HOWARD vineyard ADELAIDE HILLS

Submission

to the

Australian Federal Government's

Consultative Process

on

Reform to the WET Rebate Eligibility Criteria.

Amos Vignerons Pty Ltd

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6th October, 2016.

EXECUTIVE SUMMARY

We do not support the reduction in WET rebate from $500,000 currently to $290,000. This will adversely impact the financial viability of small wine businesses. The wine industry is just emerging from significant structural hardships caused by a high currency (increased competition, less demand), supply imbalance and poor seasons for FY:2013 and FY:2014.

We do support measures to address the "rorts" caused by loopholes in the current legislation and financial engineering.

We do not consider that the WET Rebate should apply to any imports of bulk or packaged wine under any circumstances: that is contrary to the intent of the original policy to support small winemakers and regional employment.

We support in general the removal of the WET Rebate for bulk and unbranded wine but with the exception that it be continued for owners of vineyards (an asset test). There is a circumstance wherein vignerons may elect to value add or be forced in the absence of acceptable grape prices to process and ferment grapes to bulk wine but without intent to establish a wine label.

We do not support the definition of a "winery" as the exclusive basis to determine eligibility to receive the WET Rebate. The majority of wine brands do not own or lease wineries but rely on access to infrastructure on a fee of service basis. Assent of this proposal will cause massive financial collapse to the majority of small winemakers by denying access to any WET Rebate.

We consider that policy development and legislative changes for any asset test should be based on the original objectives of the WET Rebate:

1. To promote employment in rural communities; and,
2. To assist small winemakers.

We support that a component of WET Rebate be based on the sole criteria of a cellar door and mail order sales. Thus an asset test would rely on the criteria of both a vineyard and a cellar door.

We support an asset test of two from three criteria (vineyard, cellar door &/or winery) for application of eligibility for WET Rebate to provide assistance for small winemakers. We declare a vested interest as investors in vineyards and a cellar door.

We do not support the timetable to implement the reductions in WET Rebate cap and the 1st July, 2019 as the start date of the eligibility criteria (as proposed). In principle, the schedule needs to provide a reasonable transition.

It is our view that the rorts could and should be stopped without delay and similarly foreign access to the WET Rebate which was intended to provide domestic assistance. We consider that legislative amendments should focus on this aspect before further consideration of reducing the cap and adversely affecting the 3,000 odd small winemakers. If the legislation reflects the original policy objectives the rebate pool will be minimised and more acceptable from a national budgetary perspective and there will not be any imperative to significantly reduce the financial viability for the many small winemakers and cellar door owners.

OUR WINE BUSINESS

Our wine businesses were established in 1998 with wine grapes planted at two locations in the Adelaide Hills with an area of 60 hectares and annual production of up to 700 tonnes. Initially, all wine grapes were sold to the major wine companies, but with increasing regional brand awareness and wine sales growth we are more dependent on mid-size wine producers with an Adelaide Hills geographic focus. We established our value-added company in 2006, trading as Howard Vineyard, using exclusively estate grown grapes and currently produce 10,000 cases of wine annually with steady growth in sales. We have achieved domestic distribution in South Australia, Victoria, New South Wales, ACT and Queensland and have commenced limited (trial) exports. Our grapes are processed at two contract winery locations; a small winery in the Adelaide Hills and a medium sized winery at Strathalbyn with bottling and packaging at Angaston in the Barossa Valley. For vintage 2016, 180 tonnes were processed. All operations are overseen and directed by our Executive Winemaker and our wines are marketed exclusively as product of the Australian Geographical Indication zone of Mount Lofty Ranges, appellation: Adelaide Hills. Our Cellar Door, Bistro and Function Centre was established in 2006 and our customer attendance is in excess of 10,000 persons annually and increasing. We have relied upon the support provided, as intended, by the WET Rebate, both as a small winemaker and also cellar door regional employer. Our minimum, sustainable economic size is determined by the maximum WET Rebate ($500,000). Our business plan is predicated on domestic wine sales growth to the maximum WET Rebate.

In summary, we have a capital investment of approximately, $10 million in vineyards, cellar door and wine label. We are significant small business employers (6 permanent and 10 casuals directly; and, around 20 part-time indirectly via contracted vineyard activities plus the economic multiplier of suppliers). For FY:2016 we have finally benefited firstly, from an economic upturn driven by:

- a devalued currency resulting in greater grape prices realised by growers and a more positive, industry outlook for export wine sales;
- improvement in the balance of the supply / demand cycle after 10-years of adversity; and,
- gradual financial recovery from consecutive poor seasons FY:2013 and FY:2014.

Our first 18 years were financially, very challenging but we have overcome the adversity and we are now reasonably established. Our future is focused on increasing sales of Howard Vineyard wines using grapes from our vineyards. ***We expect to be profitable over the near-term outlook, provided punitive legislative amendments do not destroy the financial viability of small winemakers and cellar doors.***

This submission was prepared in response to the Wine Equalisation Tax Rebate: Tightened Eligibility Criteria.

WET REBATE BACKGROUND

Finlaysons (2014)[1] provide an informative precis of the WET. Initially the WET Rebate was introduced in 2000 as part of the GST reform package by the Howard Federal Government. The rebate applied to wine sales from cellar doors and mail order with objectives to provide assistance to small and medium winemakers and promote employment in regional areas. Initially, eligibility for the rebate required a (State) Producer's License. With subsequent amendment the scheme was extended to its current form:

- Cellar door criteria removed;
- No requirement for a Producer's License;
- Extended to New Zealand producers; and,
- Rebate increased to $500,000.

The Finlaysons' report summarises (supposed) unintended consequences (including "rorts") and how the rebate by the ATO had increased significantly in the interim.

It is appropriate to iterate observations from the WFA Action Plan (December, 2013):

- The WET Rebate *"... **remains an important revenue source for small and medium winemakers**..."*; and,
- *"...**without the rebate a significant number of wine businesses would be severely impacted financially**...";*

and, the WFA concluded that the WET Rebate be retained, but in a form aligned with the original intent and advanced a three-stage proposal:

1. Immediate Action
    a. Improve compliance (stamp out rorts);
    b. Re-examine blending rules
2. Legislative Changes in the Near Term
    a. Phase out WET Rebate for bulk or unbranded wine
    b. Restrict eligibility to WET Rebate to Australian producers
    c. Second WET Rebate on mergers
3. Ongoing Policy Review

Thereafter, the Australian Government released the Wine Equalisation Tax Rebate: Tightened Eligibility Criteria (Implementation Paper; Sep. 2016). In the 2016-17 Budget the Government announced:

- M$50 over 4 years for the AGWA for overseas promotion and wine tourism;
- Strengthen the producer rules;
- From 1st July, 2017 reduce the WET Rebate cap from $500,000 to $350,000;
- From 1st July, 2018 reduce the WET Rebate cap to $290,000; and,
- From 1st July, 2019, apply stricter eligibility criteria where a wine producer must own or lease a winery.

The Government has proposed three discussion questions:

1. For rebatable wine, is the proposed definition of packaged and branded wine appropriate?

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[1] Mathew Brittingham. Finlaysons. Wine Equalisation Tax – Back to the Future. Appendix E1

2. For eligible producers, how should a winery ownership and leasing test be applied? What should be the nature and extent of investment in the wine industry required to access the rebate, and how can this be implemented?
3. What is the impact from a 1 July 2019 start date of the tightened eligibility criteria? How might this change from an earlier transition period

QUESTION-1: REBATABLE WINE

We agree the definition of packaged and branded wine is appropriate. Trademarks should be permitted with restriction to access only a single rebate.

The proposed removal of the WET Rebate for bulk or unbranded wine provides a more complex issue. If the intention is for the ATO to avoid rorts by those blending then it is entirely reasonable, subject to the following proviso. There is the circumstance of growers' processing wine grapes and selling as bulk wine either involuntarily with unsold fruit (insufficient demand or price) and/or voluntary to take the risk of value adding to achieve a better price. In this case access to the WET Rebate for sale of bulk or unbranded wine is reasonable but, should be subject to an appropriate eligibility test. Perhaps an appropriate test, is for ownership of a vineyard. Larger producers would not be disadvantaged since they would be above the WET Rebate cap.

In regard to imports, we do not accept that wine sourced from other countries should be eligible as Rebatable Wine (refer Q 2 below) under any circumstances.

QUESTION-2: ELIGIBLE PRODUCERS – OWNING OR LEASING A WINERY.

We are <u>not persuaded</u> that asset tests should not be applied and consequently, that there be no restriction on what constitutes an Eligible Producer.

In the first instance wine imported from another country, either in bulk or packaged, should not be eligible for the WET Rebate. Such access by NZ producers, for example, is inconsistent with the twin Government objectives of supporting small winemakers and regional communities in Australia. In fact it is obvious that the more than twice fold expansion of NZ imports (21 to 51 million litres between 2007 and 2012) has harmed Australian producers and particularly those producers of Sauvignon Blanc. This was exacerbated by the currency advantage of NZ until recently. (Would the French support this policy and extend such largesse to Australian producers?)

The proposed definition for ownership or leasing of a "winery" is too narrow. There is a great number of vineyards, a large number of cellar doors but a much fewer number of wineries (*ie*. as identified by crushing, fermenting and bulk storage facilities of commercial scale). Any asset test should be based on one or more of a vineyard, cellar door and/or winery rather than exclusively on a "winery".

In our view the Government should reconsider and focus on the importance and relevance of the original, two key policy objectives: i) to promote employment in regional communities and ii) to assist small winemakers. We consider these as somewhat separate and independent objectives.

Cellar doors (and bistros) provide a component of tourism in general. Our experience is that employment is constrained by primarily weekend activities which are coincident with maximum penalty rates for staff wages. Further vignerons seeking to value-add do not have easy access to distribution channels and there is a natural barrier to entry until threshold scale is achieved. For those producers and the regional objective there is a compelling argument to provide a component of WET Rebate tied to cellar door and mail order sales. The asset test becomes a vineyard and a cellar door. If there is no WET Rebate applying only to Cellar Doors then we are penalised in part for providing regional employment and wine tourism.

An argument was developed elsewhere and promoted to potential authors of submissions that younger winemakers represent (indispensable) innovators but as new entrants face barriers to entry with an asset test. "Innovation" is not the exclusive domain of one sector only. Further, in our view the wine industry is very, very competitive and effectively there are no (or limited) barriers to entry as demonstrated by the >3,000 domestic wine brands. It may well be argued that with large sums of capital committed to vineyards, cellar doors & wineries that upstream producers have a greater barrier to enter the market for packaged wine sales owing to capital limitations (and the lesser return on equity of agriculture). A virtual brand (ie. no fixed assets) may concentrate scarce capital upon inventory and marketing and gain advantage. Innovation with alternative varieties relies upon the vigneron accepting the risk of long lead times (4-7 years to maturity). There may well be alternative policies to promote "innovation" rather than unfettered extension of the WET Rebate.

The specific purpose of the policy target of supporting small winemakers needs further debate. Should there be a component of WET Rebate to support small winemakers separate from regional employment in cellar doors?

QUESTION-3: 1st JULY, 2019 START DATE

At our stage of business development our operating margin on wine sales is effectively, approximately equal to the 29% WET Rebate. Any loss of the amount of rebate will have a dramatic affect on our business economics. Rapid changes to the rules over a short period will exacerbate the financial challenges. If the asset test is to be introduced as proposed (ie. A "winery") then a longer transition not less than five years would be more reasonable.

The potential impacts of the proposed changes and timetable are illustrated beow by scenario analysis.

Scenario-1: Government proceeds as per 2016-17 Budget

In this scenario it is difficult to foresee any alternative to a distressed sale or collapse of our value adding business (sale of estate wines). It is unlikely we could re-adjust our business model in sufficient time to recover from the loss of 29% of wine sales revenue given we neither own or lease or have the financial resources to own or lease a winery. This directly affects approximately 15 full and part-time staff and with knock-on to suppliers. Further it reduces the viability of our vineyards since we would need to substitute buyers for ~200 tonnes of wine grapes; probably with greater risk of lesser grape prices.

In our view the greatest risk lies with the proposed reduction in WET Rebate cap rather than implementation of the asset test by 1st July 2019.

We respectfully submit that the WET Rebate not be reduced from the existing cap of $500,000 (owing to the dramatic adverse impact on small producers, the 80% of the participants in the wine industry) but that eligibility be constrained to limit the gross impact on ATO revenues to more palatable levels. Rorts should be eliminated and foreign access to the WET Rebate be terminated as inconsistent with the original policy objectives.

Scenario-2: No asset test; WET Rebate reduces to $290,000

Effectively we would lose access to the balance of $210,000 in WET Rebate (*cf* previous maximum of $500,000). All else being equal our operating profit will fall by $210,000 and it seems doubtful, given the competition in the wine industry, that margins could be increased to compensate. It is unlikely, given the competition and the cost of increased inventory that gross wine sales could be increased in a short period to compensate for the loss in rebate.

Scenario-3: Asset test vineyard, cellar door &/or winery – WET Rebate $290,000

We should qualify for the full WET Rebate but the financial challenges remain as for Scenario-2. Virtual wine businesses without assets would not receive the WET Rebate and will be less competitive. Complex economic modelling would be required to forecast the outcome since there are many impacts including: possibly less suppliers; will demand remain near constant?; will receivers of rebates increase sales *cf* others?; will prices rise and margins improve, etc. etc.

Scenario-4: Base Wet Rebate $290,000 and an additional Cellar Door WET Rebate $210,000

Under this scenario we would retain the general assistance for small winemakers. We would continue to be encouraged to expand our cellar door tourism and mail order sales efforts and not be penalised for owning and running a cellar door and promoting regional employment.

<u>This is the best scenario for small winemakers and owners of cellar doors (& vineyards).</u>

Yours faithfully,

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