to AGWA and provide additional support through the EMDG scheme to promote Australian wine overseas, as part of the 2015-16 MYEFO.

AMEND THE DEFINITION OF A 'PRODUCER' OF WINE

The Consultative Group agreed the current definition of a 'producer' of wine is too broad and this has significantly contributed to the exploitation of the current WET rebate. The Consultative Group agrees the definition should be aligned more closely with the original policy intent of the WET rebate. Undertaking this reform will result in a tightening of the definition and restrict

entitlement of the WET rebate to those with 'skin in the game' and investments in the winemaking industry.

Some members of the Consultative Group felt that to tie 'skin in the game' too closely to assets could add to excess industry capacity and potentially exclude producers who make substantial investments in the wine industry from the WET rebate. The definition of a 'producer' of wine takes this into consideration but is still in line with the original intent of the WET rebate.

The following characteristics are considered key to defining a 'producer' of wine as one who:

- operates a wine business premise in Australia who manufactures and sells wine in a form fit for retail sale where the finished product is identifiably theirs;
- the business owns or leases one out of three of a vineyard, winery (production facilities or fermentation facilities) or cellar door outlet;
- holds a licence to sell liquor in an Australian state or territory;
- is self-employed or engages employees; and
- sells their wine from wine businesses mentioned above through direct or indirect channels of distribution.

While the definition above received majority support amongst Consultative Group members, there was some divergence in views held about the 'one out of three' test. While the majority of members supported the test, in recognition that any definition should not operate as a barrier to new innovative entrants, there was a strongly held minority view that this test would not be sufficient to address other problems in the industry, and that a 'two out of three' test should be preferred.

In making the above changes to tighten the definition of a 'producer' of wine, consideration should be given to the following:

- minimising any changes to the cost of compliance for those claiming the rebate; and
- minimising the costs of administration of the rebate.

1. A majority of Consultative Group members recommend the Government amend the definition of a 'producer' of wine to better target the WET rebate, in line with the characteristics outlined above.

AMEND THE DEFINITION OF 'REBATEABLE WINE'

The Consultative Group agrees that in conjunction with amending the definition of a 'producer' of wine, that changes are made to limit WET rebate entitlements to packaged wine and branded wine.

This could be done by amending the definition of 'rebateable wine' to require that:

- wine is packaged in a single container with a capacity not exceeding a certain capacity (for example, 5 litres) at the time of the dealing; and

- is labelled with a brand on the primary packaging that is wholly owned by, or licensed exclusively to, the producer of the wine.

There was consensus from the Consultative Group in support of amending the definition of 'rebateable wine' to limit entitlement of the WET rebate. There was considerable discussion amongst Consultative Group members around limiting the WET rebate to producers of branded products, with a number of members noting the challenges in designing an effective 'branding' constraint that could operate as intended, without imposing undue regulatory and administrative costs on the sector.

A number of other members, however, pointed out that addressing the issue of unbranded products as well as bulk products was important to prevent access to the rebate by multiple producers selling their wine to a single high volume home brand.

Limiting the entitlement of the WET rebate to a packaged and branded product in conjunction with amending the definition of a 'producer' of wine would help:

- ensure there is no entitlement to the rebate for sales of bulk and unbranded wine;
- reduce the prevalence of certain blending and structural arrangements that have exploited the rebate; and
- limit rebate availability for 'virtual' producers who have no tangible investment in the industry.

2. The Consultative Group recommends the Government amend the definition of 'rebateable wine' to limit entitlement of the WET rebate to packaged product and branded product.

INTRODUCE SPECIFIC ANTI-AVOIDANCE PROVISIONS IN THE WET ACT RELATING TO THE WET REBATE

The current WET rebate anti-avoidance provisions, which are contained in Division 165 of the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act), are not specific to the WET and therefore fail to capture the full range of structuring arrangements that take advantage of the WET rebate.

Under the GST Act, the only entity considered to be an 'avoider' is one that gains a GST benefit and that works for GST, where there are two entities that obtain a benefit - one at each end of the GST transaction.

The WET, however, is a tax that is designed to apply to a single entity only once. This means that instigators may implement a scheme in order to secure the financial benefit of wine that has received the WET rebate, but will not be subject to existing anti-avoidance provisions.

In these schemes the only 'avoider' under the GST Act is the producer as they have obtained a rebate to which they would not be entitled to, but for the scheme. The instigator, who has received the financial benefit of the scheme in the form of lower prices, is not classified as an avoider.

Anti-avoidance provisions that apply an administrative penalty regime to all those taking part in the scheme would be an effective mechanism to deter WET avoidance activities.

There was consensus from the Consultative Group in support of the introduction of specific anti-avoidance provisions being introduced in the WET Act in order to capture a wider range of active participants in WET rebate schemes.

3. The Consultative Group recommends the Government introduce specific anti-avoidance provisions in the WET Act to strengthen the ATO's capacity to address schemes that inappropriately take advantage of the WET rebate.

PHASE IN RECOMMENDATIONS

The impact of elements one and two of the recommendation: amending the definition of 'producer' of wine; and amending the definition of 'rebateable wine', were subject to some differences of views among Consultative Group members.

However, the majority of Consultative Group members supported a phase-in of elements one and two of the recommendation to better manage industry transition, along with industry assistance.

Some Consultative Group members strongly held the view that immediate action is necessary to support the sustainability of the industry, given the breadth of access to the rebate. However other members considered it likely that 'acute' action through the immediate removal of the rebate from various claimants would be an undesirable outcome for those affected.

The Consultative Group discussed providing claimants with a minimum of three years of adjustment through equal and incremental step-downs in access to the rebate. The Consultative Group was also of the view that if a shorter timeframe was considered by Government that there should also be a specific and generous industry assistance package designed to support affected participants, and to provide industry exit opportunities.

4. A majority of Consultative Group members recommend the Government phase-in elements one and two of the recommendation to better manage industry transition, along with industry assistance.

PROVIDE FUNDING TO AGWA AND THE EMDG SCHEME TO PROMOTE AUSTRALIAN WINE OVERSEAS

The Consultative Group recommends that savings from any eligibility changes and improved anti-avoidance activity by the ATO be directed, in part, to the AGWA and through additional support via the EMDG scheme to promote Australian wine overseas, and future growth in the industry. AGWA is the Government statutory body for the Australian grape and wine industry and the EMDG scheme is a Government financial assistance program for current and future exporters administered by Austrade.

A clear majority of the Consultative Group agreed that this change is important in assisting the industry to recover from its current circumstances and help it to take advantage of recent improvements in exchange rates and new free trade agreement opportunities.

While there are a range of possible mechanisms through which savings could be returned to industry, the Consultative Group supported the two primary vehicles for support being AGWA and the EMDG scheme. Some group members also noted that there are a range of 'supply-side' measures outlined in the Winemaker's Federation of Australia (WFA)/Wine Grape Growers Australia submission, that could also be considered by Government, including programs that facilitate uptake of more suitable grape growing business models, facilitating more rapid turn-over in vineyards in times of downturn or trend change, and improving the capability of vineyard operators.

More broadly though, Consultative Group members emphasised that the funding matter is urgent if the industry is to improve its global market share and deal with over-supply in the industry.

While a formal Treasury costing of the eligibility changes has not yet been able to be undertaken, the WFA has previously estimated that there should be more than sufficient savings to fund \$43 million over four years to AGWA, along with additional industry assistance.

5. A clear majority of Consultative Group members recommend providing funding to AGWA and providing additional support through the EMDG scheme to promote Australian wine overseas, as part of the 2015-16 MYEFO.

FURTHER WET REFORM

The Consultative Group agreed that their reform recommendation is critical in addressing some of the structural problems caused by the WET rebate. However, a minority of members were also of the view that further future reform is needed to fully resolve the problems faced by the wine industry.

With this in mind, there was a wide-ranging discussion among Consultative Group members as to future areas of reform that the Government may wish to investigate, including in consultation with the industry, and potentially using this Consultative Group if desired.

While there was no consensus on the future reform options and views were held to varying degrees, some ideas follow below. While these ideas are clearly not exhaustive in terms of future options, they attracted some discussion among Consultative Group members, and certainly among many submissions received in response to the discussion paper.

REDUCING THE WET REBATE CAP

Material before the Consultative Group showed that the majority of wine producers in Australia claim significantly less than the current \$500,000 cap and, as a result, any cap reduction may only impact a relatively small number of larger wine producers. A minority of members raised the option of lowering the cap to better target small and regional producers as one possible area for consideration by Government for future reform.

When the WET rebate was originally introduced in 2004 its cap was \$290,000. This was raised to \$500,000 in 2006 when changes were made to the WET rebate in the 2006-07 Budget.

DELIVERING WET REBATE SUPPORT THROUGH A LEGISLATED GRANT SCHEME

Some submissions were received which discussed replacing the WET rebate with a targeted grant scheme aimed at providing support to small regional producers. A grant scheme would administer industry support outside the taxation system and would be able to better target eligibility to wine producers in Australia. However, Consultative Group members were also of the view that this is simply a change in the delivery mechanism for industry assistance, and would face the same eligibility and definitional challenges of a tax rebate arrangement.

Removing the link between the rebate and the tax system could in some cases reduce complexity and compliance costs for industry and government, and could remove any scope to obtain multiple rebates through restructuring arrangements.

Any new grant scheme would need to be consistent with Australia's international trade obligations and would need to consider the constraints on the types and amount of subsidy provided. This overall constraint would present issues for Government in terms of funding support through this mechanism given there is a cap on support that can be provided to the agriculture sector through a direct grant scheme.

Some stakeholders highlighted the role of the WET rebate in investment decisions in winemaking infrastructure, vineyards and cellar doors and emphasised that certainty in relation to industry support would play an important role in further growth and development of the industry.

A minority of members supported the option of delivering WET rebate support through a legislated grant scheme as one possible area for consideration by Government for future reform.

Consultative Group members considered that any exploration of this option by Government should only proceed with a grant scheme whose eligibility is legislatively established so that any changes to eligibility would require Parliamentary amendments. This would help address concerns raised that a grant scheme would provide less certainty to producers.

AD VALOREM WET

In the context of wider and more significant changes to the WET rebate, a minority of Consultative Group members felt that the Government could consider and investigate the implications for industry of longer-term reform of the taxation of wine either as part of or separate to the Government's Tax White Paper process.

The WET is an ad valorem tax that currently applies at a rate of 29 per cent on the final wholesale price on domestic sales of both Australian and imported wine.

Given that the WET is levied on the final wholesale price of wine, more expensive wine is subject to more taxation than less expensive wine. Some submissions to the Discussion Paper argued that because of this, the current system subsidises the production of cheap wine, while penalising the production of expensive, premium wine. Other taxation arrangements for wine, such as a volume based tax on wine, could help address this.