WINES OF
WESTERN AUSTRALIA
Extraordinary Regions

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WoWA response to Exposure Draft of Treasury Laws Amendment (Measures for a Later Sitting) Bill 2017 Explanatory Material (**ED**) 28 April 2017

Wines of Western Australia (**WoWA**) makes this submission to the Australian Government in response to the ED. The ED follows on from the Government's Wine Equalisation Tax Rebate: Tightened Eligibility Implementation Paper released on 2 September 2016. WoWA participated in the industry consultation process conducted by The Hon. Senator Anne Ruston relating to the Implementation Paper at the end of September 2016, and is in general agreement with the outcomes of the consultation and the Fact Sheet accompanying the announcement of the final changes to the WET Rebate scheme on 2 December 2017 (**Fact Sheet**).

However, there are several important respects in which the ED does not appear to follow the position agreed during consultations, or as subsequently announced. These are:

- The proposed amendment to the definition of producer, which appears to disqualify producers who are not also manufacturers from claiming the rebate – this, in effect, introduces the very asset test that had been agreed was not to be introduced.
- The change from the requirement for ownership of grapes at the crusher – which appears to allow trade in grape juice, thereby undermining the integrity measure introduced to ensure that producers claiming the WET Rebate had "skin in the game" prior to the commencement of the manufacturing process by requiring them to own grapes prior to crushing.
- The requirement that 85% of the final product is from source material owned by the producer, rather than 85% of the wine used in the final product – this distinction is important for fortified wine producers and for consistency with other compositional requirements and labelling provisions.

In addition, there do not appear to be transitional provisions dealing with the run out of wine from the 2017 and previous vintages which, while satisfying the packaging requirements, may not satisfy the new ownership of source material or labelling requirements.
WoWA also urges the Government to have regard to the overriding principle of not creating additional, unnecessary, bureaucratic procedures and hurdles in legislating and implementing these changes. The Interim Report of the Senate Select Committee on Red Tape, released in March 2017, discusses the stifling effect of red tape on the sale, supply and taxation of alcohol. This report should serve as a timely reminder of the need to avoid, if at all possible, placing additional compliance burdens on small businesses generally, and small businesses in the alcohol and tourism industries in particular.

Detailed Comments

1. Definition of Producer

The term “producer” is currently defined in the A New Tax System (Wine Equalisation Tax) Act 1999 (**WET Act**) as meaning “… an entity that manufactures the wine, or supplies to another entity the grapes, … from which the wine is manufactured”.
It is proposed that the current definition be repealed and replaced with the following definition: “producer, of wine, means an entity that manufactures the wine”.
This new definition therefore removes the second limb from the current definition, namely the words “*or supplies to another entity the grapes, … from which the wine is manufactured*”. The reason given for this change is that the second limb of the definition will be redundant, as under the proposed changes, a producer must maintain ownership of the grapes throughout the winemaking process. The proposed rules around ownership of source material are not relevant to the question of who is the manufacturer. If the second limb of the definition of producer is redundant under the proposed rules, then it would also have been redundant under the existing rules. However, this is clearly not the case, and the change would result in winemakers, who have their grapes contract processed into wine by a third-party winery, no longer qualifying as producers.
Under the WET Act, “manufacturer, in relation to a particular wine, means the entity that … manufactured the wine, whether or not the entity owned the materials out of which the wine was manufactured”. In other words, the “manufacturer”, for WET purposes, is not necessarily the entity that owns the grapes or other source material, but is the entity that actually manufactures the wine. What the current definition of producer clearly contemplates, and has always been understood to include, is that a producer can either make wine itself or supply grapes to another entity to make wine on its behalf. The proposed change to the definition of producer would eliminate this certainty and make it clear that only the entity which actually manufactures the wine can be regarded as the producer of the wine. This is despite the example given in the ED, which would appear to be at odds with the proposed definition.
It is essential that it remains crystal clear that a producer is able to make wine under contract processing arrangements. The definition of producer should therefore not be changed.

2. Ownership of Source Product

The various references throughout the ED to “excluding crushing”, in the context of ownership of source material, are confusing and contrary to the position accepted during the industry consultation process. The understanding reached with the industry, and announced, was that the test is to be the ownership of the grapes at the crusher. In other words, a producer needs either to grow the grapes itself or buy grapes prior to processing so that the entire manufacturing process is carried out in respect of source material owned by the producer. The explanation that it is “common industry practice” for producers to gain legal ownership of the source material only after crushing does not withstand scrutiny. It was also common industry practice for producers to sell bulk wine and then claim a WET Rebate!
It is not unusual for grapes not to be crushed prior to the commencement of the manufacture of wine, for example in whole bunch fermentation. The system will be significantly clearer and easier to audit if ownership of the grapes is required to be established at the point of delivery into the winery, for example at the weighbridge, or at some other auditable point prior to the commencement of manufacturing.
The ED contains convoluted logic to justify allowing, in effect, a producer not to own grapes at the crusher, but to buy grape juice after it has been processed from grapes. The rationale for requiring grapes to be owned by the producer prior to crushing was two-fold. First, it ensured that the producer had a significant investment in the wine from the very start of the production process, and secondly it provided support and certainty for grape growers in the industry by effectively requiring the grapes to be sold prior to crushing. The currently proposed position will force growers into contract crushing grapes and then selling bulk juice, which is simply shifting the problem a little further down the supply chain from the speculative bulk wine production scenario that currently exists.
At the very least, the words “excluding crushing” should be removed from the proposed changes.

3. 85% of Final Product

The distinction made in the ED between owning “at least 85 per cent of the grapes used to make the wine” (see Fact Sheet, para 6), and owning “85 per cent of the wine that is in its final form” (see ED, para 1.14) is important. Under the ED version, the 15% will effectively include all additives and other ingredients, such as concentrates, fortifying spirits, production and processing aids, etc. Again, this is a departure from the position agreed during the industry consultation process, and will impact most significantly on the fortified wine sector. It will also create confusion and additional administrative procedures due to the differences between the compositional requirements for WET Rebate purposes and for other labelling requirements. The benefit to the Government from such a change is marginal, but the impact on the industry in terms of additional bureaucratic reporting and the potential to be inadvertently disqualified from claiming the WET Rebate is potentially significant.

4. Trademark Ownership

The proposed requirements regarding the ownership and registration of trademarks used in labelling rebatable are generally supported. However, WoWA suggests that the Government allows a longer transitional period and allows flexibility in the structural arrangements for the ownership of trademarks. It is not unusual for producers, for efficient management of assets of a group of related businesses and other legitimate reasons, to hold ownership of trademarks in a separate related entity rather than the trading entity that is the wine producer. Under the proposed changes this would disqualify a producer from claiming the WET Rebate.
An alternative proposal that would avoid the need for significant restructuring of these arrangements would be to allow a related party of the producer to own the trademarks and allow the producer the use of the trademarks, either informally or through formal licensing of the trademarks to the producer. In addition, WoWA suggest that a longer transitional period be allowed for the restructuring of trademark ownership arrangements to bring them within the new rules.

5. Transitional Arrangements for 2017 and Earlier Vintages

The ED contains transitional arrangements for wine made from the 2018 vintage. However, there will be a significant amount of wine from the 2017 and earlier vintages that will not be eligible for the WET Rebate under the new rules if it is not sold before 1 July 2018. This will have a significant impact, particularly on fine wine producers who often do not release wine until several years after the vintage in which the source material was harvested. These producers will probably meet the packaging requirements (although possibly not the trademark requirements) of the new rules, but may not meet the ownership of source material or 85% of final product requirements. It is suggested that, provided these wines meet the packaging size requirements at the point of the first wholesale sale after 1 July 2018, the wines should be exempted from the remaining requirements.

6. Quoting

The proposed quoting rules add more complexity to the WET Rebate system, and, importantly, create confusion and difficulty for producers selling both packaged and bulk wine. The proposed new quoting statements appear to be focused on the circumstances of when a producer will be eligible to claim a WET Rebate, and ignore another important purpose of the quote, which is identifying the circumstances when a producer does not need to charge WET on the sale of its wine, whether in bulk or packaged form.
The changes to the WET Rebate system will mean that a producer cannot claim a WET Rebate for wine destined for export (GST-free supply), wine to be on-sold under quote (which WoWA believes is unfair – see below), or for bulk wine (i.e. to be used as an input to manufacture). However, that does not mean that a producer should not be able to sell its wine under quote, free of WET, in these circumstances, as either WET will not be applicable (export) or will be assessable at a later stage of the supply chain. The ED appears to require WET to be charged in these circumstances at the point of sale by the producer because a purchaser would not be able to give a quote in the revised form. This will create significant unnecessary working capital funding issues for purchasers, unnecessary complexity for purchasers due to the need to rely on WET credits to claim WET paid as an input, and a revenue windfall for the Government.

The proposed quoting rules are also confusing and problematic for producers for two further reasons:

- Onus on producer to verify quote – Section 13-30 of the WET Act provides (in effect) that a quote will not be effective if the producer has reasonable grounds for believing that the purchaser was not entitled to quote, or the quote was false or misleading in a material particular. Under the current rules, producers need only be reasonably satisfied that the purchaser does not intend to make a GST-free supply of the wine. Under the proposed rules wine producers will also need to satisfy themselves that the purchaser does not intend to on-sell the wine under quote or use the wine as an input to manufacture. The proposed rules place a higher onus on the producer to make enquiries of the purchaser and its circumstances, and therefore add an additional layer of administrative complexity, which many small wine producers will be ill-equipped to administer.
- Eligible product to be on-sold - In the context of a producer's wine that would otherwise be rebatable wine (i.e. branded and packaged and ready for retail sale, ownership test met, etc) the proposed quoting rules will unfairly deny a producer access to the WET Rebate where the wine is to be on-sold or used as an input into manufacture. WoWA notes that is difficult to envisage circumstances where a purchaser of otherwise rebatable wine would remove it from its packaging and use the wine as an input into manufacture. More concerning is the denial of access to the rebate for producers whose otherwise rebatable wine is likely to be re-sold by a wholesaler or other intermediary. In either case, unless the ultimate sale is a GST-free supply, WET will be collected in respect of the wine and the producer should still be able to claim a WET Rebate in respect of that wine. The WET credit rules have been tightened, and new rules introduced to make a purchaser who buys under quote liable for the WET. Both of these measures ensure that the WET will get collected, and the producer should not be penalised for these additional steps in the supply chain.

The current quoting rules are effective to identify the circumstances (GST-free supply) in which otherwise rebatable wine will not be subject to WET and therefore no WET Rebate should be available. The proposed quoting rules confuse two issues – when a quote is relevant for claiming the WET Rebate, and when it is relevant for not having to charge WET on the initial sale. Producers should not be penalised as a result of this confusion. Without a simpler and clearer system being tabled, WoWA believes that the current quoting rules are appropriate and should not be changed. WoWA is happy to offer its services to work with the Government to achieve simpler and clearer outcomes for producers.