Fox Creek Wines Pty Ltd (Fox Creek) Wine Equalisation Tax (WET) Rebate – Submission regarding proposed alteration to cap
6 October 2016

Executive Summary

This submission is intended to highlight to the Federal Government the potential damage that may be caused to medium sized wineries, and their regional communities, in the event that the proposed WET rebate cap reduction occurs in the manner and timeframe announced.

Fox Creek recommends that detailed economic modelling be undertaken prior to any move towards reduction of the WET rebate cap from $500,000, to show the potential loss of employment, economic activity and competition that would be associated with medium sized wine businesses receiving less that the current level of support (now received by way of WET rebate).

Fox Creek is supportive however of attempts to better define eligibility to ensure that the WET rebate is only available to legitimate wine businesses making and selling wine in Australia. In the case of the artificial duplication of claims, Fox Creek strongly endorses the complete eradication of this activity, and observes that the Australian Taxation Office has done a good job in this regard. Further moves to eradicate this abuse is endorsed by the company.

The redirection of funding to an industry body, in the manner proposed, would be less efficient than cost conscious wine companies receiving direct support by way of the rebate and utilising that funding to firstly promote wine sales domestically and abroad, and secondly enable innovation within their own enterprises. Industry Bodies receiving funds to enable extensive travel of delegates and umbrella branding activity by groups would do less to assist individual wine companies.

Background Facts

Fox Creek is a family owned wine company that was established in 1984 when the owners first purchased arable land in McLaren Vale to create its vineyard and winery facilities. Over the last 31 years Fox Creek has grown from being solely grape growers to starting their own wine label in 1994 and today owning its own vineyard, cellar door, 1,500 tonne wine processing complex and dry goods and finished goods warehousing. Fox Creek also contracts grapes from 18 different grape growers ($750,000) throughout the McLaren Vale wine region. Fox Creek also employees a contract vineyard management company for its own vineyards ($230,000) as well as contract bottling and associated packaging services from two bottling companies ($730,000), Torresan's Wine Bottling Services in McLaren Vale and Yalumba Wines in Barossa.

Fox Creek produces approximately 500,000 bottles of labelled wine each year at different price points starting at $15 up to $85 per bottle, has distribution throughout Australia by agents in each state and exports to 24 different countries and employees 20 full time equivalent staff with a payroll expense of $1,445,000 per annum.

Fox Creek is budgeted to make a net profit before tax of less than $300,000 in FY 2017. This represents a return of just 4.2% on total assets deployed. Reduction of the rebate in the manner proposed would reduce this return on assets deployed to 1.8%, return that would make most reasonable investors question the risk/return of the enterprise.

Notwithstanding this Fox Creek has made significant investments in enhanced infrastructure, including winery expansion, over the past two years in anticipation of ongoing support from the WET rebate, and will continue to invest in the business as finances allow.

Contrast this with large wine companies (for the purposes of this report – with sales greater than $50,000,000) where the $500,000 rebate is largely immaterial to their operations and profitability, it is easy to see why they are not as concerned with the changes. If anything it is potentially a significant opportunity for them by eliminating competition, with many medium size wineries potentially going out of business.

Similarly, small wine companies (defined in this submission as making wholesale sales of less than $1,000,000) will be unaffected, as they will still continue to their full rebate up to $290,000. It is accepted that these make up a vast bulk of claimants by number.

The key concern we raise relates to the lack of economic analysis done in respect of businesses with sales between these ranges. There are a significant number of these and they employ many people in regional Australia, directly and indirectly.

Operating on a five-year strategic plan cycle, Fox Creek would find it difficult to implement and execute remedial strategies in the short time frame proposed to alleviate this loss of support. Post GFC there is little that can be done in terms of cost reductions (and pushing for example grape price reductions onto growers is not possible due to long term contracts) and moving wines up to higher price points in an environment where retail sales are dominated by two major retailers and large wine companies, is extremely difficult.

Fox Creek has run a detailed scenario analysis in relation to the price increase that would be needed to cover the proposed lack of support. Due to the complex nature of wine distribution throughout Australia and overseas a tiered pricing model exists to make sure consistent recommended retail pricing is maintained. This means that a model of dividing the total amount of lost income, (in this case $210,000) by the number of bottles sold (500,000 bottles = 42 cents per bottle) doesn't work as importer, distributor and retailer/restaurant margins need to be factored in as well as taxes. As such for Fox Creek to generate the $290,000 of reduced WET rebate by increasing gross margin, would mean that recommended retail prices would need to be increased by $4.00 per bottle across every sector (on the assumption that all other costs of doing business remain the same). Fox Creek is happy to be a test case for the Government and to provide the detailed modelling we have done on this subject to assist the Government in understanding the impact that this change will cause the wine industry.

The value of cellar door operations to employment and Tourism is also, in our view, not adequately considered in the announced policy. Again Fox Creek has expanded its number of employees in its cellar door recently and this, together with the significant number of foreign and domestic tourists that visit the facility (FY15/16 17,153 visitors up 20% Year on Year for the last three years in a row), has a significant positive multiplier impact on the McLaren Vale and South Australian economies.

Alternative Suggested Policy Direction(s)

There are a number of alternative policies that we believe should be considered, in order of priority:

1. Retain $500,000 cap indefinitely for eligible claimants, whist significantly eradicating duplicative claims and tightening eligibility criteria to legitimate wine entities making and distributing wine in Australia;
2. Continue with proposed reduction over a five-year horizon, with additional rebates available to businesses where cellar door operations exist in regional Australia, with total support as between the WET rebate and Cellar Door Rebate capped at $500,000;
3. Reduce the proposed reductions whilst also reducing monies directed towards a central Industry Body;
4. Make the WET rebate an element of the Governments Small Business Tax Concessions, available only to businesses with a turnover of less than $10,000,000, together with also tightening eligibility criteria for all claimants.

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