WINES OF
WESTERN AUSTRALIA
Extraordinary Regions

Wines of Western Australia
Wine Equalisation Tax Position Paper

August 2016

Wines of Western Australia

Wine Equalisation Tax Position Paper
August 2016

Table of Contents

	Page
Executive Summary	1 - 4
- Core Principles from Industry Engagement	3
- Revenue Neutrality of WoWA Integrity Measures	4
Explanatory Addendum	5 - 14
- Significance of Wine Industry to Regional Economies and Tourism	5 -7
- Impact of Announced Changes on Regional and Rural Economies	8 - 10
- Wines of WA Proposed Integrity Measure Amendments	11 - 14
Appendix	15 - 25
- 1999 WIAWA Letter to Government	15 - 20
- Schedule 1 – WET On-cost to Producers: Large vs Small	21
- Schedule 2: Impact of WET on Retail Price: Large vs Small	22

Wines of Western Australia
Claremont Showgrounds, Lou Giglia Pavilion, Gate 1, Graylands Rd, CLAREMONT WA 6010.
PO BOX 2091, Claremont North WA 6010
T– 9284 3355 **F –** 9284 2199 **E** – winewa@winewa.asn.au **W –** www.winewa.asn

Wines of WA Wine Equalisation Tax Position Paper

Executive Summary

In the 2016 Federal Budget, the Government announced changes to the WET Producer Rebate (WET Rebate). Wines of WA (WoWA) supports the policy objectives behind the changes, namely addressing integrity concerns, better targeting support, and tightening eligibility for the WET Rebate. However, following extensive consultation with local industry, WoWA is very concerned about the direct and indirect consequences of the announced changes for regional growth and development, and regional communities. These consequences, which we believe are unintended, will have significant negative social and economic impacts in Australia's regional communities in which wine producers are based.

It is important to remember the history of the WET Rebate and why it was introduced. WET as a value based tax places smaller fine wine producers at an enormous disadvantage relative to large producers, as it results in substantially higher tax being paid on high value fine wines relative to lower value wines. This was well explained in a paper written in 1999 by the Wine Industry Association of Western Australia, the predecessor to WoWA, (see Attachment A) which remains just as relevant today as it was 17 years ago. The current proposals to reduce and remove the WET Rebate for smaller producers today raise the same issues that were canvassed in the 1999 paper. History is repeating. The WET Rebate was introduced to support small and medium wine producers in regional and rural Australia with domestic sales, and to effectively exempt those wine producers from WET. WoWA agrees that the WET Rebate needs to be refocused on this objective.

WoWA recognises the need for the positive Budget outcomes from the announced changes to be maintained and does not wish to, and believes that its alternative integrity measure amendments set out below will not prejudice those outcomes. WoWA and its members believe that the positive Budget outcomes announced by the Government can be achieved without negative regional growth and development consequences, while refocusing the WET Rebate to its original purpose of supporting small and medium wine producers in regional and rural Australia. **We believe the savings are greater than presented in the paper. We feel it is essential that industry is provided with the modelling used by Treasury in setting the forward estimate savings so that a forensic analysis of proposed alternatives can be undertaken.**

The overall WET Rebate should not be cut for smaller producers until such time as the inequitable basis of wine taxation of wine is addressed. We support longer-term reform of wine taxation to a system that is simpler and fairer. A tax based on the value of the product, not the volume of its contents, is inequitable to fine wine regions.

A further point which should be addressed at the outset is the notion that the AGWA funding allocated in the budget will allow small producers to take advantage of the recently concluded free trade agreements. The reality is that the vast majority of small wine producers do not have the scale, expertise or marketing budget to access export markets. While it is true that these small producers will generally also be claiming less than $290,000 in WET Rebate, there are many medium sized producers that now claim, or in building their businesses to the scale necessary to access the export markets would have claimed, between $290,000 and $500,000 in WET Rebate whose businesses will be significantly damaged by the reduction in the cap. Even if these producers are able to access export

Wines of WA
Claremont Showgrounds, Claremont WA
T - +61 08 9284 3355 E – winewa@winewa.asn.au

markets under the FTAs, and this is not at all certain given the competitive disadvantages they have relative to the large producers who are already targeting these markets, it will take many years to build export sales to the point where they compensate for the loss of the WET Rebate.
Industry engagement included:

- A survey of producers conducted by RSM Australia.
- Industry "town-hall meetings" facilitated by Wines of WA and WA Members of the Federal Government. These meetings formed part of an informal consultation process by the Federal Government. Senator Anne Ruston visited most wine producing states in June 2016. The process included 4 meetings in the following regions and towns: Mt Barker, Pemberton, Busselton and Swan Valley.
- Extensive written and verbal communications with Regional Wine Associations. The positions documented in this paper have been ratified by all fine wine regions in WA.

Summary of Integrity Measure Amendments Proposed by WoWA

The integrity measures amendments which WoWA supports to achieve these aims are as follows. The reasoning behind these measures are set out in the attached Explanatory Addendum.

1. **Eligible Product (rebatable wine):**

As announced, access to the WET Rebate should be limited to packaged, branded wine which is for sale to domestic customers, and bulk and unbranded wine should be excluded from the WET Rebate. The phase out should happen on an accelerated timeline.

2. **Eligible Producer:**

Maintain the current definition of producer (being an entity that manufactures the wine or supplies to another entity the grapes, other fruit, vegetable or honey from which the wine is manufactured), but add two important additional criteria; that an eligible producer must:

(a) operate from a place of business in a wine region; and

(b) maintain ownership of the grapes from which such wine is made from the crusher to the finished bottled and branded product, allowing for up to 25% blending of third party product to tolerate seasonal and style influences.

3. **Overall WET Rebate Cap maintained at $500,000**

Maintain the overall rebate of $500,000 available on cellar door or direct sales and cap wholesale sales at $350,000, transitioned in over four years.

4. **Target the WET Rebate to Small and Medium Producers**

We encourage the Government to consider restricting access to the WET Rebate to small and medium wine producers. The WET Rebate was never intended to support significant scale of operation businesses in the Australian wine industry.

Wines of WA
Claremont Showgrounds, Claremont WA
T - +61 08 9284 3355 E – winewa@winewa.asn.au

Core Principles from Industry Engagement

1. The WET Rebate has provided the intended support and enormous benefit to wine regions and communities across regional and rural Australia, and must continue to do so. It has been instrumental in enhancing tourism and winery/vineyard infrastructure developments and regional employment. Authentic producers provide regional employment and growth, and drive tourism. ***That is the essence of the rebate, to support small and medium wine producers in rural and regional Australian wine communities.***

2. The industry is concerned that access to the WET Rebate by parties that it was never intended to benefit has led to market distortions and is substantially eroding the protection to small and medium Australian producers that the WET Rebate was intended to provide. ***The integrity and original intent of the WET Rebate must be restored as soon as possible.***

3. ***The Eligible Product changes announced in the Budget are strongly supported and should be introduced as early as possible.***

4. An eligible small or medium producer is genuine by their actions and commitment – not the size or nature of their investment. ***Genuine producers who purchase or grow grapes instead of trading bulk wine provide certainty for growers and processors and true market signals for removing or planting vineyards and fruit pricing. These actions provide certainty and profitability across the value chain.***

5. To **restore integrity and simplify** the Eligible Producer definition, two additional limbs to the definition should be added: that ***the producer must operate its business from a wine region,*** and that ***custodianship and ownership of the grapes should be maintained from the crusher to the finished, branded product,*** with no more than 25% third party wine blended in to allow for seasonal or style variables. This directly targets the WET Rebate to genuine producers based in wine regions, is very easy to audit utilising the Wine Industry Label Integrity Program (LIP) requirements, and recognises that eligible producers may adopt a variety of business models that are equally legitimate.

6. The premium wine industry is a vital component of Australia's tourism industry, particularly in regional and rural Australia. The damage caused by any reduction in support for the wine industry will be felt throughout the tourism industry. Excluding genuine cellar door operations from any WET Rebate reduction will ***support our tourism industry by encouraging continued investment in cellar doors***.

7. The Industry Assistance Fund that aims to strengthen regional wine communities should be based on a strategic intent to provide an enduring outcome. ***The investment should complement state and regional development programs to amplify efforts and results.***

8. ***Future taxation reform*** – we support longer-term reform of wine taxation to a system that is simpler and fairer. A tax based on the value of the product, not the volume of its contents, is inequitable to fine wine regions.

Wines of WA
Claremont Showgrounds, Claremont WA
T - +61 08 9284 3355 E – winewa@winewa.asn.au

Revenue Neutrality of WoWA Integrity Measures

See Table 1 below comparing the Forward Estimates from the Budget 2016-17 announcement with the position outlined by WoWA in this submission. This demonstrates that the positive budget outcomes announced can be maintained or improved while addressing integrity concerns, better targeting support and avoiding unintended consequences for regional and rural communities. We have assumed a conservative estimate of 25% of rebate claims between $290K and $500K to be bulk and unbranded. WoWA modelling suggests this could be as high as 50%, which increases the savings.

The assumptions that the WoWA calculations are based on can be easily verified by the Government. Note that they do not include a costing of the benefits of introducing two key elements of the WoWA integrity measures:

- a two-tiered rebate cap, which ***refocuses the rebate back to its original intent*** and will provide additional savings from the status quo of a $500,000 cap, by limiting the amount that can be claimed on wholesale sales to $350,000 and;
- the additional eligible producer criteria that a producer operate from a wine region and maintain ownership of the grapes from the crusher.

WoWA does not have available to it the data necessary to make any credible estimate of the savings from adopting these two positions, but would be happy to work with the Government to establish what those benefits would be.

REVENUE NEUTRALITY OF WOWA POSITION						
WET Rebate Integrity Measures - Forward Estimates from Budget 2016-17						
Revenue ($m)		**2016-17**	**2017-18**	**2018-19**	**2019-20**	**Total**
Cap reduction		0	50	70	70	**190**
Bulk wine and unbranded		0	0	0	110	**110**
Less AGWA		2	16	15.9	16.1	**50**
Net		-2	34	54.1	163.9	**250**
WoWA Position on WET Rebate Integrity Measures						
Revenue ($m)	Note	**2016-17**	**2017-18**	**2018-19**	**2019-20**	**Total**
Cap reduction	1	0	0	0	0	**0**
Accelerate bulk wine and unbranded ineligiblity	2	0	0	110	110	**220**
Bulk wine and unbranded - $290k to $500k	2,3	0	12.5	17.5	17.5	**47.5**
Large producers	4	0	15	15	15	**45**
Less AGWA		2	16	15.9	16.1	**50**
Net		-2	11.5	126.6	126.4	**262.5**
Notes: Assumptions for WoWA Position calculations						
1 no cap reduction - rely on other measures to achieve budget savings						
2 accelerate elimination of bulk and unbranded eligibility						
3 assumed percentage of bulk and unbranded claims in $350-500k and $290-350k bands, say						25%
4 30 largest producers no longer eligible						

Table 1 – Revenue Neutral Options for WET Integrity Measures

Wines of WA
Claremont Showgrounds, Claremont WA
T - +61 08 9284 3355 E – winewa@winewa.asn.au

Explanatory Addendum

Significance of the Wine Industry to Regional Economies and Tourism

The significance of the Australian wine industry is well documented. The wine industry creates and provides:

- $40.2 billion per annum in output
- $19.7 billion in value added
- $10.4 billion in household incomes
- 172,736 FTE direct and indirect jobs

(AgEconPlus Consulting "Economic Contribution of the Australian Wine Sector" December 2015, Commissioned by the Australian Grape and Wine Authority) (AgEcon Report – available here)

The Australian wine industry is dominated by a few major producers, with 2 of these accounting for over 50% and 16 accounting for more than 86% of production. Some 2,500 producers account for less than 14% of production.

Number of wine producers by tonnes crushed from 2012 to 2015:

	2012	**2013**	**2014**	**2015**
Less than 10 tonnes	470	543	557	548
10 to 19 tonnes	423	449	434	391
20 to 49 tonnes	540	553	545	506
50 to 99 tonnes	350	316	318	328
100 to 249 tonnes	261	235	247	229
250 to 499 tonnes	158	147	143	146
500 to 999 tonnes	87	85	86	81
1,000 to 2,499 tonnes	55	52	58	61
2,500 to 4,999 tonnes	42	36	33	27
5,000 to 9,999 tonnes	18	16	14	12
10,000 to 19,999 tonnes	12	14	15	9
20,000 or more	19	17	13	18
Unknown or don't crush	97	109	110	125
Total	**2,532**	**2,572**	**2,573**	**2,481**

Source: The Australian and New Zealand Wine Industry Directory, 2015

Wines of WA
Claremont Showgrounds, Claremont WA
T - +61 08 9284 3355 E – winewa@winewa.asn.au

This submission focuses on the importance of the wine industry to the Western Australian regional and rural economies in which it is situated, and the aspects of the industry that are unique to WA. In addition to its direct and indirect contribution as an industry sector, the WA wine industry is also a critically important part of the tourism industry, Western Australia's largest industry, and its biggest employer.

The WA wine industry is located in 9 premium wine growing regions. More than 90% of production is located in the state's south west, mainly in the Margaret River and Great Southern regions. WA producers are predominantly small, family owned businesses, focusing on premium wine. In 2015, nearly 90% of WA producers processed less than 500 tonnes of fruit, and nearly 70% processed less than 100 tonnes of fruit. A significant proportion of sales are based on cellar door/wine tourism activities and direct to consumer sales, and WA producers sell more wine domestically as a proportion of total sales than most other Australian states. These businesses form an integral part of the regional economies in which they are located and employ a significant number of people in those economies.

WA is a relatively low yield, high cost producer of high quality fine regional wines. It produces 45 million litres of wine annually, representing nearly 4% by volume of Australia's production, but 12% by value. It produces around 25% of Australia's fine wine. The future of the wine industry in WA lies in the continued production of fine wine from WA's premium wine regions at premium prices.

In May 2016 WoWA commissioned RSM to conduct a survey of the WA wine industry (WET Reform Consequences – available here) which was responded to by 194 (55%) of the estimated 350 active wine producers in WA (interestingly, ATO data indicates that there are 444 claimants (wine producer) of the WET Rebate in WA). These respondents represent 85% of the wine production in WA and directly provide 2,157 full time jobs, mainly in regional areas. It is important to note that the survey did not seek responses regarding the number of part time or casual employees, and made no reference to contracted employees that are engaged in the industry. Of the 156 non-respondents, it is estimated that the majority of these were small producers crushing less than 100 tonnes. The survey also did not include an estimated 200 grape growers who do not produce wine but supply fruit to these wine producers.

Wine and grape production at the scale generally undertaken by the industry in WA is heavily labour and capital intensive. In addition to direct employment and economic activity generated by wine producers in WA's regional areas, many flow on full time, part time and casual jobs are created by businesses that are reliant on the wine producers. These include vineyard contractors, labour hire companies, winemaking facilities, bottling lines, freight companies, warehouses, producers of dry goods such as labels and packaging, and so on, most of which are also regionally based. No estimation has been made of these related and interdependent jobs.

Tourism is the largest industry in WA, and employs 94,000 people with over 7,000 of those in the south west of WA. Tourism in WA is set to generate over $8.5 billion in in 2016, with an aim to reach $12.4 billion by 2020 (source: Tourism WA). In the Margaret River Region alone, the Margaret River Busselton Tourism Association (MRBTA) is focussed on increasing visitation from 1.164 million overnight visitors and $521 million spend in 2013, to 1.63 million visitors and $729 million spend by 2020, a growth of 40%. The MRBTA said in June 2016 that "the wine industry is the cornerstone of tourism in the Margaret River Region, and continues to be the key focus in our destination marketing strategies … the impact [of reduction in the rebate] to our local industry will result in reduced cash flow;

Wines of WA
Claremont Showgrounds, Claremont WA
T - +61 08 9284 3355 E – winewa@winewa.asn.au

potential job losses and in some cases, the closure of some smaller operations all of which would be detrimental to both tourism industry, and the local economy". This is consistent with and a microcosm of the importance of the wine industry in other regional tourism destinations in the south west of WA and in other regional tourism destinations throughout Australia that include wine producing areas.

At a national level, WA's south west region was ranked 12th in Australia in terms of tourism expenditure in 2013-14 (source: Austrade). Tourism Australia has developed a food and wine strategy built around the concept of "Restaurant Australia" that seeks to capitalise on gourmet tourism and is underpinned by the quality and diversity of premium Australian food and wine, and will be a major feature of its global marketing campaigns. A May 2014 survey by Tourism WA confirmed that good food, wine, local cuisine and produce was the 4th most influential factor when choosing a holiday destination, with almost two thirds of visitors regarding this factor as important.

Wines of WA
Claremont Showgrounds, Claremont WA
T - +61 08 9284 3355 E – winewa@winewa.asn.au

Impact of Announced Changes on Regional and Rural Economies

The key issues of concern with the announced changes are the reduction in the WET Rebate cap within two years to $290,000, and the change to the eligibility criteria which would require a producer to own an interest in a winery.

Cap Reduction

Small and medium wine producers operate at the premium end of the wine market and make a huge contribution to the reputation for quality that Australian wines enjoy, both domestically and internationally. However, they generally do not have the economies of scale that large producers are able to achieve in grape production, purchasing power of inputs or wine making volumes. Their production techniques, marketing and sales and distribution channels are also very different to the major producers and much more expensive. This requires premium wine producers generally to charge more for their wines than large producers and this pricing differential is magnified by the WET system. The result is that it is very difficult for small and medium producers to achieve sustained profitability under a system where taxation of wine is based on value rather than volume. The distance to market WA faces also makes this system worse as we pay WET on freight costs inputted into our cost of goods, including getting dry goods into WA and the finished product to market.

This was recognised by the Government in 2000 and 2004 when the WET Rebate was introduced and expanded with the intent of ensuring that "Around 90% of wine producers will be able to fully offset their WET liability by accessing the new rebate. In particular, small wine producers in rural and regional Australia will benefit significantly, receiving around 85% of rebate benefits." (Tax Laws Amendment (Wine Producer Rebate and Other Measures) Bill 2004, Explanatory Memorandum at para 1.6). It is clear from this and other statements made at the time that the intent of the WET Rebate was to provide relief to small and medium wine producers from the WET, in recognition or the important contribution of those producers to regional tourism and regional employment.

The WET Rebate Consultative Group's report in October 2015 found that since its introduction, the WET Rebate has underpinned investment in regional areas in winemaking infrastructure, vineyards and cellar doors. This has enabled the number of smaller winemakers to increase, and the increase in producers has created diversity in the wine industry, which has in turn supported tourism and regional employment.

A 2011 survey of WA wine producers conducted by WoWA found that for 95% of respondents the WET Rebate was critical to the profitability of their business. Any reduction in the WET Rebate for producers in these regions will have a significant flow on effect, and for many producers will mean the difference between a profitable and a loss making business, and will require substantial changes to their businesses in order to survive. The WoWA 2016 Survey revealed that:

- 23 WA producers claim the full $500,000 rebate, which is 29% of all producers nationally who claim the full rebate
- 24% of respondents (46 producers) claim more than $290,000 in WET Rebate
- 68% of respondents felt they would require an unsustainable price increase to compensate for the reduction in the rebate

Wines of WA
Claremont Showgrounds, Claremont WA
T - +61 08 9284 3355 E – winewa@winewa.asn.au

- 58% would reduce the amount they invested in regional promotion and development
- 63% would reduce the amount they invest in innovation to improve or expand their business
- 50% would reduce the number of people that they employed, including 30 of the 46 respondents who currently claim more than $290,000 in rebates
- 24% would require an exit from grape supply contracts due to expected reduced sales

Eligibility Criteria

The announced changes also included a significant change affecting the eligibility of some producers to claim the WET Rebate at all; that is the requirement to own an interest in a winery. The WoWA 2016 Survey found that 43% of respondents (84 producers) do not have an interest in a winery. These businesses provide 1,307 full time jobs and currently claim $9.9 million in rebates. Almost all of the producers that have no interest in a winery do have an interest in a vineyard (79 of 84 respondents). These 79 businesses represented nearly $11 million in cellar door sales and $23 million in domestic bottled wholesale sales. In addition, WoWA estimates that of the 156 non-respondents, 94 do not have an interest in a winery. The $9.9 million figure and the jobs figure do not include these non-respondents. In all, it is estimated that over 50% of WA's 350 wine producers do not have an interest in a winery and would therefore be ineligible to claim the WET Rebate under the announced changes.

A large number of the responses to the WoWA 2016 Survey indicated that as a result of the announced changes producers would be re-evaluating their continuation in the wine industry at all. However, producers that are dependent on the WET Rebate for their survival are often in that position due to the competitive disadvantage that the current value based system of wine taxation places on premium wine producers. Without the inequities of this tax, they would in many cases be profitable. The effect on regional and rural economies and communities of significant numbers of small and medium producers being forced out of the wine business as a result of the announced changes would be disastrous.
The AgEcon Report states that "Input-Output analysis has shown that the average effects of a contraction or expansion within the wine sector suggests:

- The economy would gain an extra $2.01 million for every additional $1 million of gross output generated by the wine sector.
- The economy would gain an extra $2.17 million in contribution to value-added for every additional $1 million of value-added generated by the wine sector.
- The wider economy would gain an extra 1.53 jobs for every job gained in the wine sector."

These responses and the AgEcon Report illustrate that the flow on effects of a reduction in the cap and the change in eligibility criteria for WA's regional and rural economies would be far greater than the estimated $18 million p.a. in lost rebates.

According to Australian Grape and Wine Authority levy collection data, at a national level there are 778 wine production facilities. The number of levy payers who own fruit at the crusher is 2,928. Therefore, almost 75% of Australian wine producers do not own wine

Wines of WA
Claremont Showgrounds, Claremont WA
T - +61 08 9284 3355 E – winewa@winewa.asn.au

processing facilities, and will be ineligible to claim any part of the WET Rebate under the new eligibility rules. The impacts outlines above are likely to be replicated in every wine region in Australia.

Wines of WA
Claremont Showgrounds, Claremont WA
T - +61 08 9284 3355 E – winewa@winewa.asn.au

Wines of WA Proposed Integrity Measure Amendments

Eligible Product Definition

WoWA supports the Government's announcement that access to the WET Rebate should be limited to packaged, branded wine which is for sale to domestic customers, and bulk and unbranded wine should be excluded from the WET Rebate. The phase out should happen on an accelerated timeline.

Eligible Producer Definition

WoWA does not support the Government's announced tightening of the eligible producer definition which would require ownership of an interest in a winery. This criteria fails to recognise that there are many equally legitimate business models that small and medium producers may adopt in an effort to achieve a sustainable and profitable business. If the winery ownership requirement is retained, then as described above the immediate effect would be to disqualify 50% of the wine producers in WA from claiming the WET Rebate at all. WoWA believes that this, and the disastrous consequences for the communities in which these producers operate, is not what was intended.

Due to the competitiveness of the wine industry, and the significant capital cost involved in entry into the wine industry, small and medium producers have developed a variety of business models that efficiently utilise limited capital, expertise and resources. These business models, which may or may not include cellar doors, include:

1. Own and/or lease vineyard resources and utilise contract wine processing facilities;
2. Establish a wine processing facility, offering contract processing services and purchase or grow grapes;
3. Purchase fruit, engage a contract processor and mature commercial quantities of branded stock. The investment is in stock and regional marketing. (e.g. how Wolf Blass started)
4. Purchase fruit, make wine in a rented winemaking facility and direct market branded wine; a method successfully used by many young and innovative winemakers with skills but limited capital.

Common to all of the above business models is financial risk and ownership of grapes at the crusher and custodianship though to finished, branded product. Also common to all of these business models is that the activities are based in wine regions.

The economic activity, employment and societal benefits and diversity that these business models bring to the regional areas in which they are based are vital to the economic and social health of those regions.

Wines of WA
Claremont Showgrounds, Claremont WA
T - +61 08 9284 3355 E – winewa@winewa.asn.au

The WA wine industry firmly believes that a winery asset test will lead to unintended consequences and inefficient use of limited capital.

Producer Rebate Cap

WoWA does not support the Government's announced reductions in the WET Rebate cap. We believe that this proposal ignores the purpose for which the WET Rebate was introduced, which was to ensure that small and medium wine producers in regional and rural Australia were protected from the effects of WET, thereby supporting the wine and tourism sectors in the regional economies in which those producers are based. **WoWA believes that the alternative measures in this submission will eliminate the abuses of the WET Rebate and deliver the announced budget savings without any need to depart from the original intent of the WET Rebate.**

We propose that the overall WET rebate cap effectively remains at $500,000 on Cellar Door/direct sales with a cap on wholesale at $350,000, to be transitioned in over 4 years.

Historically, Cellar Door sales (sales to unlicensed individuals) were always eligible for a full tax rebate (part funded by state governments and part federal governments). When the WET was introduced, after consultation with the wine industry this position was maintained through the introduction of the WET Rebate, while recognising that a substantial portion of small and medium producer sales will also be though wholesalers.

The benefits of limiting the claim to $350,000 of wholesale sales (licensed sales) should be considered, and are as follows:

- NZ claimants can only claim $350,000 as they don't have a cellar door in an Australian Wine Region.
- 90% of small wine producers will not be affected as they do not claim the full $500,000 presently.
- We estimate 10 wine producers in WA that claim above $350,000 rebate on wholesale sales don't have a cellar door. A producer that only sells through wholesale (licenced channel), will then need to consider establishing a cellar door to access additional WET rebate, up to the cap of $500k. The incentive is now to invest in regional development via a tourism facility – the cellar door.

The economic benefits of cellar doors to regional Australia are undoubted. They create jobs and are major tourist attractions.

The definition of a Cellar Door/direct sale needs to be clear: it is for all "on and off premise" sales (including internet, phone and mail order) to an "unlicensed" person from premises located in a wine region of Australia controlled by the producer.

Wines of WA
Claremont Showgrounds, Claremont WA
T - +61 08 9284 3355 E – winewa@winewa.asn.au

Target the WET Rebate to Small and Medium Producers

It is clear from a review of the rationale for the introduction of the WET Rebate that it was never intended to be accessed by anyone other than small and medium producers in regional and rural Australia. Under the current system, and the announced changes, the WET Rebate is accessible by any taxpayer who produces eligible product, regardless of their size or location.

Several of the largest businesses who currently claim the rebate, and will continue to be eligible to claim the rebate under the announced changes, have the scale of operation to produce lower cost wine that a value based taxation system benefits. The introduction of the WET rebate equalised the burden per unit to higher cost smaller fine wine operators.

Continuing to allow the rebate to be accessed by these businesses is simply a waste of tax-payers' money.

In our calculations of the WET Rebate position if the WoWA changes in this submission were accepted, we have assumed that the top 30 businesses currently claiming the rebate will no longer be eligible.

Wines of WA
Claremont Showgrounds, Claremont WA
T - +61 08 9284 3355 E – winewa@winewa.asn.au

Wine Industry Association of Western Australia (Inc.)
R.A.S. Showgrounds,
Claremont 6010
P.O. Box 83,
Claremont W.A. 6910
Telephone: (+61 8) 9385 1699
Fax: (+61 8) 9385 1538

23rd December, 1999

DESTRUCTION IN REGIONAL AUSTRALIA

(Sent to All Federal Government Members of Parliament)

This letter represents a genuine attempt to put before you a very significant problem your WET legislation is going to bring about in Regional Australia, which in the view of many is of such magnitude that alone **IT HAS THE POTENTIAL TO UNSEAT YOUR GOVERNMENT AT THE NEXT ELECTION.**

Significant changes are occurring in the Australian wine industry that many are totally unaware of and which are going to have an enormous adverse effect on small wine producers and their communities.

Your Government has not recognised this and has with the WET introduced a value based tax that will compound the problems small producers will face to a point where many will not survive financially.

This letter outlines the problem and the solution.

By way of background, in 1995 the Industry Commission held an inquiry into taxation on the wine industry and concluded that a GST type tax, along with a volume tax, was appropriate - not a value based tax as you have introduced.

The Treasury officials recognising this, initially put forward a volume based tax to your Government, and it was only the lobbying of "the big end of town" that resulted in the change of mind to the value based WET.

The wine industry in Australia is in the control of a few major companies, with 20 accounting for over 95% of all wine produced. Some 1,200 small, mainly family businesses account for the remaining 5%.

Because over 60% of the major producers' Australian sales are comprised of cheap cask wine, a value rather than volume tax gives them a substantial benefit over small producers who do not sell cask wine.

A value based WET is "inequitable and unjust" on small wine producers. Let me explain why.

The large companies have 75,000 to 100,000 tonne wineries - some 100+ wineries in Western Australia by comparison handle 33,000 tonnes between them.

Obviously small producers cannot therefore enjoy the economies of scale of the large in production or distribution. The value based WET compounds those commercial disadvantages. Schedule 1 clearly demonstrates that and shows how a small producer's shelf price must be increased by $2.72 to recover an additional $1.00 of cost. The WET is a significant contributing factor to that oncost. (- Our isolation to the major markets of Sydney and Melbourne alone adds 50c per bottle.)

To demonstrate the inequity of WET on small producers set out on Schedule 2 attached is an example of the ultimate price of a bottle of wine sold by both large and small producers. The example is based on the following:

a) the product produced by both large and small being identical
b) the small producer, because of size and location incurring an additional $1.00 per bottle cost in production and freight (conservative)
c) The respective mark ups at distribution and retail points being as they are for large and small producers because of volumes etc.

This shows that the shelf price of the small producer's bottle of wine, to return him the same profit as the large, needs to be $4.83 or 42% higher than that of the larger producer.

Of the above increase, 95 c or 20% is directly attributable to additional taxes. If the retailer's margin on these tax imposts is taken to account the tax effect on the price increase is $1.69 or 44%.

In restaurants, where small producers sell a higher percentage of their wines than the large the situation is even worse because of the usual 100% to 200% mark up. Based on 150% the wine list price will be $6.12 higher, with $4.91 or 80% of that accounted for by the tax effect.

If small producers were exempt from WET the Bottle Shop price would still be $1.15 or 10% higher than that of the large, whilst in restaurants they would be approximately the same.

As the small do not produce cask wine, a much greater percentage of their production is in the premium and ultra premium range than the majors. Quality has a cost associated with it – costs which are compounded by the value based WET thereby further disadvantaging small producers over the large in the same manner as set out earlier.

Effectively, the WET will contribute very significantly to pricing small producers out of the market by making them non competitive with the large who, because of their cask production pay less than 50% of the tax per litre on wine sold in Australia as that paid by small producers.

It should be appreciated that the only justification for any additional tax on wine can be the perceived damage its consumption causes and to recoup society for that cost. If there is any damage, that is from the alcohol content of the wine, not its quality and there is a strong body of evidence that the premium wine produced by small wineries has more beneficial effects on health than adverse, and in any event is not subject to abuse to anywhere near the degree that other alcoholic beverages may be including cask wine, the province of the large producers and which accounts for over 60% of wine consumed in Australia.

Obviously small producers cannot therefore enjoy the economies of scale of the large in production or distribution. The value based WET compounds those commercial disadvantages. Schedule 1 clearly demonstrates that and shows how a small producer's shelf price must be increased by $2.72 to recover an additional $1.00 of cost. The WET is a significant contributing factor to that oncost. (- Our isolation to the major markets of Sydney and Melbourne alone adds 50c per bottle.)

To demonstrate the inequity of WET on small producers set out on Schedule 2 attached is an example of the ultimate price of a bottle of wine sold by both large and small producers. The example is based on the following:

a) the product produced by both large and small being identical
b) the small producer, because of size and location incurring an additional $1.00 per bottle cost in production and freight (conservative)
c) The respective mark ups at distribution and retail points being as they are for large and small producers because of volumes etc.

This shows that the shelf price of the small producer's bottle of wine, to return him the same profit as the large, needs to be $4.83 or 42% higher than that of the larger producer.

Of the above increase, 95 c or 20% is directly attributable to additional taxes. If the retailer's margin on these tax imposts is taken to account the tax effect on the price increase is $1.69 or 44%.

In restaurants, where small producers sell a higher percentage of their wines than the large the situation is even worse because of the usual 100% to 200% mark up. Based on 150% the wine list price will be $6.12 higher, with $4.91 or 80% of that accounted for by the tax effect.

If small producers were exempt from WET the Bottle Shop price would still be $1.15 or 10% higher than that of the large, whilst in restaurants they would be approximately the same.

As the small do not produce cask wine, a much greater percentage of their production is in the premium and ultra premium range than the majors. Quality has a cost associated with it – costs which are compounded by the value based WET thereby further disadvantaging small producers over the large in the same manner as set out earlier.

Effectively, the WET will contribute very significantly to pricing small producers out of the market by making them non competitive with the large who, because of their cask production pay less than 50% of the tax per litre on wine sold in Australia as that paid by small producers.

It should be appreciated that the only justification for any additional tax on wine can be the perceived damage its consumption causes and to recoup society for that cost. If there is any damage, that is from the alcohol content of the wine, not its quality and there is a strong body of evidence that the premium wine produced by small wineries has more beneficial effects on health than adverse, and in any event is not subject to abuse to anywhere near the degree that other alcoholic beverages may be including cask wine, the province of the large producers and which accounts for over 60% of wine consumed in Australia.

On that basis alone, there is a strong argument that WET should not apply to those companies that produce only premium wines and in particular small producers should not be asked to contribute to the perceived community costs caused mainly by the consumption of cask wine produced by the majors.

Let me move on to demonstrate how the financial pressures that your Government's WET will impose on small producers will have significant adverse effects in regional Australia, using WA as an example.

Of the 1997 crop, in Western Australia 22,000 tonnes was consumed in Australia, with approximately 2,000 tonnes being exported.

The 1999 crop is 33,000 tonnes.

With the price advantage, outlined earlier, so overwhelming in favour of the large producers, and the increased volumes becoming available, the ability of small wineries to increase sales within Australia is highly questionable and indeed there is every likelihood that they will decrease.

On the basis, however, that sales within Australia are maintained, that leaves an additional 11,000 tonnes of the 1999 crop that needs to be exported - a 550% increase over 1997 levels.

If the above is a challenge, contemplate how the 66,000 tonnes of production - a 100% increase over 1999 - which will occur within five years from vines already planted in Western Australia, are going to be marketed.

Small producers are simply not organised to move that growth in wine production into the international market place, as they do not have in place the international distribution and marketing networks of the large.

The small producers domain has traditionally been the domestic market – the very market that your Government's WET tax is pricing them out of – just where do they go to market their wine?

What should be of particular concern to you and your Government is that, like you, many of Australia's small producers are yet to recognise the financial challenges they face from WET in Australia let alone their need to export.

Let me just reinforce:-

What is happening in WA is occurring in Tasmania, Yarra Valley, Mornington Peninsular, Adelaide Hills, the Hunter Valley, Queensland and other districts, where small producers are in abundance.

Your Governments' iniquitous WET tax will simply send small producers broke and the backlash in regional Australia will be enormous - in the view of many, sufficient to put you out of Government.

Here, do not just focus on the wineries, but what they represent to regional Australia and the local population.

Over the last 25 years I have been a proud witness to the town of Margaret River going from one that had the highest level of unemployment in Australia - to one of the lowest and fastest growing. The small wine producers were directly responsible for that change. The big producers simply would not have injected the drive, creativity and energy into that town as the small producers have to make it what it is today.

There are many similar examples throughout Australia.

Is it right, therefore, for a Government to introduce an inequitable tax policy which will bring small producers to their knees and result in what they have achieved being handed to the large on a plate, because the small face financial ruin as a result of an unjust impost?

Look what the "West Australian" had to say about your WET in an editorial:-

Threatens the viability of small wine producers
was a
regressive and unjust tax that cannot be justified
was
fundamentally flawed being based on value rather than volume

clearly discriminates against small producers
and
perpetrates a self-evident inequity.

The Murdoch press in "The Sunday Times" has also called for the abolition of WET as an unjust tax in an Editorial on 5th December 1999.

If the problem is not fixed and fixed very soon, the day of reckoning is not far off.

This Association is not alone in recognising the plight of small producers.

- Two State Governments, Western Australia and Tasmania, have unanimously rejected the WET in both Houses of their respective Parliaments.

- The lay parties of both the Liberals and Nationals have recognised the problem and passed motions at their respective national conferences supporting a Small Business Exemption from WET for those wine producers selling less than 1 million litres of their own production within Australia annually.

  Many lay party members are concerned that this will become an election issue and that the Parliamentary party is simply not listening to them.

- The Winemakers' Federation of Australia has also recognised the problem small producers face and recently gave their support to the exemption - that should allow Cabinet to gain the support of South Australian members for the proposal.

- A group of astute political folk in Eastern Australia are stalking the small wine producers to gain their support for a new political party focused on gaining a hold in regional Australia.

They are well aware of the WET inequity and the millions of Australians that small producers interface with annually, through their tourism and cellar door activities, from whom they can seek voter support.

The cellar door rebates etc. that the Democrats have forced on your Government are clearly not the answer to the challenges outlined in this letter - they apply equally to large and small producers and fail to recognise that the small, as the volumes of grapes being produced dictate, must compete with the large in bottle shops and on restaurant wine lists.

We have formally written to Peter Reith requesting the exemption, providing reasons for that - a copy is attached for your information.

The attached article from "The Economist", reprinted in "The Weekend Australian" of 18th-19th December, 1999 is essential reading in respect of this debate.

The major companies of the Australian wine industry were the ones who encouraged the large plantings of recent years. It was those same parties who pushed so vigorously for a value based WET.

The plantings and the tax basis bring them significant advantages over small producers - the former in cheap fruit, the latter in lower taxes. Both enhance their competitive advantage over small producers.

To compound the problem, if the large are wrong, as "The Economist" suggests, in their overseas sales projections, the domestic market will be flooded, with small producers, because of WET, at a very severe competitive disadvantage.

An appropriate domestic tax policy would be one that encouraged the majors to use their expertise and financial strength to vigorously pursue export markets where they have very real and significant advantages over the small. The tax policy should therefore be such that the domestic market is open to the small producers who do not have the advantages of the large in exporting.

Your Government's WET policy however does exactly the opposite - it prices the small out of the domestic market by giving the large a very real competitive and commercial advantage over them.

We are not dealing with "rocket science" here, but a simple case of inequity - a mistake by your Government that presumably was not recognised when you implemented the basis of WET.

The WET delivers to Government more money than the tax it replaces. Surely Government is not all about collecting money - and there are principles involved. The solution here is very simple - grant the exemption requested and give back that over collection.

In doing so, can we strongly caution against the lowering of the exemption below the 1M litres, as that will place small producers in a "poverty trap" and restrict the very producers who have the commercial skills and capacity to fix the challenges we have outlined in regional Australia. The National Party Conference motion, which is supported by this Association and the Winemakers' Federation of Australia, a copy of which is attached, is the fairest and best course to take.

By granting the above, your Government will have done what your lay parties and the wine industry - large and small - is requesting. More importantly you will have won back the support of over 1,200 small family businesses, their families, staff and communities and avoided a crisis in regional Australia.

Above all, you will have acted with integrity in correcting your mistake.

On behalf of our members, may I wish you and your family all the very best for Christmas, the Year 2,000 and beyond.

Yours sincerely,

Denis Horgan

Denis B. Horgan, FCA.,
President.

Schedule 1

WET AS AN ONCOST TO SMALL PRODUCERS

			Total	WET OnCost	
(a)	Ex Winery Price		$1.00		
(b)	Distributor's Margin	+1/3	$0.33		
(c)	Wholesale Price		$1.33		
(d)	Wine Equalisation Tax	+29%	$0.39	$0.39	
(e)	Retailer's Cost		$1.72		
(f)	Retailer's Margin	+44%	$0.76	$0.17	
(g)	Retail Price		$2.48	$0.56	44%
(h)	GST	10%	$0.24	$0.05	Tax
(i)	Consumers Cost		$2.72	$0.61	

Oncost as a result of WET – A TAX EFFECT OF **61%**

Schedule 2

Bottle Shop

	Large	Small	Margin Effect	No WET
Ex winery price per bottle	5.00	5.00		5.00
Add $1.00 additional cost of Production and freight	-	1.00		1.00
Distributors margin – 25%-33% *Note 1*	5.00 1.25 6.25	6.00 2.00 8.00		6.00 2.00 8.00
WET at 29%	1.81	2.32		NIL
Retailers and Restaurateurs Cost	8.06	10.32		8.00
Add retail margin – 30 & 44%	2.41	4.54	67c	3.52
Retail price	10.47	14.86		11.52
GST + 10%	1.05	1.49	7c	2.15
Selling price	$11.52	$16.35		$12.67
Increased shelf price of small over the large	$4.83			$1.15
% increase	42%			10%
Taxes paid – WET	1.81	2.32		-
- GST	1.05	1.49		1.15
TOTAL TAX PAID	**$2.86**	**$3.81**		**1.15**
Difference in tax paid	**95 c**			
Add margins effect on tax	**74 c**		**74 c**	
	-			
TOTAL TAX EFFECT	**$1.69**			

1. Large producers distribute their own wines and the cost is likely to be lower than this.